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Directorate of Distance Education

M.Com.

I - Semester

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BUSINESS ENVIRONMENT

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SYLLABI-BOOK MAPPING TABLE

Business Environment

Syllabi	Mapping in Book
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BLOCK 2: Industrial Environment UNIT – V: Industrial Policies and Regulations - Industrial Policy upto 1991, 2014 - Public, Private, Joint and Co-operative Sectors. UNIT – VI: Privatization and Disinvestment - Ways of Privatization - Benefits and Arguments against Privatization - Privatization in India. UNIT – VII: Technological environment-Factors Governing Technological Environment- Management of technology - Patents and Trademarks. UNIT – VIII: Indian Contract Act 1872 – Indian Companies Act 1956 – Consumer Protection Act 1986 – Consumer Rights – World Trade Organization (WTO). UNIT – IX: Industrial Finance – Short term finance – medium term finance - long term finance – Corporate securities.	Unit 5: Industrial Policies and Regulations (Pages 74-99) Unit 6: Privatization and Disinvestment (Pages 100-111) Unit 7: Technological Environment (Pages 112-133) Unit 8: Business Legislations (Pages 134-157) Unit 9: Industrial Finance (Pages 158-179)
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INTRODUCTION

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Two words 'business' and 'environment' comprise the business environment. Business refers to the state in which a person remains busy performing some or the other activity. From an economic point of view, business implies human activities like production, extraction or purchase or sales of goods that are performed for earning profits. Ideally, the external factors influencing a business comprise a business environment. They can be forces of economic, social, political and technological factors.

In this era of globalization, a business cannot perform in isolation, since it is the social and economic organ of the society. The government of a particular country has an important role to play in the functioning of a business. It enacts legislation, formulates business policies and controls business in the best interest of people.

On one hand, business environment affects the political, social and economic environment of the region it is operating in, and on the other hand, the business in turn is affected by the country's social, legal and political environment. A competent management system is capable of adapting to the business environment. A sound knowledge of business environment helps in capitalizing emerging opportunities, forming basis of business strategies and activating further management. This book takes a detailed look at the notion of business environment at the backdrop of the Indian business scenario.

This book, *Business Environment* has been divided into fourteen units. The book has been written in keeping with the self-instructional mode or the SIM format wherein each Unit begins with an Introduction to the topic, followed by an outline of the Objectives. The detailed content is then presented in a simple and organized manner, interspersed with Check Your Progress questions to test the student's understanding of the topics covered. A Summary along with a list of Key Words, set of Self Assessment Questions and Exercises and Further Readings is provided at the end of each Unit for effective recapitulation.

BLOCK - I
BUSINESS ENVIRONMENT

*Introduction to
Business Environment*

**UNIT 1 INTRODUCTION TO
BUSINESS ENVIRONMENT**

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Structure

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1.0 INTRODUCTION

Business environment implies all the internal and external factors that influence the functioning of the company including employees, customers, management, supply and demand and business regulations. The business environment consists of two parts: macro-environment and micro-environment. Hence, one should keep in mind the external factors and internal factors that can influence each other and work together to affect a *business*. In this unit, you will be introduced to the concept of business environment, its significance and limitations. The unit will also throw light on the inter-relationship between economic and non-economic environment.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Define business environment
- Analyse the significance of business environment
- State the limitations of the study of business environment
- Evaluate the inter-relationship between economic and non-economic environment

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1.2 CONCEPT OF BUSINESS ENVIRONMENT

The term 'business environment' comprises of two words—'business' and 'environment'. In simple terms, the state in which an individual remains busy is known as business. The word Business in its economic sense relates to human activities like production, extraction or purchase or sales of goods that are performed with the objective of earning profits. A business has two types of environments: internal and external.

Internal environment: This includes the 5 Ms, i.e., man, material, money, machinery and management, typically within the control of business. Business can make changes to these factors depending on the change in the functioning of enterprise.

External environment: Those factors which are beyond the control of the business comprise the external factor. These factors include: government and legal factors, political factors, socio-cultural factors, geo-physical factors, demo-graphical factors, etc. External environment is of two types:

1. Micro/Operating environment
2. Macro/General environment

1.3 SIGNIFICANCE AND LIMITATIONS

Studying business environment helps to identify strength, weakness, opportunities and threats. Analysis is essential for the survival and growth of the business.

1. **Identification of strength:** The study of the internal environment helps to identify strength of the firm. For instance, if the company has good personal policies with regard to promotion, transfer, training, etc., it can indicate strength of the firm with regard to personal policies. This strength can be identified through job satisfaction and employee performance. After identifying the strengths, an organization must consolidate its strengths by further improving its current policies and plans.
2. **Identification of weakness:** The study of the internal environment indicates not only strengths but also the weakness of the organization. A firm may be strong in specific areas, while it may be weak in some other areas. The firm should recognize some weakness and correct them as quickly as possible.
3. **Identification of opportunities:** An analysis of the external environment aids the organization to identify market opportunities. The business firm should make every possible effort to grab the opportunities as and when they come.
4. **Identification of threats:** Businesses are constantly under threat from competitors. Here, environmental analysis helps to identify threats from the

environment quickly, which is helpful to the firm as it helps to defuse the same.

5. **Exploitation of business opportunities:** Environment opens new opportunities for business expansion. Study of environment is essential discovering and exploiting such opportunities fully.
6. **Keeping business enterprise alert:** Environment study is needed as it keeps the business unit alert in its approach. Without environmental change, the business activities will be lifeless. The problems and prospects of business can only be fully understood with the study of business environment. This enables an enterprise to face the problems with confidence and secure the highest benefits of business opportunities available.
7. **Keeping business flexible and dynamic:** Study of business environment is required for keeping business flexible and dynamic with regard to the changes in the environmental forces. This allows the development of business organization.
8. **Understanding future problems and prospects:** The study of business environment allows understanding of future problems and prospects of business. Thus, business organizations can face the problems boldly and also take the benefit of positive situations.
9. **Making business socially acceptable:** Environment study allows businessmen to increase the business and also make it suitable to diverse social groups. Business organizations can make positive contribution for maintaining ecological balance through the study of social environment.
10. **Ensures optimum utilization of resources:** The study of business environment is required to ensure optimum use of resources. For this, the study of economic and technological environment is helpful. Such study allows an organization to take full advantage of government policies, concessions provided, etc.
11. **Ensures survival and growth:** Business environment informs about suitable changes to be affected in policies, aiding the business to grow and prosper.
12. **Maintaining adaptability to changes:** Business environment guides the business organization with regard to socio-economic changes and the organization must accordingly adapt to these changes. This enables the business organization to survive longer.

Limitations

Limitations of the study of business environments are as follows:

- Business environment is complex in nature.
- Business environment is continually changing process.
- Business environment is different for diverse business units.

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- It has both long-term and short-term impact.
- There is unlimited influence of external environment factors.
- It is uncertain.
- It has interrelated components.

1.3.1 Types of Environment

A business cannot be said to function within a vacuum; like any other organic entity, it is in constant interaction with – and is duly impacted by – its environment. Its immediate environment may be said to be composed of micro-components such as its suppliers, customers, competitors, the workforce and attendant working climate, and regulatory agencies. Extending beyond this troposphere lies a more diffused but no less influential outer zone acting on the organization—an incredibly complex medley of influences which may be described as the macro environment. This peripheral layer comprises macro components such as the economic environment, and the natural environment, the political environment, demographic environment, international environment. Therefore, we shall study the effect of both the micro as well as the macro environments on business organizations.

There does not seem to be any comprehensive and all-encompassing definition of the environment surrounding a business organization. While author, Gerald Bell says that, ‘An organization’s external environment consists of those things outside an organization such as customers, competitors, government units, suppliers, financial firms and labour pools that are relevant to an organization’s operations.’ while authors, Paire and Anderson claim that the business environment is ‘the sum of those inputs to an organization which are under the control of other organizations or interest groups or are influenced by interaction of several groups, such as the economy’.

The authors, William F. Glueck and Lawrence R. Jauch imply that there are two distinct components of the environment, micro and macro, when they say that, ‘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 are socio-economic, technological, suppliers, competitors and government.’ on the other hand, authors Richman and Copen maintain that the environmental factors largely, if not totally impact the firm, the boundaries of which extend well beyond its formal limits. Given this cross-section of opinions culled from management tracts, we shall be on safe ground if—for purposes of academic study—we treat the micro and macro components as separate sets of factors influencing the overall business environment of a country.

I. Micro-environment

The micro-environment comprises those forces in the immediate vicinity of an organization that influence its functioning. It is this proximity that makes them so potent in their impact. While all firms have a micro environment, the components

thereof affect different firms in different ways, depending on their peculiar set of circumstances. As for example, while a firm manufacturing cigarettes will be directly affected by shrinking supplies of tobacco, labour unrest or ageing plant and machinery, a flour miller will be hard hit by its customers gradually drifting towards packaged flour brands like ITC's 'Aashirwad'. Prof. Philip Kotler sums it up neatly when he says that, 'The micro-environment consists of the actors in the company's immediate environment that affect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the public.' Taking a cue from Kotler, let us proceed to examine these one by one.

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1. **Suppliers:** A company's suppliers are its umbilical cord, since they provide it with the raw materials, components and other provisions that enable it to function. An army with its supply chain cut off will be defeated. Since suppliers are so important, companies rarely depend on only one supplier, since if, for some reason, that supplier is paralysed or shuts down operations, the company will be left stranded. In a situation, where supplies are uncertain or sporadic, companies are forced to maintain huge inventories of stocks and components such as dealers of a car maker like Daewoo, which went out of business due to an overstretched financial position and serious irregularities. Sometimes, a concerted move by suppliers to organize themselves in order to wrest more concessions from the company can also be a cause of concern. Hence, it is necessary for firms to keep track of suppliers' attitudes, financial health, changes in their immediate environment, and so on.
2. **Customers:** Customers are the single most important reason why a company is in business, apart from its own profitability. A firm could have customers spread across a variety of segments such as governmental buyers, foreign buyers, industrial users, wholesalers, retailers, and domestic buyers. Each segment will need a separate approach, in order to tap business and for data needed for improving products and services. Each segment will need to be constantly probed and analysed so as to find out what products or services these customers prefer, or want, so that efforts can be made to meet these demands before competition.

This is an area that presents constant challenge in as much as the demands of customers are constantly changing. They are getting increasingly more complex, and loyalties are prone to shift to a competitor who offers what they want. Customer retention is even more crucial than winning new customers, since it is as much as five times more expensive to win a new customer than to retain an existing one. As products get increasingly commoditized, i.e., similar in terms of features, appearance and price, it is the intangibles like after sale service and the overall buying experience that helps retain/pull in customers, and more customers across segments means greater market share and share of the customer's heart and wallet space—vital ingredients of the company's profitability.

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3. **Labour:** A healthy industrial relations climate creates amicable terms between the workforce and the management that allows a company to function smoothly. In large organizations where the labour force may number in thousands, they are usually organized into unions that periodically negotiate with the management in order to increase wages, facilities and retirement benefits. A militant trade union can lead to crippling strikes and lockouts that can severely affect a firm's prospects. Hence, labour is a force to be reckoned with in large companies. Since these labour unions often have substantial political backing, it is crucial to find various avenues to placate them or lobby for support against their anti-organizational activities, all of which only goes to illustrate how the various factors in the micro environment can be interlinked.
4. **Business partners:** An organization's business allies can be valuable sources of support, whether in coming out in support of their policies, helping out in times of financial stringency or in any type of crisis. They could be tapped for new business avenues, sources of supplies, or even for introductions to import markets.
5. **Competitors:** Directly as well as indirectly, competitors play a crucial role in any organization's performance and progress. The various ways in which this could happen are:
 - (i) **Share of wallet:** With the vast majority of Indian buyers having limited disposable incomes, it has become important for businesses to actively pursue customers and influence them to buy their products. For example, a typical middle-class family may nurse the dream of owning a colour television set, a 310 litre refrigerator and an automatic washing machine, but can afford to buy only one of them. In such a situation, the company that has the most persuasive advertising and the best financing tie-ups will attract such families.
 - (ii) **Generic competition:** A variety of alternatives within the same market is known as generic competition. For instance, an investor looking for a suitable investment opportunity will have a number of alternatives to choose from—bank deposit, mutual funds, insurance policy and share market.
 - (iii) **Product variants:** This is where a potential buyer is confronted by a range of alternative models to choose from. To illustrate, a buyer for Hyundai's Accent model has to select from the Viva hatchback, the CRDi diesel version or the 'straight' version, with or without automatic transmission.
 - (iv) **Brand competitors:** A person willing to spend about ` 1,000 on a pair of denim jeans has a choice between several branded products including 'Levi's', 'Flying Machine', 'Ruf n Tuf', 'Woodlands', 'Wrangler', 'Pepe' and 'Numero Uno'.

6. **Regulatory agencies:** These would include a variety of government or independent agencies such as the Bureau of Indian Standards, the ISO (International Standards Organization), the Customs and Excise department, the Income Tax department, Civil Aviation Authority, TRAI (Telecom Regulatory Authority of India) DRDO (Defence Research and Development Organization), not to forget consumer courts, which of late have become very protective of consumer rights, taking punitive action against erring companies on the slightest pretext.

In order to thrive, gain market share and expand their customer base, companies need to adhere to a variety of statutory and regulatory provisions as laid down from time to time.

II. Macro-Environment

The macro-environment comprises the external factors which impact a company's planning and performance, and are beyond its control. Such factors include socio-economic, legal and technological change. These factors include all the external environmental forces affecting the manner in which a company operates.

Studying the business environment helps to identify the strength, weakness, opportunities and threats. Analysis is essential for the survival and growth of the business.

1. **Identification of strength:** The study of the internal environment helps to identify the strength of the firm. For instance, if the company has good personal policies with regard to promotion, transfer and training, it can indicate the strength of the firm with regard to personal policies. This strength can be identified through job satisfaction and employee performance. After identifying the strengths, an organization must consolidate its strengths by further improving its current policies and plans.
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7. **Keeping business flexible and dynamic:** Study of the business environment is required for keeping the business flexible and dynamic with regard to the changes in the environmental forces. This allows the development of the business organization.
8. **Understanding future problems and prospects:** The study of the business environment allows understanding of future problems and prospects of business. This helps business organizations face the problems boldly and also take the benefit of positive situations.
9. **Making business socially acceptable:** Environment study allows businessmen to increase the business and also make it suitable for diverse social groups. Business organizations can make a positive contribution for maintaining ecological balance through the study of social environment.
10. **Ensuring optimum utilization of resources:** The study of the business environment is required to ensure optimum use of resources. For this, the study of economic and technological environment is helpful. Such study allows an organization to take full advantage of government policies, concessions provided, etc.
11. **Ensuring survival and growth:** The business environment informs about suitable changes to be affected in policies, aiding the business to grow and prosper.
12. **Maintaining adaptability to changes:** The business environment guides the business organization with regard to socio-economic changes and the organization must accordingly adapt to these changes. This enables the business organization to survive longer.

1.3.2 Internal and External Environment

The factors of the internal business environment can best be explained by the five Ms.

Man

Man, the first of the five Ms is the most significant factor. The right man for the right position is a guarantee for organizational effectiveness and efficiency. Thus, lateness and absenteeism, alcoholism, poor training, unsafe acts, incompetence are just some of the attributes of man at work that could cost business ventures. Human resources decide the workings of the other four basic business resources. People make sure materials, machines, minutes and money are utilized in a productive manner in order to achieve goals or aims and objectives of organizations

and enterprises. Poor employment practices are unfavourable to the sustenance of such ventures. With the right person in the right job, a large portion of effective business management will be achieved.

Materials

Without materials, human resource is made superfluous. Good organizations know that materials needed for any business or service must be in place before 'man' can be of use in any business. Supply chain departments came out of this line of thinking and have been a very useful aspect of business management. A group of cement factory workers waiting for supply of cement may have nothing much to do for as long as the supply does not arrive. Even if it arrives, but in poor quality, the production is affected badly. Quality compromised is business compromised. Poor quality of materials often ruins entrepreneurship.

Machines

The metal contraptions called machines have made man fulfill almost effortlessly various dreams of creating things that make a existence more worthwhile. Machines have replaced man in tilling, planting, and harvesting. Man has been replaced with looms in cotton and fabric processing. Countless other ventures requiring physical exertions of force have been taken over by things fixed with gears, bolts and nuts and conveyor belts. Recently, computers joined in the fray of increasing production and reduction in time spent by man for manufacturing and general production of goods and services. However, without man and materials, machines will be useless. They need to be operated by man and fed with materials. That again is a doubtless fact.

Management of time

Time management is an aspect of business that has been employed in use by effective and successful business ventures to optimize delivery. Lateness and absenteeism of man at work is a large chunk of time off production. Poor time management is as hopeless as a broken-down machine, an indisposed employee, lack of adequate materials for production of goods or services, etc. Various schemes have been used by successful enterprises to guarantee proper and efficient use of time by man and machine, including timely delivery of materials, to make certain business sustainability. Compromising time is equal to a business venture shooting itself in the foot.

Money

Without money, no venture or enterprise can motivate employees, get quality and sufficient materials, get the proper machines and maintain them or even ascertain that time is properly managed. Money management, when not organized has been the most common factor in collapse of enterprises in history. The quantity and quality of money expended in enterprises is directly related to the fruitfulness of

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same over time. The accounts department has been revolutionarized over the years, by man, to guarantee maximum operations of surviving business organizations. Where there is not enough money, good workers, materials, or machines cannot be gathered.

External Environment

Business includes production and supply of commodities and rendering of services to society and thereby enhances its well-being. At the same time, it owes its very existence to society and is deeply influenced by social institutions.

By business environment, we mean the totality of all the factors which are external to and beyond the control of an individual business enterprise. As we noted earlier, the environment provides the macro-context while the business firm is the micro unit. The environmental factors are taken as given within which the business firm has to operate.

Business enjoys social sanction because it has a social purpose. In order to discharge social responsibility properly, it is necessary to understand the sociological environment of business. Sociological environment includes value system, culture, tradition, convention, social institutions, social pressures, etc.

The family, the caste system, the joint family system, child marriage and the inheritance system are all important external environments. Let us discuss them in greater detail.

1.4 INTER-RELATIONSHIP BETWEEN ECONOMIC AND NON-ECONOMIC ENVIRONMENT

Let us now study the inter-relationship between economic and non-economic environment.

Economic Environment of Business and its Importance

Economic environment of business encompasses all those forces or factors which have an economic impact on business. Business enterprises that play their role under the existing economic environment is an economic institution. It works, with the objective of maximizing the profits.

Therefore, both micro and macro-economic environment play an important role in the economic decisions of business enterprise. But the economic environment of business normally reflects the prevailing economic system. Thus, it gives more emphasis on macro-economic environment.

The economic environment of business in contemporary times is highly complex. Business decisions are always taken considering all these complex factors constituting economic environment of business. Some of the complex factors are

the basic economic philosophy and economic policies of the government, stages of economic development, agricultural and industrial production, infrastructure, planning process, trade cycles, national income, population, etc.

The structure of the economy is conditioned by the five sectors jointly. These are the business sector, the household sector, the capital market, the external sector and the government sector. But the activities of all these sectors create an economic environment on which business firms are working. Although, individually the business firms cannot change the prevailing economic environment but collectively they can change the economic environment to their favour under capitalist and mixed economic system by putting pressure on the government through their associations. Thus, the economic environment is playing an important role in mobilizing the business enterprises towards its right direction.

Non-Economic Environment of Business

All non-economic issues related to business are included in non-economic environment of a country. The non-economic environment of business can be classified into politico-legal, demographic, socio-cultural, technological and natural environment.

Politico-Legal Environment

The politico-legal environment includes three political institutions—legislature, executive and judiciary. These three institutions play a useful role in shaping, directing, developing and controlling business activities.

The legal environment of business includes legislations related to property and business organisations, laws of contracts, bankruptcy, mutual obligations of labour and management and a host of laws of regulations concerning business activities.

Demographic Environment

Demographic environment is affected by factors like, rise and growth rate of population, rural-urban distribution of population, educational levels, religion, ethnicity, caste, language etc. These factors are all relevant to business conditions.

For example, the labour supply position and the rate of wages, determines the technologies of business being finalized. In a labour surplus economy, labour intensive technology would be adopted.

Socio-Cultural Environment

Socio-cultural environment includes people's attitude to work and wealth, ethical issues, role of family, marriage, religion and education and the social responsibilities of business. All the business firms usually operate in a definite socio-cultural environment and formulate their business policies considering this factor. A successful

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business firm takes care of these diversified societies and their cultural sensitivities in order to capture the market for their products.

Technological Environment

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Technological environment implies systematic application of scientific or other organized knowledge to practical tasks or activities. In present times, the technology is changing fast. Thus, businessmen should keep a close link on the technological changes for its adoption in their business activities.

Natural Environment

In earlier times, the effects of industrial activities on natural environment were not so serious. But in recent times, growing industrial activities have not only caused a serious damage to exhaustible natural resources (minerals and forest resources) but also polluted water and air to a considerable extent. All these have created a serious environmental damage.

1.4.1 Fundamental Issues Captured in Pestle

Extending far beyond the boundaries of the firm's internal and immediately exterior environments, the larger macro environment includes a host of forces and influences that have a powerful impact on policies and strategies that it would need to contend with. Many of these are beyond the power of the firm to control; all it can do is to capitalize on opportunities while steering clear of obstacles and potential minefields, all the while staying on the right side of ethicality, public opinion and statutory provisions. Moreover, with the emergence of regional alliances and the unmistakable signs of the emergence of a nascent global economy, no firm can afford to ignore the critical factors in the macro environment.

PESTLE (Political, Economic, Social, Technological, Legal and Environmental) is an analytical tool which considers external factors and helps you to think about their impacts on the economy of a country. It a useful tool for understanding the 'big picture' of the environment (i.e., macro environment) the country is operating in. As the name suggests, there are six factors in PESTLE analysis—political, economic, social, technological, legal and environmental. Let us discuss these factors in detail.

Political Environment

The economic and political systems of a country are mutually dependent, the one reflecting the ideologies of the other. India is a sovereign democratic state operating through a multi-party parliamentary system of government modelled on the British pattern, majority rule being the basic tenet thereof. There is a ruling party (or coalition of parties such as the currently ruling NPA), and there is the 'opposition' (represented in parliament by opposition members who have seats in parliament by virtue of having being elected from their respective constituencies).

The three pillars of the government are

- (i) Legislature
- (ii) Executive
- (iii) Judiciary

The legislature enacts legislation, i.e., creates laws by means of statutes or Acts, after issues are debated and passed by majority vote in parliament and the Bill (as an inchoate Act is called) receives the Presidential assent. The Executive branch of government, i.e., the bureaucracy, is entrusted with the task of implementing these statutes (including ordinances or regulations flowing therefrom), while the Judiciary adjudicates on issues arising from non-compliance with these laws.

This being the basic structure of our political, judicial and administrative set-up, within which all human activity in the State must operate, it follows that business and industry are legally and morally bound to conform to it. How well they do so to a large measure determines their (and the country's) long-term growth and prosperity. Non-compliance entails punitive measures that are meant to discourage deviations from the standards laid down. As the world shrinks and society becomes increasingly more complex in organization and administration, and as problems multiply across a vast spectrum of human activities, business and industry will need to be more proactive and innovative in managing the fallout.

Economic Environment

The economic framework is that within which the firm functions plays a crucial role in its efforts to thrive, grow and beat its competitors. Since business is fundamentally an economic activity, the economic environment, both within the country as well as beyond its national frontiers will have a definite influence on its fortunes. It is inconceivable that there could be any institution, bodies or persons who are insulated from the effects of the economic environs. Business has to deal with a vast number of governmental bodies, rules, regulations, and guidelines relating to its statutory responsibilities, the capital market, sources of finance including stock market options, venture capital, offshore funds, disinvestment options, bank funding and so on.

All these factors compel careful analysis before decision or action, since once a particular business policy is adopted, it is practically irreversible. Economic forecasts and reports of the state of the national and global economy help the firm in making business decisions. Overall, it is only those firms that can judge the trends in the economy that survive and prosper over long periods.

Social Environment

Every society has a heritage, of cultural values and belief systems, that plays a vital role in all decisions concerning the way social life is organized, and which subtly imposes norms that encourage acceptable individual and group behaviour. This

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includes conventions about dress, food habits, notions of personal and public hygiene, formal and informal relationships, family traditions and local customs, marriage and procreation, respect and general attitudes and approach to life. In this respect, India is several countries within a country, for such norms can vary dramatically across regions, making for heterogeneity within an outwardly homogeneous whole. This is a major reason in favour of encouraging mutual interaction and acceptance/ tolerance for another's point of view.

As regards the impact of this apparently turbulent situation on business and industry, it may be said (albeit with a little trepidation) that the improvement in primary education and rising literacy levels has created a better overall climate for investment (both domestic as well as foreign). With the proliferation of media such as TV, national (and even international) homogeneity is only a matter of time. This is good news for national unity and mutually harmonious relations between what used to be discordant and widely different communities.

Technological Environment

This is another factor that has given a massive impetus to the economic revival. While India may be trailing far behind the west in terms of technological prowess, in the long run it will overhaul the developed countries, as they get swamped by their aging populations' gerontological liabilities. Caring for an aged population will put a heavy burden on social welfare that can only be met by diverting funds from elsewhere, may be even Research & Development.

Thus, when it comes to survival, India will find that the developed countries will be increasingly willing to cooperate in sharing technology with us, which is not the case at present. Time will tell that India and other developed countries will regain their importance in the eyes of western nations, albeit in their own self-interest. For example, there are currently 120,000 vacancies for trained nurses in the US, but very few candidates. In another decade, the demand will touch 800,000. Where will they find so many trained nurses, except in Third World countries like India? The US will pay them premium salaries; already, the going rate is US\$ 60 per hour! In return for this, will not technological aid flow to India, apart from billions of repatriated US Dollars?

Nevertheless, we need to be more innovative, inventive and adventurous in our approach to business. In the US, failure is no shame. Henry Ford I failed five times in business before he got his motor car company going smoothly. Institutional finance must support individual R&D efforts; such efforts should not be left to a few private sector giants alone (apart from the government's own research laboratories). Many great inventions never see the light of day because there are no funds to support development, and competitors ensure that such new technologies never reach the commercial stage. Without technological advances, business will stagnate and India will be left behind in the global marketplace.

Legal Environment

Legal environment of business means all factors relating to laws and legal orders which affect business and its working. Business must be operated under the rules and regulation of different laws made by a country. Basically India is an emerging economy and it promotes Foreign Direct Investments in the country. That's why the legal system for businesses in India is very flexible. The implementation of the legal system starts right from your decision to start a business in India. You have to take an online Digital Identification number and then you obtain an online Digital signature certificate. It is a legal requirement to register the name and nature of the business in Registrar of Companies or ROC. Then you have to get the company documents stamped from a superintendent. Medical insurance is also required for all sorts of businesses. There is an employee provident organization, where registration of companies is carried out. It is a legal requirement for all of the businesses to register for profession tax. Although India encourage business opportunities but still the legal environment requires a lengthy process to start or carry on a business.

Natural Environment

Just as our cultural heritage is important, so is our natural heritage. This includes the land, its forests (what's left of them), its interlinked ecosystems, and its myriad varieties of flora and fauna. We learn vicariously from the laments of western conservationists that development comes at an avoidable price, if only one is alert to the perils of unrestrained industrial growth. Climatic changes across the planet are warning enough that hard days lie ahead for humanity if we do not cooperate with nature instead of conspiring against her. Needless to say, depletion in the earth's natural resources and atmosphere that support life will have disastrous effects on all. Business and industry have a major role to play by seeing to it that their actions reduce environmental impacts to the barest minimum.

The major factors involved in environment-friendly business operations can be grouped as follows:

- (i) Natural resources and special features of the environment
- (ii) Climatic conditions and weather patterns
- (iii) Topographic variations
- (iv) Locational factors
- (v) Infrastructural factors such as roads, ports, etc.

In the final analysis, business is completely dependent on the environment.

No business can survive in climatically inhospitable conditions, even if it were to be established there. Some of the relevant observations are summarized below:

- (i) Business and industry are dependent on a vast variety of natural inputs

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- (ii) Oil, forest-based produce and mineral wealth come from natural sources
- (iii) Agricultural activity, which gives us food, comes from the natural environment. No amount of technological inputs can help if the environment is (rendered) incapable of supporting food production.
- (iv) Domestic and international trade is dependent on geographical factors
- (v) Business and industry flourish due to certain advantages enjoyed from the natural environment.

With growing awareness of the importance of preserving and protecting the natural environment and ecologies of the region, the country's leadership has of late shown a certain amount of interest in this direction. While much remains to be done, business and industry should, in their own (as well the national) interest, come forward and voluntarily play an active role in environmental preservation.

Check Your Progress

1. Name the types of business environment.
2. State the limitations of the study of the business environment.
3. List the five Ms of the internal business environment.

1.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The two types of business environment are internal environment and external environment.
2. The limitations of the study of the business environment are the following:
 - Business environment is complex in nature.
 - Business environment is continually changing process.
 - It is uncertain.
 - It has interrelated components.
3. The five Ms of the internal business environment are the following:
 - (i) Man
 - (ii) Materials
 - (iii) Machines
 - (iv) Management of time
 - (v) Money

1.6 SUMMARY

- The term ‘business environment’ comprises of two words—‘business’ and ‘environment’. In simple terms, the state in which an individual remains busy is known as business.
- Studying business environment helps to identify strength, weakness, opportunities and threats. Analysis is essential for the survival and growth of the business.
- A business cannot be said to function within a vacuum; like any other organic entity, it is in constant interaction with – and is duly impacted by – its environment.
- The micro-environment comprises those forces in the immediate vicinity of an organization that influence its functioning. It is this proximity that makes them so potent in their impact.
- The macro-environment comprises the external factors which impact a company’s planning and performance, and are beyond its control. Such factors include socioeconomic, legal and technological change.
- Man, the first of the five Ms is the most significant factor. The right man for the right position is a guarantee for organizational effectiveness and efficiency.
- The metal contraptions called machines have made man fulfill almost effortlessly various dreams of creating things that make a existence more worthwhile.
- Business includes production and supply of commodities and rendering of services to society and thereby enhances its well-being. At the same time, it owes its very existence to society and is deeply influenced by social institutions.
- The family, the caste system, the joint family system, child marriage and the inheritance system are all important external environments.

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1.7 KEY WORDS

- **Customs:** These are long-established usages or modes of behaviour. They primarily refer to practices such as eating, conversing, shaking hands to greet other people and so forth that have been continuously repeated generation after generation.
- **Generic competition:** A variety of alternatives within the same market is known as generic competition.

1.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. Define business environment.
2. Write a short note on the macro-environment.
3. Briefly mention the forces which comprise the micro-environment.

Long Answer Questions

1. Analyse the significance of the business environment.
2. What do you think has been the contribution of the family as an important factor of external environment?
3. Assess the inter-relationship between economic and non-economic environment.

1.9 FURTHER READINGS

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UNIT 2 BUSINESS ENVIRONMENT AND STRATEGIC DECISIONS

Business Environment and Strategic Decisions

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Structure

- 2.0 Introduction
- 2.1 Objectives
- 2.2 Impact of Environment on Business and Strategic Decisions
- 2.3 Culture and Business
- 2.4 Social Responsibility of Business
 - 2.4.1 Nature of Social Responsibility
 - 2.4.2 Need for Social Responsibility of Business
 - 2.4.3 Social Responsibility of Business towards Different Groups
 - 2.4.4 Arguments For and Against Social Responsibility
- 2.5 Answers to Check Your Progress Questions
- 2.6 Summary
- 2.7 Key Words
- 2.8 Self Assessment Questions and Exercises
- 2.9 Further Readings

2.0 INTRODUCTION

A business enterprise is a part of society and changes in environment influence its functioning and performance. The environment may pose constraints on the enterprise as well as open new opportunities for it. In this context, it becomes vital for the top management to take strategic decisions. Strategic decisions are the decisions that are concerned with the complete environment in which the business enterprise functions, all the resources and the people who form the business enterprise and the interface between the two of them. Strategic decisions have major resource propositions for an organization. These decisions may be concerned with holding new resources, organizing others or rearranging others. In this unit, you will study about the impact of environment on business and strategic decisions. The unit will also deal with the topic of organizational culture and the social responsibility of business.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Analyse the impact of environment on business and strategic decisions
- Discuss the relationship between culture and business
- Explain the various aspects of social responsibility of business

2.2 IMPACT OF ENVIRONMENT ON BUSINESS AND STRATEGIC DECISIONS

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The monitoring process of the appropriate environment by an organization to identify the opportunities and threats, that affect the business, is known as environmental scanning or analysis.

When the environmental scanning process is completed, planners gather all the information related to the opportunities and threats for the organization. The techniques used for environmental scanning are as follows:

- Environmental Threat and Opportunity (ETOP) Analysis
- Quick Environmental Scanning Technique (QUEST) Analysis
- Strengths Weaknesses Opportunity and Threats (SWOT) Analysis
- Political, Economic, Social and Technological (PEST) Analysis

Techniques of Environmental Analysis

Let us analyse the various techniques of environmental analysis.

1. ETOP Analysis

ETOP is a device that considers the environmental information and determines the relative impact of threats and opportunities, for the systematic evaluation of environmental scanning. This analysis divides the environment into different sectors and then analyses their effect on the organization.

Table 2.1 The ETOP Analysis for HAL

Environmental Variable	Opportunity	Threat
Economic	Infrastructural development is enhanced. This development includes power supply, transport and internal consumption.	Resource constraints.
Technological	Organization's production increases and technology upgrades that helps the organization to grow.	
Supplier		Scarcity of resources due to implementation of the new technology.
Government	Liberalization of technology import policy.	Applying new rules and policies in the organization.
Competitor		To retain the market share, the organization needs to take the risks based on new ideas to raise the market demand. It is difficult for an organization to find a specialist or highly qualified personnel for the enhanced technology.

For example, the environmental analysis of Hindustan Aeronautics Limited (HAL) shows the opportunities and threats of the organization, considering different environmental variables. Table 2.1 shows the ETOP analysis for HAL.

2. QUEST Analysis

QUEST analysis was proposed by B. Nanus. It is a four-step process that uses scenario writing for environmental scanning. The four steps involved in this technique are as follows:

- Strategy planners first observe the events and trends of the organization.
- From the first observation, they broadly consider important issues that may affect the organization, using environment appraisal.
- A report is created by summarizing these issues, their effects and different scenarios to show the implementation of these strategies.
- In the last step, reports and scenarios are reviewed by the planners who decide the feasibility of the suggested strategies that are beneficial for the organization.

3. SWOT Analysis

SWOT is the heart of strategic analysis. SWOT analysis is the process of carefully inspecting the business and its environment through the various dimensions of strengths, weaknesses, opportunities, and threats. SWOT is also known as TOWS analysis. SWOT is a tool used for auditing the organization, which helps in finding the key issues and problems in the business. SWOT analyses the problems through internal and external analysis. In internal analysis, strengths and weaknesses of the organization are considered, whereas in external analysis, opportunities and threats for the organization are considered. The factors that are considered during internal analysis are as follows:

- Organizational structure
- Business location
- Organization's operational efficiency and capacity
- Market share
- Brand awareness
- Financial resources
- Patents and trade laws
- Expertise of marketing personnel
- Business reputation in the market

Similarly, various factors that an organization needs to consider in external analysis are as follows:

- Customers and clients
- Competitors

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- Market trends
- Suppliers
- Business partners
- Social change
- Latest technology
- Economic situation
- Political and legal restrictions

Figure 2.1 shows the SWOT analysis process.

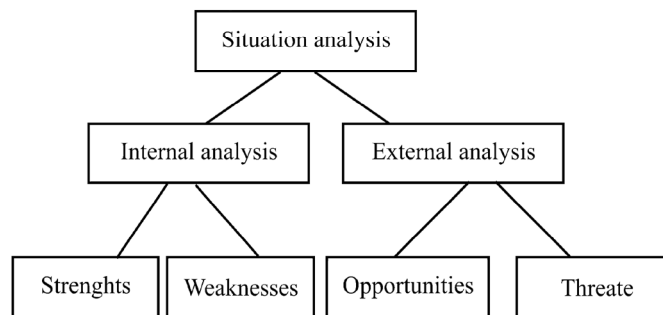


Fig. 2.1 SWOT Analysis

Strengths are a company's core competencies, and include proprietary technology, skills, resources, market position, patents and others. Weaknesses are the conditions within the company that can lead to poor performance and could be obsolete equipment, heavy debt burden, poor product or market image, weak management, and others.

Opportunities are external conditions or circumstances a the company which suddenly realizes a growth in broad market interest, could turn to its advantage.

The following opportunities must be considered in SWOT analysis:

- Advertising a product on the Internet.
- Mergers, joint ventures or strategic alliances.
- Business proposal from a new client with a good reputation in the market.
- Moving into new market segments with improved profits.
- Getting a chance to enter the international market.

Threats are the current or future conditions in the environment that may harm the company and might include an increase in competition. The following threats must be considered in SWOT analysis:

- A new competitor in the same location.
- Price wars with competitors.
- Innovative products and services of competitors.
- Competitors with superior access to channels of distribution.

- Tax to be paid for a product or service.
- Purchasing preferences.
- Population shifts.
- New technologies.
- Increase in competition.

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4. PESTLE Analysis

PESTLE analysis helps in analysing the environmental factors that highly affect organizational strategies.

There are a few questions that need to be considered during PESTLE analysis to ascertain the key forces at work in the wider environment. These questions are as follows:

- What are the environmental factors affecting the organization?
- Which of these factors is the most important at the present time?

PESTLE analysis helps in analysing the organizational strategies in the following ways:

- It helps in identifying the environmental factors that affect the strategies of the organization. However, it is not necessary that the environmental analysis provides valuable information to the organization. Hence, it becomes important for the organization to go in for a more quantitative approach to get the real data for organizational goals.
- PESTLE analysis may be used to identify the long-term factors that lead to globalization. For example, given the increasing globalization of some markets, it is important to identify the forces that lead to globalization. The worldwide convergence of production systems and consumer tastes in the market leads to the possibility of major economies benefiting from global manufacturing and marketing. The growth of the multinational customer and competitor has also led to the shift towards global markets, as has the overall pressure on the business for cost reduction and therefore, the search for scale economies. A further force for global development is the worldwide search for raw materials, energy and often, skills to provide service to the global business networks.
- PESTLE analysis helps in identifying the key factors of business and their differential impact on the organization. It also helps in determining the extent to which these factors affect the competitors of the organization. The three key external factors that affect the organizations include short life-span of technology, convergence of customer requirements and access to the resources available globally.

Consider an example of the three competitors, A, B and C who have the differential ability to cope with factors such as short life-span of technology,

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convergence of customer requirements and access to the resources available globally. The PEST analysis shows that firm A can easily handle the technological changes by examining its track record, its investment in Research and Development and its high market. Similarly, for firm C, centralized product planning helps in coping with more convergent customer requirements. However, A and C are not well placed when compared to B, in accessing the technical changes. But when B is compared to A and C, in terms of purchasing organizational resources, it is not centralized and does not help to cope with the convergent customer requirement.

2.3 CULTURE AND BUSINESS

Customers live in societies. A large part of the being of an individual is dependent on the society he resides in. Social factors include the attitudes, values, and lifestyles of people. Social factors influence the products people buy, the prices they are willing to pay for the products, the effectiveness of specific promotions, and how, where, and when people expect to purchase products. But societies are hardly ever static. They change gradually and some changes will be imperceptible if not watched closely. Social change is the most difficult variable for marketing managers to forecast, influence, and integrate into marketing plans. But it is important that marketers take into account social changes happening in societies in which their customers live when they are framing their marketing strategies. Societies can change in manners which can make companies' current products and services totally redundant.

Values

A value is a strongly held and enduring belief. The majority of people living in a society uphold the values of the society. A person's values are key determinants of what is important and not important to him, how he reacts in a particular situation, and how he behaves in social situations.

Values affect the goods that a customer buys and the ways he buys them. Customers themselves are part of organizations which are trying hard to become customer-oriented. Customers who are conscientious marketers themselves will not tolerate ineffective products and sloppy behaviour of marketers of other companies. In this manner, companies are putting pressure on each other to become more customer-oriented. Customers are increasingly developing a global outlook as more and more of them are working in multinational companies and are travelling more frequently to countries which are alien to their own countries in political, economic, and social parameters. To cope in such an environment, people have become inquisitive, discriminating and demanding. They carry these values as buyers too. They carry out a detailed search and ask uncomfortable questions before settling on a brand. There is no guilt in making lives of marketers miserable. Things are not easy in their lives and they do not want to make it easy for the seller. When children are pressurized to excel and be in front in their formative years, they are

not going to be easily swayed by marketers' rhetoric. Performance has been demanded from them in all their growing years and they will demand performance from companies who want to sell them. Societies and businesses have become competitive within themselves. The buyer will expect the same competitiveness from companies. He will not take less because nobody takes less from him. Companies should learn to expect tough customers.

Time-starved customers

Today, fewer customers say that expensive cars, designer clothes, and pleasure trips are necessary components of a happy life. Instead, they put value on non-material accomplishments, such as having control over their lives, and being able to take a day off when they want. Dual-career families do not have time for each other, and most of them are unhappy, though they have all the trappings of a supposedly good life. A scarcity of time means that people will decrease the amount of time spent doing things they do not like doing. This means doing less housework and home maintenance, and dining out more. It also means paying more attention to brand names to make buying decisions quicker and easier. Customers who are constrained for time are likely to favour small shops over large ones, spend less time comparing prices, use technology to reduce transaction time, and patronize businesses that help them save time and make their life easier.

As work-life gets longer and more stressful, people are going to spend their leisure time recuperating and making themselves fresh and energized for work, i.e., more and more people spend their leisure time getting ready for work. Casual Fridays and home offices are further blurring the boundaries between work and leisure. Spending time with the family is becoming the most preferred leisure activity. People will increasingly place more value on time than money. More employers will have to offer time off as an incentive. Companies which arrange holiday trips or provide leisure activities will have to provide something substantial for each member of the family. Even when on holiday or on leisure trips, people want everything to be planned meticulously, so that they can recuperate in a planned manner. There is no time to while away.

Multiple lifestyles

Lifestyle is a mode of living, i.e., it is the way people decide to live their lives. Today, people lead multiple lifestyles. They are choosing products and services that meet diverse needs and interests rather than conforming to traditional stereotypes. In the past, a person's profession defined his lifestyle. Today, a person can be a teacher and also a gourmet, fitness enthusiast, and so many other things. Each of these lifestyles is associated with different products and services and is a potential customer for companies. For example, for the gourmet, marketers will offer cooking utensils, wines, and exotic foods. The fitness enthusiast buys Nike shoes and special jogging outfits. Multiple lifestyles increase the complexity of consumers' buying habits. A person may go on holidays to exotic locales and may

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spend a fortune to travel to distant and inaccessible places, but may dine in very ordinary restaurants. He may buy fast food for lunch but may wear the most expensive suits. People are more willing to indulge in their passions and live the way they want to live. There is no 'stereotype lifestyle'. This can be a nightmare for marketers. It is impossible to profile a customer in terms of occupation, or income, or place of residence, or education, and believe that he will buy a certain set of products and services. It is impossible to decipher that if a person has bought a certain product or service, he will also buy some other products too. It has become extremely difficult to categorize a person and expect that he is a potential customer for certain products and services, and not a potential customer for some other products and services. A segment of just one customer may finally be becoming a reality.

The changing structures of families

Multiple lifestyles have evolved because people can choose from a growing number of products and services, and most have the money to exercise more options. The growth of dual-income families has resulted in increased purchasing power. More women are working outside homes and this number is only going to increase. The phenomenon of working women has had greater effect on marketing strategies and initiatives of companies than any other social change. As working women's earnings grow, so do their expertise, experience, and authority. Today's working women are very different from the working women companies targeted a decade back. They want different things in life – from their spouses, from their jobs, and from the products and services they buy.

The growth in the number of working women means an increase in dual-income families. Dual-income families have greater household income but they have less time for family activities. More working women has meant an increasing demand for time-saving devices and products, particularly for the kitchen. Their purchasing roles which defined the items traditionally bought by the man or the woman, are changing. Their purchasing patterns are also changing. Products like cars which were traditionally thought of as male products, are bought by women, and companies are responding to their new buyers by designing cars specifically for them and by employing more women in the sales force. Women are making major economic decisions either independently or equally with their spouse. Most women are not leaving important marketplace decisions to others. It is being discovered that cost is more prominent in decisions made by women, whereas quality is relatively more important to men. This will have important influence when companies design marketing mixes for products where the woman is the prime decision maker. In purchase of expensive and long-term items, women are active but they are likely to make decisions jointly with their spouses. Life experiences is an important factor in women's independence in long-term planning and decision making. Married women over the age of fifty are more likely to make decisions on their own than their younger counterparts.

2.4 SOCIAL RESPONSIBILITY OF BUSINESS

Maximize profits was the underlying maxim in the hey-day of *laissez-faire* capitalism of Europe. Social responsibility had no place in its philosophy. *The business of business is business*. Business began merely as an institution for the purpose of making money. So long as a man made money and kept himself out of jail he was considered successful. He felt no particular obligation and acknowledged no responsibility to the community. As he was the owner of his business he thought he had a perfect right to do with it what he pleased. 'The public be damned'. Social welfare was not his job.

But such attitude does not hold good in the present situation. The recognition of social responsibility has been termed as the emergence of corporate conscience.

Business is not an end in itself. It is only a means to an end. That end is man himself. Therefore, business has to contribute to man's happiness, his freedom, his material, moral and spiritual growth.

New Management Philosophy

A new philosophy of management is emerging which has deeply influenced corporate goals and business policies. The major elements that contributed to its evolution are:

1. The business leaders as a whole were becoming increasingly conscious of the fact that the public was an integral part of the general business scheme. Sense of service thus came to qualify and modify the greed for profit.
2. The second element was the purchasing power of the public. The demand of the public meant nothing unless sufficient purchasing power was placed in their hands. Industry had come to understand that its functions were to manufacture and distribute purchasing power as well as to manufacture and distribute merchandise. The most important effect of this changed attitude was a new business policy which demanded higher wages and lower prices.
3. The third consideration in the process is the rise of a new relationship between the public and business, slowly displacing the era of purely private business for private profits. Business has a duty to report to the public, whose money it is constantly asking for, in order to conduct the business itself.

The concept of social responsibility of Oliver Sheldon, a British business leader, was derived from four basic observations of the social environment. First, he saw an awakening of public interest in the inner workings of business. This was a result of the close co-operation that existed between industry and the community during the war effort. Secondly, Sheldon understood the demand of the workers for more leisure time and increased opportunity for self-development. Thirdly, he observed that the association of workers into large groups such as trade unions and political clubs, was the beginning of an atmosphere conducive to social change.

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Lastly, he noted a new spirit of enquiry emerging from application of the scientific approach to problem-solving. He subscribed to the view that the future problem of management would be to obtain a proper balance between production and human areas.

Meaning social responsibility: According to the classical view, if a business was efficiently using the resources at its disposal in producing the requisite goods and services, it was acting in a socially responsible manner. But the modern concept of social responsibility has grown, in a different manner, though no consensus is available as regards its definition or the extent of its scope.

According to K.R. Andrews, social responsibility may be taken to mean intelligent and objective concern for the welfare of the society that restrains individual and corporate behaviour from ultimately destructive activities. According to H.R. Bowen, a businessman has an obligation to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and values of our society. Therefore, business must recognise and understand the aspirations of the society and determine to contribute to its achievement. According to Keith Davis, social responsibility begins where the law ends. A firm is not being socially responsible if it merely complies with the minimum requirements of law, because this is what any good citizen would do. Social responsibility goes one step further. It is a firm's acceptance of a social obligation beyond the requirements of law.

Social responsibility means that organizations have significant influence on the social system and that this influence must be properly considered and balanced in all organizational actions. It simply means that business organizations must function as part of a larger social system because they are, in fact, a part of that system.

The social responsibilities may be internal or external to a business organization. Internal obligations are concerned with assuring due process of justice, equity and morality in employees' hiring and firing or their promotion or training. They may also relate to such issues as increasing employees' productivity, or improving work environment. External obligations refer to such actions as fair deal to minority shareholders, earning foreign exchange or training or hiring the unemployed, etc.

2.4.1 Nature of Social Responsibility

Social responsibility of business involves consideration of general public interest by businessmen while taking business decisions and actions.

According to Bowen, social responsibility refers to the 'obligations of businessmen to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and values of our society.'

This entails that businessmen should perform their operations with due consideration of the aspirations of society. They should fulfil the demands of those

who have a claim in the operations of business. They must measure the consequences of their decisions and courses of action on the society and ascertain that no undue harm is done to the interests of the society.

Causes of Growing Awareness for Social Responsibility

The concept of social responsibility has emerged due to several economic, social, political and legal influences. These forces, which have obliged, persuaded and helped businessmen to become aware of their responsibility to society, are as follows:

- 1. Public opinion:** Public interference with the help of the government has instilled a fear in the heart of businessmen. The threat of public regulation and public ownership has compelled them to acknowledge the fact that responsible behaviour is essential on their part for their survival in the private sector.
- 2. Trade union movement:** The recent development of socialism that boosted the strength of labour unions has forced businessmen to give a fair share to workers. Human relations and labour legislation have facilitated trade unions to increase their influence.
- 3. Consumerism:** Consumer organizations have encouraged awareness about consumer rights. Consequently businesses have become more responsive to consumer needs and stress the dictum of 'consumer is the king'. Businessmen can no longer adopt the approach of 'let the buyer beware'.
- 4. Education:** Extensive education has made the businessmen conscious about the quality of life, moral values and social standards. Liberal business leaders have been pressing business community to acknowledge its social obligations.
- 5. Public relations:** Modern businessmen are aware that a good public image contributes to their growth. There is a greater alertness in their hearts that business is a construction of society and hence it should consider and react positively to the expectations of the society.
- 6. Managerial revolution:** Separation of ownership from control in large corporations has resulted in the professionalism in management. A professional manager is fairly aware of the society's expectations and attempts to meet the demands of all the social components like, customers, employees, shareholders, and the government in a well-adjusted manner.

2.4.2 Need for Social Responsibility of Business

- 1. The Iron law of responsibility:** The institution of business exists only because it performs an invaluable service to society. Society gives business its charter to exist and the charter can be amended or revoked at any time if it fails to live up to society's expectations. Therefore, if business intends to retain its existing social role and social power, it must respond to society's needs

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constructively. This is called the 'iron law of responsibility', which is that in the long run, those who do not use power in a manner which society considers responsible will tend to lose it. Though the long run may be decades or even centuries in some instances, history confirms that society ultimately acts to reduce the power of those who have not used it responsibly.

2. *To fulfill long-term self-interest:* A business organization most sensitive to community needs would in its own self-interest like to have a better community in which to conduct its business. To achieve that, it would implement special programmes for social welfare. As a result of social improvements, crime will decrease. Less money will be required to protect property. Labour recruitment will be easier. Turnover and absenteeism will be substantially reduced. A better society would produce a better environment in which the business may aim at long run profit maximization.
3. *To establish a better public image:* Each business organization must enhance its public image to secure more customers, better employees and higher profits. The public image concept may be extended to the accomplishment of various types of social goals. According to this line of argument, social goals are now a top priority with members of the public. So, if a firm wants to project a favourable public image, it will have to show that it supports these social goals.
4. *To avoid government regulation or control:* Regulation and control are costly to business, both in terms of energy and money and restricts its flexibility of decision-making. Failure of businessmen to assume social responsibilities voluntarily invites government intervention and regulation or control of their activities. By their own socially responsible behaviour they can prevent government intervention. Businessmen have learnt that once a government control is established it is seldom removed even though the warranting conditions change. If these are the facts, then the prudent course for business is to understand the limit of its power and to use that power responsibly, giving government no opportunity to intervene.
5. *To avoid misuse of national resources and economic power:* Businessmen command considerable power on the productive resources of a community. They are obliged to use those resources for the common good of society. They should not forget that the power to command national resources has been delegated to them by the society to generate more wealth for its betterment. They must honour social obligations while exercising the delegated economic power. Society will not indefinitely tolerate their misdeeds in wasting away these resources.
6. *To avoid class-conflicts:* Industrial peace is a precondition for the success of business. Trade unions are becoming more and more militant and demand social welfare measures, better wages, better working conditions, etc. Their demand derives its force from the fast changing social environment.

Businessmen must win over the confidence of workers and avoid violent class conflicts in their own interest.

7. *To convert resistances into resources:* If the innovative ability of a business is used to solve social problems, many resistances (problems) can be transformed into resources and the functional capacity of resources may be increased manifold. All problems may not be capable of being handled this way, but many of them would be solved to the ultimate benefit of society. It is recognised that prevention is better than cure. Any delay in dealing with social problems now may leave business managements constantly occupied with extinguishing social fires in future. It is economical and wise to deal with such problems before they snowball and become uncontrollable. Business organizations can do a lot in this regard.
8. The effluence of many factories damages the surrounding environment. They are duty-bound to repair the damage by recognizing their responsibility towards society.

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2.4.3 Social Responsibility of Business towards Different Groups

According to Earnest Dale, it is the duty of business to provide a fair return to the shareholders, fair working conditions to the employees, fair deal to the suppliers and customers and to make the business an asset to the local community and the nation.

1. *Owners of business:* Management must provide fair, adequate and stable long-run rate of return and steady capital appreciation to the shareholders for their investments. It must also provide to them regular, accurate and up-to-date information about the working of the company. Maximum disclosure about the progress and achievements of the company is very satisfying to the shareholders. It must ensure planned growth, solvency of the business and optimum utilization of the resources of the business.
2. *Employees:* Employees need security of jobs, higher wages, full employment, better conditions of work, opportunities for self-development and promotion. They want to unite and form their trade unions to achieve rights and to seek protection against high-handedness of the management. They also desire their work itself to be rewarding. Management, as a part of its social responsibilities, is expected to provide for their social security, welfare, grievances settlement machinery and sharing of excess profits.

Management should serve as a model employer. A model employer is one who does not exploit his employees. As a model employer, the management should provide stable employment, adequate wages, good and safe working conditions, job satisfaction and opportunities for self-development. Healthy trade union practices may be encouraged. Employees may be considered as partners in business, since their interests in business is not very much different from the interests of the shareholders. They may be allowed to

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participate in the decision-making process at all levels of management. A feeling of fellowship and a sense of belonging to the company as a whole should be allowed to grow.

3. *Consumers:* In the words of Henry Ford, management must provide those goods and services which the society needs at a price which the society can afford to pay. Management is supposed to provide good quality products to the consumers at reasonable prices. It should develop a liberal and fair attitude towards the consumers. It must maintain regular supply of high quality products and provide services to the consumers. Managers must meet the needs of the consumers of different classes, tastes and with different purchasing powers at the right time, place, price and in right quality. A businessman should act as a friend and guide to the consumer. It is his duty to protect consumers' interest at any cost. He must guard against adulteration, poor quality, lack of service to the consumer, misleading and dishonest advertisements, under-weighting, supply of state goods, etc. He must handle the complaints of the consumers carefully and efficiently.

The concept of social responsibility of private business may be new to the western world, but in India it is not so. Gandhiji reminded us of these values when he propounded the theory of trusteeship. The rich businessman should recognize that he is the trustee for all the wealth which he has collected from the members of the society. So the entrepreneur has to strike a balance between profit and social good.

The concept of social responsibility of business was first mooted by President Wilson in USA as early as 1913 as a measure of the 'New Democracy'. He gave a new shape to the manners and morals of business through the Chamber of Commerce under the doctrine of self-rule in industry which listed fair trade practices and enforced self-discipline by the business community.

Social issues with which business corporations have been concerned since the 60s may be divided into three categories: The first of these refers to social problems external to the corporation which were not caused by any direct business action. Poverty, drug abuses, decay of the cities are examples of problems in this category. The second category consists of the external impact of regular economic activities. Pollution by production is a case in point. The quality, safety, reliability of goods and services, deception from marketing practices, the social impact of plant closings and plant location belong to this category. The final category of issues occurs within the firm and is tied up with regular economic activities. Equal employment opportunity, occupational health and safety, the quality of work life and industrial democracy belong to this category.

The second and third categories are of increasing importance and are tied up with the regular economic operations of business. Improved social performance demands changes in these operations.

Broadly speaking, business has two major objectives—economic and social.

Economic objectives

The first objective of business is economic in nature. 'Management is that activity whereby economic forces (land, labour and capital) are utilised in combination, always with a view to profits of one kind or another'. In the words of Drucker, it is the purpose, nature and necessity of this institution to take risks, to create risks. 'Unless we provide for risk, we are going to destroy capacity to produce. And therefore, a minimum profitability, adequate to the risks which by necessity, assume and create, is an absolute condition of survival not only for the enterprise but for society.'

Profits are the reward for which a business enterprise is brought into being. No one will take the risks involved unless he is assured of adequate returns. Once a business is started, the profits must continue to accrue if the business is to continue. A business may bear losses provided there are chances of being compensated by adequate profits in the long run.

Apart from meeting the costs of being and continuing to be in business, profits serve two other purposes. They ensure the supply of future capital for expansion either through retained earnings or providing inducement to new outside capital. Profit is also an ultimate test of business performance; it is a criterion of efficiency. The more efficient a business is, the greater the profit it earns.

Social objectives

Urwick has rightly observed that profit can no longer be an objective of business than eating the objective of living. Although profit is one of the major objectives of business, it does not mean that there is no limit to the profit which the firm can make. Profit should be distinguished from profiteering. Limitation on the profit motive arises from the fact that business does not thrive in a vacuum. It exists in society. Even in a free enterprise system, individual business may be restricted by social pressure, political action and legislative interference. A business organization may be compelled to maintain the quality of its product, charge a prescribed price from its customers or pay a living wage to its employees. It may also be prevented from earning profits beyond a fixed ceiling.

So, good business keeps before itself some social objectives such as those of producing articles of good quality, charging reasonable prices, adopting fair labour practices and so on. Society is based on some ethical principles and makes some promises to its members. Business has to conform to these beliefs and promises. It must not behave in a manner which is not conducive to the stability of society. On the other hand, business should aim at positively contributing to the well-being and uplift of the community in which it is situated. This it does by participating in the welfare activities of the surrounding area such as running of schools, libraries, hospitals, organising sports, providing entertainment and so on. Bowen has propounded a doctrine of social responsibilities, according to which business should be conducted for the attainment of valued social goals like a high

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standard of living, economic progress, economic stability, personal and national security.

It is a fact that the concept of social responsibility of business has received public attention in India in recent times. Some enlightened companies like TISCO have focused on social responsibility and proposed social audit. But the following facts show that social responsibility is at a low pitch in India.

- (a) A large section of business firms are inspired solely by the profit motive to the complete neglect of social good.
- (b) Tax evasion is widespread. Many firms maintain duplicate books of account.
- (c) Essential commodities like baby food, kerosene, cement etc. are frequently hoarded and artificial scarcity is created by dishonest businessmen for making abnormal profit.
- (d) Adulteration is rampant, particularly in respect of food articles.

Ethics, Values and Business

Today, it is generally accepted that business has social responsibilities, and that management must ensure goods at fair, reasonable and relatively stable prices without seasonal fluctuations and without unethical practices such as hoarding, black-marketeering and profiteering. While there are legal deterrents for these, business should unilaterally encourage the adoption of a code of ethics analogous to professions such as law, medicine and accountancy as a means of punitive self-regulation.

Moreover, judgements at apex Court level have proclaimed that no industry has the right to function if it cannot ensure fair or at least minimum wages to its workmen. Labour has the right to organize peacefully for collective bargaining, including going on pre-notified strike outside the business premises, while management has the responsibility of providing working conditions that enable its workforce to give of their best. A plethora of seesaw judgements have swung the pendulum of justice either in favour of or against business, and it is only now—with the looming threat of global competition—that a degree of stability has emerged in management–labour relations.

Traditionally, business believed that that government is best which governs the least—a typically laissez-faire approach that stood for non-intervention. Today, it is a well recognized fact that under such conditions, government abdicated executive power in favour of economic power—a situation incompatible with our socialistic pattern of society. In fact, business has to partner closely with government to ensure that all interests, including those of the public, are catered for adequately. While in several fields the two sectors are *de facto* rivals, a planned economy such as ours tries to ensure a degree of balance between the two.

As realization dawns that cooperation is better than confrontation, the social responsibilities of business toward government demand that a businessman:

- (i) pays all taxes and dues promptly and honestly, and behaves like a law abiding

citizen (ii) does not resort to corrupt practices subvert democratic processes for selfish motives (iii) refrains from adulterating goods or commodities for pecuniary advantage at the cost of the public, and eschews hoarding or other methods for creating artificial scarcities. Of course, it follows therefrom that government, in turn, will reciprocate by maintaining the highest ethical and moral standards—a remote possibility given the enormous expense involved in having a shy at the hustings, which exacts its own toll on democratic processes and ethical standards. As Otto von Bismarck said, 'Politics ruins the character.' The recent media reports (April 2006) about Tony Blair's government receiving huge donations from parties who were beneficiaries of official patronage tell their own sad story of human bondage to mammon.

Place of ethics and values: Ethical systems tend to pass value judgements on human behaviour with reference to a certain moral ideal. Based on what that ideal represents in a particular society – because a universal morality has yet to be found—value judgements are judgements of *what ought to be*, as opposed to judgements of facts, which are judgements of *what prevails*. The day has passed when all that a businessman had to do was to make profits and stay out of jail; ethics and business were hardly felt to have any correlation. In our 21st century world, hard-pressed by the global fallouts of unethical malpractices of multinational corporations and even national governments, there is a new realization that ethical behaviour is the cornerstone of human progress, both material as well as spiritual.

Managements are becoming increasingly aware of the social repercussions of unethical decisions, so much so that the subject has become a compulsory paper in many management institutes abroad: a welcome addition in the light of deteriorating family relationships and parental guidance from early childhood. There is general consensus that there must never be another Andrew Fastow of Enron, or a Bernard Ebbers of WorldCom, no matter the relentless pressures of quarterly financial results, annual profitability estimates or shareholder expectations. With the rise of a hedonistic consumer society that believes in flaunting its wealth, obsessed with constantly updating its outward appearance at the expense of inner harmony, it is hardly surprising that venerable social institutions like marriage are on the way out. This alarming global scenario of declining moral and ethical standards brings with it the awareness that everything is inter-related and intrinsically interconnected. Nothing functions in isolation. This is especially true of governments or multinational corporations, and their actions. One irresponsible currency trader on a remote island can bring down a hoary old institution like Baring's Bank and trigger a regional crisis that cripples the economies of several countries.

While businessmen feel obliged to interpret themselves and the industrial systems they represent in terms of democracy or (as in our case) a socialist system, the dilemma is that the system of free enterprise, perhaps the most successful model of business, still fails to co-exist happily with the idea of giving precedence to global or national priorities over personal interest. Despite a large and vocal body of organizational thinkers who champion the cause of maintaining ethical

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standards in business, the fact remains that as yet, there is no compulsion apart from legal deterrents that can force professional managers, beset by the overwhelming need to balance morality with survival, to be consistently ethical in their functioning, even if some objective yardstick was available to measure the same. As such, the search for a universally acceptable moral philosophy continues.

Resolving Corporate and Socio-Economic Conflict

The executive has to strike a balance between the technical *must* and the ethical *ought*. To resolve the conflict between personal and social objectives, Adam Smith evolved the concept of enlightened self-interest. Self-interest, Smith maintained, was the best guide to social and personal policy. With a view to harmonise personal, social and corporate values, George Geyder recently developed the concept of the *responsible company*. This concept of responsible business is a part of the larger concept of a responsible society: a society in which the individual discharges his responsibility to the community, the community to the individual, the citizen to the State, the State to the citizen, the father to the son, the son to the father, the teacher to the students, the student to the teacher, the management to the employee, the employee to the management and so on. The responsible society is the universal goal of mankind.

The concept of social responsibility of private businesses may be new to the Western world, but not to India where Gandhiji reminded us of these values when he propounded the theory of *trusteeship*. All life is a trust and all power carries with it obligations. Idea of trusteeship expresses the inherent responsibility of business enterprise to its consumers, workers, shareholders and the society and the mutual responsibilities of these to one another.

The business is a community and justice should be its rule. This means that there should be a *company code of conduct* which facilitates improved performance. It is the duty of management to see that responsibilities of business to shareholders as well as to stockholders are fulfilled. Each of the parties involved in business has no more than a partial interest in the enterprise; only management entrusted with its governance carries the overall responsibilities for its success and growth. Management must be freed from one-sided dependence on any single interest if it has to take a broad view of its obligation.

2.4.4 Arguments For and Against Social Responsibility

Arguments in favour of social responsibility

The case of social responsibility has been subject of controversy since long. There have been arguments both in favour and against it. The main points that support the assumption of social responsibility by business enterprise are as follows:

- 1. Long-term self-interest of business:** As stated earlier a good public image is bound to give better returns to business enterprise. The businessmen can benefit in the long run by helping for the welfare of the society through

education, and better living conditions. This will result in better employees in business and enlightened customers in society who will benefit through increased purchasing power to the organization.

- 2. Ascertain law and order:** Social responsibility on the part of business can avoid the unrest in society. If the society feels that it is not getting its appropriate share in business it is bound to create disorder by adopting anti-social and illegal activities and rebellions. Pursuing the doctrine of social responsibility can help the business organizations to prevent social chaos.
- 3. Maintenance of free enterprise:** Government or public regulation can hinder the development of business by decreasing the flexibility of decision-making and freedom of choice and action. Therefore voluntary assumption of social responsibilities is essential for the growth of a business organization.
- 4. Creation of society:** Business is a part of society and survives on the demands of the society. Therefore it should be responsive to social expectations and welfare. The right of the business to grow goes hand in hand with its awareness of social responsibility and welfare. It is the duty of the business enterprise to contribute in some way to the well being of its society.
- 5. Moral justification:** Enlightened businessmen have now become more aware about their moral duty to serve the society. Business has the resources and power to solve social problems. Therefore, its power should be balanced with social responsibility.
- 6. Profitable environment:** To ensure a profitable environment in the society in which it operates, business needs to meet the challenges of social evils. Active interference on part of businessmen in solving these challenges can convert them to opportunities, which in turn will ascertain not just the existence but also the benefit of the organization.
- 7. System interdependence:** Business system and social dependence are inter-related and thus affect each other.

If business does not supply quality goods and services at reasonable prices, it may, in turn, face a restricted flow of inputs. Therefore, it is essential for business to be responsive to social expectations.

Arguments against social responsibility

The arguments against social responsibility on part of business enterprise are as follows:

- 1. Dilution of profit maximization:** The economic value is the main criterion by which the success of an economic institution of business should be estimated. According to Milton Friedman, 'few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much

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money for shareholders as possible. This is a fundamentally subversive doctrine. Management's spending for society is hypocrisy. Only people can have responsibilities not corporations.'

2. **Loss of incentive:** The motivation to utilize resources effectively is decreased when social responsibility is considered important. It is the profit motive principally that encourages optimum use of resources and manpower to run the business with enthusiasm.
3. **Lack of standard:** Besides the effort motive profit serves as a standard to measure the performance of business. A business organization goes off course as it loses the guiding measure that depicts the efficiency of its performance and thus hinders decision-making.
4. **Business is an objective venture:** The emotional insights and experience essential to tackle social problems are lacking in the businessmen's temperament. They cannot determine what is in public interest. The social problems solutions should be expected from specialised social agencies and not businessmen.
5. **Undue use of power:** If business organizations involve in social institutions they are likely to dominate the decisions of these institutions for their own interests. They can use their financial power to take decisions concerning the functioning of these institutions. This may further lead to increased social detriment
6. **Market mechanism gets distorted:** The principle of social responsibility is based on the assumption that market mechanism is not the appropriate way to allocate scarce resources to alternative uses and so it should be replaced by political mechanism. If the market price of a product contains the cost of social actions, it does not actually represent the relative cost of producing it and thus the market mechanism gets distorted.

Check Your Progress

1. Define environmental scanning or analysis.
2. Who proposed the QUEST analysis?
3. What does social responsibility of business entail?
4. State the two main objectives of business.

2.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The monitoring process of the appropriate environment by an organization to identify the opportunities and threats, that affect the business, is known as environmental scanning or analysis.

2. The QUEST analysis was proposed by B. Nanus.
3. Social responsibility of business entails consideration of general public interest by businessmen while taking business decisions and actions.
4. The two main objectives of business are economic and social.

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2.6 SUMMARY

- The monitoring process of the appropriate environment by an organization to identify the opportunities and threats, that affect the business, is known as environmental scanning or analysis.
- ETOP is a device that considers the environmental information and determines the relative impact of threats and opportunities, for the systematic evaluation of environmental scanning.
- QUEST analysis was proposed by B. Nanus. It is a four-step process that uses scenario writing for environmental scanning.
- SWOT is the heart of strategic analysis. SWOT analysis is the process of carefully inspecting the business and its environment through the various dimensions of strengths, weaknesses, opportunities, and threats. SWOT is also known as TOWS analysis.
- PESTLE analysis helps in analysing the environmental factors that highly affect organizational strategies.
- Customers live in societies. A large part of the being of an individual is dependent on the society he resides in. Social factors include the attitudes, values, and lifestyles of people.
- A value is a strongly held and enduring belief. The majority of people living in a society uphold the values of the society. A person's values are key determinants of what is important and not important to him, how he reacts in a particular situation, and how he behaves in social situations.
- Multiple lifestyles have evolved because people can choose from a growing number of products and services, and most have the money to exercise more options. The growth of dual-income families has resulted in increased purchasing power.
- Maximize profits was the underlying maxim in the hey-day of *laissez-faire* capitalism of Europe. Social responsibility had no place in its philosophy.
- Social responsibility of business involves consideration of general public interest by businessmen while taking business decisions and actions.
- According to Earnest Dale, it is the duty of business to provide a fair return to the shareholders, fair working conditions to the employees, fair deal to the suppliers and customers and to make the business an asset to the local community and the nation.

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2.7 KEY WORDS

- **Value:** It is a strongly held and enduring belief.
- **Culture:** It is defined as the characteristics and knowledge of a particular group of people.
- **Strategic decisions:** These are long-term, complex decisions made by senior management.

2.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write short notes on the following:
(a) SWOT analysis (b) PESTLE analysis
2. State the inter-relationship between culture and business.
3. Briefly mention the social responsibility of business towards different groups.

Long Answer Questions

1. Give one example of the use of ETOP analysis for a business organization.
2. What is the need for social responsibility of business?
3. Critically analyse the arguments for and against social responsibility.

2.9 FURTHER READINGS

Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.

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UNIT 3 ECONOMIC SYSTEMS

Structure

- 3.0 Introduction
- 3.1 Objectives
- 3.2 Meaning, Characteristics and Types of Economic Systems
 - 3.2.1 Capitalist Economy
 - 3.2.2 Socialist Economy
 - 3.2.3 Mixed Economy
- 3.3 Answers to Check Your Progress Questions
- 3.4 Summary
- 3.5 Key Words
- 3.6 Self Assessment Questions and Exercises
- 3.7 Further Readings

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3.0 INTRODUCTION

In the previous unit, you studied about the impact of environment on business and strategic decisions and the notion of social responsibility of business. This unit will introduce you to the meaning, characteristics and types of economic systems. An economic system can be defined as an organized way in which a state or nation allocates its resources and apportions goods and services in the national community. They are used to control the five factors of production, including labour, capital, entrepreneurs, physical resources and information resources.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Define a capitalist economy
- Differentiate between a capitalist economy and a socialist economy
- List the features of a mixed economy

3.2 MEANING, CHARACTERISTICS AND TYPES OF ECONOMIC SYSTEMS

Every economic system aims to answer the following relevant questions:

- What is to be produced?
- What is the method of production and how much to be produced.
- Who receives the production's output.
- How change is going to be effected and accommodated.

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The structure of every economic system intends to answer these questions. The system sets the rules of play for all the players in an economy and defines how they can interact with one another.

The study of every economic systems aims to analyse how their various components are interlinked, how information is disseminated among them, and their social relations, including the structure of management and property rights.

The analysis of every economic system is used to lay emphasis on two extremes: firstly, planned and market economies, and secondly, on the differences between socialism and capitalism.

Today the classification of economic systems has expanded to include other models and topics that do not fit in to those traditional extremes. The world over, the currently dominant form of economic organization is based on varying versions of a market-oriented mixed economy.

3.2.1 Capitalist Economy

A capitalist economy is an economy where the laws of demand and supply operate freely. The capitalist system is one which is characterized by private ownership of the means of production, individual decision-making and the use of market-mechanism to carry out the decisions of individual participants and facilitate the flow of goods and services in markets.

The capitalist system has the following features:

1. **Market-mechanisms are the key factors that regulate the capitalist economy:** A market economy is one in which buyers and sellers express their opinions about how much they are willing to pay for goods and services. Prices guide the purchasing decisions of the consumers. At the same time, while they decide to buy or not to buy a product, consumers vote for or against the product by using their money. Thus, market prices, which reflect the desires of millions of consumers, provide guidelines to investors and other business persons. The market system, also called the price system, may therefore, be regarded as the organizing force in a capitalist economy.
2. **Consumers' sovereignty:** This is at its best in the capitalist system where consumers have complete freedom of choice of consumption. The production decisions in the free market economy are based on the consumer's desires which are reflected in the demand pattern. Under capitalism, the consumer is the king.
3. **Competition:** Among sellers and buyers, competition is an essential feature of an ideal capitalist system. Competition reduces market imperfections and related problems. Therefore in a free market economy, a sufficient amount of competition is necessary in a private enterprise economy to keep initiative constantly on alert, to protect the consumer and to maintain a sufficiently flexible price system.

4. **Private ownership:** In a capitalist economy, the factors of production – land, labour and capital are privately owned and production occurs at private initiative. Individuals have their property rights protected and are usually free to use their property as they like, as long as they do not infringe on the legal property rights of others. Private property is protected, controlled and enforced by law.
5. **Free enterprise:** This feature of the capitalist system is merely an extension of the concept of property rights. The term free enterprise implies that private firms are allowed to obtain resources to organize production and to sell the resultant product in any way they choose. In other words, there will not be any restrictions on the freedom and ability of the private individuals to carry out any business.
6. **Freedom of choice of occupation:** In a capitalist economy, the individual is free to choose any occupation he is qualified for. This freedom of choice enables the worker to make the best possible bargain for his labour. This implies that the employers have to competitively bid for labour. Freedom of occupational choice, however, does not mean guarantee of a job a worker opts for; the choice is practically limited by the extent of availability of the jobs.
7. **Freedom to save and invest:** The freedom to save is implied by the freedom of consumption. The term saving implies the sacrifice of consumption. The right to save is supported by the right to transmit wealth so that the choice between present and future consumption is not limited to the adult life of one person. The freedom to save, inherit and accumulate wealth is, therefore, a right which is perhaps more typical for the private enterprise system than in free choice of consumption and occupation.
8. **Limited role of government:** Government has no role in economic activities. Capitalism believes that government is an evil necessary and that government is the best which governs the least.

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3.2.2 Socialist Economy

Allocation of resources through central authority

Within the wide spectrum of socialism, there are indeed a variety of systems. At one end, there are the communist countries characterized by state capitalism and at the other, there are the democratic socialist nations with a dominant private sector. It is therefore, very difficult to clearly define the socialist system. Socialism, however, is generally understood as an economic system, where the means of production are either owned or controlled by the state and where the resource allocation, investment pattern, consumption, income distribution, etc., are directed and regulated by the state.

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The salient features of a socialist system are:

1. **Government ownership:** In socialist countries, the major means of production are either owned by the government or their use is controlled by the government. In communist economies, the private sector also plays a very important role. In such cases, the government directs and regulates investment allocation and production patterns in accordance with national priorities. In some countries such as India, some of the basic sectors are in the public sector so that resource allocation and investment pattern of the private sector may be regulated and controlled. When the state owns almost all the means of production, it is easier to achieve the desired pattern of resource allocation.
2. **Central authority:** The socialistic economies generally have a central authority like the central planning agency to formulate the national plan for development and to direct resource mobilization, allocation and investment to achieve the plan targets. Socialist economies are sometimes called command economies, because the central planning authority commands the pattern of resource utilization and development. They are also called centrally-planned economies.
3. **Restriction on consumption:** In communist countries, there is no consumer sovereignty because the state decides what may be made available to consumers, unlike in the market economies where the consumers have the freedom to choose from a wide variety. The consumers in a communist system, thus, have to be content with what the state thinks is sufficient for them.
4. **Restriction on occupation:** The freedom of occupation is absent or restricted in socialist countries. An individual may not have the freedom to choose any occupation he is qualified for. Similarly, individual freedom of enterprise is absent.
5. **Fixation of wages and prices:** The wages and prices in a communist economy are fixed by the government and not by market forces. Non-communist socialist countries may also fix wages and prices by certain means.
6. **Distribution of income:** An equitable distribution of income is an important feature of the socialist system. This does not mean, however, that socialist systems aims at perfect equality in income distribution. Wage differentials, depending on the nature and requirements of the job, are recognized in socialist economies. The objective of equitable income distribution may be achieved by fixing the wage rates and other economic rewards or by means of fiscal and other appropriate measures.

3.2.3 Mixed Economy

Allocation of resources through both market mechanism and planning

Mixed economy is the outcome of compromise between two diametrically opposite schools of thought—one which champions the cause of laissez-faire capitalism and the other which espouses the cause of socialization of all means of production. The vast economic development of UK, USA and all free nations of Europe and Australia was due to private enterprise. The economic system worked through the operation of invisible hands. Karl Marx did not accept the capitalist ideas and pleaded for socialization of all the means of production and the state to direct the economy.

It was the failure of the capitalist system that led to the emergence of the mixed economy. Prof. Laski declared that laissez-faire as a principle ended with the outbreak of World War I in 1914. The World War I led to the near total government control of every aspect of economy in nearly all western countries. The worldwide depression brought unemployment and economic misery on an unprecedented scale and led to vigorous demands for state intervention. Keynes' *General Theory* which was published in 1936 is a repudiation of the foundations of laissez-faire. Keynes remarked that the outstanding faults of the economic system in which we all live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and income.

Keynes recommended the establishment of certain controls in matters which are now left in the main to individual initiative in order to exercise a guiding influence on the propensity to consume partly through its scheme of taxation and partly in other ways, and also in order to ensure a somewhat comprehensive socialization of investment which will prove the only means of securing an approximation to full employment. The central controls necessary to ensure full employment will, of course, involve a large extension of traditional functions of government.

Keynes thought neither pure capitalism nor pure socialism could survive as a stable social system. And so came the philosophy of mixed economy. Keynes is the originator of the concept of mixed economy or the controlled economy. Mixed economy operates through a combination of planning and pricing.

Considering the limitations of both maximum role of government under socialism and minimum role of government under capitalism, the world politico-economic order has moved towards mixed economy with optimum role of government. The increasing government intervention in business is justified for welfare capitalism. Government is expected not to end, but to mend capitalist patterns of development in accordance with the principle of maximum social advantage. Government is required to supplement the individual entrepreneurs whenever they fail.

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In a mixed economy, private, public and joint sectors and the like all have some say in the major decisions that influence the functioning of an economy.

There are four important economic roles played by the government in a mixed economy.

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- The regulatory role
- The promotional role
- The entrepreneurial role
- The planning role

1. **The regulatory role:** A large part of the economy is regulated by the government. The government cuts across all broad categories of economic enterprises.

First, the government may determine the conditions under which persons or associations may enter certain lines of business as in the granting of a charter, a franchise or a licence or permitting them to use public resources.

Second, the government may regulate the conduct of economic ventures of any kind.

Third, public control may extend to the results of business operations as in the limitations of public utility profits, ceilings on dividends and the imposition of excess profits tax.

Fourth, the government controls the relationships between various segments of the economy, the purpose being to settle conflicts of interests and to prevent undue concentration of economic powers in a few hands.

2. **The promotional role:** The promotional role played by the government is very important both in the developed and developing economies. In developing countries, where the infrastructural facilities for development are inadequate and experimental activities are scarce, the promotional role of the government assumes special significance. The state will have to assume direct responsibility to build and strengthen the necessary development infrastructures such as power, transport, finance, marketing, institutions for training and other promotional activities.

The promotional role of the state also encompasses the provision of various fiscal, monetary and other incentives for the development of certain priority sectors.

3. **The entrepreneurial role:** The growing importance of the entrepreneurial role of the state is evident from the rapid expansion of the public sector in most countries.

Dimock mentions the following reasons for the growth of public ownership in free societies:

- (i) The growth of public ownership in a free society depends on a combination of belief systems plus practical necessities.
 - (ii) In a democracy, the national emergency of war inevitably causes an expansion in state activity, including public ownership. This is because modern requirement of total war causes people to forsake their convictions concerning private responsibility and to concentrate on massed power.
 - (iii) Major economic dislocations such as the Great Depression of the 1930s tend to stimulate state activity again, leaving a residue of public ownership that takes time and effort to dissipate.
 - (iv) In the economic growth of nations, governments are called on to act as bankers or owners of infant industries and generally to expand their central concern for the economy, thus quoting a considerable degree of public ownership at the outset.
 - (v) When private undertakings become unprofitable, but the need for their service continues, the government may be prevailed upon to acquire and manage such non-profitable business concerns.
 - (vi) Governments are also required to extend the owner-manager relationship when there has been pronounced wastage of national resources.
 - (vii) Government ownership may be extended when the private management fails to deliver the goods.
4. **The planning role:** In developing countries, the state plays a very important role as planner. The modern state is the custodian of the welfare of society. The welfare government has the responsibility for fulfilling the aspirations of the people by bringing about all-round prosperity. The ends to be achieved and the purposes to be served, are many. In the pursuit of the task, the most important problem is the scarcity of resources. The available resources are quite insufficient to meet all the ends. The resource constraints demand that some of the purposes should go unserved. This calls for the determination of the more urgent needs or national priorities and the optimal allocation of the available resources to subserve the common goods. And this is the principal objective of national planning.

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Check Your Progress

1. What is a capitalist economy?
2. What is a market economy?
3. State one major factor that led to the emergence of mixed economy.

3.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A capitalist economy is an economy where the laws of demand and supply operate freely.
2. A market economy is one in which buyers and sellers express their opinions about how much they are willing to pay for goods and services. Prices guide the purchasing decisions of the consumers.
3. It was the failure of the capitalist system that led to the emergence of the mixed economy.

3.4 SUMMARY

- The structure of each economic system seeks to answer these three or four questions. The system sets the rules of play for all the players in an economy, and defines how they can interact with one another.
- A capitalist economy is an economy where the laws of demand and supply operate freely. The capitalist system is one which is characterized by private ownership of the means of production, individual decision-making and the use of market-mechanism to carry out the decisions of individual participants and facilitate the flow of goods and services in markets.
- Within the wide spectrum of socialism, there are indeed a variety of systems. At one end, there are the communist countries characterized by state capitalism and at the other, there are the democratic socialist nations with a dominant private sector.
- Mixed economy is the outcome of compromise between two diametrically opposite schools of thought—one which champions the cause of laissez-faire capitalism and the other which espouses the cause of socialization of all means of production.
- In a mixed economy, private, public and joint sectors and the like all have some say in the major decisions that influence the functioning of an economy.

3.5 KEY WORDS

- **Free Enterprise:** It is a type of economy where products, prices and services are determined by the market, not the government.
- **Laissez-Faire:** In economics, the term implies to absenteeism by governments from interfering in the workings of the free market.

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3.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. List the salient features of a socialist system.
2. Write a shot note on mixed economy.
3. Differentiate between a socialist economy and a capitalist economy.

Long Answer Questions

1. Discuss the role of government in a mixed economy.
2. Explain the various kinds of economic systems existing in the world.
3. Describe the features of a socialist system.

3.7 FURTHER READINGS

Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.

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UNIT 4 ECONOMIC PLANNING

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Structure

- 4.0 Introduction
- 4.1 Objectives
- 4.2 Economic Planning: An Overview
- 4.3 Nature, Scope and Significance of Economic Planning in India
- 4.4 Achievements and Failures of Economic Planning
- 4.5 Answers to Check Your Progress Questions
- 4.6 Summary
- 4.7 Key Words
- 4.8 Self Assessment Questions and Exercises
- 4.9 Further Readings

4.0 INTRODUCTION

In the previous unit, you studied about the meaning, characteristics and types of economics systems. This unit will focus on the nature, scope and significance of economic planning in India. Moreover, you will also thoroughly study about the achievements and failures of the twelve Five Year Plans that have been introduced in India up till now since independence. Economic planning is to make decision with respect to the use of resources. Economic planning is a term used to describe the long term plans of government to co-ordinate and develop the economy. Economic planning in India was started in 1950 and it is necessary for economic development and economic growth.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Prepare an overview of economic planning
- Discuss the scope and significance of economic planning in India
- Describe the achievements and failures of economic planning

4.2 ECONOMIC PLANNING: AN OVERVIEW

All economies of the world have been endeavouring to achieve economic development through economic planning.

Economic planning has no definite and universally accepted definition. Most often, it depicts well-managed and rational economic system in which all economic activities are executed according to envisaged goals with an aim to achieve maximum

social welfare. All the predetermined objectives are realized within a fixed time period.

Origin of Economic Planning in India

Immediately after achieving independence in 1947, the All India Congress Committee (AICC) appointed the Economic Programme Committee in November 1947. This Committee was chaired by Jawaharlal Nehru. The AICC stated that one aim should be to evolve an economic structure, which will yield maximum production without operation of private monopolies and create a proper balance between urban and rural economies. The Committee was of the opinion that such a social structure can provide an alternative to acquisitive economy of private capitalism and the regimentation of totalitarian state. This gave rise to the idea of mixed economy.

The Economic Programme Committee submitted its detailed proposal on 25 January 1948 and recommended to establish a permanent planning commission. On 6 April 1948, the first Industrial Policy was announced. In March 1950, the Planning Commission was set up by the Government of India under the chairmanship of Jawaharlal Nehru to prepare a plan for the effective and balanced utilization of country's resources. In July 1951, the Planning Commission issued the draft outline of the First Five Year Plan (1951 to 1956).

Reasons for Incorporating Five-Year Plans

India's first Prime Minister Jawaharlal Nehru was deeply impressed with the remarkable progress that the Soviet Union made during his short visit to the nation in 1927. The centralized planning model of the Soviet Union attracted Nehru's attention and in the post-independent period, it became an integral part of the Nehruvian model of development. Nehru set up the Planning Commission with a Government of India resolution in March 1950.

The Planning Commission was setup in pursuance of the declared objectives of the government, which was to promote a swift rise in the standard of living of the people by the efficient utilization of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community. Nehru was the first chairman of the Planning Commission, a post that has been held by all subsequent prime ministers. The charge of the Planning Commission was to assess all the resources of the country, increasing deficient resources, formulating plans for the most effective and balanced utilization of resources and determining priorities.

Nehru launched the first Five-Year Plan in 1951. Two subsequent five year plans were devised till 1965, when there was a break as a result of the 1965 India Pakistan War. Two successive years of drought, devaluation of the currency, a general rise in prices and an erosion of resources disrupted the planning process and after three annual plans between 1966 and 1969, the Fourth Five Year Plan

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was started in 1969. During the years 1990-91 and 1991-92, political instability at the centre resulted in those years being treated as annual plans.

The Eighth Five-Year Plan was launched in 1992 after the World Bank enforced structural adjustment policies on India after the balance of payment crises of 1991. For the first eight plans, the growth of the public sector with immense investments in basic and heavy industry was given prominence, but since the start of the Ninth Five-Year Plan in 1997, the emphasis on the public sector has become less pronounced and the current thinking on planning in the country is that it should increasingly be of an indicative nature. We will discuss these aspects in detail later on in the unit.

Objectives of Five Year Plans

India embarked on the path of planned economic development on 1 April 1951. Since then, it has gone through twelve Five Year Plans. Some of the objectives of these plans have been as follows:

- To increase national income and per capita income
- To raise agricultural production
- To industrialize the economy
- To achieve balanced regional development
- To expand employment opportunities
- To eradicate poverty
- To reduce income and wealth inequalities
- To achieve self-reliance

4.3 NATURE, SCOPE AND SIGNIFICANCE OF ECONOMIC PLANNING IN INDIA

Planning in the economic sphere is the most important development of modern age. Today, planning in the economic sphere has the same significance as God in the spiritual sphere. If a Rip Van Winkle were to wake up today from a slumber which had started in the 1930s, he would be surprised by the importance attached to centralized planning.

In most countries, the authority of the government is freely invoked to stimulate the new investment and technological changes in a systematic manner, so as to use the natural resources in accordance with the economic conditions of the country and to synchronize the process of economic development with the socio-economic institutions of the country.

The planning mechanism is an urgent necessity in an underdeveloped economy to end poverty and stagnation.

Economic planning is the making of major economic decisions – what and how things are to be produced and whom they are to be allocated – by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole.

The case for planning or state control of the economy essentially rests upon the failures of unplanned economy. The case for planning in advanced countries rests on three grounds, viz., the painful experience of the worldwide depression of the 1930s, the wartime experience of rationing and price control to achieve national goals and the Soviet success in the initial period with five year plans. These three developments attracted some developing countries towards planning.

In a developing economy, socio-economic problems like poverty, unemployment, stagnation in agricultural and industrial production and inequality in the distribution of income and wealth can hardly be solved within the framework of an unplanned economy. Planning is required to remove these maladies.

Objectives and Strategies of Planning in India

Economic planning is characterized by some definite and predetermined objectives to be realized within a definite time period. The objectives pursued in the different planned economies in the last three or four decades are many and varied; they are not the same for all countries, nor are they same for the same country for all time to come. The objectives to be set forth by the planners depend on, among other things, the nature of the present state of the economy, the stage of economic development, socio-economic conditions prevalent at the time and the requirements of a particular situation.

Economic planning may have political objectives like the strengthening of defence, building nuclear plants or the maintenance of international peace or social objectives like the provisions for social security and social justice. But, the economic objectives are far more important and significant than others. Let us review briefly the leading economic objectives of planning in India.

1. **Improvement in the standard of living of the people:** That the standard of living of the people in the less-developed countries is very low as compared to those in the highly developed countries is not the most important issue. But the people in less-developed countries are ill-fed, ill-clothed, ill-housed and undereducated. Accordingly, planning in such countries strives for a quick improvement in the living conditions of the people.

Although such an objective did not clearly appear in the early years of planning in Soviet Union, it had been accorded a top priority in Indian plans

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right from the beginning. Thus, the report of India's First Five Year Plan begins with the statement: The central objective of planning in India at the present stage is to initiate a process of development which will raise living standards and open out to the people new opportunities for richer and more varied life.

2. **Rapid increase in national income and per capita income:** This objective directly follows from the first one. It is clearly understandable that the people's standard of living cannot be easily raised unless the plans provide for the rapid increase in national and per capita income of the people. The experience of the different countries demonstrates that only centralized and planned efforts can bring about a quick increase in national and per capita income. In all the five year plans of India, the broad aim has been the rapid increase in national income through massive investment in different sectors of the economy.

3. **Achieving full employment:** Another basic objective of various planned economies has been the planning for full employment. Thus, Zweig remarks, the provision of wholtime employment appears either as a primary objective of planning or a necessary by-product of planning of whatever kind primarily undertaken for other reasons. Full employment is inherent in the nature of planned economy.

The Great Depression of the 1930s created serious problems of unemployment in countries like Great Britain and USA. Since then, the economic policy of almost every country has been directed towards full employment. In fact, full employment has stepped out of the pages of the economic textbooks to become one of the most powerful slogans of the time. Accordingly, in developed economies of the USA and UK, the attainment of full employment has become the principal objective of planning.

In a developing economy, planning is pursued for the rapid development of the economy through the development of agriculture, industry and other vital sectors. Accordingly, full employment in such economies is sometimes strongly emphasized and sometimes, it is implied. In India, the expansion of employment opportunities had been one of the principal objectives of all the five year plans.

4. **Rapid industrialization:** Rapid industrialization, with particular reference to the development of basic and heavy industries, is also considered to be one of the basic objectives of planning in the underdeveloped countries. Apart from strengthening the infrastructure of the economy, industrialization brings in its wake inventiveness, a modern and entrepreneurial outlook, the environment for rapid technological process, indeed the whole complex of industrial civilization which is necessary for a progressive nation. For this reason, the Soviet planners placed supreme importance on the development

of industries. The objective of the First Five-Year Plan (1928–32) in former Soviet Union was the development of production forces through steady industrialization. India also aimed at rapid industrialization in its Second Plan. It is now universally recognized that rapid industrialization is necessary for attaining a higher rate of economic growth in addition to its favourable impact on the resource utilization and on the creation of employment opportunities. Indeed, there is a fairly strong empirical association of industrialization and high national incomes.

In a predominantly agricultural country like India, the priority is very often placed upon the development of agriculture as is evident from the Indian planning. But the economic, sociological and political factors may reinforce one another in making industrialization a desirable policy for developing countries.

5. **Self-sufficiency in food and basic raw materials:** This objective aims at making the country self-sufficient in food and other basic raw materials within a reasonable period of time. Such self-sufficiency provides a strong and solid base for the economy as a preparatory background for future stable growth.

The dependence on foreign countries for food and basic materials is not only undesirable, but also dangerous especially in a situation of critical foreign exchange position. In view of this, one of the principal objectives of India's Third Plan was the attainment of self-sufficiency in foodgrains and the increase in agricultural production for meeting the basic requirements of industry and exports.

6. **Reduction in disparities in income and wealth:** Economic planning in the less-developed countries also aims at reducing economic inequality as found in such countries. Equality in economic affairs for all sections of the people is desirable for establishing social justice. The planning strategy is to be directed to increase the income and opportunities for the people at the lower levels and to reduce the income of the people at the upper levels by suitable methods. In India, this objective has been incorporated in the Five Year Plans. Thus, one of the principal objectives of India's Third Five Year Plan was to establish progressively greater equality of opportunity and to bring about reduction in disparities in income and wealth and a more even distribution of economic power. This was proposed to be achieved through the establishment of a socialist pattern of society.

7. **Removal of poverty:** An underdeveloped country is characterized by a vicious circle of poverty. Accordingly, planning in such countries has to be well-directed towards its early elimination. This is sought to be achieved through raising the minimum level of consumption for people living below the poverty line. This objective has been emphatically underlined in India's

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Fifth Five Year Plan. One of the major strategies of the plans for the removal of poverty is the adoption and implementation of the minimum needs programmes, under which the supply of essential articles of consumptions are to be assured to the poor. At the same time, the planning strategy is to be directed towards the early elimination of mass unemployment and underemployment. But, poverty is too big and complex a problem in a vast country like India to be overcome within a short period of time; it calls for a sustained effort over a long period for its gradual removal.

8. **Other objectives:** The other principal objectives of planning are attainment of economic self-reliance for a self-sustaining growth, correcting imbalances in the economy, providing economic security to the people, reconstruction of the economy damaged by war or political partition of the country, etc.

As stated earlier, economic planning in the underdeveloped economies usually has multiple objectives, instead of a single objective as is possible in the developed countries. The problems of underdeveloped countries are many and the shortcomings are varied; accordingly, the planning contains a number of objectives to be realized over a period of time.

Instruments of Planning

Let us assume that the major objectives of planning are to achieve a high rate of economic growth. The major choice areas revolve around the volume of investment, the allocation of investment and the choice of techniques in production. The latter two are closely interrelated. The need for planning arises because the perceptions of the planner regarding the optimal values of the three crucial variables mentioned are different from what the market mechanism would decide. In other words, the divergence between social and private costs and benefits makes it necessary, for the planner to intervene with a battery of instruments. In this context we must distinguish between the public and private sectors. In addition a distinction must be drawn between price and non-price instruments where the former operates through the price mechanism and the latter operates outside it.

Fiscal and monetary policy instruments are used to influence the volume of investible resources from domestic sources. Direct allocations of investment by the private sector are sought to be controlled by price and non-price instruments. Price controls and tariffs are used to alter private profitability so that it coincides with social profitability. Hence, private sector allocation of investment funds conforms to social goals. When this is not possible, non-price instruments like quantitative controls on the expansion of existing industries, the use of import quotas to restrict raw material imports and restrictions on foreign collaborations are used to guide the allocation of private sector investment along desired channels. In many developing countries, non-price instruments have been found to be more effective.

Quantitative controls on foreign collaboration as well as restrictions on royalty payment are used as instruments to reach the objective of self-reliance. Import tariffs and export subsidies are a part of price instruments, while import quotas and export obligations are a part of non-price instruments in reducing imports and increasing exports.

Inequality in asset distribution is sought to be reduced through qualitative non-price measures like monopoly controls. Regular inequalities are reduced through fiscal subsidies to induce private investment in backward areas.

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4.4 ACHIEVEMENTS AND FAILURES OF ECONOMIC PLANNING

Table 4.1 Summary of Various Five-Year Plans in India

Plan	Aspects
First Plan (1951–56)	<ul style="list-style-type: none"> • Based on the Harrod-Domar Model • Community Development Program launched in 1952 • Focus on agriculture, price stability, power and transport • Plan successful primarily because of good harvests in the final two years of the plan
Second Plan (1956–61)	<ul style="list-style-type: none"> • Also called the Nehru-Mahalanobis Plan • Focus on rapid industrialization • Advocated huge imports through foreign loans • Shifted the emphasis from agriculture to industry • Target Growth: 4.5 per cent • Actual Growth: 4.27 per cent • During this plan, prices increased by 30 per cent, against a decline of 13 per cent during the first plan
Plan	Aspects
First Plan (1951–56)	<ul style="list-style-type: none"> • Based on the Harrod-Domar Model • Community Development Program launched in 1952 • Focus on agriculture, price stability, power and transport • Plan successful primarily because of good harvests in the final two years of the plan
Second Plan (1956–61)	<ul style="list-style-type: none"> • Also called the Nehru-Mahalanobis Plan • Focus on rapid industrialization • Advocated huge imports through foreign loans • Shifted the emphasis from agriculture to industry • Target Growth: 4.5 per cent • Actual Growth: 4.27 per cent • During this plan, prices increased by 30 per cent, against a decline of 13 per cent during the first plan

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Third Plan (1961–66)	<ul style="list-style-type: none"> • At the inception of the third plan, it was felt that the Indian economy had entered a take-off stage. Therefore, the aim of the plan was to make India a 'self-reliant' and 'self-generating' economy • Based on the experience of first two plans, agriculture was given top priority to support the exports and industry • Target Growth: 5.6 per cent • Actual Growth: 2.84 per cent • The plan failed completely in reaching targets due to the Chinese aggression of 1962, the India-Pakistan War of 1965 and a severe drought in 1965–66
Annual Plans (1966–69)	<p>The prevailing crisis in agriculture and a serious food shortage necessitated the emphasis on agriculture during the Annual Plans</p> <p>During these plans a completely new agricultural strategy was implemented. It involved the wide-spread distribution of high-yielding varieties of seeds, extensive use of fertilizers, exploitation of irrigation potential and soil conservation</p> <p>During the Annual Plans, the economy absorbed the shocks that were generated during the third plan</p> <p>The annual plans paved the path for the planned growth ahead</p>
Fourth Plan (1969–74)	<ul style="list-style-type: none"> • The main emphasis of the plan was on growth rate of agriculture to enable other sectors to move forward • Target Growth: 5.7 per cent • Actual Growth: 3.30 per cent • The first two years of the plan saw record production. The last three years did not measure up due to poor monsoons • The influx of Bangladeshi refugees before and after the 1971 Indo-Pak war was an important issue
Fifth Plan (1974–79)	<ul style="list-style-type: none"> • D.D. Dhar prepared and launched the fifth five year plan • The two main objectives of the plan was 'Garibi Hatao' (removal of poverty) and the 'attainment of self reliance' • The promotion of a high rate of growth, better distribution of income and significant growth in the domestic rate of savings were seen as key instruments of the plan • The fifth plan was abruptly terminated in 1978 instead of 1979 after the Janata Party came to power at the centre • Target Growth: 4.4 per cent • Actual Growth: 3.8 per cent
Rolling Plan (1978–80)	<ul style="list-style-type: none"> • There were two sixth five-year plans. The Janata party government put forward a plan for 1978–1983. However, the government lasted for only two years. The Congress returned to power in 1980 and launched a different plan

Sixth Plan (1980–85)	<ul style="list-style-type: none"> • The Congress government's sixth five-year-plan focused on increasing national income, modernising technology, ensuring the continuous decrease in poverty and unemployment, population control through family planning, etc • Target Growth: 5.2 per cent • Actual Growth: 5.66 per cent
Seventh Plan (1985–90)	<ul style="list-style-type: none"> • The focus of the seventh plan was the rapid growth in food-grains production, increased employment opportunities and productivity within the framework of the basic tenants of planning • The plan was very successful with the economy recording 6 per cent growth rate against the targeted 5 per cent • Target Growth: 5.0 per cent • Actual Growth: 6.01 per cent
Eighth Plan (1992–97)	<ul style="list-style-type: none"> • The eighth plan was postponed by two years because of political uncertainty at the Centre • The Balance of Payment crisis and inflation during 1990–91 were the key issues during the launch of the plan • The plan undertook drastic 'structural adjustment policies' enforced by the World Bank to combat the bad economic situation and to undertake an annual average growth of 5.6 per cent • Some of the main economic outcomes during the eighth plan period were rapid economic growth, high growth of the agriculture and allied sector the manufacturing sector, the growth in exports and imports, improvements in trade and the current account deficit
Ninth Plan (1997–2002)	<ul style="list-style-type: none"> • The ninth five year plan was developed in the context of four important dimensions. The dimensions were quality of life, generation of productive employment, regional balance and self-reliance • Target Growth: 6.5 per cent • Actual Growth: 5.35 per cent
Tenth Plan (2002–2007)	<ul style="list-style-type: none"> • The objective of the tenth five year plan was to achieve 8 per cent GDP growth rate, reduce poverty by five percentage points by 2007, provide universal primary healthcare by 2007, and to provide sustained drinking water to all villages by 2012. • The plan also aimed at providing high quality gainful employment to the labour force over the plan period and aimed at increasing literacy rate to 72 per cent within the plan period and to 80 per cent by 2012 • Target growth: 8.1 per cent • Growth achieved: 7.7 per cent

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Eleventh Plan (2007–2012)	<ul style="list-style-type: none"> • Accelerate GDP growth from 8% to 10 per cent, increase agricultural GDP growth rate to 4 per cent per year, create 70 million new work opportunities and reduce educated unemployment to below 5 per cent • Raise real wage rate of unskilled workers by 20 per cent • Reduce dropout rates of children from elementary school from 52.2 per cent in 2003–04 to 20 per cent by 2011–12 and increase literacy rate for persons of age 7 years or above to 85 per cent • Lower gender gap in literacy to 10 percentage point and increase the percentage of each cohort going to higher education from the present 10 per cent to 15 per cent • Reduce infant mortality rate to 28 and maternal mortality ratio to 1 per 1000 live births • Reduce Total Fertility Rate to 2.1 • Attain WHO standards of air quality in all major cities by 2011–12 • Provide clean drinking water for all by 2009 • Increase forest and tree cover by 5 percentage points • Reduce malnutrition among children between 0–3 years to half its present level and reduce anaemia among women and girls by 50 per cent • Raise the sex ratio for age group 0–6 to 935 by 2011–12 and to 950 by 2016–17 • Ensure that at least 33 per cent of the direct and indirect beneficiaries of all government schemes are women and girl children • Ensure all-weather road connection to all habitation with population 1000 and above (500 in hilly and tribal areas) by 2009, and ensure coverage of all significant habitation by 2015 • Treat all urban waste water by 2011–12 to clean river waters • Connect every village by telephone by November 2007 and provide broadband connectivity to all villages by 2012 • Increase energy efficiency by 20 percentage points by 2016–17
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Planning: Achievements, Limitations and Suggestions

Some of the achievements of Five Year Plans in India are as follows:

- (i) **National income:** Indian economy is no longer stagnant; it is moving on the path to development. The growth rate during the planning period was 4.4 per cent. As a result, the growth in per capita income has been around 1.8 per cent.
- (ii) **Agriculture sector:** On the eve of independence, Indian agriculture was backward, stagnant and non-vibrant. After independence, planners and politicians realized the need for major transformation in agriculture. In fact, the First Five Year Plan was exclusively an agricultural plan. During this period, the production of food grain rose from 54 million tonnes in 1950-51 to 64.8 million tons in 1955-56 against the targeted of 61.6 million tonnes. The performance of agriculture sector during the different Plan period is shown in the Table 4.2.

Table 4.2 Performance of Some Agricultural Commodities

Crops	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01	2008-09	2009-10
Rice	34.6	42.4	53.6	74.3	73.7	85.0	99.15	89.09
What	06.4	11.0	23.8	36.3	55.1	69.7	80.58	80.80
Pulses	14.4	12.7	11.8	10.6	14.3	11.0	14.66	14.66
Total food grain	50.8	82.0	108.4	129.6	176.4	196.8	233.88	218.11
Oil seeds	5.2	7.0	9.6	9.4	18.6	18.4	28.16	24.88
Sugarcane	57.1	110.0	126.4	154.2	241.0	296.0	273.9	292.30
Cotton	3.0	5.6	4.8	7.0	9.8	9.5	23.16	24.22
Jute	3.3	5.3	6.2	8.2	9.2	10.5	10.40	11.22

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Unfortunately, after growing at 4 per cent per annum during the 11th Five Year Plan (2007-12), agriculture has come under heavy stress lately. At constant 2011-12 prices, growth rate in agriculture fell to 1.6 per cent during the first four years of the 12th Plan.

- (iii) **Industrial sector:** The compound annual growth rate of industrial output was quite impressive during the first three Five Year Plans. It rose from 5.7 per cent in the First Five Year Plan to 7.2 per cent in the Second Five Year Plan and 9.0 per cent in the Third Five Year Plan. After this, the performance of industrial sector was not good from 1966 to 1984.

During 1985-90, production increased at a satisfactory rate in almost all types of industries. The sector registered a growth of 9.0 per cent in 1990-91 as well. During Ninth Five Year Plan, industrial output increased only by 5.5 per cent. The slow-down was due to a number of structural and cyclical factors. Industrial growth rate rose to 6 per cent in 2002-03 and 8 per cent in 2004-05. According to economic survey 2006-07, industrial sector grew at 10.6 per cent in 2006-07. This growth rate is the highest since 1995-96. The Eleventh Plan (2007-2012) aimed at raising the rate of growth of industrial sector to 10 per cent per annum. The manufacturing sector registered a growth of 6.2 per cent and 5.3 per cent respectively in 2012-13 and 2013-14 (6.1 per cent and 5.3 per cent in terms of GVA at factor cost)

As per appraisal of the 12th plan period, it is important to note that the share of the manufacturing sector in GVA has been falling in the first three years of the Twelfth Plan and is further expected to decline to 16.2 per cent in 2015-16 (PE).

- (iv) **Self-reliance:** The ultimate goal of planning economic development in India is to make the country self-reliant. Self-reliance implies that the nation must have economic security, political security and social security. The minimum condition for this is the elimination of dependence on foreign aid. Due to

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rapid increase in population, increase in the food grains production was inadequate to meet the demands. Thus, India had to import food grains on a large-scale. Large-scale import of food grains puts considerable pressure on the balance of payment. Right from the beginning of the First Five Year Plan, the balance of trade has always been against India. The gap had to be filled up through foreign aid.

The percentage of foreign aid was quite high in the initial years of development but with the passage of time, it has declined. During the First Plan period, considerable progress has been made in the achievement of this goal. Foreign aid was recorded to be 28 per cent in the Second Plan. It declined to 27.2 per cent in the Third Plan and 5.5 per cent in the Eighth Plan.

India's external sector performed well during the Ninth Five Year Plan. Therefore, account deficit came down from 1.4 per cent to 0.7 per cent of GDP in 2001-2002. Many critical products like steel and machinery have started been produced in India. This has reduced our dependence on the import of these goods. The growth rate of exports has increased from 4.8 per cent in the Third Plan to 12.5 per in the Sixth Plan. It further increased to 15 per cent in the Seventh Plan and 11.4 in the Eighth Plan. In the Ninth Plan period, the growth rate of exports declined in the initial year because of global slow down but picked up later. Till 2014, there was 7.4 per cent growth rate in the export of goods and services.

Exports had increased at an average of around 20.3 per cent per year in US\$ terms during the Eleventh Plan. But as per the appraisal of the Twelfth Plan, taking into account the performance of exports during the Eleventh Plan and the prospect that the global economy would gradually recover, expected exports to be over US\$ 570 billion by 2016-17. However, in 2014-15 the annual growth rate of exports declined to 1.3 per cent, with exports valued at US \$ 310.3 billion (RBI, Real Time Handbook of Statistics on the Indian Economy).

- (v) **Social justice:** From the Second Plan onwards, all Five Year Plans in India have been emphasizing the objective of planned growth with social justice. These Plans have been focusing on improving the standard of living of people, reducing poverty, eliminating unemployment and reducing inequality of income and wealth. The number of poor people below the poverty line has no doubt declined, but the magnitude of poverty continues to be large with 260 million people living below the poverty line. This constitutes about 22 per cent of the total population.

One of the most important objectives of economic planning in India has been to create employment opportunities. This was sought to be done through expansion programmes in large industries, cottage industries, small

industries, agricultural sector and service sector of the economy. Various surveys show that unemployment has reduced in the last few years, however, situation has not changed much as large number of people are either under employed or seasonally employed. This is because the rate of growth in population is faster than the rate of increase in employment opportunities. In addition, large inequalities in income distribution are still there in India.

- (vi) **Modernization:** A variety of structural and institutional changes in the framework of economic activities can be termed as modernization. Indian economy has shown a number of such changes. For instance, a number of Indian industrial units are now using modern and sophisticated technologies. The development of public sector has also contributed to the modernization of Indian economy. It has played a dominant role in the establishment of heavy industries such as steel, petrochemicals, petroleum and fertilizers. Structural changes in the industrial sector are also reflected due to the development of a network of banking institutions and money market.

A number of institutions have been set up to provide infrastructure, raw material and marketing facility to small-scale sector. The country has made rapid strides in the production of food grains, cash crops and horticulture crops. Agricultural sector has also been modernized with the help of new technologies. The production of coal and crude oil also increased during the Plan period. There has been a marked improvement in transport facilities.

Limitations of Planning

Indian economy has made significant progress during the Plan period. However, even after 67 years of economic planning, India is still facing some serious problems like poverty, unemployment, inequality of income, concentration of economic power and inflation. Some of the limitations of economic planning are as follows:

- (i) **Inadequate use of natural resources:** Resources are generally defined as things available in our physical environment on which we depend for the satisfaction of our needs and wants. A number of economists feel that India's resources have not been tapped adequately for economic development. India's total geographical area is 329 million hectares on which 184 million hectares is arable land. However, only 141-million-hectare land has been used for cultivation. Keeping in view the increasing needs for food, fodder, fiber and fuel, this area is inadequate. Moreover, unplanned urban growth and industrialization are increasing the levels of pollution that threaten the country's economic and social progress.

Water is a prime natural resource which is required for satisfying one of the basic needs of humans. Thus, water has become a precious national asset. India has vast water resources estimated at 114 million hectare meters.

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However, only a limited area has been developed for irrigation and other essential uses. Further, the Plans have not been successful in improving the efficiency of water management and using surface and ground water resources adequately.

Availability of minerals can influence the course of economic development to a great extent. However, India has not made enough efforts for the discovery and exploration of minerals. In spite of the fact that energy development has been given high priority during the Plans, the supply of energy is becoming less in relation to its demand. The demand for energy has been continuously increasing but adequate steps have not been taken towards its efficient use and conservation. Moreover, little has been done to improve efficiency in the generation and distribution of energy.

- (ii) Growth in population:** The lack of concentrated efforts towards population control has been one of the serious weaknesses of Indian planning. Population has been increasing at an annual rate of more than 2 per cent. The population of India on 31 March 2011 was 1,21,01,93,422 (or 1,210,193,422). India added 181 million to its population since 2001, slightly lower than the population of Brazil. India with 2.4 per cent of the world's surface area accounts for 17.5 per cent of its population. Such growth is a big hurdle in solving India's socio-economic problems such as poverty, unemployment and urbanization.
- (iii) Standard of living:** All Five Year Plans have been aimed at raising the standard of living of the people. However, despite more than six decades of planned economic growth, social development has been inadequate to improve the standard of living of the people. According to the Planning commission, 22 per cent of the population of India is living in absolute poverty. During the Plan period, India has not made any significant improvement in the elimination of poverty. In India, mortality rate is still very high. Also, the goal of universalization of primary education is far away.
- (iv) Inflationary pressure:** Most of the Five Year Plans aimed at controlling inflationary pressure and bringing stability in price. However, they have failed to check price rise in India. With the exception of the First Plan, inflationary pressure has built up in every Plan. With the continuous increase in the prices of consumer goods and agro-based goods, it has become difficult to reduce poverty and inequalities in the country. Rise in prices have adversely affected the poor and fixed income group people.
- (v) Increase in unemployment:** In spite of the fact that reduction of unemployment has been one of the principal objectives of each Plan, unemployment has increased during the Plans. The problem of unemployment has not been tackled effectively by Five Year Plans.

- (vi) **Inequality in the distribution of income and wealth:** Many economists feel that in India, the rich are becoming richer and the poor are becoming poorer. Inequality of income and its distribution is not only found in industrial sector but in agricultural sector as well. Various factors such as inadequate development in many regions, tax evasion, black money, inflation and increase in population are responsible for this phenomenon. Higher relative inequalities are seen in urban areas as well.
- (vii) **Low capital formation:** In India, there are a number of people whose income is really low. They spend a major part of their income on consumption and are not able to save enough. Thus, economic planning has failed to give a big push to capital formation in India. Other reasons behind low capital formation are slow economic growth, less facilities of investment, lack of able entrepreneurs and lack of infrastructure facilities.
- (viii) **Increase in deficit financing:** Indian economy has been facing the problem of deficit financing and consequent inflationary pressures. The fiscal deficit has been rising continuously. The country has been in the grip of fiscal crisis due to increase in non-Plan expenditure.

Suggestions for Planning

A plan is a document showing detailed scheme, programme and strategy worked out in advance for fulfilling an objective. India's planning strategy is divided in four phases:

- Phase I: Growth Oriented Development Strategy (1951-1966)
- Phase II: Equity Oriented Development Strategy (1966-1990)
- Phase III: Post Liberalization Development Strategy (1990-2007)
- Phase IV: Sustainable Development Strategy (2007 onwards)

Let us discuss these phases in detail:

Phase I: Growth Oriented Development Strategy (1951-1966)

The first three Five Year Plans were parts of Phase I and they are mentioned as follows:

- **First Five Year Plan (1951-56):** The First Five Year Plan was a modest plan with limited objective of tackling difficulties created by World War II and the partition of the sub-continent in 1947. The First Five Year Plan was based on Harrod-Domar Model of Development Economics. The Plan had the target of 2.1 per cent per annum growth in national income. In this Plan, top priority was given to the development of agricultural sector because planners believed that agriculture development would lead to higher rate of economic growth. The performance of the Plan was better than it was

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estimated due to good harvest in these years. The national income increased at the rate of 3.6 per cent per annum.

- **Second Five Year Plan (1956-61):** In the Second Five Year Plan, the Mahalanobis strategy of development was adopted, which was prepared by P. C. Mahalanobis. The Mahalanobis strategy had three main aspects: developing a sound base for initiating the process of long-term growth, high priority to industrialization and emphasis on development of capital goods industries against consumer goods industries. This strategy has also been termed as import-substituting strategy. The Plan focused on self-reliance.

The import-substituting strategy is based on infant industry argument. According to this argument, domestic industries should be protected from foreign competition in the initial stage of industrialization. This is done by imposing high import tariffs or quantitative restriction on imports. In this Plan, industrial allocation was raised tremendously and investment in other sectors like agriculture was reduced.

- **Third Five Year Plan (1961-66):** The Third Five Year Plan kept the basic elements of industrial strategy, as laid down in the previous Plan, and also emphasized on the development of agriculture and allied activities. In this Plan, public sector was assigned the role of promoting growth of infrastructural facilities, creating the capacity of capital goods industries and reducing the concentration of economic power through public ownership of means of production.

The Plan aimed at securing 5.6 per cent per annum growth in national income, achieving self-sufficiency in food-grains and expanding basic industries so that the requirement of further industrialization could be met. However, the performance of the Plan fell short of expectations. During this Plan, the growth rate came down to 2.2 per cent per annum. The main reasons of failure were bad harvest for two consecutive years (1965-67), drought in 1965-66, devaluation of rupee and war with China in 1962. The failure during the Third Plan created so much distress in the economy that long-term planning was abandoned for three years. This period of three years was known as annual Plan period.

Phase II: Equity Oriented Development Strategy (1966-1990)

This phase covered annual plan period from 1966 to 1969 and the Fourth, Fifth, Sixth and Seventh Five Year Plans and they are discussed as follows:

- **Annual plan period (1966-69):** To overcome agricultural stagnation, a new strategy of agricultural development was formulated during the 'annual plan period'. The emphasis shifted towards technological reforms in agriculture in order to increase productivity. Technological reforms included development of high-yielding seeds, chemical based fertilizers, pesticides,

commercial sources of energy and controlled water supply. The new strategy was supported by the Agriculture Price Support Policy. The New Agriculture Strategy (NAS) also created a link between agriculture and industries.

- **Fourth Five Year Plan (1969-74):** After the failure of the Third Plan, planners emphasized growth with stability in the Fourth Five Year Plan. The Plan emphasized on reducing fluctuation in agricultural production and reducing dependence on foreign assistance. During this Plan, the growth in national income was aimed at 5.7 per cent per annum. However, due to poor monsoon and shortage of critical inputs, the actual growth rate was as low as 3.4 per cent per annum.
- **Fifth Five Year Plan (1974-79):** The Fifth Five Year Plan stressed on elimination of poverty which was required for the growth of domestic production. The Plan aimed at 4.4 per cent per annum increase in national income, however, the actual growth rate was 4.9 per cent per annum.
- **Sixth Five Year Plan (1980-85):** The strategy of the Sixth Five Year Plan was around food and fuel. With the Green Revolution, the use of chemicals, oil based inputs and commercial sources of energy increased in the agricultural sector. In this Plan, special programmes, aimed at tackling poverty problem, were introduced. The Plan aimed at 5.2 per cent per annum increase in the national income. The target set for the Plan was achieved due to good performance of agricultural sector and rapid growth in the service sector.
- **Seventh Five Year Plan (1985-90):** The Seventh Plan focused on improving existing facilities. This was closely linked with measures for human resource development, i.e., education, technical training and health. The government exempted some industries from Monopolies and Restrictive Trade Practices (MRTP) and also raised the investment limit for some of them. In this Plan, a policy was introduced under which except 32 industries, all industries could set up units without taking license from the government. The Seventh Five Year Plan strategy aimed at tackling the problem of poverty, unemployment and regional imbalance. Many anti-poverty programmes were introduced to tackle the problem of unemployment. The Plan aimed at 5 per cent per annum growth in national income. Due to bumper harvest in previous years, the agricultural sector recorded impressive growth. During this Plan, the actual growth rate in national income was 6 per cent per annum.

Phase III: Post Liberalization Development Strategy (1990-2007)

This phase includes the Eighth, Ninth and Tenth Five Year Plans and they are as follows:

- **Eighth Five Year Plan (1992-97):** Between 1990 and 1992, there was economic instability in India and hence no Five Year Plan was implemented.

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There were only Annual Plans during this time. The Eighth Five Year Plan aimed at extending economic reforms and building a sound foundation for growth.

In this Plan, it was realized that the true meaning of self-reliance was expansion of exports. Hence, for the expansion of trade, tariff was lowered, quantitative restrictions were removed, and human development was emphasized.

- **Ninth Five Year Plan (1997-2002):** Growth with social justice and equity was the focus of this Plan. During this Plan, the role of state and market in Indian economy was realized. The principal task of the Ninth Five Year Plan was to usher in a new era of people-oriented planning in which not only government but people at large, particularly the poor, were effective instruments of participatory planning process. Thus, people's participatory bodies like Panchayati Raj institution, cooperatives and self-help groups were promoted.

In the Ninth Five Year Plan, the annual growth rate in national income was 5.5 per cent per annum. This was lower than the targeted growth rate of 6.5 per cent per annum. The performance was not good due to East Asian crisis in 1997-98, increase in oil price in 2000-01, world economic slowdown, adverse security environment and natural disasters such as Orissa cyclone and earthquake in Gujarat.

- **Tenth Five Year Plan (2002-07):** In the Tenth Five Year Plan, the development strategy enabled private sector to reach its full potential for raising production, creating jobs and raising income levels in the society. This Plan adopted three-pronged strategy to pursue the objective of growth with equity and social justice. This strategy covered agricultural development that ensured widest spread of benefits to the rural poor, rapid growth of those sectors which were most likely to create gainful employment opportunities, and continuing and expanding programmes to supplement the impact of development. This was done for the benefit of those target groups which may not benefit sufficiently from normal growth process. The Tenth Five Year Plan aimed at 8 per cent growth rate per annum in national income but achieved 7.2 per cent growth rate per annum.

Phase IV: Sustainable Development Strategy (2007 onwards)

This phase includes only Eleventh Five Year Plan (2007-2012) and the Twelfth Five Year Plan (2012-2017) which is, as we know, the last Five Year Plan.

The 11th Plan aimed at putting the economy on a sustainable growth rate of approximately 10 per cent per annum. In 2007-08, economic growth was 9 per cent, while in 2008-09, the growth rate was 6.7 per cent. Table 4.3 summarizes the focus areas of each Five Year Plan.

Table 4.3 Plan Objectives

Plan	Focus Area of Plan
First Plan	Agricultural development
Second Plan	Import substitution led growth, and growth of heavy and basic industries.
Third Plan	Economic sufficiency
Fourth Plan	Technological reforms in agricultural growth with stability
Fifth Plan	Elimination of poverty
Sixth Plan	Food and fuel strategy
Seventh Plan	Human resource development
Eighth Plan	Privatization, liberalization and globalization
Ninth Plan	Growth with social justice and equity
Tenth Plan	Growth with social justice and equity
Eleventh Plan	Faster and inclusive growth

NOTES**The 12th Five Year Plan (2012-2017)**

Rather than project a single average growth rate over the five-year period, the Twelfth Five Year Plan (2012-17) envisaged three scenarios termed as ‘strong inclusive growth’, ‘insufficient action’ and ‘policy logjam’. The aim of the 12th Five Year Plan was faster more inclusive and sustainable growth. The Plan pegged the average annual growth rate of the Gross Domestic Product (GDP) under the three scenarios at 8 per cent, 6 to 6.5 per cent and 5 to 5.5 per cent, respectively.

The Twelfth Plan document stated that the objective of 8 per cent annual average growth of GDP can be achieved provided policies that take care of weaknesses in the system are put in place. To emphasize the role of policies, alternative scenarios were presented in the Plan. Scenario one is called ‘Strong Inclusive Growth’ and presents what is possible if well-designed strategy is implemented, intervening at key leverage points through the numerous policy actions. The Twelfth Plan targeted growth rates of 4.0 per cent for agriculture, 7.6 per cent for industry and 9.0 per cent for services, thereby aiming at 8.0 per cent growth in overall GDP.

There were three important revisions to the calculation of GDP in this period: (i) The base year has been changed from 2004-05 to 2011-12; (ii) more reliable data sources are used for the corporate, finance corporations and autonomous institutions and (iii) GDP is now calculated at market prices (broadly equivalent to consumer prices) instead of factor costs (broadly equivalent to producer prices).

Because the GDP had been estimated under the old methodology only up to the year 2013-14, we have the growth rates associated with both the old and new methodology for years 2012-13 and 2013-14 only. When measured at factor cost, the real GDP growth under the old methodology turns out to be 4.5 per cent in 2012-13 and 4.7 per cent in 2013-14. Because the Twelfth Plan projections were based on the old series, it may be reasonably concluded that at least in

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2012-13 and 2013-14, India has performed worse than the ‘policy logjam’ scenario.

While the growth in industrial sector improved significantly over the years, the rate of growth of GVA in Agriculture, forestry & fishing and Services showed mixed trends. Increasing large share for services in total output at a relatively early stage of development is not typical and a matter of concern as, in India, the structural shift from agriculture to services is actually bypassing the industrial sector. The Twelfth Five Year Plan is the last Five Year Plan. The Planning Commission was replaced by the NITI Aayog.

NITI Aayog

The Government of India, in keeping with its reform agenda, constituted the NITI Aayog to replace the Planning Commission instituted in 1950. This was done in order to better serve the needs and aspirations of the people of India. An important evolutionary change from the past, NITI Aayog acts as the quintessential platform of the Government of India to bring States to act together in national interest, and thereby fosters Cooperative Federalism. The National Institution for Transforming India, also called NITI Aayog, was formed via a resolution of the Union Cabinet on 1 January 2015.

At the core of NITI Aayog’s creation are two hubs—Team India Hub and the Knowledge and Innovation Hub. The Team India Hub leads the engagement of states with the Central government, while the Knowledge and Innovation Hub builds NITI’s think-tank capabilities. These hubs reflect the two key tasks of the Aayog.

Instead of the Five Year Plans, NITI Aayog has been tasked with preparing the following documents:

- (i) A vision document keeping in view the social goals set and/or proposed for a period of 15 years;
- (ii) A 7-year strategy document spanning 2017-18 to 2023-24 to convert the longer-term vision into implementable policy and action as a part of a ‘National Development Agenda’; and
- (iii) A 3-year Action document for 2017-18 to 2019-20 aligned to the predictability of financial resources during the 14th Finance Commission Award period. This is also to help translate into actions the goals of the government to be achieved by 2019.

The decision to discontinue Five Year Plans has also meant that the distinction between plan and non-plan expenditures conventionally made will no longer be made in the future Budgets beginning 2017-18. This is a suggestion that has long been made by economists. The principal distinction will now be between revenue and capital expenditures.

Check Your Progress

1. Who was the chairman of the Economic Planning Committee constituted in 1947?
2. In which year was the Planning Commission set-up in India?
3. When was the NITI Aayog formed?

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4.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Jawaharlal Nehru was the chairman of the Economic Planning Committee constituted in 1947.
2. In March 1950, the Planning Commission was set-up by the Government of India.
3. The National Institution for Transforming India, also called NITI Aayog, was formed via a resolution of the Union Cabinet on 1 January 2015.

4.6 SUMMARY

- Immediately after achieving independence in 1947, the All India Congress Committee (AICC) appointed the Economic Programme Committee in November 1947. This Committee was chaired by Jawaharlal Nehru.
- The Economic Programme Committee submitted its detailed proposal on 25 January 1948 and recommended to establish a permanent planning commission. On 6 April 1948, the first Industrial Policy was announced.
- India embarked on the path of planned economic development on 1 April 1951. Since then, it has gone through twelve Five Year Plans.
- Planning in the economic sphere is the most important development of modern age. Today, planning in the economic sphere has the same significance as God in the spiritual sphere.
- Economic planning is the making of major economic decisions – what and how things are to be produced and whom they are to be allocated – by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole.
- The need for planning arises because the perceptions of the planner regarding the optimal values of the three crucial variables mentioned are different from what the market mechanism would decide.
- Indian economy has made significant progress during the Plan period. However, even after 67 years of economic planning, India is still facing

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some serious problems like poverty, unemployment, inequality of income, concentration of economic power and inflation.

- Rather than project a single average growth rate over the five-year period, the Twelfth
- Five Year Plan (2012-17) envisaged three scenarios termed as ‘strong inclusive growth’, ‘insufficient action’ and ‘policy logjam’.
- The Government of India, in keeping with its reform agenda, constituted the NITI Aayog to replace the Planning Commission instituted in 1950. This was done in order to better serve the needs and aspirations of the people of India.
- The decision to discontinue Five Year Plans has also meant that the distinction between plan and non-plan expenditures conventionally made will no longer be made in the future Budgets beginning 2017-18. This is a suggestion that has long been made by economists. The principal distinction will now be between revenue and capital expenditures.

4.7 KEY WORDS

- **Deficit Financing:** It is the budgetary situation where expenditure is higher than the revenue. It is a practice adopted for *financing* the excess expenditure with outside resources.
- **Inflation:** It is the devaluation of a currency marked by a sustained trend of rising prices in the economy.
- **Gross Domestic Product (GDP):** It is a monetary measure of the market value of all the final goods and services produced in a period of time, often yearly or quarterly.

4.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the instruments of planning?
2. Briefly mention the leading economic objectives of economic planning in India.
3. Write a short note on the origin of economic planning in India.

Long Answer Questions

1. Discuss the salient features of the First Five-Year Plan of India.
2. What do you think have been the achievements of Five-Year Plans in India?
3. Analyse the role of the NITI Aayog.

4.9 FURTHER READINGS

- Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.
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Economic Planning

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BLOCK - II
INDUSTRIAL ENVIRONMENT

NOTES

**UNIT 5 INDUSTRIAL POLICIES
AND REGULATIONS**

Structure

- 5.0 Introduction
- 5.1 Objectives
- 5.2 Industrial Policy upto 1991
 - 5.2.1 Industrial Policy 2017
- 5.3 Sectors of Business
 - 5.3.1 Public Sector
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- 5.4 Answers to Check Your Progress Questions
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5.0 INTRODUCTION

Industrial policy 1991 set out directions for industrialisation in an economy that began its journey in liberalisation. It dealt with liberalising licensing and measures to encourage foreign investments. A policy for public sector enterprises and the Monopolies and Restrictive Trade Practices Act was introduced.

India today, as it was in 1991 is at a modulation point. In 1991 the country rose to change from the brim of a financial crisis with foreign exchange reserves at the lowest, exports at the lowest, growing current account and trade deficit. In 1991 it was a country trying to break the conservatism in enterprise but today it is a resurgent India aspiring for its rightful place among the countries of the world.

In this unit, you will go through the various industrial policies of India introduced from independence up to 1991 including the industrial policy of 2017. You will also get to study about the emergence and features of various sectors of business in India namely, public sector, private sector, joint sector and cooperative sector.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the industrial policies of India from independence up to 1991
- List the salient features of the public sector
- Define the cooperative sector
- Differentiate between public sector and private sector

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5.2 INDUSTRIAL POLICY UPTO 1991

The Industrial Policy of 1948: The first industrial policy statement was issued in the Government's Industrial Policy Resolution of April 1948. *The resolution contemplated a mixed economy. There was a sphere reserved for private enterprise and another for public ownership.* The Government of India felt that for sometime the state could continue to increase national wealth by expanding its present activities wherever it was already operating and by concentrating on new units of production in other fields rather than on acquiring and running existing units. Meanwhile, private enterprise, properly directed and regulated, had a valuable role to play. *Thus, ours is a mixed economy in which both the public and private enterprises would work side by side for the economic development of the country. It is a compromise between private capitalism and state socialism.* Private enterprise is actuated by the profit motive which may be looked upon as an index of efficiency, while public enterprise has a social end. Therefore, we may say that a mixed economy is a combination of efficiency with social end. To secure the objective of rapid industrialization, the public sector has not only to initiate development which the private sector is either unwilling or unable to undertake; it has also to play the dominant role in shaping the entire pattern of investments in the economy, whether it makes the investments directly or whether these are made by the private sector.

Categories of industry: *In the Industrial Policy Statement of 1948, industries were divided into four categories:*

The *first category* included such strategic industries as the manufacture of arms and ammunition, the production and control of atomic energy and the ownership and management of railway transport. It was decided that these should be the exclusive monopoly of the state and private enterprise was not to be permitted.

The *second category* included such basic and key industries as coal, iron and steel, ship-building, aircraft manufacture and manufacture of telephone, telegraph and wireless apparatus and mineral oils. For these industries, it was laid down that the State would be exclusively responsible for the establishment of new

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undertakings while existing units would be allowed to operate for a period of ten years at the end of which the position was to be reviewed. Since the responsibility of inviting new concerns was assumed by the State, private enterprise lost interest in this category of industries.

In the *third category*, there was a list of eighteen basic industries. These industries would not ordinarily be operated by private enterprise but would be subject to central regulation and control since their locations had to be governed by economic factors of all-India importance or they required considerable investment and a high degree of technical skill.

The other industries would normally be opened to private enterprise, individual as well as co-operative. But even here, the State would also participate progressively in this field and would not hesitate to intervene whenever the progress of an industry under private enterprise was unsatisfactory.

In addition to the four categories of industries, there was a fifth one in which the Government took a very keen interest. These were the cottage and small industries. The role of cottage and small industries in the national economy was emphasized in as much as they offer scope for individual, village or co-operative enterprise and means for the rehabilitation of displaced persons.

Foreign capital: As regards foreign capital, it was recognized that in securing rapid industrial development, it had an important part to play. A free flow of foreign capital would be welcome because it would ensure the supply of capital goods and of technical know-how. But at the same time, the conditions under which foreign capital would participate in Indian industry should be carefully regulated in the national interest. The Government's policy gives the following assurances to foreign capital : (i) there will be no discrimination between foreign and Indian undertakings in the application of the general industrial policy; (ii) reasonable facilities would be given for the remittance of profits and repatriation of capital consistent with foreign exchange position of the country; and (iii) in the event of nationalization, fair and equitable compensation would be paid.

For increasing industrial production, the resolution enunciated a policy of social justice, fair wages, increasing participation of labour in industrial affairs as a basis of harmonious relations between labour and management.

Mixed economy: The Industrial Policy of 1948 envisaged a mixed economy. Mixed economy is the outcome of compromise between two diametrically opposite schools of thought—one which champions the cause of *laissez faire* capitalism and another which supports the cause of socialization of all means of production.

It was the failure of capitalism which led to the emergence of the mixed economy. Laski declared that *laissez faire as a principle ended with the outbreak of war in 1914*. The First World War led to the near total government control of every aspect of economic life in nearly all western countries. The worldwide depression brought unemployment and economic misery on an unprecedented scale and led to vigorous demands for state intervention.

Keynes' General Theory is a repetition of the foundations of *laissez faire*. Keynes himself played an important part in the evolution of the concept of mixed economy. He believed that capitalism without its defects was the best system. Socialism of the authoritarian type would kill individual freedom. But state control and direction was inevitable in a mixed economy. A mixed economy is a compromise between socialism and capitalism. Neither pure capitalism nor pure socialism could survive as a stable social order. And so came the philosophy of mixed economy. Keynes is the originator of the concept of mixed economy. Mixed economy operates through a combination of planning and pricing.

Considering the limitations of both *maximum role* of the government under socialism and *minimum role* of the government under capitalism, the world politico-economic order has moved towards mixed economy with *optimum role* of the government. The increasing government intervention in business is justified for *welfare capitalism*. The Government is expected not to end but to mend the capitalist pattern of development in accordance with the principle of *maximum social advantage*. Today, there is no country either of pure capitalism or pure socialism. Everywhere it is a mixed form of economy.

Ours is a mixed economy in which both the public and the private enterprises work side by side. It is a compromise between private capitalism and state socialism.

In a mixed economy the entire economic system is divided into three parts:

- (i) Sectors exclusively controlled and managed by the private enterprise subject to the general control and regulation by the state;
- (ii) Sectors which are exclusively controlled and managed by the state; and
- (iii) Sectors which are jointly managed and controlled by the State and private enterprise.

Industrial Policy of 1956: The 1956 industrial policy has six objectives: (i) to accelerate economic growth and industrial development of the country, (ii) to expand the public sector, (iii) to prevent the growth of monopolies and the concentration of economic powers in the hands of a few people, (iv) to develop a large cooperative sector, (v) to develop heavy and machine-made industries, and (vi) to reduce disparities in wealth and income.

1. The new industrial policy divided industries into three categories on the basis of the part which the State would have to play in each of them. It should be remembered that this demarcation was not rigid and it was always open to the State to undertake any types of industrial production.

The **first category** included industries, the future development of which would be the exclusive responsibility of the State. There were 17 industries in this category. All the new units in these industries would be set up only by the state.

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The **second category** consisted of industries which would be progressively State-owned and in which the State would generally take initiative in establishing new units but in which private enterprise would also be expected to supplement the effort of the State. This category comprised 12 industries which were less important than those included in the first category.

The **third category** included all the remaining industries and their future development which would, in general, be left to the initiative and enterprise of the private sector. Even in this category it would be open to the State to start any new industry. Thus, no field was safe from government encroachment. It would be the policy of the State to facilitate and encourage the development of these industries in the private sector in accordance with the programme formulated in successive Five-Year Plans. In special cases, the State might grant financial assistance to the private sector.

Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will be subject to control and regulation in terms of the Industries (Development and Regulation) Act and other relevant legislation.

2. The industrial policy statement stressed the role of cottage and village and small scale industries in the development of the national economy for they provide immediate large-scale employment, offer a method of ensuring a more equitable distribution of the national income and facilitate an effective mobilization of capital and skill which might otherwise remain unutilized. Moreover, the establishment of small industries all over the country will secure a balanced development of the economy and will avoid problems connected with unplanned urbanization.
3. It has been reiterated that the maintenance of industrial peace is one of the prime requisites of industrial progress. In a socialist democracy, labour is a partner in the common task of development and should participate in it with enthusiasm. There should be joint consultation and workers should be associated progressively in management. Enterprises in the public sector have to set an example in this respect.
4. In order that industrialization may benefit the country as a whole, it is important that disparities in the levels of industrial development between different regions be progressively narrowed down, and for this purpose the State should provide the required facilities to those areas which are lagging behind industrially or where there is greater need for providing opportunities for employment : only by securing a balanced and co-ordinated development of the industrial and the agricultural economy in each region, can the entire economy attain higher standards of living.
5. The programme of industrial development as envisaged in our Five-Year Plans will make large demands on the country's resources of technical and

managerial personnel and to meet the needs, proper managerial and technical cadres in the public services should be established.

The most important difference between the 1948 and the 1956 policy statements is with regard to the policy of nationalization. In the first policy, it was laid down that industries in the second category would be permitted to operate for 10 years, at the end of which the Government would decide whether to nationalize them or not. This provision discouraged private enterprise and created uncertainty in the industrial field. The 1956 policy statement removed the threat of nationalization from the minds of private entrepreneurs operating in the predominantly public sector. Thus, private enterprise was given a new opportunity to justify its existence in a socialist democracy.

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Industrial Policy of July 1980: While sticking to the spirit of the 1956 Industrial Policy Resolution, the Congress Government announced on July 23, 1980 the new industrial policy which included major relaxations and concessions benefiting the small, medium as well as large-scale sector with the triple objects of modernization, expansion and spread to backward areas. The thrust of the concessions is in doubling the investment limit of tiny, small and ancillary sectors, regularization of the excess capacity and permitting automatic expansion facilities for large units in the priority sector and setting up of several nucleus industrial centres in industrially backward areas.

The following are the highlights of the New Industrial Policy:

- (i) In order to promote the development of small-scale industries and ensure their rapid growth, the Government has decided to increase the limit of investment in case of tiny units from ` 1 lakh to ` 2 lakh. In the case of small-scale units the limit has been raised from ` 10 lakh to ` 20 lakh and from 15 lakh to 25 lakh in the case of ancillary units.

In March 1985, the investment limit for small-scale industries was raised further from ` 20 lakh to ` 35 lakh. For ancillary units, the investment limit is ` 45 lakh.

- (ii) The Government decided to pursue a goal of vibrant, self-reliant and modern economy in which all sectors had a positive role to play. Therefore, the Government recognized that it was desirable to allow private sector undertakings to grow in consonance with targets and objectives of national plans and policies but would not permit growth of monopolistic tendencies or concentration of economic powers and wealth in a few hands.
- (iii) The Government has decided to revive the efficiency of public sector undertakings. Industrial undertakings in this sector will be closely examined on a unit-by-unit basis and corrective action will be taken in terms of a timebound programme wherever necessary.
- (iv) As regards automatic growth, the Government feels that no avoidable restrictions should be placed on the fullest utilization of the existing industrial

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capacities. In 1975, the Government had permitted the facility for automatic expansion in respect of only 15 industries. The extent of increased capacity permitted in these industries was limited to 5 per cent per annum or 25 per cent in a Five-Year Plan period and could be undertaken in one or more stages. The Government announced that this facility would be extended to other industries also.

- (v) *The 'district industrial centre' idea which was introduced by the Janata Government has not received full support from the 1980 Industrial Policy Statement. On the district industrial centre programme, the 1980 policy points out that the scheme has not produced benefits commensurate with the expenditure incurred. The Government therefore, decided to initiate more effective schemes.*
- (vi) *In the context of development of backward areas, the New Policy Statement has mentioned *nucleus plants* which should radiate industrial impulses all round. The so-called concept of *nucleus plants* when implemented, is expected to concentrate mainly on assembling the products of ancillary units falling within their orbit.*
- (vii) *The 1980 policy refers to considerable simplification and streamlining of licensing procedures and concedes that there is scope for further improvement in reducing the time taken for disposal of applications for the creation of new capacities, proposal for substantial expansion and production of new items. It is proposed to speed up the process of examination and decision-making in the sphere of industrial licensing.*
- (viii) *The Government would endeavour to ensure that the process of modernization percolated down to small units and the villages. For this purpose, the incentives available to the large-scale sector might also be made available to the decentralized sector.*
- (ix) *Industrial processes and technologies which would aim at optimal utilization of energy or the exploitation of alternative sources of energy would be given special assistance, including finance on concessional terms. The Industrial Policy of July 1980 hits hard at the Janata Party's policy statement of December 1977 and its record in promoting industrial growth. But on close examination it will be found that the 1980 Industrial Policy has made no serious departure from the earlier policies. For instance, though the 1980 policy deplores the *artificial divisions* between the small and large-scale sectors promoted by the Janata Government, it also wants to continue the policy of reservation of items for the small-scale sector. It has also retained the distinction between the tiny and the small-scale sectors though the investment limits for both have been doubled. Moreover, the *nucleus plants* idea is good but it will be difficult to achieve. As we get it in the 1980 policy statement, it appears to be just another new appealing word.*

The so-called excess capacities and excess production above licensed limits are expected to be regularized for more industrial units. This encourages and boosts the industrial growth. Induction of new technology is to be encouraged by allowing additional capacities to be created, if necessary, in more cases. This is certainly a step in the right direction.

Elements in the industrial policy of Rajiv Gandhi's government: We give below the elements of the Rajiv Gandhi Government's Liberalized Industrial Policy, as enunciated from time to time by ex-Prime Minister late Rajiv Gandhi himself or his senior cabinet ex-colleagues:

- (i) Upward revision of asset limit of MRTP companies from ` 20 crores to ` 100 crores. In the Union Budget for 1985-86, the Finance Minister announced a steep upward revision in the threshold limit of MRTP Companies from ` 20 crores to ` 100 crores.
- (ii) Automatic Expansion Permission is currently being granted for expansion of existing industrial units up to 1/3rd of their capacity in case the industries have already utilized 93 per cent of their installed capacity.
- (iii) Upward revision in delicensing of investments under the Industries (Development and Regulation) Act, 1951 from ` 3 crores to ` 5 crores subject to the formal requirement of registration of such units. In April 1983, the exemption limit for industrial licensing was raised from ` 3 crores to ` 5 crores.
- (iv) Complete delicensing of twenty-five industries in March 1985.
- (v) Redefinition of investment criteria of small-scale and ancillary industries. The investment limit of ` 20 lakh for small-scale industries has been raised to ` 35 lakh and that of ancillary units has been enhanced from ` 25 lakh to 45 lakh. These limits have been further raised for small-scale industries to ` 60 lakh and for ancillary units to ` 75 lakh.
- (vi) Industries exempt from Section 21 and 22 of the MRTP Act for MRTP/FERA companies for backward areas. The Government of India earlier delicensed broad categories of industries along with 82 bulk drugs for non-MRTP and non-FERA companies subject to production of items reserved for the small-scale sector and certain locational considerations. Later, it was decided to extend the scheme of delicensing also to MRTP and FERA companies in respect to 22 out of 27 industries exempted under section 22A of the MRTP Act provided such undertakings apply for locating these units in centrally declared backward areas.
- (vii) *Setting up of industries by MRTP companies in no-industry districts and other backward districts:* According to the earlier policy, MRTP and FERA companies were permitted to set up industrial units in areas of high technology. Their entry into other fields has been subject to export obligation of 60 per cent with a view to industrializing backward regions within the

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country. The level of export obligation was reduced to 50 per cent for categories B and C districts and 30 per cent for category A districts in 1983. In order to give an impetus to the industrialization of backward areas it has now been decided to reduce the level of export obligation to only 25 per cent for category B and C districts and to totally dispense with export obligations in respect of category A backward districts.

- (viii) *Revision of foreign exchange limits for imports of new materials and components for the purpose of exemption from licensing:* Industrial undertakings with investment below ₹ 5 crores are not required to obtain any industrial license under the Industries (Development and Regulation) Act but one of the conditions of the exemption from licensing was that the foreign exchange requirement for import of raw materials and components in such cases should not exceed 15 per cent of the ex-factory value of industrial production or ₹ 40 lakh, whichever was less. If the import requirement exceeded this limit, even units with investments below ₹ 5 crores would require an industrial license. On account of a rise in the cost of raw materials, it has now been decided to raise the limit to ₹ 75 lakh subject to a ceiling of 15 per cent of the cost of ex-factory value of industrial production. This limit would not however, apply in case of industries in respect of which specific phased manufacturing programmes have been approved by the Government.

New Industrial Policy, 1991

Jawaharlal Nehru laid the foundations of modern India. The aims and objectives set out for the nation by Nehru on the eve of independence were rapid agricultural and industrial development of the country, rapid expansion of opportunities for gainful employment, progressive reduction of social and economic disparities, removal of poverty and attainment of self-reliance. These remain as valid as at the time Nehru set them before the nation. Any industrial policy must be contribute to the realization of these aims and objectives. *Though the present statement of industrial policy is inspired by these concerns, actually it bids farewell to Nehruvian socialism and brings the public sector at par with the private sector in several areas.* Hence, in core areas like steel, power and several other industries, the public sector will have to climb down from the commanding heights to street level commercialism where it has to compete with private enterprise.

In 1948, the Government adopted the industrial policy resolution which emphasized the importance to the economy of securing a continuous increase in production and ensuring its equitable distribution. After the adoption of the Constitution and the socio-economic goals, the industrial policy was revised and adopted in 1956. To meet new challenges from time to time, it was modified through statements in 1973, 1977 and 1980.

The 1956 policy resolution had as its objective the achievement of a socialist pattern of society. In 1956, capital was scarce and the base of

entrepreneurship not strong enough. Hence, the 1956 industrial policy resolution gave primacy to the role of the state to assume a predominant and direct responsibility for industrial development.

The industrial policy statement of 1973 identified high-priority industries where investment from large industrial houses and foreign companies would be permitted.

The industrial policy statement of 1977 laid emphasis on decentralization and on the role of small-scale, tiny and cottage industries.

The industrial policy statement of 1980 focussed attention on the need for promoting competition in the domestic market, technological upgradation and modernization. The policy laid the foundation for an increasingly competitive export base and for ensuring foreign investment in high technology areas. These policies created a climate for rapid industrial growth in the country. Basic industries had been established. New growth centres of industrial activity had emerged as had a new generation of entrepreneurs. A number of policy and procedural changes was introduced in 1985 and 1986 under the leadership of late prime minister Rajiv Gandhi, which aimed at increasing productivity, reducing costs and improving quality. The public sector was freed from a number of constraints and given a large measure of autonomy.

In the 1950s and 1960s the principal instrument for controlling the commanding heights of the economy was investment in the capital of key industries. Today, the state has other instruments of intervention, particularly fiscal and monetary instruments. The state also commands the bulk of the nation's savings. Bank and financial institutions are under state control. Where state intervention is necessary, these instruments will prove more effective.

The Government will fully protect the interests of labour, enhance their welfare and equip them to deal with the inevitability of technological change. Labour will be made an equal partner in progress and prosperity. Workers' participation in management will be promoted.

The Government will continue to visualize new horizons. The major objectives of the new industrial policy will be to build on the gains already made, correct the distortions that may have crept in, maintain a sustained growth in productivity and gainful employment and attain international competitiveness. The government's policy will be in continuity with change.

5.2.1 Industrial Policy 2017

The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry initiated the process of formulation of a new Industrial Policy in May 2017. Since the last Industrial Policy announced in 1991, India has transformed into one of the fastest growing economies in the world. With strong macro-economic fundamentals and several path breaking reforms in the last three years, India is equipped to deploy a different set of ideas and strategies to build a globally

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competitive Indian industry. The new Industrial Policy will subsume the National Manufacturing Policy.

A consultative approach has been taken for industrial policy formulation wherein six thematic focus groups and an online survey on DIPP website have been used to obtain inputs. Focus groups, with members from government departments, industry associations, academia, and think tanks have been setup to delve deep into challenges faced by the industry in specific areas. The six thematic areas include Manufacturing and MSME; Technology and Innovation; Ease of Doing Business; Infrastructure, Investment, Trade and Fiscal policy; and Skills and employability for the future. A Task Force on Artificial Intelligence for India's Economic Transformation has also been constituted which will provide inputs for the policy.

It is proposed that the new Industrial Policy will aim at making India a manufacturing hub by promoting 'Make in India'. It will also suitably incorporate the use of modern smart technologies such as IOT, artificial intelligence and robotics for advanced manufacturing.

WTO and Indian Industry

In order to achieve the gains from WTO the government of India has announced the Export-Import policy 1992-1997 to liberalize trade and boost domestic manufacturing sector. The ministry of commerce of the Government of India at the time expected that by WTO India would benefit by creating 10 million additional jobs annually and India's market share in world exports would improve.

A Federation of Indian Chamber of Commerce and Industry (FICCI) Task Force reports (March 1996) on WTO, rightly observed that in changing scenario there was no alternative to Indian industry but to gear up itself to raise the efficiency and competitiveness, so that India was able to meet the competition in both, the domestic and external markets. By, this, under certain areas like agricultural and allied exports, textiles and trade in services India can meet not only the challenges and will be able to exploit opportunities successfully when developed countries will co-operate to share the fruits of growth and openness in the new world trade order.

5.3 SECTORS OF BUSINESS

Let us now study the emergence of various kinds of business sectors in India.

5.3.1 Public Sector

Public sector or public enterprises include all governmental activities including public, industrial and commercial enterprises. Public enterprise occupies a strategic and crucial position in the Indian economy. It is no exaggeration to say that the economy would sink or swim depending upon the efficiency with which these enterprises operate.

Concept: The modern Indian economy is the creation of the Congress party and its leaders, Mahatma Gandhi and Nehru, who referred to India as a 'Socialist' economy. Socialism is largely a misnomer in the case of India, except for government ownership in industry and commerce. India is still primarily an agricultural country and the distribution of income depends mainly on the distribution of agricultural property. Although there have been some attempts to distribute land to the peasants, land remains unequally distributed and there is evidence that the range of income inequality has been reduced. The tax system continues to be regressive, direct taxes are rarely levied on land and high urban income taxes are marked by evasion. The pre-tax income distribution figures sum up the failure to establish a more equitable distribution of income. In 1960, the bottom 10 per cent of families accounted for less than one per cent of all income, while the top 10 per cent accounted for over one-third. This income distribution is less equitable than in industrialized capitalist countries. Rather than seeking to achieve 'socialist' objectives through income redistribution, the architects of modern Indian economy emphasized State ownership in industry. The feeling was that socialism could be achieved through State control of industry which would serve as a surrogate for social change.

Public enterprises are expected to be the principal agents for rapid economic and social transformation by developing infrastructure and the core sector and by closing the gaps in the industrial structure. Its dominant position in the financial field is intended to control and guide the private sector, wherever necessary. Lastly, the economic growth through public enterprise will ensure social justice.

In developing countries, public enterprises are largely a necessity and not a matter of choice. In India, though the Congress government was clearly committed to expanding the public sector, it did not go into areas where private enterprise was operating. Nationalization of the existing enterprises has been generally resorted to where the public interest was involved or where it was imperative to put the industry on sound footing and regulation and control were not found sufficiently effective. The vast majority of public enterprises is in areas which were hitherto untouched or unexplored by the private sector.

In the Industrial Policy Statement of 1956 it was emphasized that public enterprise was designed to control the 'commanding heights' of the economy. But in recent years, the trends toward increasing liberalization are very much in evidence in India and one gets the impression that private sector is designed to play an important role in the economy in the coming era.

Public sector in the industrial field has expanded rapidly since Independence. In 1951, there were only five non-departmental public undertakings with an investment of ` 29 crore. On 31 March 2004, the number of public enterprises had risen to 230 with the total capital employed therein amounting to ` 586,140 crore.

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The public enterprises comprise:

- (i) Public utilities, e.g., the Railways, Posts and Telegraphs and Irrigation projects.
- (ii) Departmental undertakings of the Government, Central as well as State, e.g., Post and Telegraphs, Integral Coach Factory, etc.
- (iii) Other industrial undertakings which derive their finance from the Government of India in the form of equity capital and loan, e.g., Durgapur Steel Plant, Hindustan Fertilizers, etc.

Public sector units generally are of four kinds:

- (i) National monopolies like railways that have downward sloping unit cost curves. These are hard to assess, being monopolies.
- (ii) Entrepreneurial ventures that, at the start and for many years thereafter, are monopolies or near monopolies. These are generally large units with sophisticated technologies and long gestation periods that produce basic products. Many of the Indian public sector manufacturing units are of this type.
- (iii) Sick units in the private sector that have been taken over to maintain employment etc.
- (iv) Units taken over or formed to acquire the 'commanding heights' or for other ideological reasons.

The State Trading Corporation is a case in point.

Evolution of the Public Sector

The entry of the public sector in a big way in the economic sphere is a post-independence development. Prior to 1947, public sector investment was limited to the railways, the post and telegraphs department, the ordinance factories and a few state-managed factories like the quinine factories and salt factories. It was the Industrial Policy Resolution of the Government of India in 1948 which brought the public sector into the limelight. It declares that a dynamic national policy must be directed to a continuous increase in production by all possible means, side-by-side with measures to secure its equitable distribution. The problem of State participation in industry and the conditions in which private enterprise should be allowed to operate must be judged in this context. Since then the expansion of the public sector has been very rapid.

The idea that in the economic development of the country the State enterprises would play a predominant role took root with the adoption of a socialist pattern of society in the second Plan.

The growth of public enterprises in India has taken place in two ways: (a) by nationalizing existing enterprises and (b) by starting new enterprises. The

State Bank of India, LIC, the Air India and nationalization of 20 banks etc. are included in the first category, while the Hindustan Steel Ltd and the Fertilizer Corporation of India. fall in the second category.

The enormous growth of public sector investments has taken place against a political and ideological background which is peculiar to Indian political development.

Philosophy: The Indian National Congress had traditionally expressed its socio-economic aspirations in radical terms. The 1929 Lahore Resolution had declared that in order to remove poverty and misery of the Indian people and to ameliorate the conditions of the masses, it was essential to make revolutionary changes in the present economic and social structures of society and to remove gross inequalities. The subsequent Karachi Resolution declared that the State shall own or control key industries and services, mineral resources, railways, waterways, shipping and other means of public transport.

Objectives: The objectives of establishing new enterprises and reasons for nationalizing some existing ones are varied and often different from case to case and from time to time. Perhaps, the only generalization possible in this regard is that public enterprise for us is more a matter of necessity than of choice. It is not so much the ideology as the compulsion of the situation which has led to the growth of public enterprise in India.

A brief statement about the need and role of public enterprise in India is contained in the statement of former Prime Minister Indira Gandhi where it is stated that a public sector is advocated for three reasons: to gain control of the commanding heights of the economy; to promote critical development in terms of social gain or strategic value rather than primarily on considerations of profit; and to provide commercial surpluses with which to finance further economic development.

Rationale for the Public Sector

1. **Socialist Pattern of Society:** The public sector was meant to socialize the means of mass production and benefit the masses, as is typically the case in a socialistic pattern of society. The commanding heights of the economy – the core sector comprising investment, production, distribution and consumption – were State owned, so as to promote national development as opposed to considerations of private profit. In such a situation, the so-called public sector needs to expand rapidly, cover areas where the private sector is unwilling or unable to participate, and play a dominant role in shaping the economy. Some of these areas are power, communication, mass transportation, information and broadcasting, mines and defence production. Initially, the public sector took the lead in developing the basic and capital

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goods industries, laying the foundations for national growth unhindered by narrow considerations of profit as would arguably be seen in a laissez faire economy dominated by private enterprise, where motives of personal profit would presumably supersede national priorities. In time, however, some of these monolithic establishments exhausted their early dynamism and metamorphosed into complacent, inefficient, cash-strapped, overstaffed, overunionized islands of mediocrity that generated aught but huge losses—dinosaurs that had run out of time and relevance.

2. **Socio-economic Objectives:** Reduction of inequalities of wealth and income is the most important socio-economic objective, going hand in hand with the need to eliminate poverty and establish an egalitarian society by redistributing wealth and earning potential equitably. Another important objective of a socialistic system is to help the underprivileged, realize their dormant potential by liberating them from economic serfdom and to give them all opportunity to attain social justice. Although rarely declared in so many words, the giant public sector organizations were also meant to serve this purpose by providing upliftment to these neglected sectors, by means of reserving a certain percentage of jobs for weaker sections of society including the physically handicapped. Nationalized banks rendered yeoman service by extending concessional loans under the 'Differential Rates of Interest' scheme, that allowed cheap finance to reach District Consultative Committee sponsored beneficiaries drawn from such sections of the local populace—something a purely profit-driven banking system would never dream of undertaking.
3. **Balanced Regional Development:** One of the major goals of planning is to try and correct regional disparities by spreading the benefits of economic development as evenly as possible across the country. It is vital for humane as well as for security reasons to ensure that the fruits of prosperity percolate throughout the nation, for civil unrest is usually born of discontent with a system of wealth distribution that serves but to defeat the very purpose of adopting a socialistic type of governance. This is particularly true of the sensitive north and north-eastern states, many of which are economically underdeveloped, and hence, vulnerable to ideologies incompatible with our peaceful, non-violent, democratic system of governance run on socialist principles. Industrial development of these areas is a top priority; Bhilai, Rourkela and Durgapur are well-known examples, but more such success stories are needed, and quickly.
4. **Need for Rapid Economic Development:** The need of the hour is rapid economic development. The private sector has neither the desire nor the resources to undertake the massive programme of industrialization. Hence, dependence on the private sector will only slow down the economic

development. Expansion of public enterprise will speed up the rate of economic growth.

5. **Pattern of Resource Allocation:** The main reason for the expansion of the public sector lies in the pattern of resource allocation decided upon under the plans. In the first Plan, the major emphasis was on agriculture, but in the second Plan the emphasis was shifted to basic and capital goods industries. During the first plan period, the private sector was dominant in the field of industrial activities. But, with changed emphasis it was inevitable that the public sector must grow not only absolutely, but also relatively to the private sector.
6. **Building Infrastructure:** Infrastructure provides certain basic facilities for rapid economic growth. In the economic infrastructure, there are facilities like power, irrigation, transport and communication, banking and training. Social infrastructure includes education, health, sanitation, drinking water facilities, etc. The development of infrastructure is not possible through efforts of private individuals since its benefits go to society as a whole and not to individuals. It is, therefore, mainly the responsibility of the State. The infrastructure has accounted for 95.1 per cent of the public outlays in the first Plan and nearly 75 per cent in the subsequent plans.

5.3.2 Private Sector

It is pertinent to discuss the role and future of the private sector against the background of socialist pattern of society which is the declared objective of the government policy in India. The pattern of socialism that we have envisaged is different from that pursued by many western countries. Unlike China, India has chosen an economic system that is basically capitalist in character, but it combines this system with a significant degree of state influence, the latter implemented through various types of controls and a state planning system.

Jawaharlal Nehru who shaped the destiny of the country for nearly two decades, was not in favour of socialism for its own sake. He was not in favour of nationalization of private undertakings until it could be proved that some definite social purpose would be achieved by such nationalization, a purpose which cannot be secured under private management. The acceptance of the philosophy of socialist pattern of society by the government had led to a feeling that private sector in the country has a dark future. The Third Five-Year Plan, however, clearly stated that the socialist pattern of society envisaged in India's Plans does not imply that all economic initiative must rest with the state. Indeed, it assigns to private enterprise an important role in national development, provided it attunes itself to the new philosophy of democratic socialism and operates in unison with the public sector.

In the private sector, the enterprise is owned by private person. In the sphere of private sector, there is the corporate sector with such organizations as public limited companies and private limited companies. Outside the corporate sector,

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there are many forms of ownership like single entrepreneur and partnership and trade as also cottage industries. Private sector can be divided into two parts:

- (i) The organized sector
- (ii) The unorganized sector

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In the unorganized private sector it is difficult to enforce policy interventions.

The private sector plays an important supporting role in India's mixed economy. Seen in 1948 as complementary to the catalytic, dynamic and fast expanding public sector, the private sector was nonetheless accorded due recognition as playing a useful partnership role in rounding out the economy, it was not intended to nationalize it straight away, but to regulate and direct it properly, and facilitate and encourage its development through provision of infrastructure along with financial institutions, that would all serve to promote and assist it to serve social objectives.

It is pertinent to mention that the private sector not only survived this slightly patronizing approach as well as the hardships of the 'license Raj' but went to achieve heights of glory and achievement. Meanwhile, several public sector units stultified and decayed, to the point that they had to go the BIFR way or be disposed of (under the policy of divestment or 'disinvestment'). The main reasons as to why the private sector turned the tables on its bigger, stronger stablemate are:

1. Entrepreneurial talent is its greatest asset, while most of the public sector units did not have a mindset that promoted cost or profitability consciousness as opposed to western countries, where private enterprise has played such an important role in economic development that Joseph Schumpeter has described it as the initiator and moving force behind industrialization.
2. Private entrepreneurs are driven by profit and survival needs to constantly innovate, reduce costs and improve both products and bottomlines, in response to stakeholders' demands.
3. In India, the role of the private sector – even after five decades of planning – translates to 75 per cent of the economy, while the State-aided public sector is a distant straggler with a mere 25 per cent share.
4. The private sector in India is vast; agriculture – the most important productive activity – is the largest employer. It employs 66.5 per cent of the working population and contributes around 30 per cent of the net domestic product, though much of it is mere subsistence farming for a vast multitude of destitute marginal farmers and agricultural labourers. Nevertheless, it is practically exclusively in private hands.
5. Moreover, trading activities are mostly concentrated in private hands; the few public sector organizations engaged in trading, like the State

Trading Corporation, withered away after their monopoly was demolished by liberalization

6. Recent trends in private sector engagement in large retail and real estate developments, including the involvement of the two Reliance Group companies, presages a new thrust by the private sector into the service industry—an evolutionary step that signals that the Indian economy is approaching the next stage of development already well under way in the developed countries.

Trading activities are mostly concentrated in private hands. This is because of the general belief that the trading community renders useful services and its returns are justifiable.

Private sector in industry can be conveniently classified into three groups:

- (i) Unorganized industrial units
- (ii) Small-scale industrial units
- (iii) Large-scale industrial units

In 1988–89, large units having capital investment of more than ` 35 lakh formed only 6.3 per cent of the total industrial units in the country. But, these units accounted for 60 per cent of the gross output and 80.1 per cent of the total value added in the factory sector. Thus, these large-scale industrial units form the backbone of the private sector in India.

Most of the consumer goods' industries are generally left to private enterprise. The consumer goods industries are left to private enterprise as this sector has already established itself in some major consumer goods industries like cotton textiles, jute, edible oils, etc. These industries require small capital and yield quick returns. As such, these are fit for the private sector. These industries are also regulated with a view to control investment in different industries.

While the large-scale private industries are restricted and regulated, the small sector is encouraged to expand in the old field and enter into new spheres. Quite a large number of products, more than 800, are reserved for this sector. These industries are encouraged for being labour-absorbing industries as also those that can be easily dispersed over space.

The general pattern of development of the corporate form in India is similar to that in the western countries. The methods of growth have been through diversification, integration, acquisition and merger. Crossing international borders in joint ventures to other countries is also in progress. Most of the growth in the corporate sector has been through foreign collaboration in technology and sometimes capital also and rarely through innovation by means of internal research and developing technology.

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The hereditary succession is still very powerful, though a professional managerial class is slowly evolving. Some authorities even equate private sector to the 'family sector' in view of the widespread prevalence of family management in large companies.

Favourable factors in the environment

The economic environment in India at present has some favourable as well as unfavourable factors from the point of view of private enterprise.

The favourable factors are as follows.

1. Private enterprise derived many special benefits from the plans and policies of the government. The vast outlays in the public sector since the beginning of the Plan period provided the necessary infrastructure for the development of private business and generated widespread demand for its products.
2. The Plan documents indicated the specific areas in which further investment could be made. These provided valuable guidelines for the private enterprise to proceed.
3. The Indian market is completely sheltered since the policy of developing indigenous resources led to almost total banning of such imports as might compete with the products of local industry. This is a further reason why the private enterprise has been able to make good profits even when some of their products were substandard.
4. The various feasibility studies and demand projection estimates made by the public sector institutions enabled the potential entrepreneurs to know the prospects of investment in those fields.
5. Various institutions have been set up to see that industries are not starved of legitimate financial needs. Development banks like IFC, ICICI, IDBI and SFC provide industries with financial accommodation. They help industries in the form of long-term loans, underwriting of shares and debentures and participating in equity. A study of the balance sheets of a large number of companies indicates that finance provided by such institutions enabled them to grow and prosper.
6. The private enterprise received some direct incentives from the government. Despite the heavy doses of taxation, many of the Finance Acts contained various tax concessions such as tax holidays for new undertakings, developmental rebate and abolition of bonus tax etc. Income Tax Act also provides fiscal incentives to the individual and corporate sectors.

Unfavourable factors in the environment

1. The government has declared itself to be pursuing the aim of establishing a socialist pattern of society which puts a constraint on the expansion plans of the private enterprise. In pursuance of its declared economic policy, the government has established its own undertakings to capture the 'commanding heights of the economy'. If need be, government will use its economic power to put a restriction on the activities of private undertakings. Nationalization of commercial banks is a case in point.
2. Private undertakings in India have been operating in an environment of taxation. The heavy burden of taxation has acted as a disincentive to increased production. By immobilizing funds which might have flowed into private undertakings, it has acted as a brake on industrial growth.
3. Big business is subject to a large number of restrictions, especially the MRTP Act. After the virtual abolition of the MRTP in the new industrial policy, the situation has changed.
4. According to the industrial policies announced from time to time there are a large number of industries which are either reserved for the public sector or for the small sector. Also in the remaining sector, the government has reserved the right to establish new undertakings. Thus, the private sector does not have any independent field of its own, which is worthwhile for investment.
5. The decision of the government to vest the public financial institutions with powers to convert their long-term loans of companies into equity capital and to nominate directors on the boards of the latter is also viewed as an attempt to put a brake on the growth of private enterprise. The plea that this is being done in the interests of shareholders does not seem to be very convincing to many.

Despite these constraints, there has been an expansion of private sector activities. Under the new Industrial Policy of 1991, emphasis has been shifted from public to private sector.

It should be noted that there has been growing concentration of economic power in the hands of big business houses. This economic power has secured control over political power. Owing to the commanding position of big businesses in the total industrial sector, they can exercise considerable influence over government policies. The report of the Dutta Committee showed that twenty big business houses secured a disproportionately large share in the number of licenses issued. During the last twenty-five years, through the process of concentration of wealth and economic power, they have strengthened themselves with the result that the two top business houses (Tatas and Birlas) have amassed huge total assets.

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5.3.3 Joint Sector

The radical shift in government policy has brought the concept of the joint sector into sharp focus. It is nothing but a form of partnership between the public sector and the private sector.

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Concept: Although the Joint Sector concept was conceived by the authors of the Industrial Policy Resolution, 1956 was really the brainchild of the Industrial Licensing Policy Enquiry Committee, popularly known as the Dutta Committee. Besides the public and the private sectors, there was a need for a new sector—a joint sector—for the harmonious industrial development of the economy. The joint sector is envisaged as something in between the public and the private sector and in which the state could actively participate in management, control and decision-making. It is claimed that the joint sector scheme has the advantages of both the public and the private sectors and at the same time avoids the evils of both sectors, and thus, fulfils the basic socio-economic objectives of the country. Moreover, it offers an avenue of growth when all other gates to growth seem to have been closed. The concept of a joint sector is basically an extension of the idea of mixed economy in which the public and private sector units are separate and function independently, but are nevertheless part of a national plan. It is a compromise between total nationalization and complete private autonomy. In the joint sector, the relationship between the representatives of the private and public sectors is much closer as they have to work together within the same unit. The joint sector was recommended for units where a large proportion of the cost of a new project was to be met by public financial institutions either directly or through their support.

There are three different concepts of joint sector: First, financial institutions can exercise the right to convert debt into equity and appoint directors on company boards. Second, the government may appoint directors on company boards through the exercise of powers granted by the Monopolies and Restrictive Trade Practices Act to check malpractices. This need not involve share participation and must not be confused with the joint sector. The third form is the real joint sector where the government directly, or through its agencies, is a co-shareholder in an enterprise. The government, in this case, plays a promotional and entrepreneurial role and is an active majority partner.

Features of the Joint Sector: In a memorandum submitted to the government, JRD Tata suggested a slightly different definition of the joint sector. ‘A joint sector enterprise is intended to be a form of partnership between the private sector and the Government in which the State participation of capital will not be less than 26 per cent, the day-to-day management will normally be in the hands of the private sector partner, and control and supervision will be exercised by a board of directors on which government is adequately represented’.

The Dutta Committee advocated conversion of some of the private sector units into joint sector enterprises as an important means of curbing the concentration

of economic power in certain private groups. A number of new industrial projects had been established in the private sector with the help of funds provided by public financial institutions, but the latter had not asked for a voice in the management. It was strange that huge private industrial empires should be built with funds provided by public institutions without knowing how the money was actually spent. The Dutta Committee asked the government to enunciate a new industrial policy whereby this anomaly could be rectified.

There was a change in the industrial policy without there being a change in the 1956 Policy Resolution. The government announced the new industrial policy in February 1970. The joint sector concept as suggested by the Dutta Committee, was accepted in principle. It was laid down that while sanctioning loans or subscribing to debentures, public financial institutions should in future have the option to convert them into equity within a specified period of time. Specific guidelines had been laid down. In case the aggregate loans granted were below ₹ 25 lakh, the financial institutions are not to insert any convertibility clause in the agreement. If the loans granted were between ₹ 25 lakh and ₹ 50 lakh, it is optional for the financial institutions to insert a convertibility clause in the agreement. Once convertibility was agreed to, the undertaking is required to appoint representatives of the lending institutions as directors on company board.

It is not difficult to understand the logic behind the joint sector. As had been emphasized by the then Prime Minister, the old concepts of exclusive private ownership and private profit do not fit in with today's social values and priorities. An open society requires an open corporate structure; the joint sector provides this openness without taking away the advantages of private enterprise and initiative. The joint sector is a departure from exclusive private ownership, but it should be welcomed in preference to outright nationalization.

The joint sector experiment has been viewed with misgivings by many industrialists. It has been assailed as 'nationalisation by the backdoor'. But others have welcomed it on the ground that it is preferable to wholesale nationalization of existing private undertakings. There is one serious objection to the joint sector. The concept is based on mutual trust and confidence, yet the idea originated because the private sector could not be trusted enough to grow on its own. Thus, conceived in mistrust, the marriage might be a disastrous failure.

The joint sector was evolved to check the concentration of economic power of private groups. But, some think it is not necessary to check the concentration of economic power as the existing Monopolies and Restrictive Trade Practices Act was adequate for the purpose.

5.3.4 Cooperative Sector

The cooperative sector has emerged as an important sector in our economic environment. Cooperatives, inspired by the principle of self-help, are of great

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importance for the poor people of India. Cooperatives consist of persons of small means. Unable to face cut-throat market competition, these people get together and organize themselves into cooperatives. Thus poor individuals, through cooperatives, acquire strength to perform tasks which they would not be able to do otherwise.

The cooperative idea took a concrete shape in India for the first time in 1904 when the Cooperative Credit Societies Act—a measure designed to combat rural indebtedness and provide for registration of credit societies—was passed. Later in 1912, the Cooperative Societies Act also provided for registration of non-credit societies as well as federations of cooperatives. Since then the cooperative movement has made noticeable progress, especially in agricultural credit, marketing and processing of agricultural produce, supply of farm inputs and distribution of consumer goods. An idea of the growth of cooperative movement in India can be had from the fact that there were as many as 3.50 lakh cooperative societies of all types with the total membership of about 16 crores and total working capital of about ₹ 62,500 crore as on 30 June 1990. Another distinguishing feature of the cooperative scene is that it is largely village-based. The government's emphasis on institutionalization of distribution of inputs to farmers and marketing of their agricultural produce through cooperatives owned by them has helped in strengthening cooperative sector in the rural areas.

By June 1989, there were 93,000 Primary Agricultural Credit Societies operating in the rural areas. Membership of these societies comprised 9.20 crore persons. Cooperatives occupy an important place in the field of village and small industries and handloom weaving. As on 30 June 1989, there were 53,786 industrial cooperatives with a membership of 43.76 lakh. The National Federation of Industrial Cooperatives was set up in 1966 with a view to assisting the marketing of products of the member societies.

The total number of cooperative spinning mills installed was 10,948 in the growers' sector and 61 in the weavers' sector with a capacity of about 29.13 lakh spindles which was about 11 per cent of total spindlage in the country.

Functional cooperatives for programmes like dairy, fishery and poultry mainly extended help to the weaker sections. As such cooperatives provide increased employment and income opportunities to different sections like small and marginal farmers and fishermen. The National Cooperative Development Corporation (NCDC) also gives financial assistance to various types of cooperatives.

Cooperative societies is a state subject under the Constitution. However, such cooperative societies having their objects not confined to one State, come under the jurisdiction of Central Government. The Multi-State Cooperative Societies Act, 1984 came into operation from 16 September 1985. At present, there are 182 Multi-State Cooperative Societies in the country.

A major development after Independence has been the emergence of the National Cooperative Federations which added a new dimension to the cooperative infrastructure. With the National Cooperative Union of India at the apex, other National Level Cooperative Federations established in the country are: National Agricultural Cooperative Marketing Federation, National Federation of State Cooperative Banks, National Federation of Cooperative Sugar Factories, National Cooperative Agriculture and Rural Development Banks' Federation, National Cooperative Consumers' Federation, National Federation of Industrial Cooperatives, All India Federation of Cooperative Spinning Mills, National Cooperative Housing Federation, National Cooperative Dairy Federation, National Federation of Urban Cooperative Banks and Credit Societies, National Federation of Fishermen's Cooperatives, National Federation of Labour Cooperatives and National Cooperative Tobacco Grower's Federation.

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Check Your Progress

1. Mention the major divisions of the economic system in a mixed economy.
2. What was the main focus of the Industrial policy statement of 1980?
3. State the kind of economy existing in India.

5.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In a mixed economy the entire economic system is divided into three parts:
 - (i) Sectors exclusively controlled and managed by the private enterprise subject to the general control and regulation by the state;
 - (ii) Sectors which are exclusively controlled and managed by the state; and
 - (iii) Sectors which are jointly managed and controlled by the State and private enterprise.
2. The industrial policy statement of 1980 focussed attention on the need for promoting competition in the domestic market, technological upgradation and modernization.
3. The Indian economy is a mixed economy in which both the public and private enterprises work side by side. It is a compromise between private capitalism and state socialism.

5.5 SUMMARY

- The first industrial policy statement was issued in the Government's Industrial Policy Resolution of April 1948. The resolution contemplated a mixed

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economy. There was a sphere reserved for private enterprise and another for public ownership.

- The Government's policy gives the following assurances to foreign capital : (i) there will be no discrimination between foreign and Indian undertakings in the application of the general industrial policy; (ii) reasonable facilities would be given for the remittance of profits and repatriation of capital consistent with foreign exchange position of the country; and (iii) in the event of nationalization, fair and equitable compensation would be paid.
- The Industrial Policy of 1948 envisaged a mixed economy. Mixed economy is the outcome of compromise between two diametrically opposite schools of thought—one which champions the cause of *laissez faire* capitalism and another which supports the cause of socialization of all means of production.
- The 1956 industrial policy has six objectives: (i) to accelerate economic growth and industrial development of the country, (ii) to expand the public sector, (iii) to prevent the growth of monopolies and the concentration of economic powers in the hands of a few people, (iv) to develop a large cooperative sector, (v) to develop heavy and machine-made industries, and (vi) to reduce disparities in wealth and income.
- Jawaharlal Nehru laid the foundations of modern India. The aims and objectives set out for the nation by Nehru on the eve of independence were rapid agricultural and industrial development of the country, rapid expansion of opportunities for gainful employment, progressive reduction of social and economic disparities, removal of poverty and attainment of self-reliance.
- Public sector or public enterprises include all governmental activities including public, industrial and commercial enterprises. Public enterprise occupies a strategic and crucial position in the Indian economy.
- It is pertinent to discuss the role and future of the private sector against the background of socialist pattern of society which is the declared objective of the government policy in India. The pattern of socialism that we have envisaged is different from that pursued by many western countries.
- The radical shift in government policy has brought the concept of the joint sector into sharp focus. It is nothing but a form of partnership between the public sector and the private sector.
- The cooperative sector has emerged as an important sector in our economic environment. Cooperatives, inspired by the principle of self-help, are of great importance for the poor people of India.

5.6 KEY WORDS

- **Public sector:** It includes all governmental activities including public, industrial and commercial enterprises.

- **Disinvestment:** It can be defined as the action of an organisation (or government) selling or liquidating an asset or subsidiary.
- **Private enterprise:** It is a business operation or firm that is owned and operated by private individuals rather than government.

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5.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What were the major objectives of the Industrial Policy of 1956?
2. Write a short note on the emergence of joint sector in India.
3. Mention the four categories in which industries were divided under the Industrial policy of 1948.

Long Answer Questions

1. Discuss the major elements introduced in the industrial policy of Rajiv Gandhi's government.
2. Differentiate between private sector and public sector.
3. 'The cooperative sector has emerged as an important sector in the economic environment of India.' Explain the statement.

5.8 FURTHER READINGS

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UNIT 6 PRIVATIZATION AND DISINVESTMENT

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Structure

- 6.0 Introduction
 - 6.1 Objectives
 - 6.2 Ways of Privatization
 - 6.2.1 Benefits and Arguments Against Privatization
 - 6.3 Privatization in India
 - 6.4 Answers to Check Your Progress Questions
 - 6.5 Summary
 - 6.6 Key Words
 - 6.7 Self Assessment Questions and Exercises
 - 6.8 Further Readings
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6.0 INTRODUCTION

In the previous unit, you studied about the Industrial policy of India from independence up to 1991 and the concept and features of various sectors of business in India namely, public sector, private sector, joint sector and cooperative sector. This unit will introduce you to the idea of privatization and disinvestment and its existence in India. Let us take an example of disinvestment in the Indian scenario. The current disinvestment transaction of ONGC acquiring government's entire stake in HPCL is expected to bring in an additional ` 37,000 crore taking the total disinvestment proceeds to around ` 91,000 crore in 2017-18. However, there is no change of management in both these companies. In spite of such disinvestments, the business of government continues to be in running 'businesses'.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the ways of privatization
 - Analyse the arguments for and against privatization
 - Prepare an overview of privatization in India
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6.2 WAYS OF PRIVATIZATION

Privatization is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. It can take three forms: (i) Ownership measures, (ii) Organizational measures and (iii) Operational measures.

(i) **Ownership measures:** The degree of privatization is judged by the extent of ownership transferred from the public enterprise to the private sector. Ownership may be transferred to an individual, cooperative or corporate sector. This can have three forms:

- (a) Total denationalization implies 100 per cent transfer of ownership of a public enterprise to private sector.
- (b) Joint venture implies partial transfer of a public enterprise to the private sector. It may have several variants—25 per cent transfer to private sector in a joint venture implies that majority ownership and control remains with the public sector. Fifty-one per cent transfer of ownership to the private sector shifts the balance in favour of the private sector, though the public sector retains a substantial stake in the undertaking. 74 per cent transfer of ownership to the private sector implies a dominant share being transferred to private sector. In such a situation, the private sector is in a better position to change the character of the enterprise.
- (c) Liquidation implies sale of assets to a person who may use them for the same purpose or some other purpose. This solely depends on the preference of the buyer.
- (d) Workers' cooperative is a special form of denationalization. In this form, ownership of the enterprise is transferred to workers who may form a cooperative to run the enterprise. In such a situation, appropriate provision of bank loans is made to enable workers to buy the share of the enterprise. The burden of running the enterprise rests on the workers in a workers' cooperation. The workers become entitled to ownership dividends, besides getting wages for their services.

(ii) **Organizational measures:** These include a variety of measures to limit state control:

- (a) A holding company structure may be designed in which the Government limits its control to top level major decisions and leaves a sufficient degree of autonomy for the operating companies in their day-to-day operations. A big company like the Steel Authority of India may acquire a holding company status, thereby transferring a number of functions to its smaller units. In this way, a decentralized pattern of management emerges.
- (b) Leasing: In this arrangement, the Government agrees to transfer the use of assets of a public enterprise to a private bidder for a specified period, say five years. While entering into a lease, the bidder is required to give an assurance of the quantum of profits that would be made available to the State. This is a kind of tenure ownership. The Government reserves the right to review the lease to the same person or to grant the lease to another bidder depending upon the circumstances of the case.

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(c) Restructuring: It is of two types—financial restructuring and basic restructuring.

(i) Financial restructuring implies the writing-off of accumulated losses and rationalization of capital composition in respect of debt equity ratio. The main purpose of this restructuring is to improve the financial health of the enterprise.

(ii) Basic restructuring is said to occur when the public enterprise decides to shed some of its activities to be taken up by ancillaries or small-scale units.

(iii) **Operational measures:** The efficiency of public sector enterprises depends upon the organizational structure. Unless this structure grants a sufficient degree of autonomy to the operators of the enterprise or develops a system of incentives, it cannot raise its efficiency and productivity. These measures include (a) grant of autonomy to public enterprises in decision making, (b) provision of incentives for workers and executives consistent with increase in efficiency and productivity, (c) freedom to acquire certain inputs from the markets with a view to reducing costs, (d) development of proper criteria for investment planning and (e) permission to public enterprises to raise resources from the capital market to execute plans of diversifications. The basic purpose of operational measures is to infuse the spirit of private enterprise in public enterprises, so that Government control is effectively reduced and private initiative is promoted.

Privatization in a narrow sense indicates transfer of ownership of a public sector undertaking to private sector, either wholly or partially. But in another sense, it implies the opening up of the private sector areas which were hitherto reserved for the public sector. Such deliberate encouragement of investment to the private sector in the economy, while emphasising to a lesser degree, the expansion of the public sector, will increase the overall share of the private sector in the economy. The basic purpose is to limit the areas of the public sector and to extend the areas of private sector operation.

6.2.1 Benefits and Arguments Against Privatization

Proponents of privatization believe that private market factors can more efficiently deliver many goods or service than governments due to free market competition. In general, it is argued that over time this will lead to lower prices, improved quality, more choices, less corruption, less red tape, and quicker delivery. Many proponents do not argue that everything should be privatized. According to them, market failures and natural monopolies could be problematic. However, some Austrian school economists and anarcho-capitalists would prefer that every function of the state be privatized, including defense and dispute resolution.

The basic economic argument given for privatization states that governments have few incentives to ensure that the enterprises they own are well run. One

problem is the lack of comparison in state monopolies. It is difficult to know if an enterprise is efficient or not without competitors to compare against. Another is that the central government administration, and the voters who elect them, have difficulty evaluating the efficiency of numerous and very different enterprises. A private owner, often specializing and gaining great knowledge about a certain industrial sector, can evaluate and then reward or punish the management in much fewer enterprises much more efficiently. Also, governments can raise money by taxation or simply printing money should revenues be insufficient, unlike a private owner.

If private and state-owned enterprises compete against each other, then the state owned may borrow money more cheaply from the debt markets than private enterprises, since the state owned enterprises are ultimately backed by the taxation and printing press power of the state, gaining an unfair advantage.

Privatizing a non-profitable state-owned company may force the company to raise prices in order to become profitable. However, this would remove the need for the state to provide tax money in order to cover the losses.

Proponents of privatization make the following arguments:

- **Performance:** State-run industries tend to be bureaucratic. A political government may only be motivated to improve a function when its poor performance becomes politically sensitive, and such an improvement can be reversed easily by another regime.
- **Increased efficiency:** Private companies and firms have a greater incentive to produce more goods and services for the sake of reaching a customer base and hence increasing profits. A public organization would not be as productive due to the lack of financing allocated by the entire government's budget that must consider other areas of the economy. (*Note:* However, according to the Samuelson Condition, public organizations tend to produce more of a public good or service. Also, since private firms provide goods and services according to the marginal private benefit curve, private firms have an incentive to produce less.)
- **Specialization:** A private business has the ability to focus all relevant human and financial resources onto specific functions. A state-owned firm does not have the necessary resources to specialize its goods and services as a result of the general products provided to the greatest number of people in the population.
- **Improvements:** Conversely, the government may put off improvements due to political sensitivity and special interests—even in cases of companies that are run well and better serve their customers' needs.
- **Corruption:** A state-monopolized function is prone to corruption; decisions are made primarily for political reasons, personal gain of the decision-maker (i.e., 'graft'), rather than economic ones. Corruption (or principal-agent issues) in a state-run corporation affects the ongoing asset stream and

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company performance, whereas any corruption that may occur during the privatization process is a one-time event and does not affect ongoing cash flow or performance of the company.

- **Accountability:** Managers of privately owned companies are accountable to their owners/shareholders and to the consumer, and can only exist and thrive where needs are met. Managers of publicly owned companies are required to be more accountable to the broader community and to political 'stakeholders'. This can reduce their ability to directly and specifically serve the needs of their customers, and can bias investment decisions away from otherwise profitable areas.
- **Civil-liberty concerns:** A company controlled by the state may have access to information or assets which may be used against dissidents or any individuals who disagree with their policies.
- **Goals:** A political government tends to run an industry or company for political goals rather than economic ones.
- **Capital:** Privately held companies can sometimes more easily raise investment capital in the financial markets when such local markets exist and are suitably liquid. While interest rates for private companies are often higher than for government debt, this can serve as a useful constraint to promote efficient investments by private companies, instead of cross-subsidizing them with the overall credit-risk of the country. Investment decisions are then governed by market interest rates. State-owned industries have to compete with demands from other government departments and special interests. In either case, for smaller markets, political risk may add substantially to the cost of capital.
- **Security:** Governments have had the tendency to 'bail out' poorly run businesses, often due to the sensitivity of job losses, when economically, it may be better to let the business fold.
- **Lack of market discipline:** Poorly managed state companies are insulated from the same discipline as private companies, which could go bankrupt, have their management removed, or be taken over by competitors. Private companies are also able to take greater risks and then seek bankruptcy protection against creditors if those risks turn sour.
- **Natural monopolies:** The existence of natural monopolies does not mean that these sectors must be state owned. Governments can enact or are armed with anti-trust legislation and bodies to deal with anti-competitive behaviour of all companies public or private.
- **Concentration of wealth:** Ownership of and profits from successful enterprises tend to be dispersed and diversified, particularly in voucher privatization. The availability of more investment vehicles stimulates capital markets and promotes liquidity and job creation.

- **Political influence:** Nationalized industries are prone to interference from politicians for political or populist reasons. Examples include making an industry buy supplies from local producers (when that may be more expensive than buying from abroad), forcing an industry to freeze its prices/fares to satisfy the electorate or control inflation, increasing its staffing to reduce unemployment, or moving its operations to marginal constituencies.
- **Profits:** Corporations exist to generate profits for their shareholders. Private companies make a profit by enticing consumers to buy their products in preference to their competitors' (or by increasing primary demand for their products, or by reducing costs). Private corporations typically profit more if they serve the needs of their clients well. Corporations of different sizes may target different market niches in order to focus on marginal groups and satisfy their demand. A company with good corporate governance will therefore be incentivized to meet the needs of its customers efficiently.
- **Job gains:** As the economy becomes more efficient, more profits are obtained and no government subsidies and less taxes are needed, there will be more private money available for investments and consumption and more profitable and better-paid jobs will be created than in the case of a more regulated economy.

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Opposing views

Opponents of privatization dispute the claims concerning the alleged lack of incentive for governments to ensure that their public services are well run, on the basis of the idea that governments are proxy owners answerable to the people. It is argued that a government which runs nationalized enterprises poorly will lose public support and votes, while a government which runs those enterprises well will gain public support and votes. Thus, democratic governments do have an incentive to maximize efficiency in nationalized companies, due to the pressure of future elections.

Opponents of certain privatizations believe that certain public goods and services should remain primarily in the hands of government in order to ensure that everyone in society has access to them (such as law enforcement, basic health care, and basic education). Likewise, private goods and services should remain in the hands of the private sector. There is a positive externality when the government provides public goods and services to society at large, such as defense and disease control. As for natural monopolies they are by their nature not subject to fair competition and better administered by the state.

The controlling ethical issue in the anti-privatization perspective is the need for responsible stewardship of social-support missions. Market interactions are all guided by self-interest, and successful actors in a healthy market must be committed to charging the maximum price that the market will bear. Privatization opponents believe that this model is not compatible with government missions for

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social support, whose primary aim is delivering affordability and quality of service to society.

Many privatization opponents also warn against the practice's inherent tendency toward corruption. As many areas which the government could provide are essentially profitless, the only way private companies could, to any degree, operate them would be through contracts or block payments. In these cases, the private firm's performance in a particular project would be removed from their performance, and embezzlement and dangerous cost-cutting measures might be taken to maximize profits.

Furthermore, large corporations may pay public-relations professionals to convince decision-makers that privatization is a sensible idea. Corporations typically have far more resources for expert testimony, advertisements, conferences and other propaganda efforts than anti-privatization advocates.

Some would also point out that privatizing certain functions of government might hamper coordination, and charge firms with specialized and limited capabilities to perform functions which they are not suited for. In rebuilding a war torn nation's infrastructure, for example, a private firm would, in order to provide security, either have to hire security, which would be both necessarily limited and complicate their functions, or coordinate with government, which, due to a lack of command structure shared between firm and government, might be difficult. A government agency, on the other hand, would have the entire military of a nation to draw upon for security, whose chain of command is clearly defined. Opponents would say that this is a false assertion: numerous books refer to poor organization between government departments.

Although private companies will provide a similar good or service alongside the government, opponents of privatization are careful about completely transferring the provision of public goods, services and assets into private hands for the following reasons:

- **Performance:** A democratically elected government is accountable to the people through a legislature, Congress or Parliament, and is motivated to safeguarding the assets of the nation. The profit motive may be subordinated to social objectives.
- **Increased market efficiency for public goods and services:** A public organization tends to produce more of a public good or service according to the Samuelson condition and Marginal Social Benefit curve. This results in a better positive externality for society. On the other hand, a private firm does not provide sufficient public goods and services, because it provides them on the marginal private benefit curve or private demand curve. A private firm provides less in order to make more profit. Therefore the public goods and services are provided more efficiently for society as a whole by a public

organization. (Any market is more efficient for society when marginal social benefits equals marginal social costs, $MSB=MSC$.)

- **Improvements:** the government is motivated to performance improvements as well run businesses contribute to the State's revenues.
- **Corruption:** Government ministers and civil servants are bound to uphold the highest ethical standards, and standards of probity are guaranteed through codes of conduct and declarations of interest. However, the selling process could lack transparency, allowing the purchaser and civil servants controlling the sale to gain personally.
- **Accountability:** The public does not have any control or oversight of private companies.
- **Civil-liberty concerns:** A democratically elected government is accountable to the people through a parliament, and can intervene when civil liberties are threatened.
- **Goals:** The government may seek to use state companies as instruments to further social goals for the benefit of the nation as a whole.
- **Capital:** Governments can raise money in the financial markets more cheaply to re-lend to state-owned enterprises.
- **Strategic and sensitive areas:** Governments have chosen to keep certain companies/industries under public control because of their strategic importance or sensitive nature.
- **Cuts in essential services:** If a government-owned company providing an essential service (such as the water supply) to all citizens is privatized, its new owner(s) could lead to the abandoning of the social obligation to those who are less able to pay, or to regions where this service is unprofitable.
- **Natural monopolies:** Privatization will not result in true competition if a natural monopoly exists.
- **Concentration of wealth:** Profits from successful enterprises end up in private, often foreign, hands instead of being available for the common good.
- **Political influence:** Governments may more easily exert pressure on state-owned firms to help implementing government policy.
- **Downsizing:** Private companies often face a conflict between profitability and service levels, and could over-react to short-term events. A state-owned company might have a longer-term view, and thus be less likely to cut back on maintenance or staff costs, training, etc., to stem short-term losses. Many private companies have downsized while making record profits.
- **Profit:** Private companies do not have any goal other than to maximize profits. A private company will serve the needs of those who are most willing (and able) to pay, as opposed to the needs of the majority, and are thus anti-democratic. The more necessary a good is, the lower the price

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elasticity of demand, as people will attempt to buy it no matter the price. In the case of price elasticity of demand is zero (perfectly inelastic good), demand part of supply and demand theories does not work.

- **Privatization and poverty:** It is acknowledged by many studies that there are winners and losers with privatization. The number of losers—which may add up to the size and severity of poverty—can be unexpectedly large if the method and process of privatization and how it is implemented are seriously flawed (e.g. lack of transparency leading to state-owned assets being appropriated at minuscule amounts by those with political connections, absence of regulatory institutions leading to transfer of monopoly rents from public to private sector, improper design and inadequate control of the privatization process leading to asset stripping).
- **Job loss:** Due to the additional financial burden placed on privatized companies to succeed without any government help, unlike the public companies, jobs could be lost to keep more money in the company.

6.3 PRIVATIZATION IN INDIA

One basic rationale for privatization is the notion that private ownership leads to better use of resources and their more efficient allocation. Throughout the world, the preference for market economy received a boost after it was realized that the State could no longer meet the growing demands of the economy and the State shareholding inevitably had to come down. The ‘State in business’ argument thus lost out and so did the presumption that direct and comprehensive control over the economic life of citizen from the Central Government can deliver results better than those of a more liberal system that directly responds according to the market driven forces. Another reason for adoption for privatization policy around the globe has been the inability of the Governments to raise high taxes, pursue deficit/inflationary financing and the development of money markets and private entrepreneurship. Further, technology and WTO commitments have made the world a global village and unless industries, including PSEs do not quickly restructure, they would not be able to survive. Public enterprises, because of the nature of their ownership, can restructure slowly and hence the logic of privatization gets stronger. Besides, techniques are now available to control public monopolies by regulation/competition, and investment of public money to ensure protection of consumer interests is no longer a convincing argument.

Objectives: Following objectives were stated in July 1991 while propounding the disinvestment policy:

1. To meet the budgetary needs.
2. To improve overall economic efficiency.
3. To reduce fiscal deficit.

4. To diversify the ownership of PSU for enhancing efficiency of individual enterprise.
5. To raise funds for technological upgradation, modernization and expansion of PSUs.
6. To raise funds for golden handshake (VRS).

The new industrial policy statement 1991 based on economic reform measures envisaged disinvestment of a part of government holding in the case of select public sector enterprises to provide financial support and improve the performance of public sector enterprises. This became necessary because of the withdrawal of the budgetary support of 60 percent by the government to the loss making units. The Common Minimum Programme of the United Front Government has also emphasized that it would be a democratic disinvestment.

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Check Your Progress

1. What is the main purpose of financial restructuring?
2. State the two ways of restructuring an organization to limit state control.
3. Mention any two arguments against complete privatization of public goods and assets.

6.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The main purpose of financial restructuring is to improve the financial health of the enterprise.
2. The two ways of restructuring an organization to limit state control are financial restructuring and basic restructuring.
3. Two arguments against complete privatization of public goods and assets are the following:
 - **Performance:** A democratically elected government is accountable to the people through a legislature, Congress or Parliament, and is motivated to safeguarding the assets of the nation. The profit motive may be subordinated to social objectives.
 - **Capital:** Governments can raise money in the financial markets more cheaply to re-lend to state-owned enterprises.

6.5 SUMMARY

- Privatization is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. It can take

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three forms: (i) Ownership measures, (ii) Organizational measures and (iii) Operational measures.

- Financial restructuring implies the writing-off of accumulated losses and rationalization of capital composition in respect of debt equity ratio. The main purpose of this restructuring is to improve the financial health of the enterprise.
- Privatization in a narrow sense indicates transfer of ownership of a public sector undertaking to private sector, either wholly or partially. But in another sense, it implies the opening up of the private sector areas which were hitherto reserved for the public sector.
- Proponents of privatization believe that private market factors can more efficiently deliver many goods or service than governments due to free market competition.
- Opponents of privatization dispute the claims concerning the alleged lack of incentive for governments to ensure that their public services are well run, on the basis of the idea that governments are proxy owners answerable to the people.
- One basic rationale for privatization is the notion that private ownership leads to better use of resources and their more efficient allocation.
- Public enterprises, because of the nature of their ownership, can restructure slowly and hence the logic of privatization gets stronger.
- The new industrial policy statement 1991 based on economic reform measures envisaged disinvestment of a part of government holding in the case of select public sector enterprises to provide financial support and improve the performance of public sector enterprises.

6.6 KEY WORDS

- **Privatization:** It is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking.
- **Debt equity ratio:** It is a measure of the relative contribution of the creditors and shareholders or owners in the capital employed in business.
- **Liquidation:** In finance and economics, it is the process of bringing a business to an end and distributing its assets to claimants.
- **Lease:** It is usually a written agreement between an owner of property (land, building, equipment, vehicle and so forth) and a person or business that will use the property for a stated period of time at a specified series of payments.

6.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write a short note on the ways of privatization.
2. How is privatization and disinvestment related?
3. Briefly mention the position of privatization in India.

Long Answer Questions

1. 'The basic economic argument given for privatization states that governments have few incentives to ensure that the enterprises they own are well run.' Explain the statement.
2. Critically analyse the arguments made in favour of privatization.
3. Discuss the objectives of the Industrial Policy of 1991 with respect to privatization in India.

6.8 FURTHER READINGS

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UNIT 7 TECHNOLOGICAL ENVIRONMENT

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Structure

- 7.0 Introduction
- 7.1 Objectives
- 7.2 Technological Environment
 - 7.2.1 Factors Governing Technological Environment
 - 7.2.2 Management of Technology
 - 7.2.3 Technology Policy and Transfer
- 7.3 Patents
- 7.4 Trademarks
- 7.5 Answers to Check Your Progress Questions
- 7.6 Summary
- 7.7 Key Words
- 7.8 Self Assessment Questions and Exercises
- 7.9 Further Readings

7.0 INTRODUCTION

In the previous unit, you studied about the concept of privatization and disinvestment. In this unit, you will study about the technological environment. Moreover, you will also study about the factors governing the technological environment, management of technology, technology policy and transfer. In addition, you will also go through the registration process of trademarks and patents and their significance in the business environment.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Define technological environment
- List the factors governing technological environment
- State the use of patents and trademarks

7.2 TECHNOLOGICAL ENVIRONMENT

While India may be trailing far behind the west in terms of technological prowess, in the long run it will overhaul the developed countries, as they get swamped by their aging populations' gerontological liabilities. Caring for an aged population will put a heavy burden on social welfare that can only be met by diverting funds from elsewhere, may be even research and development.

Thus, when it comes to survival, India will find that the developed countries will be increasingly willing to cooperate in sharing technology with us, which is not the case at present. Time will tell that India and other developed countries will regain their importance in the eyes of western nations, albeit in their own self-interest. For example, there are currently 120,000 vacancies for trained nurses in the US, but very few candidates. In another decade, the demand will touch 800,000. Where will they find so many trained nurses, except in Third World countries like India? The US will pay them premium salaries; already, the going rate is US\$ 60 per hour! In return for this, will not technological aid flow to India, apart from billions of repatriated US Dollars?

Nevertheless, we need to be more innovative, inventive and adventurous in our approach to business. In the US, failure is no shame. Henry Ford I failed five times in business before he got his motor car company going smoothly. Institutional finance must support individual R&D efforts; such efforts should not be left to a few private sector giants alone (apart from the government's own research laboratories). Many great inventions never see the light of day because there are no funds to support development, and competitors ensure that such new technologies never reach the commercial stage. Without technological advances, business will stagnate and India will be left behind in the global marketplace.

7.2.1 Factors Governing Technological Environment

The factors which determine the technology environment in a country are the following:

- The expertise of the manpower in terms of the spirit of experimentation, innovation and enterprise.
- Services for technical education, training and research.
- Compensation systems and promotion policies for persons engaged in scientific and industrial research.
- Incentives for research and development.
- Monetary and fiscal concessions for intensive research and development in the private sector.
- Government participation in scientific and technological development.
- Implementation of laws for the protection of intellectual property rights.
- Institutional arrangements for developing a conducive technological environment.
- Access to foreign technology.

7.2.2 Management of Technology

According to Gaynor 'technology management is a procedure of operation that enhances human resources and business assets by rearranging the relationships between the technology functions of an organization. Here, we need to integrate

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science, engineering, research, development and manufacturing in order to meet the operational goals of the business in an efficient and effective manner. Managing means management of all technology operations from initiation of concept through commercialization of the product’.

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The various issues interconnected with managing technology are: technology strategy, forecasting and assessment of technology, technology transfer, Research and Development (R&D); process and product technology, HRM and Innovative capabilities, and technology project management.

The invention of the wheel set technology management into motion. It has now become organized and methodical. It encompasses several interconnected issues that start from planning of policy at the national level to planning of strategies at the firm level and grab the attention for decisions and actions at small and higher levels.

The national level of technology management, also called macro technology management, includes:

- National level planning for the development of technological capabilities
- Identification of areas (sector wise) where development is required
- Decision making (make or buy)
- Directing and coordinating institutions
- Designing of control policy

Micro technology management involves technology management at the firm or project level. It includes:

- Responding to competitors who are using technology as a strategic weapon
- Integrating technology strategy into the overall corporate strategy
- Identifying and evaluating technological options and innovations and the factors relating to their success and failure
- Directing research and development itself, including determination and definition of project feasibility
- Monitoring and planning technological obsolescence and replacement

Both macro and micro-technology management seek to raise economic efficiency.

According to Solomon, ‘technology management is the capacity of a firm, a group or society to master management of the factors that condition technical change so as to improve its economic, social and cultural environment and wealth’.

Technology Managers

A technology manager is the person in an organization who is responsible for planning, coordinating, and directing technology-related activities of the organization. They help determine the technology goals of an organization and are responsible for implementing the appropriate systems to meet those goals.

Technology is revolutionary, and its impact on our lives and capabilities grows exponentially. The headway in modern technology has impacted on various industries ranging from medical, to entertainment, to transportation, to education. With the rapid advancement of new technologies, it is very difficult for the corporates to remain updated with the latest or greatest technology and keep hoping to implement more competitive systems. This renders the role of a technology manager very important for organizations.

Following are a few roles and responsibilities of technology managers that help the concerned organizations in many ways:

- developing safe transaction platforms
- designing better inventory supply systems
- streamlining medical databases
- initiating automation of bank transactions
- mapping transportation schedules

The skills required by technology managers are as follows:

- They should be trained in information technology management philosophy
- They should be well versed in systems development and business strategy
- They should know and utilize the technologies available for the benefit of the organization and should be able to determine the technological strategies that will best suit the needs of the business
- They should monitor the work of technical professionals to ensure a reliable, productive work environment for clients and employers alike

Dimensions of Technology Management

There are many factors that make up the technology development framework. Following are six broad dimensions into which these factors are grouped:

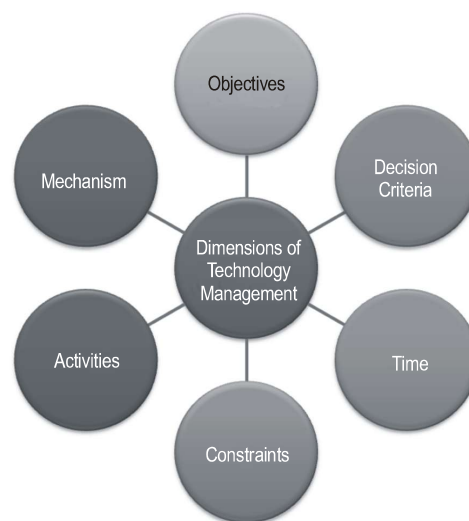


Fig. 7.1 Dimensions of Technology Management

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1. Objectives

- (a) Productivity gain
- (b) Self reliance
- (c) International trade gain
- (d) Needs satisfaction
- (e) Technological independence

2. Decision Criteria

- (a) Maximizing positive effects
- (b) Minimizing negative effects

3. Time

- (a) Short range perspective (1-5 years)
- (b) Medium range perspective (5-10 years)
- (c) Long range perspective (10-20 years)
- (d) Perspective range (>20 years)

4. Constraints

- (a) Technological level of constraints
 - (i) Knowledge
 - (ii) Skill
 - (iii) Science
 - (iv) Information
- (b) Resources
 - (i) Human beings
 - (ii) Facilities
 - (iii) Material
 - (iv) Finance
 - (v) Energy
- (c) Late starters
- (d) Management capabilities

5. Activities

- (a) Assessment
- (b) Planning
- (c) Transfer
- (d) Adaptation
- (e) Research and Development
- (f) Monitoring
- (g) Control

6. Mechanisms

- (a) Awareness measures
- (b) Science culture creation
- (c) Education and training
- (d) R & D institution building
- (e) Scientific and technological policies

7.2.3 Technology Policy and Transfer

In any society economic growth would be possible only through the introduction of improved technical inputs into the process of economic transformation. In the last few decades it has become quite clear that no economic development would be possible without higher technological input available in the society. Our planners have pointed out that capital must be created and selective capital be invested in growth for development of the economy if the country wants to achieve a desired rate of growth. The importance of capital cannot be denied, but capital by itself will not be able to bring about the change which we are looking for. Capital can only be a means for facilitating input of technology. The economic growth of Japan, Korea and Taiwan presents clear examples that the input technology and the improved grade of technology have been responsible for their progress. In spite of our eight Five-Year Plans, we have not been able to grow at the desired rate nor are we in a position to produce and compete with Japan and Korea as we have not been able to bring in and use the latest technology. Hence, we can conclude that capital and money alone cannot make us move faster towards our desired goal; instead it is the application of latest technology which is needed.

Technology means scientific knowledge for the manufacture of a product or rendering of a service.

Science produces knowledge, technology helps to produce wealth. Technology gives its owner temporary advantage over his competitors. That is why the owner of technology protects his technique from others through registration as patent and charges money from those who want to use it. The acquisition of technology from external sources is known as technology transfer.

Technology may be considered as improving something already being done, satisfying a long pending need and creating the possibility of a new need. There may be invention or innovation in this process. In its early stage of development technical change in a country is mainly the result of advanced technology imported from industrially and technologically advanced countries. That is to say technical progress is an agent of technology transfer.

Technical change is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function.

There are two distinct components of technological progress. One are the elements that are 'embodied' in the original machinery and equipments and the

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second are the ‘disembodied’ components which are subsequently added by innovation in the recipient country in the fields of production, management, marketing, raw materials etc. known as technology transfer. There is evidence to show that the rate of technological progress can be stepped up by the disembodied component even with existing technology.

The scope of technology may be explained as a resource which comprises knowledge, skills and means for using and controlling the factors of production to produce, maintain, and distribute goods and services for which there is an economic and social demand. Under this broad definition various sources of technology transfer can be grouped under the following categories:

1. *Projects*—Foreign direct investment; turn-key construction and co-production.
2. *Trade*—Sale of equipment, tools and end-products.
3. *Contractors and Development*—Licensing of patents, trademarks, management and equipment, maintenance, risk contracts for oil drilling.
4. *Research and Development*—Location of R&D operations in foreign countries; joint R&D projects.
5. *Personnel Exchanges*—Development assistance under bilateral and multilateral aid programmes, international executive corps, employment of foreign technicians.
6. *Publications*—Professional and scientific literature, technical publications.
7. *Conferences*—Professional and scientific meetings, academic preferences, technical societies, and trade associations.
8. *Teaching and Training*—Foreign study in regular undergraduate and graduate programmes, training programmes of United Nations and other international agencies, internal training programmes of business firms etc.
9. *Others*—Transfers through international tender invitations, acquisition of companies, Government-to-Government agreements etc.

The great majority of developing countries including India are poor and suffer from over-population and consequent higher rates of unemployment. The technology of advanced countries by definition is capital-intensive, whereas the technology required in most developing countries has to be employment-intensive. This is, therefore, the basic contradiction. The transfer of capital-intensive technology into developing countries is likely to worsen the employment position as such technology would deny the unemployed the gains of economic growth through the adoption of capital-intensive techniques. The extremists, therefore, argue for an almost total rejection of transferring western technology to Indian conditions and advocate for the adoption of Gandhian or Maoist patterns of economic development in which emphasis is not on maximisation of income but on the maximisation of

employment. Those who are of moderate views are of the opinion that the transference of western technology may not be feasible in toto, yet there are certain areas like the generation of power where capital-intensive technology may pay desired dividends. Both the views ascertain that import of technology needs careful handling. The priorities of national planning and the choice of technologies both have to be optimised. An appropriate technology that will maximize employment and at the same time provide to the consumers products at reasonable prices has yet to be evolved.

Sometimes it is argued that developed countries must evolve appropriate technology suitable to the environment of developing countries and should not transfer their highly sophisticated technologies.

Advanced industrialised countries are trying to sell their technology to less developed countries. This is being done either by establishing multinational companies or through technical collaboration with leading companies. This is transfer of technology. It should be selective and its application should be according to the conditions prevailing in the developing country concerned.

Methods of technology transfer

Transfer of technology can be achieved:

- (i) by improving and updating technologies
- (ii) by adopting and absorbing newer technologies
- (iii) by innovating and improving the technology imported
- (iv) by better using technology in production
- (v) by producing new kinds of products
- (vi) through improved systems and improved organizations and the effective use of technology

7.3 PATENTS

Sec.2(m) states that a 'patent' means a patent for an invention granted under the Patents Act, 1970. Patent is a form of industrial property or intellectual property. Patent is an exclusive right granted to the patent holder, for a limited period, as a reward of creative work based on his private initiative. The object of patent law is to encourage scientific research, new technology and industrial progress. A patent must have elements of 'novelty', 'utility' and 'no prior knowledge or use' like any property; it can be sold or even mortgaged. It can be transmitted by operation of law. The owner of a patent can grant licence to others to exploit the patent.

Inventions not patentable

Some inventions which are not patentable under the Act are:

- (a) an invention which is frivolous or which claims anything obviously contrary to well established natural laws;

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- (b) an invention the primary or intended use or commercial exploitation of which could be contrary to public order or morality, or which causes serious prejudice to human, animal or plant life, or health or to the environment;
- (c) the mere discovery of a scientific principle or the formulation of an abstract theory or discovery of any living thing or non-living substance occurring in nature;
- (d) mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance, or the mere discovery of any new property or new use for a known substance, or of mere use of a known process, machine or apparatus, will *not* be an invention, unless such known process results in a new product or employs at least one new reactant;
- (e) a substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substances;
- (f) the mere arrangement or re-arrangement or duplication of known devices, each functioning independently of one another in a known way;
- (g) a method of agriculture or horticulture;
- (h) any process for the medicinal, surgical, curative, prophylactic, diagnostic, therapeutic, or other treatment of human beings or any process for a similar treatment of animals or plants to render them free of disease or to increase their economic value or that of their products;
- (i) plants and animals in whole or any part thereof other than microorganisms but including seeds, varieties and spices and essentially biological processes for production or propagation of plants and animals;
- (j) a mathematical or business method or a computer program *per se* or algorithms;
- (k) a literary, dramatic musical or artistic work or any other aesthetic creation whatsoever including cinematographic works and television productions;
- (l) a mere scheme or rule or method of performing a mental act or method of playing a game;
- (m) a presentation of information;
- (n) topography of integrated circuits;
- (o) an invention which, in effect, is traditional knowledge or which is an aggregation or duplication of known properties of traditionally known component or components. (Sec. 3)

As provided in Section 4 of the Act, no patent shall be granted in respect of an invention relating to atomic energy falling within sub-section(1) of Section 20 of the Atomic Energy Act, 1962.

Application for Patents

An application for a patent may be made by any of the following persons either alone or jointly:

- (a) true and first inventor of the invention;
- (b) assignee of the person claiming to be the true and first inventor;
- (c) the legal representative of any deceased person who immediately before his death was entitled to make such an application (Sec. 6).

Form of application

Every application for a patent shall be for one invention only and shall be made in the prescribed form and filled in the patent office. The application shall be accompanied by provisions or a complete specification. The Patents Act, 1970, also provides for international application under the Patent Cooperation Treaty for a patent.

Where the application is made by virtue of an assignment of the right to apply for a patent for the invention, there shall be furnished with the application, within such period as may be prescribed after the filing of the application, proof of the right to make the application.

Every application shall state that the applicant is in possession of the invention and shall name the person claiming to be the true and first inventor and where the person so claiming is not the applicant or one of the applicants, the application shall contain a declaration that the applicant believes the person so named to be the true and first inventor (Sec. 7).

Provisional and complete specification

Where an application for a patent is accompanied by a provisional specification, a complete specification must be filled within 12 months from date of filing of earliest provisional specification. If the complete is not so filed, application shall be deemed to be abandoned (Sec. 9).

Contents of specification

Every specification, whether provisional or complete, shall describe the invention and shall begin with a title sufficiently indicating the subject matter to which the invention relates.

The complete specification filed after the provisional specification should not differ from the latter as to the nature of the invention. If adequate drawings have been furnished with the provisional specification, it is unnecessary to file a further set of the same drawings with the complete specification again.

Every complete specification should:

- (a) fully and particularly describe the invention and its operation or use and the method by which it is to be performed;

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- (b) disclose the best method of performing the invention which is known to the applicant and for which he is entitled to claim protection;
- (c) end with a claim or claims defining the scope of the invention for which protection is claimed; and
- (d) be accompanied by an abstract to provide technical information on the invention (Sec.10).

Publication and examination of application

Application for a patent will not be open to the public for such period as may be prescribed. The applicant may request the controller to publish his applications at any time before the expiry of the period prescribed. However, every application for a patent shall be published on the expiry of the period prescribed except in case of secrecy direction given for defence purpose under Section 35. The publication will include particulars of the date of application, number of application, name and address of applicant and an abstract.

Upon publication of an application for a patent, the depository institution shall make the biological material mentioned in the specification available to the public. The patent office may make the specification and drawings available to the public on payment of fees (Sec. 11A).

Request for an examination

An applicant shall make request for examination of the patent within the prescribed period. No application for a patent shall be examined unless a specific request is made. If such an application is not made within the prescribed period, it will be treated as withdrawn by the applicant (Sec. 11B).

Examination of the application

When a request for examination is made by the applicant, the controller shall refer the application and specification to an examiner for making a report to him. The examiner will make a report of his examination of specifications and other documents related thereto within the prescribed period (Sec. 12).

Where the report of the examiner received by the controller is adverse, the controller is required to issue a notice to the applicant, giving a gist of the objections (Sec. 14).

After hearing the applicant, the controller may refuse the application or may require the applicant to amend the same. If amendments are not carried out to his satisfaction, the controller can refuse the application (Sec. 15).

Opposition Proceedings to Grant of Patents

Opposition before grant of patent: Where an application for a patent has been published but a patent has not been granted, any person can file grounds. The controller shall consider and dispose of such representation in such manner and

within such period as may be prescribed. If the applicant requests, personal hearing shall be given him before disposing of the application for patent.

Technological Environment

Opposition after Grant of Patent: At any time after the grant of patent but before the expiry of a period of one year from the date of publication of grant of a patent, any person interested may give notice of opposition to the controller in the prescribed manner on specified grounds.

If notice of opposition is received after grant of a patent, notice will be issued to the patentee. The controller shall constitute an 'Opposition Board' consisting of such officers as he may determine and refer such notice of opposition along with the documents to that Board for examination and submission of its recommendations to the controller.

On receipt of the recommendation of the 'Opposition Board' the controller shall give a hearing to the patentee and opponent and then can either maintain, amend or revoke the patent (Sec. 25).

Provision for secrecy of certain inventions

Where in respect of an application for a patent, it appears to the controller that the invention is one of a class notified to him by the Central Government as relevant for defence purposes, he may give directions for prohibiting or restricting the publication of information with respect to the invention or the communication of such information (Sec. 35).

The question whether an invention in respect of which directions have been given under Section 35 continues to be relevant for defence purposes shall be periodically reviewed by the Central Government at intervals of six months or on a request made by the applicant. If on such reconsideration it appears to the Central Government that the publication of the invention would no longer be prejudicial to the defence of India, it shall forthwith give notice to the controller to revoke the direction (Sec. 36).

Grant of Patents and Rights Conferred

Grant of Patent: Where an application for a patent has been found to be in order for grant of the patent, the patent shall be granted as expeditiously as possible to the applicant with the seal of the patent office and the date on which the patent is granted shall be entered in the register.

On the grant of the patent, the controller shall publish the fact that the patent has been granted and thereupon the application, specification and other documents related to the patent shall be open for public inspection (Sec. 43).

Date of Patent: Every patent shall be dated as of the date on which the application for the patent was filed (Sec. 45).

Form, Extent and Effect of Patent: Every patent shall be in the prescribed form and shall have effect throughout India. A patent shall be granted for one invention only (Sec. 46).

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Rights of Patentee: The patent granted under this Act shall confer upon the patentee the exclusive right to prevent third parties, who do not have his consent, from the act of making, using, offering for sale, selling or informing for those purposes the patented product in India (Sec. 48).

Term of Patent: The term of every patent shall be 20 years from the date of filing the application for the patent (Sec. 53).

Patents of Addition

Where an application is made in respect of any improvement in or modification of a patented invention (known as main invention), the controller may grant the patent for the improvement or modification as a patent of addition. A patent of addition shall not be granted before grant of the patent for the main invention (Sec. 54).

A patent of addition shall be granted for a term equal to that of the patent for the main invention, or so much thereof as has not expired and shall remain in force during that term or until the previous cesser of the patent for the main invention and no longer (Sec. 55).

Amendment of Application and Specification

The controller is empowered to allow the application for the patent or the complete specification (including drawings) or any document related thereto to be amended subject to such condition as the controller thinks fit. Every such application shall state the nature of the proposed amendment and shall give full particulars of the reasons for which the application is made. If such application is made after the grant of the patent, the nature of the proposed amendment may be published (Sec. 57).

However, no amendment of the complete specification shall be allowed the effect of which would be that the specification as amended would claim or describe matter not in substance disclosed in the specification before the amendment, or that any claim of the specification as amended would not fall wholly within the scope of a claim of the specification before the amendment (Sec. 59).

Restoration of Lapsed Patents

Where a patent has ceased to have effect by reason of failure to pay any renewal fee within the prescribed period, then an application may be made to the controller for the restoration of the patent. Application may be made within 18 months from the date on which the patent ceased to have effect.

An application shall contain a statement verified in the prescribed manner, fully setting out the circumstances which led to the failure to pay the prescribed fee and the controller may require from the applicant such further evidence as he may think necessary (Sec. 60).

Disposal of application for restoration: If the controller is satisfied that the failure to pay the renewal fee was unintentional, he shall publish the application in

the prescribed manner. If a person wants to oppose the renewal, he shall give notice of opposition to the controller in the prescribed form, along with the necessary fees. Controller will hear both parties and will allow the restoration or refuse the restoration, as the case may be (Sec. 61).

Surrender and Revocation of Patents

Surrender of Patents: A patentee may at any time by giving notice to the controller in the prescribed manner, offer to surrender his patent. Where such offer is made, the controller shall publish the offer in the prescribed manner. The controller shall also notify every person other than the patentee whose name appears in the register as having an interest in the patent; opposition can be expressed and settled and then only will the controller revoke the patent (Sec. 63).

Revocation of Patent: The appellate board may revoke the patent on a petition of any person interested or of the central government. The high court is also empowered to revoke a patent on a counter claim in a suit for infringement of the patent on specified grounds (Sec. 64).

Revocation of Patent in Public Interest: Where the central government is of the opinion that a patent or the mode in which it is exercised is mischievous to the state or generally prejudicial to the public interest, it may, after giving the patentee an opportunity to be heard, make a declaration to that effect in the official gazette and thereafter the patent shall be deemed to be revoked (Sec.66).

Register of Patents

A register of patents shall be kept at the patent office. The following particulars shall be entered in the register:

- (a) the names and addresses of grantees of patents;
- (b) notifications of assignments and transmission of patents and amendments, extension and revocation of patents;
- (c) particulars of such other matters affecting the validity or proprietorship of patents.

The controller can keep the register of patents in computer floppies, diskettes or any other electronic form subject to such safeguards as may be prescribed (Sec. 67).

7.4 TRADEMARKS

In view of developments in trading and commercial practices, liberalisation and opening up of the Indian economy, increasing globalisation of trade and industry, the need to encourage investment flows and transfer of technology, a new Trademarks Act was enacted in 1999. Trademarks, 1999 has reflected the earlier 1958 Act. The Act amends and consolidates the law relating to trademarks, provides for registration and better protection of trademarks for goods and services and for

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the prevention of the use of fraudulent marks. The Act extends to the whole of India and has been made effective from 15 September 2003.

What is a Trademark?

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Trade is a valuable property of any business. Customers identify a product by its trademark. The value and importance of a trademark increases as business grows. It is necessary for business that a trademark is not used by an unauthorised person.

‘Trademark’ means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include the shape of goods, their packaging and combination of colours; and—

- (i) in relation to Chapter XII (other than section 107), a registered trademark or a mark used in relation to goods or services for the purpose of indicating or so to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right as proprietor to use the mark; and
- (ii) in relation to other provisions of this Act, a mark used or proposed to be used in relation to goods or services for the purpose of indicating or so to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right, either as proprietor or by way of permitted user, to use the mark whether with or without any indication of the identity of that person, and includes a certification trademark or collective mark (Sec. 2[1] [zb]).

It is worth noting that Chapter XII relates to offences and penalties. Section 107 provides penalty for falsely representing that the trademark is registered, though it is not.

One may note from the above definition that the major requirement is that the mark should be capable of being represented graphically. Trademark may be (a) letter mark, such as IBM, Pesi, etc. (b) symbol mark such as Maharaja of Air India. Even the shape of goods, their packaging and combination of colours can be a trademark.

Appointment of Registrar

Trademarks are to be registered with Controller-General of Patents. Section 3 provides for appointment of the Registrar of Trademarks and other officers by the Central Government. Section 5 provides for establishment of the Trademarks Registry and branch offices. Trademarks Registry established under the Trade and Merchandise Marks Act, 1958 shall continue to be the Trademarks Registry for the purposes of this Act.

Register of Trademarks

Section 6 provides for maintenance of Register of Trademarks at the Head Office of the Trademarks Registry, wherein shall be entered particulars of registered trademarks and other prescribed particulars. A copy of the Register will be maintained at each branch office. The Register can be maintained in computer floppies or diskettes or in any other electronic form.

Registration of Trademark

Registration of trademark is not mandatory, though highly desirable when stakes are high. The trademarks are to be registered with the Controller-General of Patents, Designs and Trademarks who is the Registrar for the purposes of this Act.

Any person claiming to be the proprietor of a trademark used or proposed to be used by him, can apply for registration of his trademark. Single application can be made for different classes of goods and services but separate fee are payable for each class of goods or services. Application shall be filed in the office of the Trademarks Registry under whose territorial jurisdiction the principal place of business of the proprietor is situated. Registrar can either refuse or accept the application subject to such amendments, modifications, conditions or limitations, if any, as he thinks fit. If registration is refused or accepted subject to conditions, the Registrar shall record in writing the grounds along with materials used by him in arriving at his decision (Sec. 18).

When an application for registration of a trademark is accepted, the Registrar shall cause the application to be advertised as accepted together with conditions or limitations, if any, subject to which he has accepted the application. Fresh advertisement can be issued if an error in the application has been corrected or the application has been permitted to be amended or advertisement was issued before acceptance.

It may be noted here that the advertisement is issued in the Trademark Journal and its purpose is to give third parties an opportunity for opposition and a mark will be registered only subject to the determination of opposition to it, if any (Sec. 20).

Any person can make an application to the Registrar for opposition to registration. Such application can be made within three months from the date of advertisement with a prescribed fee. The period can be extended up to one month by the Registrar.

The Registrar shall serve a copy of opposition on the applicant for registration and he has to reply within two months with his counter statement. If a reply is not sent within two months, the application for registration will be deemed to have been withdrawn. If the applicant for registration sends a counter-statement, the Registrar shall serve a copy thereof on the person giving notice of opposition. After hearing the parties and considering the evidence, the Registrar shall decide whether the registration is to be permitted (Sec. 21).

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After deciding on opposition to registration (if received) and hearing parties, the Registrar can register the trademark in the Register maintained by him. Trademark, when registered, is from the date of application for registration. A certificate of registration bearing the seal of Trademarks Registry will be issued to the applicant. If registration is not completed within 12 months due to the default of the applicant, the Registrar can treat the application as abandoned (Sec. 23).

Duration, Renewal, Removal and Restorator of Registration

The registration of a trademark shall be valid for a period of ten years. It can be renewed from time to time for successive periods of ten years from the date of the original registration or the last renewal as payment of the prescribed fee. Notice for payment of fees and as to conditions for renewal shall be sent by the Registrar to the registered proprietor of the trademark. If fees are not paid or prescribed conditions are not fulfilled, the Registrar may remove the trademark from the register. However, the Registrar shall not remove the trademark from the register if an application is made in the prescribed form and the prescribed fee and surcharge is paid within six months from the expiration of the last registration of the trademark.

Where a trademark has been removed from the register for non-payment of the prescribed fee, the Registrar can restore the trademark on the register within further six months on receipt of an application in the prescribed form and on payment of prescribed fee. This has the effect of renewing the registration of the trademark for a period of ten years from the expiration of the last registration (Sec. 25).

Effect of Registration

No person shall be entitled to institute any proceedings to prevent or to recover damages for the infringement of an unregistered trademark. (Sec. 27)

Registration of a trademark; if valid, grants to the registered proprietor of trademark the exclusive right to the use of the trademark in relation to goods or services in respect of which the trademark is registered, subject to conditions and limitations prescribed, if any. In case where the same or a similar trademark is registered in name of more than one proprietor, they do not have any right against each other, but have equal rights against third parties (Sec. 28).

Prohibition of Registration of Trademark

Absolute grounds for Refusal of Registration

Section 9 (1) of the Act containing provisions relating to absolute grounds for refusal for registration prohibit the registration of those trademarks –

- (a) which are devoid of any distinctive character, that is to say, not capable of distinguishing the goods or services of one person from those of another person;

- (b) which consist exclusively of marks or indications which may serve in trade to designate the kind, quality, quantity, intended purpose, values, geographical origin or the time of production of the goods or rendering of the service or other characteristics of the goods or service;
- (c) which consist exclusively of marks or indications which have become customary in the current language or in the *bona fide* and established practices of the trade.

However, a trademark shall not be refused registration if before the date of application for registration it has acquired a distinctive character as a result of the use made of it or is a well-known trademark.

A mark shall not be registered as a trademark if—

- (a) it is of such nature as to deceive the public or cause confusion;
- (b) it contains or comprises of any matter likely to hurt the religious susceptibilities of any class or section of the citizens of India;
- (c) it comprises or contains scandalous or obscene matter;
- (d) its use is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950 (12 of 1950) (Sec. 9[2])

A mark shall not be registered as a trademark if it consists exclusively of—

- (a) the shape of goods which results from the nature of the goods themselves; or
- (b) the shape of goods which is necessary to obtain a technical result; or
- (c) the shape which gives substantial value to the goods (Sec. 9[3]).

Relative Grounds for Refusal of Registration

Section 11(1) provides that a trademark shall not be registered if there exists a likelihood of confusion on the part of public because of (a) identity with an earlier trademark and similarity of goods and services covered by the trademark; or (b) its similarity to an earlier trademark and the identity or similarity of the goods or services covered by the trademark.

Section 11(2) provides that in case of dissimilar goods, an identical or similar trademark will not be registered if earlier trademark is a well-known trademark in India and the use of the mark proposed to be registered would be unfair or detrimental to the proprietor of the well-known trademark.

However, the trademark may be registered under this section if the proprietor of the earlier trademark gives content to the registration of the new mark (Sec. 11[4]).

A trademark shall not be refused registration unless objection is raised in opposition proceedings by the proprietor of the earlier trademark (Sec. 11[5]).

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Infringement of Registered Trademarks**NOTES**

Section 29 lays down that where a registered trademark is used by a person who is not entitled to use such a trademark under the law, it constitutes infringement. A registered trademark is infringed when a person other than registered proprietor or a person by way of permitted use, uses it in the course of trade, in the following cases:

1. Use of a mark which identical with or deceptively similar to trademark in relation to goods or services in respect of which the trademark is registered and in such manner as to render the use of the mark likely to be taken as being used as a trademark.
2. Use which, because of identity or similarity with registered trademark and identity or similarity of goods or services covered by trademark, is likely to cause confusion on the part of the public.
3. Use of identical or similar registered trademark on goods which are not similar, if the mark has refutation in India and use of the mark without due course is taking undue advantage or is detrimental to the distinctive character or reputation of the registered trademark.
4. Use of registered trademark as a trade name or name of business concern dealing in goods or services in respect of which the trademark is registered.
5. Use of registered trademark to a material intended to be used for labelling or packing goods, as a business paper or for advertising goods or services.
6. Use in advertisement, taking unfair advantage or is detrimental to its distinctive character or is against the refutation of the trademark.
7. Where the distinctive elements of a registered trademark consist or include words, spoken use of the words as well as visual representation may be infringement of trade work.

What is not Infringement

Section 30 enumerates certain acts which do not constitute infringement. It lays down that there will no infringement if the use of a mark is in accordance with honest industrial or commercial matters and is not such as to take unfair advantage or be detrimental to the distinctive character or repute of a trademark. Section 30 further enumerates the following acts as not constituting infringement of a trademark.

- (i) where the use is in relation to goods or services to indicate the kind, quality, quantity, etc., of the goods or of rendering of services, or other characteristics of goods or services.
- (ii) where a trademark is registered subject to conditions or limitations, the use of the trademark in a manner outside the scope of registration.

- (iii) where a person uses the mark in relation to goods or services for which the registered owner had once applied the mark, and had not subsequently removed it or impliedly consented to its use.
- (iv) a trademark registered for any goods may be used in relation to parts and accessories to other goods or services and such use is reasonably necessary and its effect is not likely to deceive as to the origin.
- (v) the use of a registered trademark being one of two or more registered trademarks which are identical or nearly resemble each other, in exercise of the right to the use of that registered trademark.

NOTES**Check Your Progress**

1. Who is a technology manager?
2. List the methods of technology transfer.
3. What is the validity of the registration of a trademark?

7.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A technology manager is the person in an organization, who is responsible for planning, coordinating, and directing technology-related activities of the organization.
2. Transfer of technology can be achieved in the following ways:
 - (i) by improving and updating technologies
 - (ii) by adopting and absorbing newer technologies
 - (iii) by innovating and improving the technology imported
 - (iv) by better using technology in production
 - (v) by producing new kinds of products
 - (vi) through improved systems and improved organizations and the effective use of technology
3. A trademark registered is valid for a period of ten years. However, it can be renewed from time to time for successive period of ten years from the date of original registration or the last renewal as payment of the prescribed fee.

7.6 SUMMARY

- While India may be trailing far behind the west in terms of technological prowess, in the long run it will overhaul the developed countries, as they get swamped by their aging populations' gerontological liabilities.

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- According to Gaynor ‘technology management is a procedure of operation that enhances human resources and business assets by rearranging the relationships between the technology functions of an organization.
- A technology manager is the person in an organization who is responsible for planning, coordinating, and directing technology-related activities of the organization.
- In any society economic growth would be possible only through the introduction of improved technical inputs into the process of economic transformation. In the last few decades it has become quite clear that no economic development would be possible without higher technological input available in the society.
- Technical change is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function.
- Sec.2(m) states that a ‘patent’ means a patent for an invention granted under the Patents Act, 1970. Patent is a form of industrial property or intellectual property.
- Patent is an exclusive right granted to the patent holder, for a limited period, as a reward of creative work based on his private initiative.
- Where a patent has ceased to have effect by reason of failure to pay any renewal fee within the prescribed period, then an application may be made to the controller for the restoration of the patent.
- Trade is a valuable property of any business. Customers identify a product by its trademark. The value and importance of a trademark increases as business grows. It is necessary for business that a trademark is not used by an unauthorised person.
- Registration of trademark is not mandatory, though highly desirable when stakes are high. The trademarks are to be registered with the Controller-General of Patents, Designs and Trademarks who is the Registrar for the purposes of this Act.
- The registration of a trademark shall be valid for a period of ten years. It can be renewed from time to time for successive periods of ten years from the date of the original registration or the last renewal as payment of the prescribed fee.

7.7 KEY WORDS

- **Patent:** It is an exclusive right granted to the patent holder, for a limited period, as a reward of creative work based on his private initiative.
- **Trademark:** It means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person

from those of others and may include the shape of goods, their packaging and combination of colours

Technological Environment

- **Technical change:** It is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function.

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7.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. List the factors governing technological environment.
2. Write a short note on the management of technology.
3. Mention the inventions which are not patentable under the Patent Act, 1970.

Long Answer Questions

1. Analyse the role of technology managers.
2. Discuss technology policy and transfer.
3. When is the registration of trademark prohibited?

7.9 FURTHER READINGS

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UNIT 8 BUSINESS LEGISLATIONS

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Structure

- 8.0 Introduction
- 8.1 Objectives
- 8.2 Indian Contract Act, 1872
- 8.3 Indian Companies Act, 1956
- 8.4 Companies Act, 1956 (As Amended in 2013)
- 8.5 Consumer Protection Act, 1986 and Consumer Rights
- 8.6 World Trade Organization (WTO)
- 8.7 Answers to Check Your Progress Questions
- 8.8 Summary
- 8.9 Key Words
- 8.10 Self Assessment Questions and Exercises
- 8.11 Further Readings

8.0 INTRODUCTION

In the previous unit, you studied about the technological environment. This unit will introduce you to the prominent business legislations existing in India. Several business laws have been enacted in India even prior to the country's independence. For example, the Indian Contract Act of 1872 is still in effect, although specific contracts such as partnerships and the sale of goods are now covered by new laws. Nonetheless, the Indian business scenario is often criticized by the businesses the world over, for its complex regulations. However, the Parliament of India passes and amends regulations beneficial to both businesses and investors. In addition, the Companies Act, 1956 as amended in 2013 listed provisions related to mergers and acquisitions, related party transactions, corporate social responsibility and shareholding. The act was further amended in 2015 which removed the procedural common seal, declarations for commencement of businesses, and minimum paid-up capital requirements. As a founding member of the World Trade Organization in 1995, India has continuously revised its business laws regarding copyrights, patents and trademarks.

8.1 OBJECTIVES

After going through this unit, you will be able to:

- State the salient features of the Indian Contract Act, 1872
- Identify the main provisions of the Indian Companies Act, 1956
- Recognize the protection of consumer rights under the Consumer Protection Act, 1986
- Analyse the significance of the World Trade Organization (WTO)

8.2 INDIAN CONTRACT ACT, 1872

The law of contract in India is contained in the Indian Contract Act, 1872, which came into force on 1 September 1872. It extends to the whole of India except the state of Jammu and Kashmir, though it is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts which deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc. Again, the Act does not affect any usage or custom of trade (Sec. 1). A minor amendment in Section 28 of the Act was made by the Indian Contract (Amendment) Act, 1996.

Definition of Contract

According to Section 2 (h) of the Indian Contract Act: ‘An agreement enforceable by law is a contract.’ A contract, therefore, is an agreement the object of which is to create a legal obligation, i.e., a duty enforceable by law.

From the above definition, we find that a contract essentially consists of two elements: (1) An agreement, and (2) Legal obligation, i.e., a duty enforceable by law. We shall now examine these elements in detail.

1. Agreement. As per Section 2(e): ‘Every promise and every set of promises, forming the consideration for each other, is an agreement.’ Thus, it is clear from this definition that a ‘promise’ is an agreement. What is a ‘promise’? The answer to this question is contained in Section 2(b) which defines the term: ‘When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise.’ An agreement, therefore, comes into existence only when one party makes a proposal or offer to the other party and that other party signifies his assent (i.e., gives his acceptance) thereto. In short, an agreement is the sum total of ‘offer’ and ‘acceptance’.

On analysing the above definition the following characteristics of an agreement become evident:

- (a) *Plurality of persons.* There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself.
- (b) *Consensus-ad-idem.* Both the parties to an agreement must agree about the subject-matter of the agreement in the same sense and at the same time.

2. Legal obligation. As stated above, an agreement to become a contract must give rise to a legal obligation, i.e., a duty enforceable by law. If an agreement is incapable of creating a duty enforceable by law, it is not a contract. Thus, an agreement is a *wider term* than a contract. ‘All contracts are agreements but all agreements are not contracts.’ Agreements of moral, religious or social nature, e.g., a promise to lunch together at a friend’s house or to take a walk together are not contracts because they are not likely to create a duty enforceable by law for

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the simple reason that the parties never intended that they should be attended by legal consequences.

In business agreements the presumption is usually that the parties intend to create legal relations. Thus, an agreement to buy certain specific goods at an agreed price e.g., 100 bags of wheat at ₹ 430 per bag is a contract because it gives rise to a duty enforceable by law, and in case of default on the part of either party an action for breach of contract could be enforced through a court provided other essential elements of a valid contract as laid down in Section 10 are present, namely, if the contract was made by free consent of the parties competent to contract, for a lawful consideration and with a lawful object.

Thus, it may be concluded that the Act restricts the use of the word ‘contract’ to only those agreements which give rise to legal obligations between the parties.

It will be appropriate to point out here that the law of contract deals only with such legal obligations which spring from agreements. Obligations which are not contractual in nature are outside the purview of the law of contract. For example, obligation to maintain wife and children (status obligation), obligation to observe the laws of the land, and obligation to comply with the orders of a court of law do not fall within the scope of the Contract Act. Salmond has rightly observed: ‘The law of contracts is not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations, which have their source in agreements’.

Essential Elements of a Valid Contract

A contract has been defined in Section 2(h) as ‘an agreement enforceable by law.’ To be enforceable by law, an agreement must possess the essential elements of a valid contract as contained in Sections 10, 29 and 56. According to Section 10, all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration, with a lawful object, are not expressly declared by the Act to be void, and, where necessary, satisfy the requirements of any law as to writing or attestation or registration. As the details of these, we propose to discuss them in brief here.

The essential elements of a valid contract are as follows:

1. **Offer and acceptance.** There must be a ‘lawful offer’ and a ‘lawful acceptance’ of the offer, thus resulting in an agreement. The adjective ‘lawful’ implies that the offer and acceptance must satisfy the requirements of the Contract Act in relation thereto.
2. **Intention to create legal relations.** There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. Agreements of a social or domestic nature do not contemplate legal relations, and as such they do not give rise to a contract. An agreement to dine at a friend’s house is not an agreement intended to create legal relations and therefore is not a contract. Agreements between

husband and wife also lack the intention to create legal relationship and, thus, do not result in contracts.

Illustrations: (a) *M* promised his wife *N* to get her a saree if she would sing a song. *N* sang the song but *M* did not bring the saree for her. *N* could not bring an action in court to enforce the agreement as it lacked the intention to create legal relations.

(b) The defendant was a civil servant stationed in Sri Lanka. He and his wife were enjoying leave in England. When the defendant was due to return to Sri Lanka, his wife could not accompany him because of her health. The defendant agreed to send her £30 a month as maintenance expenses during the time they were forced to live apart. She sued for breach of this agreement. Her action was dismissed on the ground that no legal relations had been contemplated and therefore there was no contract (*Balfour vs Balfour*).

3. **Lawful consideration.** The third essential element of a valid contract is the presence of ‘consideration’. Consideration has been defined as the price paid by one party for the promise of the other. An agreement is legally enforceable only when each of the parties to it gives something and gets something. The something given or obtained is the price for the promise and is called ‘consideration’. Subject to certain exceptions, gratuitous promises are not enforceable at law.

The ‘consideration’ may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. It may be past, present or future.

4. **Capacity of parties.** The parties to an agreement must be competent to contract, otherwise it cannot be enforced by a court of law. In order to be competent to contract the parties must be of the age of majority and of sound mind and must not be disqualified from contracting by any law to which they are subject (Sec. 11).
5. **Free consent.** Free consent of all the parties to an agreement is another essential element of a valid contract. ‘Consent’ means that the parties must have agreed upon the same thing in the same sense (Sec. 13). There is absence of ‘free consent’, if the agreement is induced by (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake (Sec. 14).
6. **Lawful object.** For the formation of a valid contract it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other of the reasons mentioned above the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on prostitution, he cannot recover the rent through a court of law.

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7. **Writing and registration.** According to the Indian Contract Act, a contract may be oral or in writing. But in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be in writing and registered (Sec. 25). Similarly, certain other Acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration and Conciliation Act, 1996; (ii) an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882, before they can be legally enforced.

8. **Certainty.** Section 29 of the Contract Act provides that ‘Agreements, the meaning of which is not certain or capable of being made certain, are void.’ In order to give rise to a valid contract the terms of the agreement must not be vague or uncertain. It must be possible to ascertain the meaning of the agreement, for otherwise, it cannot be enforced.

Illustration: *A* agrees to sell *B* ‘a hundred tons of oil.’ There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

9. **Possibility of performance.** Yet another essential feature of a valid contract is that it must be capable of performance. Section 56 lays down that ‘An agreement to do an act impossible in itself is void’. If the act is impossible in itself, physically or legally, the agreement cannot be enforced at law.

Illustration: *A* agrees with *B*, to discover treasure by magic. The agreement is not enforceable.

10. **Not expressly declared void.** The agreement must not have been expressly declared to be void under the Act. Sections 24–30 specify certain types of agreements which have been expressly declared to be void. For example, an agreement in restraint of marriage, an agreement in restraint of trade, and an agreement by way of wager have been expressly declared void under Sections 26, 27 and 30, respectively.

Before dealing with the various essentials of a valid contract one by one in detail, it will be appropriate to discuss the various kinds of contracts first because we shall be using terms like ‘voidable contract’, ‘void contract’ and ‘void agreement’ very often in the course of our discussion.

Types of Contracts

Types of contracts from the point of view of enforceability

From the point of view of enforceability a contract may be *valid* or *voidable* or *void* or *unenforceable* or *illegal*.

1. **Valid contract.** A valid contract is an agreement enforceable by law. An agreement becomes enforceable by law when all the essential elements of a valid contract as enumerated above are present.
2. **Voidable contract.** According to Section 2(i), ‘an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.’ Thus, a voidable contract is one which is enforceable by law at the option of one of the parties. Until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.
3. **Void contract.** Literally the word ‘void’ means ‘not binding in law’. Accordingly the term ‘void contract’ implies a useless contract which has no legal effect at all. Such a contract is a nullity, as there has been no contract at all. Section 2(j) defines: ‘A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.’ It follows from the definition that a void contract is not void from its inception and that it is valid and binding on the parties when originally entered into but subsequently it becomes invalid and destitute of legal effect because of certain reasons.
4. **Unenforceable contract.** An unenforceable contract is one which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect, such as absence of writing, registration, requisite stamp, etc., or time barred by the law of limitation. For example, an oral arbitration agreement is unenforceable because the law requires an arbitration agreement to be in writing.
5. **Illegal or unlawful contract.** The word ‘illegal’ means ‘contrary to law’ and the term ‘contract’ means ‘an agreement enforceable by law.’ As such, to speak of an ‘illegal contract’ involves a contradiction in terms because it means something like this—an agreement enforceable by law and contrary to law. Moreover, being of unlawful nature, such an agreement can never attain the status of a contract. Thus, it will be proper if we use the term ‘illegal agreement’ in place of ‘illegal contract’. An illegal agreement is void *ab initio*.

An agreement is illegal and void if its object or consideration: (a) is forbidden by law; or (b) is of such a nature that, if permitted, it would defeat the provisions of any law; or (c) is fraudulent; or (d) involves or implies injury to the person or property of another; or (e) the court regards it as immoral, or opposed to public policy (Sec. 23). Thus, an agreement to commit murder or assault or robbery or to make a gift in consideration of illicit intercourse would be illegal and void *ab initio*.

Types of contracts from the point of view of mode of creation

From the point of view of mode of creation a contract may be *express* or *implied* or *constructive*.

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1. **Express contract.** When both the offer and the acceptance constituting an agreement are enforceable by law are made in words spoken or written, it is an express contract. For example, when *A* tells *B* on the telephone that he offers to sell his car for ₹ 20,000 and *B* in reply informs *A* that he accepts the offer, there is an express contract.
2. **Implied contract.** Where both the offer and acceptance constituting an agreement enforceable by law are made other than in words, i.e., by acts and conduct of the parties, it is an implied contract. Thus, where *A*, a coolie in uniform takes up the luggage of *B* to be carried out of the railway station without being asked by *B*, and *B* allows him to do so, then the law implies that *B* agrees to pay for the services of *A*, and this is an implied contract.
3. **Constructive or quasi contract.** The term ‘constructive or quasi contract’ is a misnomer. The cases grouped under this type of contract have little or no affinity with a contract. Such a contract does not arise by virtue of any agreement, express or implied, between the parties but the law infers or recognises a contract under certain special circumstances. For example, the obligation of the finder of lost goods to return them to the rightful owner or liability of a person to whom money is paid by mistake to repay it cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent, but these are covered under quasi contracts as per Sections 71 and 72 respectively. The Contract Act has rightly named such contracts as ‘certain relations resembling those created by contract’.

A quasi contract is based upon the equitable principle that a person shall not be allowed to retain unjust benefit at the expense of another. Sections 68–72 of the Contract Act describe the cases which are to be deemed ‘quasi contracts’.

Kinds of contracts from the point of view of the extent of execution

From the point of view of the extent of execution a contract may be *executed* or *executory*.

1. **Executed contract.** A contract is said to be executed when both the parties to a contract have completely performed their share of obligations and nothing remains to be done by either party under the contract. For example, when a bookseller sells a book on cash payment it is an executed contract because both the parties have done what they were to do under the contract.

Where only one of the parties to a contract has performed his share of obligation and the other party is still to perform his share of obligation, then also the contract is called ‘executed’. For example, *M* advertises a reward of ₹ 1,000 to anyone who finds his missing son. *B*, knowing the offer finds the missing boy and brings him. As soon as *B* traces the boy, there comes into existence an executed contract because *B* has performed his share of obligation and it remains for *M* to pay the amount of reward to *B*. These types of executed contracts are also called Unilateral Contracts because in

such contracts only one obligation remains outstanding, the other obligation having being performed at the time of or *before* the formation of the contract.

2. **Executory contract.** It is one in which both the obligations are outstanding, one on either party to the contract, either wholly or in part, at the time of the formation of the contract. In other words, a contract is said to be executory when either both the parties to a contract have still to perform their share of obligations in toto or there remains something to be done under the contract on both sides. For example, where *T* agrees to coach *R*, a pre-medical student, from the first day of the following month and *R* in consideration promises to pay *T* ₹ 500 per month, the contract is executory because it is yet to be carried out. Similarly, where *M* promises to sell his car to *N* for ₹ 10,000 cash down, but *N* pays only ₹ 1,000 as earnest money and promises to pay the balance on the following Sunday. On the other hand, *M* gives possession of the car to *N* and promises to execute a sale deed on receipt of the full amount. The contract between *M* and *N* is executory because there remains something to be done on both sides. Executory contracts are also known as Bilateral Contracts.

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8.3 INDIAN COMPANIES ACT, 1956

The evolution of Joint Stock Company form of business organisation was a historical necessity. The sole proprietorship and partnership firms with limited capital, unlimited liability, limited managerial skill and other drawbacks could not prove effective to meet the challenges posed by economies of large scale production and introduction of advanced technologies. Therefore, the businessmen were forced to think in terms of bigger form of business organisation. As a result, the present form of joint stock companies emerged which is capable of mobilising large amount of capital with the provision of limited liability and efficient and specialised management. The 'company' was found to be the most suitable form of organisation for large scale enterprises requiring heavy investment and also for enterprises involving heavy risks.

Companies Act and its Administration

The Companies Act, 1956 constitutes the Company Law in India. It contains elaborate provisions relating to the formation, powers and responsibilities of the directors and managers, raising of capital, holding of company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and winding up of companies. The Act contains 658 Sections and XV Schedules.

Special Features of the Companies Act, 1956. With a view to protect the interests of a large number of shareholders and creditors of companies, to help the development of corporate sector on healthy lines and to help the attainment of the ultimate ends of social and economic policy of the Government, the Companies

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Act, 1956 was not enacted from purely legalistic point of view but it was also based on the changing social and economic needs of the country. Some of the important special features of this Act are:

1. It provides more stringent provisions relating to the company promoters and company managements in order to ensure a minimum standard of good behaviour and business honesty in the promotion and management of companies.
2. It provides elaborate provisions relating to the form and contents of a 'prospectus', maintenance of accounts by companies, reduction of share capital, etc., with a view to safeguard the interests of investors and creditors.
3. It gives extensive powers to the Central Government and the Company Law Board to intervene directly in the affairs of a company in public interest, in recognition of the fact that a public company should be regarded as a national asset and not as something of exclusive concern to the shareholders or the directors.
4. Keeping in view the importance of state enterprises under development plans, this Act recognises the institution of 'Government Companies' (in which Government holds at least 51 per cent share capital) and makes special provisions for them, *i.e.*, they can be exempted from the application of any of the provisions of the Act.
5. In accordance with the acceptance of the principle of the 'socialistic pattern of society' as the objective of social and economic policy by the government, the Act also provides measures calculated to disintegrate the concentration of economic power and wealth which affects the public interest adversely. For instance, the Act *inter alia* provides that no person can act as a Managing Director or Manager of more than two companies at a time, including both public and private, provided at least one of the two companies is a public company (Sec. 316). In the case of public companies: (i) the remuneration payable to a Managing Director or Manager cannot be more than 5 per cent of the annual net profits [Sec. 309(3)], and (ii) the maximum overall managerial remuneration has been fixed at 11 per cent of annual net profits (Sec. 198).

Amendments of the Companies Act, 1956. The Companies Act, 1956 has been amended for about two dozen times so far. The latest in the series is the Companies (Amendment) Acts, 2006. The provisions of all these Amendment Acts have been incorporated at relevant places in the text. However, the salient features of the latest amending Act are given below:

The Companies (Amendment) Act, 2006. This Amendment Act received the assent of the President of India on 29th May, 2006. Its salient features are as follows:

1. The Amendment Act contains provisions for implementing an e-governance programme of the Ministry of Company Affairs (MCA) through a project named MCA-21. E-filing or electronic filing is a key feature of the MCA-21 programme. New sections 610B, 610C, 610D and 610E have been inserted so as to make provision for electronic filing system and payment of fee in electronic form, which are essential for successful implementation of the MCA-21 Project. The major benefits that accrue due to e-filing are the ease of interaction with all citizens and a near paperless back office operation at the Ministry of Company Affairs that would improve the level of service drastically.
2. The Amendment Act has added new Sections 266A to 266G so as to provide for allotment of a unique Director Identification Number (DIN) to all existing directors as well as to those intending to be appointed as directors in future, for the purpose of his identification as such through electronic form and to provide for penalty for any violation in this regard. This would facilitate legal action against the directors keeping in view the possibility of fraud by companies.

The amending Act is being brought into effect in stages. The provisions of newly inserted Sections 610B to 610E relating to filing of various returns and statutory documents through electronic mode have been made effective from 16th September, 2006. The provisions of newly inserted Sections 266A to 266G relating to Director Identification Number (DIN) have been made effective from 1st November, 2006.

Administration. The Companies Act, 1956 is administered by the Central Government through the 'Ministry of Company Affairs', Company Law Board and the Registrars of Companies. The Company Law Board is to exercise and discharge most of the powers of the Central Government under the Companies Act, and also such other powers as may be conferred on it by the Companies Act. It is empowered to look after the day-to-day administration of the Companies Act. The Company Law Board has set up four regional offices with headquarters at Mumbai, Kolkata, Chennai and Noida (Gautam Budh Nagar), headed by 'Regional Directors'.

There is a Registrar of Companies for each State of India. He is appointed by the Central Government functioning generally at the capital of each State. He is vested with the primary duty of registering companies floated in his State and ensuring that such companies comply with statutory requirements under the Companies Act. The office of the Registrar of Companies (ROC) is a public office where companies are required to file documents and returns according to the provisions of law and the public is authorised to inspect the same on payment of a prescribed fee. The Central Government exercises control over the Registrars of Companies through the respective Regional Directors who happen to be senior officers of the Company Law Board.

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Definition of Company

Section 3(1)(i) and (ii) of the Companies Act define a company as ‘a company formed and registered under this Act or an existing company. An ‘existing company’ means a company formed and registered under any of the former Companies Acts’.

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The above definition does not reveal the distinctive characteristics of a company. Perhaps the clearest description of a company is given by Lord Justice Lindley—‘By a company is meant an association of many persons who contribute money or money’s worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted.’

A more comprehensive legal definition of a company giving its *essentials*, has been given by Haney: ‘A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.’

A company, thus, may be defined as *an incorporated association, which is an artificial legal person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprised of transferable shares and carrying limited liability.*

Characteristics of Company

An examination of the above definitions reveals the following *essential characteristics* of a company:

1. **Incorporated association.** A company must necessarily be incorporated or registered under the prevalent Companies Act. Registration creates a joint stock company and it is compulsory for all associations or partnerships, having a membership of more than *ten* in banking and more than *twenty* in any other trading activity, formed for carrying on a business with the object of earning profits.
2. **Artificial legal person.** A company is an artificial legal person in the sense that on the one hand, it is created by a process other than natural birth and does not possess the physical attributes of a natural person, and on the other hand, it is clothed with many of the rights of a natural person. It is invisible, immortal (law alone can dissolve it) and exists only in the eyes of law. It has no body, no soul, no conscience, neither it is subject to the imbecilities of the body. It is because of these physical disabilities that a company is called an *artificial person*. But it cannot be treated as a *fictitious* entity because it really exists. As a rule, a company may acquire and dispose

of property, it may enter into contracts through the agency of natural persons, it may be fined for the contravention of the provisions of the Companies Act. Thus for *most legal* purposes a company is a *legal person* just like a natural person, who has rights and duties at law. *In short*, it may be said, therefore, that a company being an artificial legal person can do everything like a natural person except of course that it cannot take oath, cannot appear in its own person in the court (must be represented by counsel), cannot be sent to jail, cannot practise a learned profession like law or medicine, nor can it marry or divorce.

3. **Separate legal entity.** A company is a legal person having a juristic personality entirely distinct from and independent of the individual persons who are for the time being its members (*Kathiawar Industries Ltd. vs C.G. of Evacuee Property*). It has the right to own and transfer the title to property in any way it likes. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or in its winding up (*Mrs B.F. Gazdar vs The Commissioner of Income Tax*). It can sue and be sued in its own name by its members as well as outsiders. Creditors of the company are creditors of the company alone and they cannot directly proceed against the members personally.

A company is not merely the sum total of its component members, but it is something superadded to them. In mathematical language it may be defined as $n + 1$ th person, where n stands for the total number of members and the 1 th person for the company itself. Even if a shareholder owns virtually the whole of its shares, the company is a separate legal entity in the eyes of law as distinguished from such a shareholder. This principle was judicially recognized by the House of Lords in the famous case of *Salomon vs Salomon & Co. Ltd.*

8.4 COMPANIES ACT, 1956 (AS AMENDED IN 2013)

As we have learnt before, the Companies Bill, 2011 was passed by the Lok Sabha on 18th December 2012 and Rajya Sabha on 8th August 2013. It received the assent of the President on 29th August 2013. Since the Companies Bill, 2011 was passed by the Rajya Sabha in August 2013, it was renamed as the Companies Bill, 2013. After the assent of the President of India, it is now called the Companies Act, 2013.

The Act **comprises 29 Chapters, 470 Sections and 7 Schedules** as against 658 Sections and 15 Schedules in the Companies Act, 1956. It is substantively a law based on **Rules to be prescribed by the Central Government, i.e., Ministry of Corporate Affairs (MCA)**. It is evident from the fact that the expression “as may be prescribed” has been used in the text of the Act at around 340 places.

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We have learnt about some of the specific alterations and provisions of the Act. Let us now have an overview of the Companies Act, 2013 through its extent, object, applicability and landmark provisions.

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Extent and Commencement of the Act

The Companies Act, 2013 extends to the whole of India [Sec. 1(2)]. The Act states that Section 1 of this Act shall come into force at once. The remaining provisions of this Act shall come into force on such date as the Central Government may by notification in the Official Gazette appoint. However, different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

In line with these provisions, **Section 1 came into force as soon as the President gave his assent to the Act on 29th August 2013.** The other Sections are being brought into force gradually. The first batch consisting of 98 Sections (or their Sub-Sections) was brought into force from 12th September 2013. Thereafter, another batch of 183 Sections was brought into force from 1st April 2014. **A large number of Sections of this Act are yet to be brought into force.**

Objects of the Act

The broad objectives of the Companies Act, 2013 are as follows:

1. To **encourage investment in the companies** by making more suitable provisions; for example, transferability of shares, payment of dividends, repayment of public deposits and redemption of redeemable preference shares and debentures within the time.
2. To **lay down minimum standards** of business integrity and conduct in the promotion and management of companies.
3. To **require full and fair disclosure** of all reasonable information relating to the affairs of the companies.
4. To **ensure effective participation and control** by shareholders and protection of their interests.
5. To **enforce proper performance of duties** by people responsible for the management of the companies.
6. To **empower the Government to intervene and investigate** into the affairs of a company where the business of the company is being carried on in a manner prejudicial to the interests of the shareholders, the company or the public at large.
7. To **achieve the objectives of social and economic policy** in the context of Directive Principles of State Policy enshrined in the Constitution of India.
8. To provide **greater autonomy of operation and innovation** with respect to reasonable process requirements and compliance cost.

9. To help **sustain the growth of the Indian corporate sector** by enabling a new legal frame-work that is compact and amenable to clear interpretation.
10. To **help respond in a timely and appropriate manner** to meet the requirements of ever evolving economic activities and business models.
11. To **foster a positive environment for investment and growth**.
12. To **avoid overlapping and conflict of jurisdiction** in the area of sectoral regulations.

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Application of the Act

The provisions of the Companies Act, 2013, shall apply to the following entities:

1. **All companies incorporated** under this Act or under any previous company law.
2. **All insurance companies**, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999.
3. **All banking companies**, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949.
4. **All companies engaged in the generation or supply of electricity**, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003.
5. **Any other company governed by any special Act** for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act.
6. **Any such body corporate, incorporated under any Act** for the time being in force as the Central Government may, by notification, specify in this behalf. However, the provisions of this Act shall apply subject to such exceptions, modifications or adaptation, as may be specified in the notification [Sec. 1(4)].

In addition, this Act **also applies to the following entities:**

7. **All partnership firms, limited liability partnerships, cooperative societies or any other business entity** formed under any law and apply for registration under this Act [Secs. 366 to 374].
8. **All unregistered companies** who apply for their winding up under Chapter XX Part II of the Act [Secs. 375, 376 and 377].
9. **All foreign companies** which have established or want to establish a place of business in India [Secs. 379 to 393].
10. **All Government companies** [Secs. 394 and 395].
11. **All *nidhis* or mutual benefit societies** declared as such by the Central Government by notification in the Official Gazette [Sec. 406].

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4. **Perpetual existence.** A company is a stable form of business organisation. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability of shares in case any shareholder wishes to drop out, as also for transmission of shares to the successor(s) of the deceased in case any shareholder dies, helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever. 'During the war all the members of one private company, while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed it. The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.
5. **Common seal.** As was pointed out earlier, a company being an artificial person has no body similar to a natural person and as such it cannot sign documents for itself. It acts through natural persons who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of a *common seal*, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.
6. **Limited liability.** The liability of the members for the debts of the company is limited to the amount unpaid on their shares howsoever heavy losses the company might have suffered. For example, if a shareholder buys 100 shares of ₹ 10 each and pays ₹ 5 on each share, he has paid ₹ 500 and can be made to pay another ₹ 500, but he cannot be made to pay more than ₹ 1,000 in all. No shareholder can be called upon to pay more than the nominal or face value of shares held by him, in case of a company with limited liability. (Later we shall see that the Act also provides for the creation of a company 'limited by guarantee' and a company with 'unlimited liability', but companies with 'limited liability' are most popular.) Thus, by virtue of this characteristic the personal property of the shareholder cannot be seized for the debts of the company, if he holds a fully paid up share.
7. **Transferability of shares.** The shares of a public company are freely transferable and members can dispose of their shares whenever they like without seeking any permission from the company or the other members. In a *private company*, however, some restriction on the right to transfer is *essential* in its articles as per Section 3(1)(iii) of the Act, but absolute restriction on the right of the members to transfer shares contained in the articles shall be void.

It may, however, be noted here that a company possesses the above mentioned characteristics by virtue of its *incorporation* or registration under the Companies Act. Although a partnership—the main alternative to the company as

a form of business organisation, may also be registered under the Indian Partnership Act, 1932, yet it does not possess any of these characteristics.

8.5 CONSUMER PROTECTION ACT, 1986 AND CONSUMER RIGHTS

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This unit introduces you to the Consumer Protection Act of 1986 and explains the various aspects of the Act. The law relating to 'consumer protection' is contained in Consumer Protection Act, 1986. This Act was enacted to meet the long-felt necessity of protecting the consumers from getting cheated by unscrupulous suppliers of goods and services for which remedy under various existing laws like the Sale of Goods Act, the Prevention of Food Adulteration Act, the Standards of Weights and Measures Act, the Dangerous Drugs Act, etc., have become illusory. These laws require the aggrieved consumer to initiate action by way of a civil suit involving expensive and time-consuming legal processes. It is a known fact that in the civil courts, judgement in a suit takes years. The Consumer Protection Act, 1986 attempts to provide an inexpensive, simpler and quicker access to redressal of consumer grievances. The Act has provided a machinery whereby consumers can file their complaints against defective goods or deficient services with consumer forums, namely, the district forum at the district level, state commission at the state level and national commission at the national level. The Act provides for an alternative system of consumer justice by summary trial. There is no need to engage a lawyer to present the case and there is a time limit for disposal of a case.

The Consumer Protection Act, 1986 is one of the benevolent pieces of legislation intended to protect a large body of consumers from exploitation. It aims to protect the interests of consumers by recognising them in the form of rights. The various rights of consumers recognised under the Act which are to be promoted and protected by the consumer protection councils are as follows:

- (i) *Right to safety.* To be protected against the sale of goods and services which are spurious or hazardous to life and property.
- (ii) *Right to information.* To be informed about the quality, quantity, weight and the price of goods or services being paid for, so that they are not cheated by unfair trade practices.
- (iii) *Right to choose.* To be assured, wherever possible, access to a variety of goods and services at a competitive price.
- (iv) *Right to be heard.* To be heard and to be assured that their interest will receive due consideration at appropriate forums.
- (v) *Right to seek redressal against exploitation.* To seek legal redressal against unfair or restrictive trade practices or exploitation.
- (vi) *Right to consumer education.* To have access to consumer education. Unless the consumers are aware of their rights and remedies, protection of their interest shall remain a myth.

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The Consumer Protection Act, 1986 was amended in 1991, 1993 and 2002 to make it more effective and purposeful. The Consumer Protection (Amendment) Act, 2002 appears to be a milestone. It has strengthened the procedures and has conferred more powers on the consumer disputes redressal agencies. The Amendment Act, 2002 is expected to greatly facilitate the working of the redressal agencies and help in achieving speedy settlement of disputes.

The main provisions of the Consumer Protection Act, 1986 as amended up-to-date are discussed in the following pages.

Scope and Applicability. The Consumer Protection Act, 1986 extends to the whole of India except the state of Jammu and Kashmir. The Act applies to all goods and services except those notified by the central government (Sec. 1). The provisions of the Act are in addition to and not in derogation of the provisions of any other law (Sec. 3). As such, the provisions of the Act grant additional remedy to the consumers. Thus, an arbitration clause in an insurance policy is no bar to a proceeding under the Consumer Protection Act.

Definition of Consumer of Goods and Services

A 'Consumer' means:

- (i) any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who uses such goods with the approval of the buyer. It does not include a person who buys goods for resale or for any commercial purpose; or
- (ii) any person who hires or avails any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who is a beneficiary of such services with the approval of the hirer. It does not include a person who avails of such services for any commercial purpose.

Explanation: For the purposes of this clause, 'commercial purpose' does not include use by a person of goods bought and used by him and services availed by him exclusively for the purpose of earning his livelihood, by means of self-employment.

The term 'person' includes a firm, Hindu undivided family, company, cooperative society, and every other association of persons whether registered under the Societies Registration Act, 1860 or not.

It may be observed that the aforesaid definition of the term 'consumer' is in two parts:

- I. Consumer of goods
- II. Consumer of services

I. Consumer of goods

The important features of the definition of ‘consumer of goods’ may be stated as follows:

1. **Buying goods for consideration.** There must be a contract of sale of goods between a seller and a buyer. The seller should be a ‘business seller’, i.e., a trader or manufacturer, and the buyer should be a ‘consumer buyer’, i.e., one who buys goods for consumption or private use. The buying of goods must be for consideration, which may be paid immediately or promised to be paid later—even in instalments. Thus, it includes credit sale and hire purchase transactions also. Consideration may be in terms of money or other goods and services.

The meaning of the term ‘goods’ is to be construed according to the Sale of Goods Act. According to Section 2(7) of the Sale of Goods Act, ‘goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.’ Thus, goodwill, trade marks, copyrights, patents-right, are all regarded as goods.

2. **User of goods with the approval of the buyer.** The term ‘consumer’ also includes any person who uses the goods with the permission of the buyer though he is himself not a buyer. When a person buys goods, they may be used by his family members, relatives and friends. The actual user of the goods may come across the defects in goods. Thus, the law treats the rightful user of the goods as the consumer.
3. **Goods should not be purchased for resale or for any commercial purpose.** The term ‘consumer’ does not include a person who buys goods for ‘resale’ or for any ‘commercial purpose’. The expression ‘commercial purpose’ implies that the goods are bought to commercially exploit them with the object to earn profits. Thus, where a company purchases a computer system to facilitate its work, the said purchase is a purchase for ‘commercial purpose’ and the company is not a ‘consumer’ under the Act.
4. **Person buying goods for self-employment is a consumer.** When the goods are bought and used by the buyer himself, exclusively for the purpose of earning his livelihood, by means of self-employment, then such buyer/user is also recognised as a consumer under the Act. Thus, a person who purchases a taxi, or a sewing machine or a photostat machine exclusively for the purpose of earning his livelihood by means of self-employment, will be a consumer.

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II. Consumer of services

The second category of 'consumer' is that of 'consumer of services'. A person is a 'consumer of service' if he satisfies the following criteria:

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1. **Hiring of services for consideration.** There must be a transaction of hiring or availing of service for consideration. However, the payment of consideration need not necessarily be immediate. It may be paid later. If the service is provided without charging anything in return, the person availing the service is not a 'consumer'.
2. **Beneficiary of service is also a 'consumer'.** A beneficiary of service, though not the hirer himself, is also regarded as a 'consumer' provided the beneficial use is made with the approval of the person who hired the service. Thus, a nominee under an insurance policy and an actual user of the subscriber's telephone have been held to be 'consumers'.
3. **Service should not be availed for any commercial purpose.** The term 'consumer of service' does not include a person who avails service for any 'commercial purpose'. Thus, where a person hires the services of a goods carrier and starts plying it on hire as public carrier with the object to earn profits, the said hiring of services of a goods carrier is for 'commercial purpose' and the person is not a 'consumer' under the Act.

Rights of a Consumer

A complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided, may be filed, with a consumer forum, by

- (a) a consumer; or
- (b) any recognised consumer association, namely, any voluntary consumer association registered under the Companies Act or under any other law for the time being in force, whether the consumer is a member of such association or not; or
- (c) one or more consumers, where there are numerous consumers having the same interest, with the permission of the consumer forum, on behalf of, or for the benefit of, all consumers so interested; or
- (d) the central government or the state government, as the case may be, either in its individual capacity or as a representative of interests of the consumers in general; or
- (e) in case of death of a consumer, his legal heir or representative.

Further, the following are also considered as a consumer and hence they may file a complaint:

- (i) *User of goods and beneficiary of services.* It may be recalled that the definition of 'consumer' itself includes user of goods and beneficiary of services.

- (ii) *Husband of the consumer*. A husband can file a complaint on behalf of his wife (*Punjab National Bank, Bombay vs K.B. Shetty*).
- (iii) *Insurance company*. Where the insurance company pays and settles the claim of the insured, it can file a complaint for the loss caused to the insured goods by negligence of goods/service providers. For example, when loss is caused to such goods because of negligence of the transport company, the insurance company can file a claim against the transport company (*New India Assurance Company Ltd. vs Green Transport Co.*).

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Judicial Machinery

The consumer protection councils are established at the centre, state and district levels. We have one central council, many state councils and many district councils. These councils work towards the promotion and protection of the rights of the consumers. They give publicity to the matters concerning consumer interests, take steps towards furthering consumer education and protecting consumers from exploitation. They advise the government in matters of policy formulation regarding protection of the consumer rights. The government has notified 'The Consumer Protection Rules, 1987' to prescribing procedure regarding the transaction of business by the central council and to prescribe the rules as to the composition of the central council. These rules also prescribe the terms and conditions of service of the members of the national commission, the procedure to be followed for conduct of business and for hearing of appeal by the national commission.

8.6 WORLD TRADE ORGANIZATION (WTO)

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to ensure that trade flows as smoothly, predictably and freely as possible. The primary purpose of the WTO is to open trade for the benefit of all.

Who we are

There are a number of ways of looking at the World Trade Organization. It is an organization for trade opening. It is a forum for governments to negotiate trade agreements. It is a place for them to settle trade disputes. It operates a system of trade rules. Essentially, the WTO is a place where member governments try to sort out the trade problems they face with each other.

What we do

The WTO is run by its member governments. All major decisions are made by the membership as a whole, either by ministers (who usually meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva).

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What we stand for?

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. But a number of simple, fundamental principles run throughout all of these documents. These principles are the foundation of the multilateral trading system.

- **Non-discrimination:** A country should not discriminate between its trading partners and it should not discriminate between its own and foreign products, services or nationals.
- **More open:** Lowering trade barriers is one of the most obvious ways of encouraging trade; these barriers include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively.
- **Predictable and transparent:** Foreign companies, investors and governments should be confident that trade barriers should not be raised arbitrarily. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition—choice and lower prices.
- **More competitive:** Discouraging ‘unfair’ practices, such as export subsidies and dumping products at below cost to gain market share; the issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.
- **More beneficial for less developed countries:** Giving them more time to adjust, greater flexibility and special privileges; over three-quarters of WTO members are developing countries and countries in transition to market economies. The WTO agreements give them transition periods to adjust to the more unfamiliar and, perhaps, difficult WTO provisions.
- **Protect the environment:** The WTO’s agreements permit members to take measures to protect not only the environment but also public health, animal health and plant health. However, these measures must be applied in the same way to both national and foreign businesses. In other words, members must not use environmental protection measures as a means of disguising protectionist policies.

It is to be noted that the World Trade Organization (WTO) has been discussed in detail in Unit 13.

Check Your Progress

1. What are the two essential elements of a contract?
2. Define voidable contract.
3. Who administers the Companies Act, 1956?
4. What is the main objective of the Consumer Protect Act, 1986?

8.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The two essential elements of a contract are (i) An agreement (ii) Legal obligation.
2. A voidable contract is one which is enforceable by law at the option of one of the parties.
3. The Companies Act, 1956 is administered by the Central government through the 'Ministry of Company Affairs', Company Law Board and the Registrars of Companies.
4. The Consumer Protect Act, 1986 attempts to provide an inexpensive, simpler and quicker access to redressal of consumer grievances. The Act has provided machinery whereby consumers can file their complaints against defective goods or deficient services with consumer forums.

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8.8 SUMMARY

- The law of contract in India is contained in the Indian Contract Act, 1872, which came into force on 1 September 1872. It extends to the whole of India except the state of Jammu and Kashmir, though it is not exhaustive.
- According to Section 2 (h) of the Indian Contract Act: 'An agreement enforceable by law is a contract.' A contract, therefore, is an agreement the object of which is to create a legal obligation, i.e., a duty enforceable by law.
- A contract has been defined in Section 2(h) as 'an agreement enforceable by law.' To be enforceable by law, an agreement must possess the essential elements of a valid contract as contained in Sections 10, 29 and 56.
- From the point of view of enforceability a contract may be *valid* or *voidable* or *void* or *unenforceable* or *illegal*.
- From the point of view of mode of creation a contract may be *express* or *implied* or *constructive*.
- The evolution of Joint Stock Company form of business organisation was a historical necessity. The sole proprietorship and partnership firms with limited capital, unlimited liability, limited managerial skill and other drawbacks could not prove effective to meet the challenges posed by economies of large scale production and introduction of advanced technologies.
- The Companies Act, 1956 constitutes the Company Law in India. It contains elaborate provisions relating to the formation, powers and responsibilities of the directors and managers, raising of capital, holding of company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and winding up of companies.

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- A more comprehensive legal definition of a company giving its *essentials*, has been given by Haney: ‘A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.’
- The Consumer Protection Act, 1986 attempts to provide an inexpensive, simpler and quicker access to redressal of consumer grievances. The Act has provided a machinery whereby consumers can file their complaints against defective goods or deficient services with consumer forums.
- The Consumer Protection Act, 1986 is one of the benevolent pieces of legislation intended to protect a large body of consumers from exploitation. It aims to protect the interests of consumers by recognising them in the form of rights.
- The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations.
- The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities.

8.9 KEY WORDS

- **Consensus-ad-idem:** It is a phrase in a contract law which denotes that both the parties to an agreement must agree about the subject-matter of the agreement in the same sense and at the same time.
- **Unenforceable Contract:** It is one which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect, such as absence of writing, registration, requisite stamp, etc., or time barred by the law of limitation.
- **Company:** It may be defined as an incorporated association which is an artificial legal person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprised of transferable shares and carrying limited liability.

8.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Mention the special features of the Companies Act, 1956.
2. Briefly mention the essential characteristics of a company.
3. Write a short note on the World Trade Organization.

Long Answer Questions

1. Discuss the rights of the consumers protected under the Consumer Protection Act, 1986.
2. Describe the kinds of contracts as mentioned in the Indian Contract Act, 1872.
3. Explain the key objectives of the Company Act, 1956 as amended in 2013.

Business Legislations

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8.11 FURTHER READINGS

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UNIT 9 INDUSTRIAL FINANCE

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Structure

- 9.0 Introduction
- 9.1 Objectives
- 9.2 Industrial Finance: An Overview
 - 9.2.1 Short-Term Finance
 - 9.2.2 Medium-Term Finance and Long-Term Finance
- 9.3 Corporate Securities
 - 9.3.1 Common or Equity Shares
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 - 9.3.3 Hybrid Securities
- 9.4 Answers to Check Your Progress Questions
- 9.5 Summary
- 9.6 Key Words
- 9.7 Self Assessment Questions and Exercises
- 9.8 Further Readings

9.0 INTRODUCTION

In the previous unit, you studied about some of the prominent business legislations which had a significant impact on the Indian business environment. In this unit, you will get introduced to the concept of industrial finance. Moreover, you will also study about the various sources of short-term finance, medium finance, long-term finance and corporate securities. The significance of industrial finance arises from the fact that every business enterprise or firm whether it is owned by an individual or a group of shareholders undertakes business in anticipation of future gain or return from it. For setting up a business, the firm has to make advance expenditure before it receives any return.

9.1 OBJECTIVES

After going through this unit, you will be able to:

- Prepare an overview of industrial finance
- Define short-term finance
- State types of ownership securities
- List types of debt securities

9.2 INDUSTRIAL FINANCE: AN OVERVIEW

Finance is the lifeblood of a business. Business cannot run efficiently if it does not have adequate finance to meet its requirements. Financial requirements of business can be classified into the following two categories:

- (i) Short-term financial requirements
- (ii) Long-term financial requirements

Short-term funds are required for **meeting working capital needs**. They are usually required for a period up to one year. They are raised from sources which can provide funds only for a short period quickly and at reasonable cost. The requirement of these funds is usually met by taking short-term loans or getting the bill discounted from the commercial banks.

Long-term funds are required to a great extent for meeting the fixed capital requirements of the business. They are required for a period exceeding one year. They are further classified into (i) intermediate or medium-term funds, and (ii) long-term funds. The former category includes funds required for a period between one and five years, while the latter category includes funds required for a period exceeding five years. These funds are raised by business from sources which provide, in an uninterrupted way, the use of funds for a long period, viz., shares, debentures, loans from specialized financial institutions, etc. Recently commercial banks have also entered into this area and they have also started providing medium-term as well as long-term funds to trade and industry, either independently or sometimes in collaboration with one or more specialized financial institutions such as Industrial Finance Corporation of India and State Financial Corporations.

The sources from which a business meets its financial requirements can be classified as follows:

(i) **According to period**

- (a) Long-term finance, viz., shares, debentures, long-term loans, etc.
- (b) Short-term finance, viz., advances from commercial banks, public deposits, advances from customers and trade creditors, etc.

(ii) **According to ownership**

- (a) Own capital, viz., share capital, retained earnings and surpluses, etc.
- (b) Borrowed capital viz., debentures, public deposits and loans, etc.

(iii) **According to source of generation**

- (a) Internal sources, viz., retained earnings and depreciation funds, etc.
- (b) External sources, viz., securities such as shares and debentures and loans.

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However, for the sake of convenience, the different sources of funds can be classified into three categories:

- (i) *Security financing*: This includes financing through shares (including both equity and preference shares) and debentures. They are sources of long-term funds.
- (ii) *Internal financing*: This includes financing through retained earnings. This could also be a source of long-term funds.
- (iii) *Loan financing*: This includes both short-term and long-term loans.
- (iv) *Asset Based Financing*: This includes hire purchase financing and lease finances.

Long-Term, Medium-Term and Short-Term Finance

Long-term finance for industries comprises those financial resources which are advanced to the industries by the banks for a period of three years and above. Long-term finance plays a pivotal role in the expansion and modernization of industrial projects and also to meet its fixed capital expenditure requirement.

Long-term finance is largely made available from the sale of shares and debentures, and loan from term lending financial institutions like IDBI, IFCI, ICICI and so forth. Medium term loan is also provided by banks and other financial institutions for a period above one year and up to three years.

Short-term finance for industries includes those financial resources which are advanced by banks to the industries for a period varying between one month and twelve months. Short-term finance is required to meet working capital needs and other sundry expenses of the industrial projects. Commercial banks offer short-term loans on cash-credit basis on the security of stocks and overdraft facilities to the industries. Industries can also raise short-term finance by raising public deposits for one to three years.

Corporate Securities

Corporate securities occupy an important position in the corporate world as they are extremely vital for the basic survival of company, without which no one can imagine the capital market or the formation of company. Corporate securities is the fundamental method through which a company raises its finance. Public company issues prospectus in order to raise finance from the public. Through prospectus, the company issues shares and pay a dividend on these shares. This share is one form of securities. There are many forms of securities like debenture, stock, bond and so forth.

The term securities have been broadly defined under the Companies Act and includes the following :

- (i) Shares, stocks and bonds
- (ii) Debentures

- (iii) Mortgage deeds, instruments of pawn, pledge or hypothecation, and any other instruments creating or evidencing a charge or lien on the assets of the company; and

Instruments acknowledging loans to, or indebtedness of, the company and guaranteed by a third party, or entered into jointly with a third party.

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9.2.1 Short-Term Finance

There are several sources of short-term funds, important among which are listed below:

- Internal sources
 - o Accrued liabilities
 - o Accounts payables
- Market finance
 - o Commercial paper
 - o Factoring
 - o Forfaiting
 - o Public deposits
- Inter-corporate deposits
- Bank financing
 - o Overdraft
 - o Cash credit
 - o Bill discounting
 - o Note lending
 - o Letter of credit
 - o Line of credit (fixed or revolving)
 - o Export financing
 - o Special purpose financing

Internal sources

Accrued liabilities and accounts payable are the two internal sources of short-term funds available for financing the current assets. These funds can be easily accessed, they are part of normal business operations, and if used within the business custom, they are free of cost.

Accrued liabilities: The accounts are kept on accrual basis. For example, salary is accrued and becomes payable only when it is due. Electricity, water and other resources are consumed, but paid only after the bill is received and that too on the due date. Accrued liabilities fund the current asset. Some firms attempt to delay these payments in the situation of cash crunch. Such acts can spoil the image of the company.

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Accounts payables: Purchases are often not paid immediately. That creates accounts payables. If paid as per the terms, accounts payable would be the free fund. Some argue that the suppliers do build the loss of interest on credit terms in their price. This is true to an extent as many suppliers would be willing to offer goods at reduced price if paid in advance or on purchase. Occasional delay in payment to suppliers may not cause much harm to the company, but repeated delay can cause ill-effect on creditworthiness. Suppliers may get hesitant to supply next order, or if they do, then charge premium price.

Market Sources

Commercial papers (CPs): Commercial papers are issued by the companies in the primary money market for financing the current assets. Commercial paper is in a way a promissory note which gives 'promise to pay maturity sum on a due date'.

Some important points regarding the commercial paper are as follows:

- RBI regulates the commercial papers.
- Corporates, primary dealers and all-India financial institutions are eligible to issue CP.
- An eligible firm with (a) tangible assets of ` 4 crore and more, (b) sanctioned working capital limit and (c) classification as 'standard asset only can issue CP.
- Companies with A2 or equivalent credit rating for CP only can issue them.
- Maturity period cannot be less than 7 days and not more than one year as per the RBI requirement.
- Par value is ` 5,00,000 and multiple of it.
- Commercial papers are traded on the OTC market.
- Issued at discount and repaid at par. Because of this the interest rate is decided by the market mechanism.
- CPs are not backed by any collaterals.
- Issue of CP has to be just informed to RBI.

Usually, firms with high quality debt rating will easily sell the commercial papers at affordable cost. The procedure is simple, no collateral needed are the advantages. However, the CP cannot be refunded early even if the issuing firm has surplus money, and refund cannot be postponed beyond the maturity date if the firm has no cash on hand on the maturity date.

Factoring: Accounts receivables pay on due date only. Any quicker payment from them would require convincing and offer of cash discount. This may be expensive. The *factoring* product allows the firms to sell their accounts receivable to a third party (factor), usually a bank at a discount. Thus, factoring is the process

of converting accounts receivables into the cash before the due date through a third party. Some features of factoring services in India are,

- Banks and corporations established by Parliament are eligible to provide factoring services.

Any others company can commence factoring services after obtaining registration as non-banking finance company from RBI.

- Usually a factor pays 80% of the discounted value of the accounts receivables on the date of agreement. The remaining 20% is paid when the customer pays the dues. Initial amount may be higher than 80% in some cases.
- The responsibility of collection can be either with the client company or with the factor depending upon the agreement.
- Factoring can be two types (a) recourse factoring and (b) non-recourse factoring. In **recourse factoring** client is responsible to collect money and give it to the factor. That means the credit risk is on the client and not on the bank. Therefore, recourse factoring is cheaper than non-recourse factoring. In **non-recourse factoring** the factor buys out the accounts receivables and is responsible for collection as well as bad debt. Non-recourse factoring, therefore, is expensive for the client. Bank, having several branches as well as collection mechanism, is in a better position to make higher rate of collection and fewer bad debts. In India non-recourse factoring services are not present.

Factoring is usually a more expensive form of short-term financing than any other sources. The cost may vary from 1.5% to 3% per month. This is one of the reasons that the factoring has been still a very small market in India. Only small and new firms with less financial strengths use factoring services.

Forfaiting: Forfaiting involves purchase of accounts receivables from exporters by a forfaiter. An exporter is enabled to receive cash against the export from the forfaiting agent, who in turn will get payment from the buyer firm abroad. Forfaiting is like international non-recourse factoring with a small difference that the forfaiting is done for a particular export, whereas factoring involves a pool of accounts receivables.

- Forfaiting is 100% financing without recourse to the seller of the debt.
- The debt is in the legally enforceable form and transferable payment obligation like bill of exchange, promissory note, letter of credit or note of purchase agreement.
- There may be a support for the payment obligation through the bank guarantee, but not always so.
- If the transaction is in the major currency of the world the forfaiting becomes easy.

Public deposits: These are the deposits collected by the firms from the public. Any company registered under the Companies Act, whether public company or

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private, is eligible to accept public deposit within the ambit of rules. Though public deposit is truly a medium term fund, it is largely useful in financing the current assets. The important points about public deposits are,

- Public deposits are short-term as well as medium term.
- Before the Companies Act 2013, any company, public or private, was allowed to accept public deposit without any restriction on size. But now, the companies with less than ₹100 crore net worth and less than ₹500 turnover cannot accept public deposits.
- The Companies Act 2013 allows companies to accept public deposits for three months to three years
- The amount of public deposit cannot exceed 10% of paid up capital and free reserves.

This limit is decided by the central government in consultation with RBI.

- Public deposits were unsecured, but the Companies Act 2013 provides for security as well as insurance scheme for the public deposits.
- Depositors usually get higher return than the bank deposits. The company get deposits at the rate than lower than bank loan, without any collateral. Cost of administering public deposit is much less than any other sources of medium term funds.

Inter-corporate deposit (ICD)

The deposit taken by one company from the other is inter-corporate deposit. The companies with funds surplus are allowed to extend deposits to other firms with paucity of funds.

- ICD is unsecured and therefore risky for depositing company. However, a depositing company may get higher returns.
- This option is useful for the companies with low rating.
- Amount cannot exceed 60% of paid up capital and 100% of free reserves.
- There is no organised market for the ICD.
- Usually the maturity period of ICD can be either (a) 3-months, or (b) six-months or (c) they can be call deposits, which can be withdrawn at short notice, usually 24 hours. Up to one year ICD is allowed, but it is not common.
- Call and put options can be built of the ICD.

Bank finance

Bank finance is available in different forms. Important of them are:

- Bank overdraft
- Cash credit
- Bill discounting

- Note-lending
- Letter of credit
- Line of credit (fixed or revolving)
- Export financing
- Special purpose financing

Bank overdraft: An individual or a company with the current account or savings account with a bank may request a bank to grant overdraft facility. If overdraft facility is extended to the customer then the customer can withdraw more money than the balance in the account, subject to the limit on overdraft. Means, the account balance would go negative. The bank would charge fee for extending such facility and also would charge interest on the overdrawn amount, while giving interest (where applicable) on the positive balance in the account.

Cash credit: Cash credit account is a separate account from the deposit account unlike in overdraft. The cash credit account operates just like a current account. It has an upper limit of credit as may be approved by the bank. Client can write cheques against the cash credit account and also deposit money in this account. Cash credit limit is fixed against the security of commodities and debt owned by the client, as per the norms prescribed by the RBI appointed committees from time to time.

Bill discounting: Bill discounting is a mechanism by which a company can get money against the accounts receivables before they become due. The selling company would write a bill (a kind of promise to pay), which is accepted by the vendor (accounts receivable). This bill is discounted with the bank. The borrower gets the discounted value of the bill amount. Therefore it is called bill discounting. The bank will collect the amount of bill from the customer upon the due date. If the bill payment is delayed then the bill is reverted back on the borrower. Relationship with bank makes it quick and affordable short-term financing for the company. A particular client of the company has agreed to pay the amount on due date to any party that presents the bill, acts as a good security reducing the default risk and the cost.

Note lending: Note-lending is similar to commercial paper. In this the firm in need of short-term funds issues promissory note of not more than 90 days, against which bank provides funds.

Letter of credit: Letter of credit popularly known as LC is one in which a bank agrees to pay liability after credit period. LC is given for inland as well as export transaction. LC offers credit even when buyer and seller do not know each other and therefore credit transaction between them is not possible. The LC is a bank guarantee to the seller that he would get paid by the bank even if the buyer fails to pay. Buyer's bank issues the letter of credit and seller's bank pay to the seller after confirming that seller has completed his entire obligation under the contract. There are different types of letter of credits.

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Line of credit (LOC): A customer may need different types of short-term loans from a bank. The bank would, therefore, after assessing the need and creditworthiness of the customer, grant a line (amount) of credit as per the lending norms prescribed by RBR. Bank would offer different short-term loans under this line of credit and within the limit determined. If a customer has got the LOC approved, he can access various types of short-term funds very quickly. Effectively this fund would be at the discretion of the borrower. LOC may be secured with collateral or unsecured.

Revolving credit arrangement: Most line of credits are revolving. Revolving line of credits means the upper limit is fixed within which the client firm can withdraw the amount and payback as many times as possible for a period for which the line is approved.

Export financing: Export finance means financial assistance extended by banks for promoting export of goods outside the country or region. These schemes especially encourage MSMEs to expand their reach to the global market and earn valuable foreign exchange. Export finance scheme is available at pre-shipment stage as well as post-shipment stage of export.

Loans and advances granted by financial institutions for the activities leading to the shipment of goods is the pre-shipment stage. The pre-shipment stage export financing schemes include,

- (a) Packing credit and
- (b) Advance payment (advance against cheque/draft)

The pre-shipment finance is extended exporters so that they can:

- Procure raw materials.
- Carry out manufacturing process.
- Provide a secure warehouse for goods and raw materials.
- Process and pack the goods.
- Ship the goods to the buyers.
- Meet other financial cost of the business.

The post-shipment finance aims at financing the export sales receivable after the date of shipment of goods to the date of realisation of export proceeds. Various schemes of post-shipment finance include:

- (a) Export Bills purchased/discounted.
- (b) Export Bills negotiated
- (c) Advance against export bills sent on collection basis.
- (d) Advance against export on consignment basis
- (e) Advance against undrawn balance on exports
- (f) Advance against claims of Duty Drawback.

The post-shipment finance can be secured or unsecured

Special financing schemes: In India certain industries are provided special support due to the nature of these industries. They are either small scale industries or dependent on weather (like agri-business). The schemes vary for different target groups but they are providing working capital finance. The readers may search for such special schemes.

9.2.2 Medium-Term Finance and Long-Term Finance

The sources of funds are classified into two main types – ownership funds and debt funds. Some securities are of hybrid type with features of both ownership and debt securities. A holder of ownership securities enjoys ownership rights; whereas a holder of debt security enjoys the rights as a lender but the holder of a hybrid security enjoys a mix of rights depending upon the terms and conditions.

One can include subsidy and tax incentives as the sources of funds. These sources are available in a limited way, subject to qualification of projects and businesses. Usually, small entrepreneurs and export-oriented units qualify for subsidy on their qualified investments. Tax incentives are also available to desired investments made by any firm.

9.3 CORPORATE SECURITIES

For non-corporate (sole-proprietorship and partnership) businesses, there is a single type of ownership security available and that is the owners' capital. Owners (sole-proprietor or partners) bring capital and enjoy the rights to participate in managing business (depending upon agreement) and the right to share profit or loss (usually in the proportion of every partner's share in capital). Therefore, the material given in this chapter on the types of ownership security is more appropriate for corporate form of business.

9.3.1 Common or Equity Shares

In case of a company, total ownership fund is called a 'stock' and it is divided into smaller units called 'shares' or 'common shares'. This allows a company to obtain funds from several owners, who are called 'shareholders' or 'members'. However, a private company can issue shares only *privately* through friends and relatives but a public company can issue shares to the public. The salient rights and obligations of equity shareholders are listed below:

- Shareholders have dividend rights, but getting it is uncertain depending upon the profits of the company and decision of the company to distribute profits as dividends.
- Shareholders enjoy the right to vote on matters defined by the Companies Act 1956, which includes right to elect their representatives on the Board of Directors. Right to vote can be exercised in person or via proxy.

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- Shareholders have pre-emptive right which means a right to get allotment from the issue of new shares.
- Shareholders have residual rights on surplus funds in the event of liquidation of the company.
- Shareholders have the right to transfer shares, albeit with restrictions if the shares are in a private company.
- Shareholders' liability for the debt of the company is limited to the par value of shares held by them.

A firm has to pay tax on its profit and when distributed as dividends, the firm again pays dividend distribution tax, subject to law and the shareholders also pay personal income tax on dividend income.

Equity shares give permanent funds to the business and put no pressure on the liquidity of the firm because dividends are payable only if profit is earned and capital is never repayable. However, equity shares have other implications too. It is usually more costly than debt funds and after the successful project, if the firm does not grow enough or does not adjust the dividends policy, it can sit on a large cash balance. Demoralized shareholders' action of selling shares can create a situation where some management group can take over the firm.

Retained earnings are also source of equity capital. Most firms distribute only a part of the profit and retain the rest. This is internal financing of capital. Retained earnings are a part of equity capital, because it belongs to the shareholders.

1. In Western countries, the term 'common stock' is used for 'share' or 'common share' and the same is now being accepted here in India.
2. Not to confuse with public sector companies. A public sector company is owned by government, whereas a public company is defined by the Companies Act, 1956, and is owned by shareholders.

Types of common shares

Firms issue different types of common shares (so, common shares are not common anymore). In India, a different type of common share issue was opened for the first time by Tata Motors in September 2008. Tata Motors announced that they would issue two types of shares on pre-emptive right basis; one at ₹ 340 on one-vote-one-share basis and another at ₹ 305 with lower voting right (one-tenth vote per share) and 5 per cent extra dividends. This creates two categories or types of common shares.

In the West, some types of common shares are entitled to dividends from a particular income stream. Also other varieties or types of common stock are found.

The suppliers of common share capital are promoters, friends and relatives (sometimes called 'love money'), general public, venture capitalists, angel capitalists and charitable venture capitalists. Some of these are described below.

Venture capitalists: Usually, start-up businesses with new ideas (like information technology businesses, bio-technology businesses are the current examples) are risky and therefore, it is unlikely that regular suppliers of funds will fund such projects. Such ventures may be potentially quite profitable but very risky. Some investors (usually wealthy individuals, investment banks and other financial institutions) see an opportunity here. They pool their own funds to form a *venture capital fund* with the purpose of finding and providing equity capital to such high potential growth firms. Venture capitalists also provide technical and managerial expertise and keep a say in the firm's decisions. In the initial agreement, venture capitalist inserts an exit clause, which is via taking the firm public or sale of business. As per this clause, after a pre-determined number of years, the new venture will 'go public' (means will become a company and will make initial public offering of shares), or sell the firm and the venture capitalist walks out with his share from the proceeds.

The entrepreneur, while getting the much-needed funds and technical and managerial expertise, faces the risk of interference in the activities of business and more important the risk of losing ownership and control of business upon going public.

Angel capitalists: Angel investors are those that 'save struggling firms with both finance and know-how when no one else will' (Van Osnabrugge and Robinson, 2004). Historically, it was appropriate to say that angel investors were willing to accept more risk than venture capitalists. There is hardly any angel investing in India, but in the West, this is quite common. Angel capitalists and venture capitalists are quite similar in nature except for risk taking. Angel funds can be considered for project investment as a part of turning around a sick business, where venture capitalist is not available.

Charitable venture capitalists: Charitable venture capitalists are not present in the Indian market but the West has adopted this mechanism for regional growth. These are venture capitalists with a charitable purpose, which fund the early-stage high potential small businesses. This kind of venture capitalists are established privately as non-profit organizations with the support of operating funds from the government (like state government and municipal corporations) and funds for investing are provided by charitable organizations and foundations. Operating funds are used for the operating expenses of the fund and investible funds are used for financing different ventures in the region.

Charitable venture capitalists operate exactly like venture capitalists but have a broader list of businesses that they support (usually ones that are likely to result into a positive regional growth in terms of employment and tax revenue). Charitable venture capitalists do make profit but reinvest the same for further investment purposes. Those who are interested to learn about such funding organizations may have a look at an example from the US. There is a scope for such organizations in different regions of India also.

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Preference Shares

Preference shares are also ownership shares but with a difference. Preference shareholders enjoy preferential rights over the rights of equity shareholders. They have a right to get dividends (subject to an upper limit specified in the issue document) before any dividend is paid to the equity shareholders. They also have a right to get their money back before anything is paid back to the equity shareholders in the event of winding up of the business and if there is a surplus of proceeds after paying all the liabilities of the company. In exchange of these two important rights (which protect their monetary interest to some extent), the preference shareholders forgo their voting rights on issues that are not concerning them directly. However, continuous non- payment of dividends will restore their voting right. Preference shares and their types under the heading 'hybrid securities' have been discussed because preference shares have a mix of characteristics of equity shares and bonds.

Deferred Shares

Deferred shares are the type of ownership security that offers a more proportionate right of voting. The owner of one deferred share can have more than one vote, depending upon the terms of issue. In exchange of these extraordinary voting rights, the deferred shareholders' right to get dividend is deferred until a specified amount of dividend is paid to the equity shareholders. As a result of these disproportionate voting rights and deferred dividend rights, the owners of deferred shares can have a control over the management of the company with less investment. Also, they stand a chance of earning windfall dividend income if the company make extraordinary profits.

Deferred shares were innovated for promoters of businesses. Promoters have ideas and willingness to take risk but may not have enough money to preserve the controlling interest in the company promoted by them. By way of buying deferred shares, promoters can get controlling interest in the company with little investment. However, deferred shares are not allowed anymore.

Implications of deferred share capital on the firm's cost of funds, liquidity and future growth options are the same as that of equity shares.

Subsidy and Tax Incentives

The central government and state governments offer incentives for investment through subsidies, tax incentives and concessions in land and utility prices. Schemes vary from state to state. Usually, subsidy and tax incentives are offered to encourage small entrepreneurs and women entrepreneurs, as well as to promote investment in desired locations and businesses.

For example, the central government developed a scheme for capital investment subsidy in 1997 for units in 'growth centres' for the north eastern region and other areas. The central government announces subsidy plans for different

regions from time to time. One needs to read the current industrial policy of the Government of India, with special attention to the applicable subsidy based on the classification of the zone in which the business is set up.

Many states, through the state finance corporations or state industrial development corporations provide subsidy to small-scale industries (SSIs) for investment in plant and machinery and provide industrial land, sheds, water and electricity at preferential rates.

Subsidy is shown as capital and is tax-free.

9.3.2 Types of Debt Securities

Debt funds or loan funds are different from ownership funds in terms of the rights of the lenders. Suppliers of debt funds are entitled to interest (rather than dividends) on their funds at a rate decided in the agreement and that is payable by the firm whether the firm earned profits or not. However, the suppliers of funds have no right to manage the firm or appoint their representative on the Board of Directors. Rights and obligations of lenders and borrowers are determined by the terms of agreement. Sources of long-term debt, used for financing projects, can be mainly divided in three categories—term loan, lease and debentures or bonds.

Interest paid on term loan and bonds is tax deductible as legitimate business expense for the firm and the supplier of the loan pays income tax on interest receipt. In case of lease, if it is an operating lease the entire lease rental is tax deductible for the lessee (borrower). But, if it is a finance lease (also called as capital lease), then the entire lease rent may not be deductible for tax purpose and only the interest portion in the rent may be allowed as deduction.

Loan or debt can be designed with several features (Table 9.1).

Table 9.1 Features of Debt Securities

-
- Par Value
 - Maturity Period
 - o Call and put provisions
 - o Deferred callable bonds
 - Maturity Value (at par, at premium or at discount)
 - Interest
 - o Rate of Interest
 - o Fixed rate
 - o Floating (variable) rate
 - o Reverse floaters
 - o Asset backed
 - o Catastrophe bonds

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- Timing of Payment of Interest
 - o At regular interval of time
 - o Ballooning
 - o On maturity
 - o Method Payment
- Other Provisions
 - o Security
 - o Dividend restrictions
 - o Subordination of future debt
 - o Conversion

Term Loan

Term loan is usually supplied by commercial banks and financial institutions. Term loan is for a specific term (period) at a fixed or variable interest rate, with interest payable periodically, issued against some security and usually with several negative covenants attached. Negative covenants include, periodic reporting of accounting and other information, prior approval of the lender before some activities or changes are undertaken, appointment of members of Board of Directors and so on.

Term loans usually cost less than equity shares. Often, they may cost less than other debt funds too, if the firm is in a position to negotiate better terms with the funding institutions. Depending upon the terms and conditions, the firm can avoid liquidity implication, especially if project cash flow is ascertained with a reasonable degree of certainty and servicing of term loan is matched with project cash flow. Idle float (time difference between obtaining funds and spending it on project) can be minimized at a small commitment fee to reduce the cost of term loan.

A firm has to prepare a loan application with several information, documentations and calculations. The lender will evaluate the loan application to determine the creditworthiness of the applicant firm based on the firm's management, track record, project feasibility, etc. A long-term relationship with lending institution helps in quick approval of loan and in obtaining favourable terms and conditions of loans.

Lease

Lease is of two types, operating and finance (or capital) lease. Operating lease implies short-term rights of use of an asset. Therefore, lease rent on operating lease is like any other revenue expense. Operating lease does not amount to financing acquisition of an asset. Finance lease is for almost the entire life of an asset and therefore, it is a mode of financing.

A firm can acquire assets on lease instead of borrowing funds and then buying assets. In some situations lease arrangement is very helpful. A lessee (borrower) may get hundred per cent finance (except down payment) for the

assets and it may turn out to be more convenient and at times cheaper too. Lease payment is negotiable and therefore, one can create a better match of lease payment with project cash flow. Lease arrangement may be found cheaper in three ways – if the lessor (lender) has access to cheaper funds or the lessor specializes in the assets that the lessee wants or the lessor is in higher tax bracket than the lessee. Otherwise, leasing is usually expensive.

Debentures and Bonds

Companies can divide their loan requirements in units of small denominations and issue them to several parties. These units are called ‘debentures’ or ‘bonds’. If these units are backed by collateral, then they are called ‘bonds’; otherwise they are called ‘debentures’. Publicly issued debentures and bonds are listed in the bonds market to facilitate trading and enhance liquidity. In the following discussion, the term ‘bond’ will be used to denote bonds as well as debentures.

Main Features of Bonds

Issue price: Bonds are issued at par or at premium or at discount, depending upon the coupon rate versus current market expectations. The market expects a rate on a bond of a firm depending upon the risk-free rate and default possibility of the firm. If the market expected rate is higher than the coupon rate offered, bonds will be issued at a discount and vice-a-versa. If the two rates are equal, then the bonds can be issued at par.

Maturity period: The firm has to determine the maturity period of bonds. Several factors are considered in determining the maturity period, like the firm’s needs, market situation, cost of funds and so on. A firm may include a call provision, which allows the firm to issue bonds for a specific maturity period with an option to call back the bonds on and after a specified time. Usually, call-premium is embedded with call-option, which means the firm will pay a premium over the par value if bonds are called earlier than the maturity date. It is also possible to offer a right to bondholders to put the bonds back with the firm. This right is called a ‘put option’. Usually, a bondholder can exercise a put option after a certain date and accept repayment at discount over the par value. Call and put provisions are helpful in reducing maturity risk premium.

Maturity value: The terms of issue will specify the maturity amount payable on the maturity date. Bonds may be repaid either at par or at premium or at discount.

Interest: Bonds may carry a fixed coupon rate, usually payable semi-annually or quarterly. Variable rate bonds are gradually becoming popular. The different types of bonds/debentures would be briefly touched upon in the next section, to bring out different interest rates and interest payment terms.

Interest is usually paid through cheques issued by the firm upon due date. However, firms may attach post-dated interest coupons with the bonds certificate. These post-dated interest coupons are detachable and can be sold in the market separately from the bond itself.

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Supervision: Since bonds are held by public, by law, a firm has to appoint 'bond trustees' to oversee the firm's compliance with terms and conditions of issue of bonds and other laws applicable to the bondholders' rights.

Other provisions: Several other provisions can be included in the bond contract (known as bond indenture). Dividend restrictions can be imposed to conserve cash flow needed for reducing the chance of default; rights of the current bondholders over future bondholders, if any, especially if the same assets are used as collateral for future bonds; conversion option, if any; call or put provision with call or put -date and call-premium or put-discount, if any.

Carefully designed (mix and match of various terms including the maturity period, interest payment terms, call and put features and others) bonds can cost less and help matching debt servicing cash flow with project cash flow.

Types of bonds

A mix and match of features can create a new type of bonds. Some important types of bonds are:

Zero-coupon bonds: Zero-coupon bonds, also known as deep-discount bonds or strip- bonds, are issued at discount, pay no interest during the life of bonds and repay the par value at the time of maturity. Usually, zero-coupon bonds are auctioned in which investors make offer price (which is at the present value of future maturity price). Financing a long gestation period project with zero-coupon bonds is at times desirable for conserving the much-needed cash flow and for reducing cost of debt.

Floating rate bonds: These are also known as variable rate bonds on which interest rate is usually linked with treasury bill rate or inflation index or LIBOR (London Inter-Bank Offer Rate) or any other factor as per the terms in the issue of bonds. One can build caps and floors of interest rate. In case of a cap variable, the rate cannot go above the cap rate and in case of a floor variable, the rate cannot go below the floor rate. Floating rate bonds remove maturity risk premium from the cost of bonds to the extent of cap and floor, if any.

Reverse floaters: Reverse floaters are variable rate bonds but the interest rate on them moves inverse to the change in price index or treasury bill returns. The rate on reverse floaters declines when index or treasury bill rates increase and vice-versa.

Asset-backed bonds: These are also variable rate bonds but the interests rate on these bonds are tied with the income on some specified assets.

Catastrophe bonds: These bonds offer no or very low interest rate in a normal situation but extremely high rate in the event of a pre-defined catastrophe (like, hurricane, tsunami, or earthquake).

Here, only those types of bonds that have bearing on interest payment schemes are listed, while other types are excluded.

Public Deposits

Companies can accept deposits directly from the public. This is an important source of financing the medium-term requirements of the company. Legalities and procedure for inviting public deposits are relatively very simple. It is popular among pensioners, who would get higher returns on their deposits than bank deposits. Public deposits are unsecured and still usually they cost less than loans. Public deposits come without any negative covenants. The maximum duration of public deposits is specified by Reserve Bank of India, though the issue of public deposit is governed by Companies Act, 1956.

9.3.3 Hybrid Securities

Some securities are designed to carry mixed features of ownership securities and debt securities. Some important hybrid securities are briefly discussed below.

Preference Shares

Preference shares can be categorized as ownership securities but they have some features like debt. These shares are called preference shares because they enjoy preferential treatment in getting dividends before any dividend is paid to equity shareholders and getting back their money before anything is paid to the equity shareholders from the proceeds from sales of assets after paying all liabilities at the time of liquidation of the firm. In exchange for these preferential rights, preference shareholders forgo their voting rights. They can vote on the agenda items in which their stake is directly involved. However, if dividends are skipped for some number of years, the preference shareholders acquire voting right as the equity shareholders.

This being ownership security, payment of dividends is considered as distribution of profit and therefore, dividend is not considered as tax deductible expense for the firm and preference shareholders also pays income tax on dividend income.

Usually, the upper limit on the dividend rate is prescribed in the document issuing preference shares but the company may not pay any dividend or pay partial or full dividends, depending upon the firm's profit and need to retain the profit. Preferential right to get dividends before equity shareholders give the preference shareholders a better chance of getting dividends. At the same time, if the firm has earned a very good profit, unlike equity shareholders, preference shareholders will have to be satisfied with limited dividends only, when equity shareholders may get more dividends. A few types of preference shares are listed below:

Redeemable or irredeemable preference shares

If nothing is mentioned in the issue document, the preference shares are irredeemable, meaning those preference shares are permanent like equity shares and will never mature. However, a firm can issue redeemable preference shares that have a specific maturity date like bonds.

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Cumulative or non-cumulative preference shares

If the issue document is silent, the preference shares are non-cumulative, meaning that any unpaid dividend in any year will not be accumulated and that year's dividend is lost. However, if preference shares are specified as cumulative preference shares, then unpaid dividends are accumulated (though it does not become a liability of the company) and gets payable before any dividend is paid to equity shareholders anytime thereafter.

Participative or non-participative preference shares

If the issue document is silent, preference shares are non-participative. Participative preference shares participate in extraordinary dividends paid to equity shareholders. It works like this: say the issue document mentions that preference shares will carry a dividend rate of 12 per cent but they will get an additional dividend if equity shareholders are paid dividends more than 20 per cent. In this case, if equity shareholders are paid 24 per cent dividends, preference shareholders will first get 12 per cent and additional four per cent (thus a total of 16 per cent). Additional four per cent in this case is 24 per cent paid to the equity shareholders, less the limit of 20 per cent prescribed. This additional per cent can be prorated depending upon the terms.

The cost of preference shares is higher than the cost of debt but less than the cost of equity. Being ownership funds, it does not put pressure on the liquidity of the firm. Carrying features like debt, it does not threaten hostile takeover of the firm. Thus, it offers good flexibility but may not be popular in the market every time a firm needs to issue security in the market.

Convertibles (Mezzanine)

Preference shares and bonds can be convertible also. Convertible securities are often called mezzanine securities. They are considered hybrid securities because at the time of issue, they are either preference shares or bonds but are convertible into equity shares on a future date. Conversion may be either at the option of the security holder or it can be compulsory. Conversion time and conversion ratio are pre-determined. Before the conversion date, they are purely preference shares or bonds and after the conversion date, they become equity shares. Usually, a firm with good prospects is able to offer convertible securities at a low interest rate or low dividend rate because investors also derive value from the conversion. Principal sum of convertibles is never repaid because it is converted into equity shares and thus puts much less burden on the liquidity of the firm. Upon conversion, the firm's creditworthiness improves due to decline in debt-equity ratio. Therefore, high growth firms, who frequently need more funds, prefer issuing convertible securities so that they can manage their creditworthiness better, do without issuing equity shares (and save on floatation costs) and still they can maintain a desirable debt-equity ratio.

Bonds with Warrants

When bonds are issued with the right to get a certain number of equity shares on or after a certain date in the future, they are called ‘bonds with warrants’. Warrant gives its holder a right to get a certain number of shares on a future date at a favourable price. These warrants are detachable, which allows a bondholder to sell the warrants separately before they are due for shares. Warrants make bonds cheaper because of the potential capital gain after the exchange of warrant for shares. Also, they allow the firm to increase its shares without incurring any floatation cost while mostly maintaining the debt-equity ratio.

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Check Your Progress

1. What are the different forms in which bank finance is made available to customers?
2. What are commercial papers?
3. What is export finance?

9.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Bank finance is available in different forms. Some of the important forms are the following:
 - Bank overdraft
 - Cash credit
 - Bill discounting
 - Note-lending
 - Letter of credit
 - Line of credit (fixed or revolving)
 - Export financing
 - Special purpose financing
2. Commercial papers are issued by the companies in the primary money market for financing the current assets. Commercial paper is in a way a promissory note which gives ‘promise to pay maturity sum on a due date’.
3. Export finance means financial assistance extended by banks for promoting export of goods outside the country or region. These schemes especially encourage MSMEs to expand their reach to the global market and earn valuable foreign exchange.

9.5 SUMMARY

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- Accrued liabilities and accounts payable are the two internal sources of short-term funds available for financing the current assets.
- Commercial papers are issued by the companies in the primary money market for financing the current assets.
- The factoring product allows the firms to sell their accounts receivable to a third party (factor), usually a bank at a discount.
- Forfaiting involves purchase of accounts receivables from exporters by a forfaiter. An exporter is enabled to receive cash against the export from the forfaiting agent, who in turn will get payment from the buyer firm abroad.
- An individual or a company with the current account or savings account with a bank may request a bank to grant overdraft facility. If overdraft facility is extended to the customer then the customer can withdraw more money than the balance in the account, subject to the limit on overdraft.
- Export finance means financial assistance extended by banks for promoting export of goods outside the country or region. These schemes especially encourage MSMEs to expand their reach to the global market and earn valuable foreign exchange.
- The sources of funds are classified into two main types-ownership funds and debt funds.
- Angel investors are those that ‘save struggling firms with both finance and know-how when no one else will’ (Van Osnabrugge and Robinson, 2004). Historically, it was appropriate to say that angel investors were willing to accept more risk than venture capitalists.
- Preference shares are also ownership shares but with a difference. Preference shareholders enjoy preferential rights over the rights of equity shareholders.
- Debt funds or loan funds are different from ownership funds in terms of the rights of the lenders.
- Some securities are designed to carry mixed features of ownership securities and debt securities.
- Preference shares and bonds can be convertible also. Convertible securities are often called mezzanine securities. They are considered hybrid securities because at the time of issue, they are either preference shares or bonds but are convertible in to equity shares on a future date.

9.6 KEY WORDS

- **Factoring:** It is the process of converting accounts receivables into the cash before the due date through a third party.
- **Inter-Corporate Deposit:** The deposit taken by one company from the other is inter-corporate deposit.
- **Letter of Credit:** Popularly known as LC; it is one in which a bank agrees to pay liability after credit period.

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9.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Prepare an overview of industrial finance.
2. Define short-term finance.
3. What are the rights and obligations of equity shareholders?
4. Write short notes on the following:
(a) Venture capitalists (b) Angel capitalists

Long Answer Questions

1. Explain the features of debt securities.
2. Discuss the various hybrid securities.
3. Describe the various sources of short-term finance.

9.8 FURTHER READINGS

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BLOCK - III
INTERNATIONAL ENVIRONMENT

NOTES

**UNIT 10 OVERVIEW OF FINANCIAL
INSTITUTIONS IN INDIA**

Structure

- 10.0 Introduction
- 10.1 Objectives
- 10.2 Overview of Financial Systems and Institutions
 - 10.2.1 Financial Institutions in India
- 10.3 Reserve Bank of India
- 10.4 Commercial Banks
- 10.5 Development Financial Institutions (IFCI, ICICI, IDBI, IIBI)
- 10.6 Specialized Banks
 - 10.6.1 Small Industries Development Bank of India (SIDBI)
 - 10.6.2 LIC
 - 10.6.3 SIDCO
 - 10.6.4 DHFI
 - 10.6.5 SFCs
- 10.7 Answers to Check Your Progress Questions
- 10.8 Summary
- 10.9 Key Words
- 10.10 Self Assessment Questions and Exercises
- 10.11 Further Readings

10.0 INTRODUCTION

In the previous unit, you studied about the idea of industrial finance which included short-term finance, medium term finance, long-term finance and corporate securities. This unit, will provide you an overview of the significant financial institutions existing in India.

India has a diversified financial sector experiencing rapid expansion, both in terms of strong growth of existing financial services enterprises and new firms entering the market. The sector consists of commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is chiefly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system. The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. In 2017, a new

portal named 'Udyami Mitra' has been launched by the Small Industries Development Bank of India (SIDBI) with the aim of improving credit availability to Micro, Small and Medium Enterprises' (MSMEs) in the country.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- Prepare an overview of financial systems and institutions in India
- List the functions of the Reserve Bank of India (RBI)
- Define commercial banks
- Identify the various development financial institutions operating in India
- Recognize specialized banks

10.2 OVERVIEW OF FINANCIAL SYSTEMS AND INSTITUTIONS

In an economy, a financial system refers to a system that organizes the settlement of payments, raises and allocates finance, and manages the risks associated with financing and financial exchange. A developed financial system has a secure and efficient payment system, security markets and financial intermediaries to arrange finances and financial institutions to provide access to risk management instruments.

The global financial system is a network of financial institutions and regulations functioning at the international level. The key players in the global financial system are global financial institutions such as the International Monetary Fund (IMF) and the World Bank; national agencies and government departments like central banks and finance ministries; and private financial institutions like private banks and mutual funds.

Financial institutions are an integral part of the structure of a financial system, and thus play an important role in the growth and smooth functioning of an economy.

Structure of a financial system

The financial system, also known as the financial sector of a country, is like a well-framed structure, which consists of the following components:

- **Financial institutions:** In layman's terms, a financial institution is a public or private institution that collects funds from the public or other institutions and invests them in financial assets. In more specific economic terms, a financial institution acts as an agent that provides financial services to its clients. Financial institutions generally fall under the financial regulation of a government authority. Financial institutions commonly include banks, credit unions and stock brokerages.

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- **Financial markets:** This is a generic term for markets where financial instruments are traded or the transactions of financial assets take place. The key participants on the demand and supply sides of the financial markets are financial institutions, agents, brokers, dealers, savers, borrowers and lenders, etc.
- **Financial instruments and services:** This is a term used to denote any form of funding medium which is used for borrowing finance in financial markets. A financial instrument is also referred to as a document having a monetary value or a record of some monetary transaction. Examples of financial instruments are cheques, drafts, bills of exchange and promissory notes.

Figure 10.1 shows the structure of a financial system.

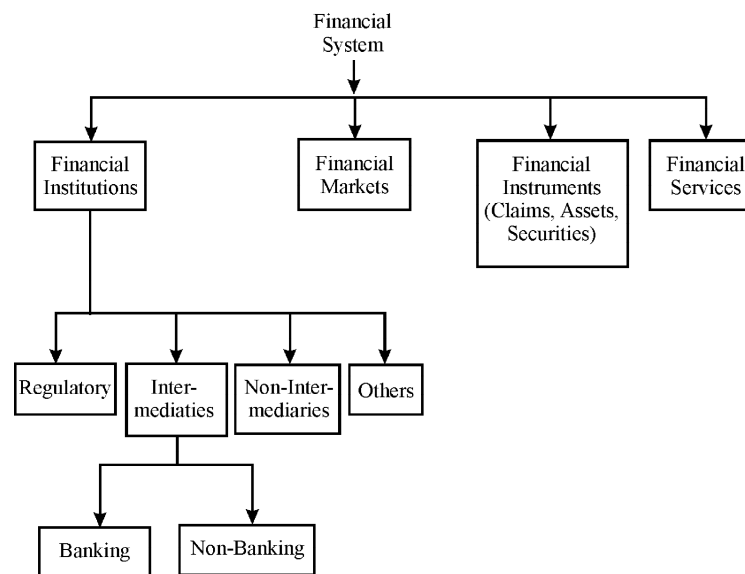


Fig. 10.1 Structure of a Financial System

All the components of a financial system that constitute its structure are not mutually exclusive, i.e., they are interdependent and interrelated to each other. For example, financial institutions operate in a financial market and make use of various financial instruments and services to carry on their business. Here, it should also be kept in mind that various procedures, rules, regulations, policies and practices prevailing in the financial markets and adopted by the financial institutions are also part of a financial system.

Overview of Financial Institutions

Broadly, in an economy two types of business organizations exist—non-financial and financial. Non-financial organizations manufacture products such as automobiles, technological equipment and food products and/or provide services that are not financial in nature such as legal services, electricity supply, and so on. However, financial organizations, better known as financial institutions, do not manufacture

any goods but provide financial services. The various financial services provided by financial institutions are as follows:

- Acquisition of financial assets that are less preferred by the public through the market and converting them into more preferable assets. This service is generally provided by financial intermediaries—the most important type of financial institutions.
- Exchange of financial assets on behalf of their customers. For example, if an individual possessing shares of a company wants to sell his shares, he need not directly deal with the buyer of the shares. The stock exchange can sell and buy shares on behalf of its customers.
- Exchange of financial assets not only on behalf of their customers, but also for their own accounts.
- Assistance to customers in creating financial assets and then selling these assets to other participants in the financial market.
- Investment advice such as how and where to invest money to other financial market participants.
- Management of portfolios of other market participants.

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Objectives of financial institutions

Financial institutions are set up for a specific purpose and to achieve certain objectives. Some of the objectives of financial institutions are as follows:

- Providing long and medium-term financial assistance to industrial enterprises.
- Ensuring balanced regional growth in socio-economic terms by attaining balanced industrial growth.
- Accelerating the pace of industrial growth.
- Building and strengthening the capital market. Capital market refers to the market where funds in the form of stocks, bonds and other securities are invested for a long-term.
- Assisting in the creation, expansion and modernization of industrial enterprises.
- Encouraging and promoting the participation of private capital.
- Providing managerial, technical and administrative services to Indian industry.

Classification of Financial Institutions

Financial institutions can be broadly classified into the following two categories based on their field of specialization:

- Banking and non-banking institutions
- Intermediaries and non-intermediaries

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Banking and non-banking institutions

Banking institutions are marked by the following three characteristics:

- They participate in or contribute to the payments mechanism of the economy, which means that they provide transaction services.
- Their deposit liabilities comprise a major part of the national money supply.
- They can create deposits or credit, which means that they actually create money in the financial market.

The banking institutions in India function under the aegis of the Reserve Bank of India (RBI) and mainly consist of commercial banks and cooperative banks.

The non-banking institutions also carry out financial activities, but their resources do not come to depositors in the form of savings. Instead, they mobilize public savings for providing other financial services, including investments. Mutual fund companies and insurance companies such as the Unit Trust of India (UTI), Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) fall under this category.

The non-banking institutions are actually financial intermediaries and when they lend money to the public, they are known as non-banking financial intermediaries (NBFIs) or investment institutions.

Intermediaries and non-intermediaries

Intermediaries, as the term suggests, act as a link between savers and investors. The main functions of intermediaries include lending money to the public and mobilizing public savings. Although they are liable towards the ultimate savers, their assets generally come from the investors and borrowers. All banking institutions are actually intermediaries and, some non-banking institutions are also intermediaries.

Non-intermediary institutions provide loans but they do not acquire their resources directly from the savers. Major non-intermediary institutions like the Industrial Development Bank of India (IDBI) and National Bank for Agriculture and Rural Development (NABARD) have been set up by the government to provide assistance to specific sectors and regions for specific causes. As they are set up by the government they are also known as Non-Banking Statutory Financial Organizations (NBSFOs). The main idea behind setting up these non-intermediary institutions was to fulfil the credit needs of the borrowers, especially rural, who are not adequately assisted by the private financial institutions.

10.2.1 Financial Institutions in India

The various banking institutions are discussed below.

Indian joint stock banks

Indian joint stock banks form an important constituent of the Indian financial system. These banks are classified into *scheduled* and *non-scheduled* banks. They follow branch banking and perform all the typical functions of commercial banks. The branch expansion policy in the recent past has resulted in correcting the regional maldistribution of branch network. Today the banking system covers a much larger segment than it did a few years ago. As a result, growth in deposits has been substantial. In 1969, the RBI introduced the Lead Bank Scheme with the twin objective of mobilization of deposits on a massive scale and stepping up of lending to weaker sections of the economy.

Since the early 1950s, there has been an earnest attempt to strengthen the banking system.

Various measures have been taken to strengthen the capital base of banks. Capital adequacy has been the corner stone of prudential regulatory framework in India. With the onset of financial sector reforms, banks have started diversifying their activities through (i) entry into insurance business, (ii) increasing the volume of retail banking, (iii) development of housing finance, (iv) investment in capital market, (v) formation of subsidiaries for para-banking activities, (vi) equity investment in commodity exchange, and so on.

Technological development and the use of information technology have transformed the functioning of Indian banks. Instances of technological development include: provision of core banking solutions, installation of ATMs, use of electronic payment systems, introduction of RTGS (real time gross settlement, or **RTGS**, system is a funds transfer mechanism where transfer of money takes place from one bank to another on a 'real time' and on 'gross' basis).

Foreign banks

Foreign banks are those which are foreign in origin and have their head offices located outside India. The requests of new foreign banks for conducting business in India are considered keeping in view the financial soundness of the bank concerned along with certain other crucial factors. The capital adequacy ratio of foreign banks is, by and large, satisfactory. The main business of foreign banks is the financing of India's foreign trade.

There are certain complaints against the working of some of the foreign banks. The minimum lending of foreign banks to the priority sector shall be 32 per cent of their net credit. Any shortfall in the target shall be compensated by depositing an amount equivalent to the shortfall with SIDBI.

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Cooperative banks

Cooperative banking movement received momentum after the World War II. Under the Banking Regulation Act, only urban cooperative banks, state cooperative banks and district central cooperative banks are qualified to be addressed as banks in the cooperative sector.

Rural areas are served by two distinct sets of institutions extending short-term credit and long-term credit. Short-term cooperative credit institutions comprise state cooperative banks, district central cooperative banks and primary agricultural credit societies. Long-term cooperative credit institutions comprise state cooperative agriculture and rural development banks and primary cooperative agriculture and rural development banks.

Urban areas are served by urban cooperative banks. Urban cooperative banks are registered under Cooperative Societies Acts of the respective state governments. They are required to channelize 40 per cent of their adjusted bank credit towards priority sector. Reserve Bank is the regulatory authority for state cooperative banks and central cooperative banks. Their supervision is entrusted with National Bank for Agriculture and Rural Development (NABARD).

NABARD

Agricultural Refinance and Development Corporation (ARDC) came into existence in 1972. NABARD was established in 1982. It took over the functions of the erstwhile Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of RBI, and ARDC. **NABARD** is an apex institution accredited with all matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas. It is an apex refinancing agency for the institutions providing investment and production credit for promoting the various developmental activities in rural areas. It takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel, and so on. It coordinates the rural financing activities of all the institutions engaged in developmental work at the field level and maintains liaison with Central Government, state governments, RBI and other national level institutions concerned with policy formulation. It promotes research in the fields of rural banking, agriculture and rural development.

State Bank of India

State Bank of India (SBI) is the founder and the flagship member of the State Bank Group; which has the largest banking branch network in India with over 16,000 branches. SBI has a market share among Indian commercial banks of about 20 per cent in deposits and loans. SBI is the largest Indian banking and financial services company (by turnover and total assets). It provides a range of banking products through its vast network of branches in India and overseas,

including products aimed at non-resident Indians (NRIs). The bank also has around 130 branches overseas. SBI is the only Indian bank that figures in *Fortune* top 100 banks. In addition to banking services, SBI offers an entire range of financial services. It has adopted and is pursuing vigorously its information technology policy. The bank's central board is primarily responsible for management of risk. SBI plays a vital role in priority sector, export credit and agricultural financing.

Reserve Bank of India

The preamble to the Reserve Bank of India Act, 1934, lays down the object of apex bank to be 'to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in British India, and generally to operate the currency and credit system to its advantage'. Originally, the bank was constituted as a shareholders' bank. Subsequently, it was nationalized. From 1949, Reserve Bank of India (RBI) began functioning as a state-owned and state-controlled central bank.

RBI performs all the typical functions of a central bank. These include monopoly of note issue and currency management, implementation of monetary policy, acting as bankers' bank and lender of the last resort, acting as banker to the Government and exchange control functions.

Maintenance of price stability and ensuring availability of adequate credit to the productive sectors are the major objectives of monetary policy in India. The conduct of monetary management has undergone significant changes in the 1990s. The process of making monetary policy in India is an elaborate one. Bank Rate policy coupled with liquidity adjustment facility and open market operations, variable reserve ratio method, qualitative controls such as selective credit controls, moral suasion, credit rationing and direct action are the major instruments of monetary policy.

Government accepted the major recommendations of the Committee to Review the Working of the Monetary System appointed in 1982. The current developmental role of the bank encompasses an extensive canvas. Several measures have been taken to develop a bill market in India. The notable ones include the establishment of the Discount and Finance House of India Limited.

Developments in Financial System

During the recent past, the Indian financial system has undergone structural transformation. With a view to enhance the macroeconomic performance of the economy, wide ranging reforms were initiated during the early 1990s focused on creating efficient and stable financial institutions and markets. The approach to reforms was one of gradual and non-disruptive progress through a consultative process. The authorities have been successful enough to put in place a proper regulatory framework coupled with prompt and effective supervision and development of technological and institutional infrastructure comparable with global

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standards. Interest rate regime has been largely deregulated with a view towards better price discovery and efficient resource allocation.

The Indian banking sector, in particular, witnessed many positive developments during the recent past. The policy makers (comprising the RBI, Ministry of Finance, and related government and financial sector regulatory entities), have taken a number of steps to improve regulation and supervision in the sector. The number of banks successful in establishing an outstanding track record of innovation, growth and value creation has been on the increase. Over the last few years, banking institutions in India have compared favourably with other regional banks in the matter of growth, asset quality and profitability. Policy makers have put in place some notable changes in policy and regulation to help strengthen the banking sector. These changes include strengthening prudential norms, enhancing the payments and settlement system, and integrating regulations between commercial and cooperative banks.

The next section is a brief description of each of these components which, it is hoped, will be useful for a fuller appreciation of the current picture relating to the Indian financial system.

10.3 RESERVE BANK OF INDIA

Central banking is of comparatively recent origin in India. The Hilton Young Commission recommended the establishment of a Central Bank in India. In compliance with this recommendation, a Bill was introduced in the Legislative Assembly by the then finance minister in 1927. Unfortunately, it had to be abandoned owing to fundamental disagreement between the Assembly and the Government of India. The question assumed importance again with the unanimous recommendation of the Central Banking Enquiry Committee (1931) which viewed the matter 'to be of supreme importance from the point of view of the development of banking facilities in India, and of her economic development generally, that a Central or Reserve Bank shall be created at the earliest possible date'. Moreover, the White Paper on Indian Constitutional Reforms reiterated the importance of a Reserve Bank free from political influence. Accordingly, a fresh bill was introduced in the Legislative Assembly in 1933 and the Reserve Bank commenced its operations from 1 April 1935. Thus, the Reserve Bank of India (RBI) took a long time to come to fruition and perhaps the longest incubation period for any central bank in the world.

Functions of the RBI

The RBI performs all the typical functions of a Central Bank. Its main function is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. For this, the Bank is given the monopoly of note issue and has wide powers over the banking system. Another important function of the Bank is to conduct the banking and financial operations of the government. The Bank

discharges certain other functions like maintaining the external value of the rupee, collection and publication of monetary and financial information, etc. The range of functions of the Bank has come to be steadily enlarged with the task of economic development assuming new urgency and dimensions. Implementation of appropriate monetary policies, no doubt, remains its most important function. At the same time, the Bank is taking an active part in fostering an adequate banking structure capable of meeting the needs of trade, industry, agriculture and commerce.

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Monopoly of note issue

Under Section 22 of the RBI Act, the RBI has the sole right for the issue of currency other than one rupee notes and one rupee coins and subsidiary coins. As in the case of Bank of England, the RBI maintains two departments, viz., the Issue Department and the Banking Department. The notes are a liability of the Issue Department alone. The assets of the Issue Department which form the backing for the note issue are kept separate from those of the Banking Department. According to Section 33 of the RBI Act, the assets of the Issue Department against which bank notes are issued should consist of gold coin and bullion, foreign securities, rupee coins, Government of India securities and such bills of exchange and promissory notes payable in India and as are eligible for purchase by the Bank. Under the original Act of 1934, not less than 2/5th of the assets of the Issue Department were required to be held in gold coin, gold bullion or foreign securities.

Currency management

As an extension to the above function, the RBI is entrusted with the task of currency management in India. Currently, it involves management of 3,800 crore pieces of currency notes valued at ` 2,33,000 crore. While currently 1,200 crore pieces are being printed every year, the printing capacity has been built up to a futuristic level of 1,800 crore pieces annually. The current position of supply of fresh notes is comfortable. Hence, the Bank is concentrating on faster and better distribution of notes and coins by augmenting its capacity to withdraw soiled notes from circulation and processing them in faster ways through increased mechanization and automation. Apart from maintaining adequate supply of fit notes in circulation and disposal of soiled notes, preventing counterfeiting of high denomination bank notes is another challenge faced by the RBI in the context of currency management. There are reports of organized counterfeiting from across the border. In order to combat this problem, the RBI has initiated a series of steps in cooperation with the Central Government. These include, among others, strengthening the security features on the currency notes and launching awareness campaigns about the available identifiable features in genuine bank notes.

Monetary policy

There appears to be a general consensus today that the primary objective of monetary policy should be domestic price stability. Maintenance of price stability and ensuring availability of adequate credit to the productive sectors of the economy

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are the major objectives of monetary policy in India. The stated objectives of monetary policy in India are 'to promote sufficient credit for growth while ensuring that there is no emergence of inflationary pressures on this account'. The relative emphasis between the objectives depends on the underlying economic conditions and is spelt out from time to time. As far as inflation is concerned, as compared to many other developing countries, India has been able to maintain a moderate level, and inflation rates in India rarely touched double digit. Although the policy objectives of the Reserve Bank of India remained broadly unchanged over the years, there is some change in emphasis from time to time. In addition to the traditional objectives of growth and price stability, a third objective that has been gaining importance in the post-reform period is that of financial stability. While in the short run, there may exist some trade-off between the stated objectives, in the long run, the complementarities among them became more pronounced. The focus on growth and stability continues to be reflected in the overall stance of monetary policy in recent years. The policy statements as well as mid-term reviews of the RBI have been focusing on the structural and regulatory measures to strengthen the financial system. The policy measures have been guided by the objectives of increasing operational efficiency of monetary policy, redefining the regulatory role of the RBI, strengthening prudential norms, and developing technological and institutional infrastructure. It may be noted in this connection that the policy statements of the RBI provide a framework for the monetary, structural and prudential measures that are initiated from time to time consistent with the overall objectives of growth, price stability and financial stability. In recent years, monetary management had to be constantly fine-tuned to keep pace with the fast evolving changes, accentuated by growing sophistication of financial markets and integration of domestic economy with the international economy.

Role of RBI as Central Bank

In terms of the RBI Act, banks which have more than the prescribed paid-up capital and reserves may be included in the Second Schedule of the Act. They are popularly known as scheduled banks. The inclusion of a bank in the Second Schedule gives no continuing guarantee of its soundness and stability. Just as the RBI has the power to include a bank in the Second Schedule, it has also the power to exclude any bank from the Second Schedule. The scheduled banks are eligible for financial facilities from the RBI. In return, they bear certain obligations to the RBI. They are required to submit to the Bank a weekly statement showing their position in the prescribed form. Failure to submit a return makes a bank liable to penalties. So also, if it fails to maintain the required amount of reserves as specified, it has to pay a penal rate of interest to the RBI and is prohibited from accepting fresh deposits during the period of default. Under the Banking Regulation Act, it has been made obligatory on the non-scheduled banks also to maintain the same percentage of cash reserves.

The controls which the RBI exercises over the banks by virtue of the powers conferred on it by the Banking Regulation Act have been highlighted in an earlier

chapter. Presently, we shall briefly deal with the facilities provided by the RBI in relation to financial accommodation to the scheduled banks. The relevant provisions are laid down in section 17 of the RBI Act. In terms of this section, a scheduled bank can obtain financial assistance from the RBI in the form of rediscount of eligible bills of exchange as well as loans and advances against eligible securities. To promote a sound banking system, the RBI, in granting accommodation, takes into account the general conditions of the bank applying for accommodation and looks into whether the bank has been indulging in overtrading or unsecured business excessively or has been granting excessive credit for speculative activities in commodities and/or securities. With a view to ensuring that its credit facilities are not abused in any manner, the RBI may call for such information or impose such restrictions as it may consider necessary and a scheduled bank is expected to supply such information as may be called for. It may also refuse to rediscount the papers of any scheduled bank without assigning any reason. But properly managed banks can always depend upon the accommodation from the RBI during periods of emergency, provided they offer satisfactory securities.

It is in the capacity of the bankers' bank that the RBI acts as the lender of the last resort to provide assurance of stability under all circumstances. The RBI as lender of the last resort accommodates demands for high-powered money in times of crisis, thus preventing panic-induced contractions in the money stock. Ideally, the announcement of the RBI of its commitment as lender of last resort would assuage fears of a shortage of cash and will be sufficient enough to neutralize panics without the necessity of taking action. However, it may also engender moral hazard problems if banks relying on this take on unwarranted risks without sufficient mitigation measures.

Although the function of the RBI as lender of the last resort has been extant, its scope and content have undergone a transformation. This is all the more so in recent times wherein concerns about financial stability have become of paramount importance. During the post-reform period the statutory pre-emptions from banks have been drastically reduced. Concomitantly, banks are required to reduce their dependence on the RBI on a continuous basis.

Exchange control

For the effective administration of exchange control, the Exchange Control Department of the RBI was constituted in 1939. It deals with the work relating to the control of foreign transactions in exchange, bullion and securities. This work was delegated to the bank by the Central Government under the Defence of India Rules. The financial provisions of the Defence of India Rules were given statutory recognition by the Foreign Exchange Regulation Act, 1947 (FERA). This Act has been replaced by the Foreign Exchange Management Act, 1999 (FEMA), with effect from 1 June 2000.

The new legislation reflects the current economic realities and is far more pragmatic in its approach. The objective of the earlier Act as contained in its

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preamble was the conservation of foreign exchange and its utilization for economic development of the country whereas the objective of the new Act is ‘facilitating external trade’ and ‘promoting the orderly development and maintenance of foreign exchange market in India’. The most significant feature of the new Act is that it provides legal basis to the current account convertibility.

Since the simplification of procedures and delegation of powers to authorized dealers is an on-going process, the citizens may approach the authorized dealers for guidance on matters relating to exchange control.

10.4 COMMERCIAL BANKS

Commercial banks are organized on a joint stock company system, primarily for the purpose of earning a profit. They can be either of the branch banking type, as we see in most of the countries, with a large network of branches, or of the unit banking type, as we see mainly in the United States of America, where a bank’s operations are confined to a single office or to a few branches within a strictly limited area. Although the commercial banks attract deposits of all kinds—current, savings and fixed—their resources are chiefly drawn from current deposits that are repayable on demand. Hence, they attach much importance to the liquidity of their investments and as such they specialize in satisfying the short-term credit needs of business rather than the long-term needs.

Commercial banks can be categorized into:

- Public Sector Banks (Nationalized Banks)
- Private Sector Banks
- Foreign Banks in India
- Regional Rural Banks (RRBs)

The functions of commercial banks are discussed in detail in the next section.

Functions of Commercial Banks

The functions of a bank may be discussed under two heads: primary functions and secondary functions.

Primary Functions of Commercial Banks

The two essential functions of a commercial bank may best be summarized as the borrowing and the lending of money. They borrow money by taking all kinds of deposits. Deposits may be received on current account whereby the banker incurs the obligation to repay the money on demand. Interest is not payable on current account deposits. When deposits are received on savings bank account as well, the bank undertakes the obligation to repay them on demand. Interest is generally allowed on savings bank deposits although usually there are restrictions on the total amount that can be withdrawn and/or the number of times withdrawals are

allowed during a defined period. When deposits are received on fixed deposit accounts, the banker incurs the obligation to repay the money together with an agreed rate of interest after the expiry of a fixed period. When deposits are received on deposit accounts, the banker undertakes to repay the customer together with an agreed rate of interest in return for the right to demand from him an agreed period of notice for withdrawals. Thus, a commercial bank mobilizes the savings of the society. This money is then provided to those who are in need of it by granting overdrafts or fixed loans or by discounting bills of exchange or promissory notes. In short, the primary function of a commercial bank is that of a broker and a dealer in money. By discharging this function efficiently and effectively, a commercial bank renders a very valuable service to the community increasing the productive capacity of the country and thereby accelerating the pace of economic development. It gathers the small savings of the people, thus reducing the quantity of idle money to the lowest limits. Then, it combines these small holdings in amounts large enough to be profitably employed in those enterprises where they are most called for and most needed. Here, it makes capital effective and gives industry the benefits of capital, both of which otherwise would have remained idle. For instance, take the practice of discounting bills of exchange. By converting future claims into present money, the commercial bank bridges the time element between the sale and the actual payment of money. This will enable the seller to carry on his business without any hindrance; and the buyer will get enough time to realize the money.

Thus, a commercial bank receives deposits which it has to repay according to its promise and makes them available to those who are really in need of them. The bank is actually distributing its deposits between the borrowers and its own vaults. Herein, lies the most delicate of the functions of a commercial bank.

Secondary Functions of Commercial Banks

Besides the two main functions just discussed, a commercial bank performs a variety of other functions which may broadly be grouped under two main heads, viz., the agency services and the general utility services.

1. Agency services

A commercial bank provides a range of investment services. Customers can arrange for dividends to be sent to their bank and paid directly into their bank accounts, or for the bank to detach coupons from bearer bonds and present them for payment and to act upon announcements in the press of drawn bonds, coupons payable, etc. Orders for the purchase or sale of stock exchange securities are executed through the banks' brokers who will also give their opinions on securities or lists of securities. Similarly, banks will make applications on behalf of their customers for allotments arising from new capital issues, pay calls as they fall due and ultimately obtain share certificates or other documents of title. On certain agreed terms, the banks will allow their names to appear on approved prospectuses or other documents as bankers for the issue of new capital; they will receive applications and carry out other instructions.

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A commercial bank undertakes the payment of subscriptions, premia, rent, etc., on behalf of its customers. Similarly, it collects cheques, bills of exchange, promissory notes, etc., on behalf of its customers. It also acts as a correspondent or representative of its customers, other banks and financial corporations.

2. General utility services

These services are those in which the bank's position is not that of an agent for his customer. They include the issue of credit instruments, like letters of credit and travellers' cheques, the acceptance of bills of exchange, the safe custody of valuables and documents, the transaction of foreign exchange business, acting as a referee as to the respectability and financial standing of customers, providing specialized advisory service to customers, etc.

10.5 DEVELOPMENT FINANCIAL INSTITUTIONS (IFCI, ICICI, IDBI, IIBI)

Development financial institutions, which were set up by the government after independence to help the private sector industries with finance and other services, form the part of the capital market. These developmental financial institutions are commonly referred to as development banks. The Industrial Finance Corporation of India (IFCI) was set up in 1948 and its establishment marks the beginning of the era of development banking in India. The role assigned to IFCI was that of a gap filler which implied that it was not expected to compete with the existing channels of industrial finance. It was expected to provide medium and long-term credit to industrial concerns including cooperatives, only when they could not raise funds by taking recourse to capital issue method or normal banking accommodation. The establishment of IFCI was followed by the setting up of financial institutions at the state level.

In view of the early experiences of the working of the IFCI and State Financial Corporations (SFCs), the need for the establishment of some more dynamic institutions which could operate as true development agencies was felt. Hence, two other institutions, the National Industrial Development Corporation (NIDC) and the Industrial Credit and Investment Corporation of India (ICICI) were created. The NIDC was established in 1954 with the objective of promoting industries which could not be easily developed otherwise, though they were considered vital for the growth of the economy. Later on, it was converted into a consultant organization and thus ceased to operate as a development bank. The ICICI was established in 1955 as a development bank. The Refinance Corporation (RCI) was set up with the purpose of providing refinance to commercial banks against loans granted by them. Since the scope of the activities of the RCI was narrow, it was not fit to emerge as an apex development bank in this country. The government therefore created an entirely new institution—the Industrial

Development Bank of India (IDBI)—to act as an apex institution in the sphere of industrial finance. With the establishment of IDBI in 1964, a major reorganization was effected in the sphere of industrial finance. In February 1976, the IDBI was made an autonomous institution and its ownership passed on from the RBI to the Government of India. The role of IDBI was conceived not merely as one of a financing agency, it was also expected to coordinate the activities of the institutions engaged in financing, promoting and developing industry. As a result of the initiatives taken by the government, a large number of other financial institutions have also come up in the post-independence period.

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1. Industrial Finance Corporation of India (IFCI)

IFCI was the first of all Indian development banks to be set up in the country. It was set up in 1948 with the object of providing medium- and long term credit to industry. With effect from July 1993, IFCI was converted into a public limited company and the general public allowed to hold its shares.

Functions of IFCI: IFCI grants financial assistance in the following forms:

- Granting loans or advances both in Indian currency and foreign currencies repayable within 25 years.
- Guaranteeing rupee loans floated in the open market by industrial concerns.
- Underwriting of shares and debentures of the industrial concerns.
- Guaranteeing (i) deferred payments in respect of imports of machinery, (ii) foreign currency loans raised from foreign institutions and (iii) rupees loans raised from scheduled banks or state cooperative banks by industrial concerns.

2. Industrial Credit and Investment Corporation of India (ICICI)

ICICI was the second all-India development bank to be established in the country. It was set up in January 1955. Unlike IFCI and IDBI which are public sector development banks, ICICI is a private sector development bank. Its distinguishing feature is that it provides underwriting facilities which are generally neglected by other institutions.

ICICI provides assistance in various forms, the important ones are listed as follows:

- Long- or medium-term loans or equity participation
- Guaranteeing loans from other private investment sources
- Subscription to ordinary or preference capital and underwriting of new issues or securities
- Rendering consultancy service to Indian industry in the form of managerial and technical advice

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3. Industrial Development Bank of India (IDBI)

In order to meet the financial needs for rapid industrialization of the country and to coordinate the activities of all agencies, a new financial institution became necessary. IDBI was initially set up as a wholly owned subsidiary of the Reserve Bank of India. In February 1976, IDBI was made an autonomous institution and its ownership passed from the Reserve Bank of India to the Government of India.

IDBI has rightly been called the apex organization in the field of development banking. It not only has the organizational links with other development banks but also renders some of these services to them, something only an apex organization is expected to perform. It provides refinance against loans granted to industrial concerns by other development banks and rediscounts their machinery bills and subscribes to the share capital and bond issues of the IFCI, ICICI and SFCs. The IDBI enjoys a unique position in India's development banking system. Apart from providing financial assistance to industry, IDBI performs certain proportional functions as well. These include provision of training in project evaluation and development of entrepreneurship.

4. Industrial Investment Bank of India (IIBI)

There are a number of industries that have sick industrial units. These units possess obsolescent machinery and poor management. The economic position of some units has deteriorated because the managers of these units have paid more attention to distribution of dividends rather than reinvestment of profits. The government does not want these units to shut down because this would lead to retrenchment of employees and large-scale unemployment of industrial workers. Accordingly, it established the Industrial Reconstruction of India (IRCI) in 1971 to provide financial assistance as well. The government converted IRCI into a statutory corporation to be called the Industrial Reconstruction Bank of India (IRBI) with a view to overcome the inherent difficulties which IRCI had faced in its efforts towards rehabilitating of sick industrial units. The IRBI was reconstituted into a new development financial institution under the Company Act, 1956, in March 1997, with adequate operational flexibility. The entire assets and liabilities of IRBI have been transferred to this new company which is known as the Industrial Investment Bank of India.

5. Unit Trust of India (UTI)

To assist the small investors of middle income group in finding a safe investment, UTI was set up in February 1964. The notable advantages of the Unit Trust of India are (i) diversified portfolio of pooling of risks, (ii) professional management and (iii) high degree of liquidity. Small investors on their own cannot avert the risk if they directly invest in the shares and debentures of companies. With small resources to invest, they cannot have a diversified portfolio. However, by making investment in the shares of unit trusts, risk is averted due to their investment policy.

The unit trusts as a policy do not make concentrated investment in a few companies whatever their financial position.

The importance of unit trusts in mobilizing savings of small savers was recognized long ago by the Indian Central Banking Enquiry Committee. The small savers by buying the units make indirect investment in industries and thereby contribute to the industrial development of the country.

6. Non-Banking Financial Companies

In recent years, non-banking financial companies have been set up all over the country. These companies have little capital of their own. They collect deposits from the public by offering attractive interest rates and lend them to wholesale and retail traders and small industries. Non-banking financial companies are of three types:

- (1) Merchant banking
- (2) Mutual funds
- (3) Leasing and hiring purchase companies

Merchant banks provide financial services in the form of underwriting new issues. They also advise corporate companies on fund raising and other financial matters.

Many public sector banks and financial institutions have set up *mutual funds*. These funds mobilize savings from the people and invest them in purchasing shares of corporate companies. Thus mutual funds perform two types of functions:

- (i) mobilization of savings from the public
- (ii) investment of funds in the securities market

Leasing companies lease out equipments on rent to industrial companies. *Hire purchase companies* provide funds to small business firms in acquiring costly machinery on installment basis.

10.6 SPECIALIZED BANKS

The banks that cater to specific needs, provide financial aid to businesses and industries along with financing foreign trade and heavy turnkey projects are known as specialized banks. These banks include industrial banks, export-import banks, foreign exchange banks and development banks. Some of the specialized banks in India and their functions are discussed below.

10.6.1 Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India started operations in April 1990 as a wholly owned subsidiary of the IDBI, taking over the Small Industries Development Fund and the National Equity Fund. It acts as the principal financial institution for the promotion, financing and development of small-scale industries.

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During the recent years, SIDBI's character has been undergoing fundamental changes. During the early years, most of the income of the Bank was earned from indirect lending, i.e., from refinancing. However, the share of indirect lending has come down from approximately 95 per cent at the beginning to 50 per cent by the late 1990s. Stepping up direct assistance was a deliberate decision because the efforts of the primary lending institutions have to be supplemented by SIDBI.

With regard to source of funds, SIDBI receives part of the funds in the form of deposits which the commercial banks, especially the foreign banks, have to make with the bank to the extent of their shortfall in priority sector lending. These had been a good source of short-term funds although, of late, the trend is declining. In addition, the bank receives low cost funds from Japan and Germany. Of these, the funds received from Japan can be utilized only for indirect lending. Funds received from Germany can be lent directly. Apart from such off-shore sources of funds, the bank is looking at domestic sources also. One such domestic source is the funds recycled to SIDBI out of National Industrial Credit (Long-term Operations) Fund.

The bank has taken an active interest in the area of infrastructure. It has not committed itself to any specific sector, but operates an Infrastructure Development Scheme, a direct lending programme. The bank has chosen marketing infrastructure as its focus. It has assisted projects which involve creation, renovation, expansion and improvement of marketing infrastructure. The bank has also organized common display for small-scale industries' items at the International Marketing Centre. The bank plays a composite role in the rapidly developing field of corporate advisory services.

10.6.2 LIC

Life Insurance Corporation of India (LIC) was formed in September 1956 by an Act of Parliament, Life Insurance Corporation Act, 1956, with capital contribution from the Government of India. The life insurance business of all companies was brought under the ownership of one organization, LIC. The various objectives of LIC are:

- To provide efficient service to policyholders in order to make insurance widely popular
- To provide life insurance to the people at a reasonable cost
- To promote a sense of pride and job satisfaction among the agents and the employees of LIC
- To guide the policyholders and protect their individual interests

Types and structure of insurance plans

A large number of insurance policies have been introduced by the LIC. The few basic types of policies are term insurance, permanent life insurance, pension plans and children's plans. These policies are mostly specific to the people who have different incomes and belong to different age groups. The permanent life insurance

charges a premium throughout one's life, while term insurance policies are taken for a fixed period. Term policies provide life cover and adequate return, whereas permanent life insurance policies do not provide any return but provide life cover.

Life policies can be of any type such as 'with profits' and 'without profits'. In the case of without profits, an assured amount of sum is paid out on maturity or at the death of a policyholder. In the case of with profits, extra earnings from various investments are added to the assured sum and it is paid out in cash. The premiums on with profits policies are higher than those on without profits. The life insurance policies and pension funds are popular because they act as a life cover or protection and medium of saving with the added benefits of profits and many tax advantages.

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10.6.3 SIDCO

It is a policy-making, organizing and monitoring organization for the development of small scale entrepreneurs. It maintains a close link with the government, financial institutions and other organizations which are concerned with the promotion and development of small scale enterprises. It offers a wide range of consultancy services and technical, managerial, economic and marketing assistance to SSI units. It has a network of 28 Small Industries Service Institutes, 30 branch SISIs, 37 Extension Centres, four Regional Testing Centres, one Product and Process Development Centre, three Footwear Training Centres and five Production Centres and ten Field Testing Centres.

Functions

The main functions of SIDCO are coordination, industrial development and industrial extension service. Some of its prominent functions are the following:

- It evaluates the basic necessity of raw materials and other components required by the small scale enterprises and accordingly arranges for their supply.
- It collates data on imported consumer items and motivates the establishment of new units by giving them assistance.
- It prepares model schemes, project reports and other technical reports for potential entrepreneurs.
- It reserves certain products for the SSIs.
- It provides consultancy and training services and marketing assistance to improve the competitive strength of small scale units.

In Tamil Nadu, SIDCO is the state small industries corporation. It plays a vital role in developing the small scale sector.

10.6.4 DHFI

The Discount and Finance House of India Ltd (DFHI) was established in March 1988 by Reserve Bank of India. This establishment was a joint venture between

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the RBI and the public sector banks and all India Financial Institutions with the objective of developing the money market and to provide liquidity to money market instruments as a sequel to Vaghul Working Group recommendations. DFHI began dealing in instruments such as the Certificates of Deposits and Commercial Paper. In 1992-93, DFHI got the authorization to deal in dated Government Securities. After getting accreditation as a primary dealer in February 1996, its operations drastically increased particularly in Treasury Bills and dated Government Securities. Moreover, DFHI expanded its network by opening branches at Ahmedabad, Bangalore, Calcutta, Chennai, New Delhi and Hyderabad. This was done with the twin objective of catering to the requirements of the small and medium sized institutions operating in these regions as well as integrating the markets in these regions with main money market at Mumbai.

Objectives

Let us now go through the major objectives of DHFI.

- (i) It intends to balance the liquidity imbalances in the banking system. This implied achieving a balance between demand and supply for short-term finance in the money market.
- (ii) Another objective is to encourage secondary market in short-term money market instruments. This implied functioning as an active trader in money market instruments rather than a mere repository and, hence, improving liquidity to short-term money market instruments.
- (iii) It intends to offer safe and hazard-free short-term investment possibilities to institutions.
- (iv) It intends to provide greater liquidity to money market instruments.
- (v) It intends to simplify money market transactions for small and medium sized institutions who are not regular participants in the market.

10.6.5 SFCs

The State Finance Corporations (SFCs) occupy a prominent position in the institutional finance structure of the country. SFCs promote small and medium industries of the states. Moreover, SFCs also facilitate in ensuring balanced regional development, higher investment, greater employment generation and comprehensive ownership of industries.

Presently, there are 18 state finance corporations (out of which 17 SFCs were established under SFC Act, 1951) functioning in the country. It is to be noted that the Tamil Nadu Industrial Investment Corporation Ltd. established under the Company Act, 1949 is also functioning as state finance corporation.

Functions

The vital functions of State Finance Corporations are the following:

- (i) They provide loans in order to facilitate the acquisition of fixed assets like land, building, plant and machinery.
- (ii) They provide financial assistance to industrial units whose paid-up capital and reserves do not exceed ` 3 crore (or such higher limit up to ` 30 crore as may be specified by the central government).
- (iii) The SFCs recommend new stocks, shares, debentures and so forth of industrial enterprises.

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Check Your Progress

1. Mention the characteristics of banking institutions.
2. Define foreign banks.
3. State the categories of commercial banks.
4. Mention the types of non-banking financial companies.

10.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Banking institutions are marked by the following three characteristics:
 - They participate in or contribute to the payments mechanism of the economy, which means that they provide transaction services.
 - Their deposit liabilities comprise a major part of the national money supply.
 - They can create deposits or credit, which means that they actually create money in the financial market.
2. Foreign banks are those which are foreign in origin and have their head offices located outside India.
3. Commercial banks can be categorized into the following:
 - Public Sector Banks (Nationalized Banks)
 - Private Sector Banks
 - Foreign Banks in India
 - Regional Rural Banks (RRBs)
4. Non-banking financial companies are of three types:
 - (i) Merchant banking
 - (ii) Mutual funds
 - (iii) Leasing and hiring purchase companies

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10.8 SUMMARY

- A developed financial system has a secure and efficient payment system, security markets and financial intermediaries to arrange finances and financial institutions to provide access to risk management instruments.
- Broadly, in an economy two types of business organizations exist—non-financial and financial.
- Financial institutions are set up for a specific purpose and to achieve certain objectives.
- The banking institutions in India function under the aegis of the Reserve Bank of India (RBI) and mainly consist of commercial banks and cooperative banks.
- Non-intermediary institutions provide loans but they do not acquire their resources directly from the savers. Major non-intermediary institutions like the Industrial
- Cooperative banking movement received momentum after the World War II. Under the Banking Regulation Act, only urban cooperative banks, state cooperative banks and district central cooperative banks are qualified to be addressed as banks in the cooperative sector.
- The preamble to the Reserve Bank of India Act, 1934, lays down the object of apex bank to be ‘to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in British India, and generally to operate the currency and credit system to its advantage’.
- Commercial banks are organized on a joint stock company system, primarily for the purpose of earning a profit.
- Development financial institutions, which were set up by the government after independence to help the private sector industries with finance and other services, form the part of the capital market.
- IFCI was the first of all Indian development banks to be set up in the country. It was set up in 1948 with the object of providing medium- and long term credit to industry.
- The banks that cater to specific needs, provide financial aid to businesses and industries along with financing foreign trade and heavy turnkey projects are known as specialized banks.
- The Small Industries Development Bank of India started operations in April 1990 as a wholly owned subsidiary of the IDBI, taking over the Small Industries Development Fund and the National Equity Fund.

- Life Insurance Corporation of India (LIC) was formed in September 1956 by an Act of Parliament, Life Insurance Corporation Act, 1956, with capital contribution from the Government of India.
- SIDO is a policy-making, coordinating and monitoring agency for the development of small scale entrepreneurs.
- DFHI was set up in March 1988 by Reserve Bank of India jointly with public sector banks and all India Financial Institutions to develop the money market and to provide liquidity to money market instruments as a sequel to Vaghul Working Group recommendations.
- The State Finance Corporations (SFCs) are the integral part of institutional finance structure in the country. SEC promotes small and medium industries of the states.

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10.9 KEY WORDS

- **Real Time Gross Settlement (RTGS):** It is a funds transfer mechanism where transfer of money takes place from one bank to another on a 'real time' and on 'gross' basis.
- **Hire Purchase Company:** It is yet another non-banking finance company that principally deals in the business of hire-purchase transactions and the financing of such activities.
- **Specialized Banks:** The banks that cater to specific needs, provide financial aid to businesses and industries along with financing foreign trade and heavy turnkey projects are known as specialized banks.
- **Monetary policy:** It is the macroeconomic policy laid down by the central bank.

10.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the functions of commercial banks?
2. List the functions of IFCI.
3. Write a short note on the establishment of SIDBI.
4. State the objectives of Life Insurance Corporation of India (LIC).
5. Mention the objectives of DHFI.
6. Write short notes on the following:
(a) LIC of India (b) SIDCO

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Long Answer Questions

1. Discuss the functions of RBI.
2. Analyse the role of RBI as a central bank.
3. Evaluate the functioning of SFCs in India.

10.11 FURTHER READINGS

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UNIT 11 GLOBALIZATION

Structure

- 11.0 Introduction
- 11.1 Objectives
- 11.2 Globalization: Meaning and Dimensions
 - 11.2.1 Features of Current Globalization
 - 11.2.2 Essential Conditions for Globalization
- 11.3 Manifestation of Globalization
- 11.4 Globalization of Indian Business
- 11.5 Answers to Check Your Progress Questions
- 11.6 Summary
- 11.7 Key Words
- 11.8 Self Assessment Questions and Exercises
- 11.9 Further Readings

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11.0 INTRODUCTION

In the previous unit, you studied about the various financial institutions existing in India. This unit will introduce you to the notion of globalization. Globalization refers to the changes whereby a country moves from being self-contained toward a more integrated world. Globalization of business refers to the change in a business of a company associated with a single country to the one that operates in many countries.

Globalization has been beneficial in many ways. It has reduced the barriers associated with the sale of products. The sale is not restricted to one/home country but the product is shipped in many countries. This change has enabled companies to sell products in international markets, since lower tariffs keep consumer prices lower and fewer restrictions are imposed on the borders. Globalization makes it easier for a company to enter a foreign market. It also means that companies must consider the cultures of other countries when developing their business strategies and adjust the product and marketing messages as per the target country.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the various dimensions of globalization
- List the features of current globalization
- State the essential conditions for globalization
- Analyse the globalization of Indian business

11.2 GLOBALIZATION: MEANING AND DIMENSIONS

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The emergence of the global economy was the result of private initiative rather than carefully orchestrated national manoeuvres; yet today, it determines the course of national economic policies. The features of the globalized economy are:

1. Activity takes place on an increasingly supranational scale.
2. Manufacturing is no longer confined to stand-alone factories within state boundaries, but involves sourcing materials/components/sub-assemblies across geographies wherever cost/quality parameters are met.
3. Labour and processes are outsourced from wherever they are most economically available at desired quality levels.
4. Financial operations are conducted around the world as matters of routine.
5. These events indicate the start of a new period of economic theory—a new globalism distinct from the relatively recent post-war period which was dominated by internationalism.
6. After World War II, nations took the lead in initiating economic activity, acting in concert through the creation of an international economic system for trade and payments.
7. There have been successive rounds of multilateral tariff reduction.
8. A new era of globalization now sees corporates taking the lead, establishing their hold in world markets for goods and services.
9. Their activities are widening and deepening the economic interdependence of nations to the extent of creating a borderless economy.
10. This is quite unlike the earlier phase, which was characterized by exchange of goods, services, capital and technology and where FDI was insignificant.
11. Technological change and deregulation has seen transnationals integrate their activities across a borderless world, to reduce costs, while consolidating home markets and taking on global ones.
12. Economic interdependence is increasingly production based, and not trade based.
13. Trade and technology transactions are taking place increasingly between transnationals, not the market.

Thus, globalization refers to:

1. The multiplicity of linkages and interconnections between states and societies which comprise the present world system.
2. It describes the process by which events, decisions, and activities in one part of the world come to have significant consequences for individuals and societies in quite distant parts of the globe.

3. Globalization has two quite distinct phenomena:
 - (i) Scope (or stretching), i.e., widening of the extent and form of cross-border transactions.
 - (ii) Intensity, i.e., deepening of the economic interdependence between the actions of globalizing entities located in one country and those located in other countries.
4. The two most important causes of globalization are:
 - (i) The pressure on business enterprises by consumers and competitors alike, to continually innovate and come up with new products while improving existing ones. Escalating R&D costs coupled with shrinking product lifecycles are compelling corporations both to downsize the scope of their value-added activities and to venture further afield in search of wider markets.
 - (ii) The renaissance of market-oriented policies pursued by national governments and regional authorities. In the last five years alone, while more than thirty countries have abandoned centralized planning as the main mode of allocating search resources, and over eighty countries have liberalized their inward FDI policies, including China and India.

Moreover, the undernoted factors have worked to stimulate cross-border corporate integration, both within TNCs and between independent firms:

1. The privatization of state-owned enterprises
2. Liberalization and deregulation of markets
3. Removal of a levy of structural distortions

Globalization of the Indian Economy

Globalization of the Indian economy implies that:

1. Commodity as well as factory market is functioning under the influence of market forces generated in the world economy.
2. There is a gain in efficiency to compete in world markets.
3. Exports increase; there is an influx of foreign exchange and private foreign capital.
4. Higher growth path with stability.
5. Better balance of payments position relieves tension of default on IBRD loan instalments.
6. Enables movement towards ultimate full convertibility on capital and current accounts.
7. There is a need to become globally competitive by creating stable micro and macroeconomies without any vested interests.

The argument in favour of integrating the Indian economy with the global economy has long been put forward by the IMF and the World Bank as the

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answer to the failure of hitherto followed economic policies. The slowdown of the world economy after 9/11 and the meltdown of the south-Asian economies showed that the global economy is unlikely to work very well unless there is globalization of both production and consumption. Yet, complete globalization would also mean vulnerability to shocks that are transmitted throughout the global economic system; India was insulated from the fallout of the Baring's Bank collapse and subsequent meltdown of the south-Asian economies, because it was not an active member of any trading blocs in the region.

Globalization is viewed as a two-way action plan, envisaging:

1. Free competition
2. High productivity
3. Selling to one market—a global one where all are in open competition
4. This facilitates integration with the global mainstream
5. Sourcing cheapest suppliers, in open global competition
6. Boosting industrial development and employment
7. Better quality, export earnings and economic stability

Independent India inherited an inward-oriented policy and in the early years of planning, an import substitution regime with anti-export bias was considered to be quite appropriate. India's trade regime remained basically inward-looking until export incentives were introduced in the mid-1960s. In the 1970s, many more export incentives were introduced but this did not help export promotion much. The 80s witnessed attempts towards export promotion and trade liberalization under the Sixth and Seventh Plans. Despite the efforts towards liberalization, India's trade regime remained more or less inward-looking.

Owing to greater reliance on the working of the closed economy, Indian economy has generated a high cost inefficient industry which has prohibited the optimum utilization of factors of production. Despite all potentialities, Indian industries are not competing with the global industries with respect to cost and quality. Protection has always given an avenue to develop a high cost industry. Under the shadow of FERA and MRTP Acts, monopoly houses have developed. It is the closeness of the Indian economy that prohibits introduction of the advanced technology of the developed nations. So the globalization of the economy is essentially needed.

It will provide an opportunity for India to become an important production centre of the world. It will also provide an opportunity to the Indian companies to become multinational concerns. At the same time, it can attract foreign investors so as to make India a centre of the world market. India can utilize these avenues very well on account of its competitive edge over other countries due to its large skilled labour.

The strategy adopted since July 1991 for further integration of the Indian economy with the world economy includes exchange rate adjustment to improve competitiveness of exports, reduction in tariffs and a more open policy towards direct foreign investment and technology.

The new economic policy aims at making the Indian economy competitive and much better integrated with the world economy. We are now clearly in a new and different world. India cannot expect large inflow of external funds while there is an irrational exchange rate policy. India has no alternative but to integrate its economy into the global mainstream to boost its economic growth. As most of the countries in the world are steadily reorienting their economies to the market-friendly forces, it will be suicidal on the part of India to remain in isolation. Competition from abroad would lead to improvement in quality, productivity, efficiency and cost-effectiveness.

For integrating the Indian economy with the world economy not only faster export growth but, also free access to imports is necessary and accordingly import duties have been brought down substantially. High tariffs have created a high cost industrial structure and Indian competitiveness has been affected by this. When many other countries had substantially reduced the tariffs, India's tariff structure also needed to be lowered.

Since globalization requires the creation of suitable environment for free flow of direct foreign investment, the new industrial policy of 1991 permits approval for foreign direct investment up to 51 per cent foreign equity in the case of high priority industries and this obviously opens the door for multinationals in a big way. The foreign investment will bring in new technology and marketing expertise from which the country will benefit. The market-friendly approach of the new economic policy is expected to create a suitable environment for the entry of foreign capital on a large scale.

An open policy towards technology transfer is also an important requirement for globalization of the Indian economy. One obstacle to the much-needed inflow of technology has been the cumbersome approval process involving delays and uncertainties. To overcome this problem, the new industrial policy recommends that automatic approval be given by the government for technology agreements related to high priority industries and similar facility be provided to non-priority industries also if expenditure in foreign exchange is not involved.

The new economic policy which advocates a market-friendly approach and removal of bureaucratic controls is expected to attract foreign capital and technology and also facilitate easy movement of goods through substantial reduction in tariffs and thus pave the way for further integrating the Indian economy with the global economy.

External environment is going to be more dynamic and complex. There will be less social protection for inefficiency. There will be noticeable fights in the marketplace for innovation and competitiveness. Unless we increase our

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productivity and efficiency, we will not be able to go beyond ‘the Hindu rate of growth’.

India’s globalization efforts are hindered by the lack of a favourable international environment. At a time when advanced countries, particularly the US, are adopting a protectionist policy with Super 301 threat, it is very difficult to accomplish the objective of globalization of the Indian economy.

Also, openness of the economy to the world competition is an invitation to multinationals. The role of multinationals is not salubrious for poor countries.

Moreover, globalization would imply certain consequences which may not be always beneficial to the developing countries. One major implication of globalization is the internationalization of prices. Globalization would also imply the equalization of domestic prices with international prices. This would mean that the firms in the developing economies should enhance their competitive strength. If some of the commodities have relatively lower prices due to subsidization, the policy prescription would be that subsidies should be withdrawn so that the prices would attain parity with prices prevailing in the international markets. In recent times, the fertiliser prices in India had been raised and the subsidies were withdrawn. The aftermath of the withdrawal of subsidies would be a hefty increase in the prices of agricultural commodities. This would mean that Indian prices must rise to US levels. So as a result of globalization, inflationary tendencies would persist as prices are expected to rise by 15 to 20 per cent.

11.2.1 Features of Current Globalization

Technological disruption: While new digital “technologies” (robotics, digital services, global platforms) are emerging which are beginning to impact productivity, they will not be able to create the same virtuous cycle of rapid economic growth through trade of goods to create a new global growth pole. Unlike in the past, digital technologies are not “dominated” by one or few countries. This marks a major deviation from previous cycles, where countries such as the US and China leveraged their competitive advantages in mass manufacturing and low-cost production, respectively, to emerge as the world’s economic “pole”. Further, the adoption of digital technologies across various industries will result in more localized manufacturing and globalized services, giving rise to very different trade patterns. Additionally, rapid, large-scale replacement of old manufacturing technologies by newer, digital ones is unlikely, given the growing unavailability of enough skilled workers like robot programmers. Rising income inequality and the need to protect jobs could also bring in stringent regulations, slowing the adoption of disruptive technologies.

New governance structures: The stable “rules of the game” set by the Bretton Woods institutions and the Group of Seven nations are now changing, with the Group of 20 states playing an increasingly influential role. This is likely to create new winners and losers. In the previous phases of globalization, there was a fair

degree of long-term alignment between economics and politics. Today, the WTO-governed free trade regime is making way for more bilateral and regional partnerships and possibly mega-regional and sub-regional trade agreements like the Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership, although the latter has been stalled. There is growing protectionism across both developed and emerging markets. The multilateral financial architecture is getting decentralized, with China and other prominent developing countries teaming up to establish new institutions such as the Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB). There is also growing influence of state capitalism on capital allocation worldwide, through multiple levers such as direct acquisition of private companies, investments via sovereign wealth funds, and loans and subsidies for the development of certain domestic industries.

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11.2.2 Essential Conditions for Globalization

In order to smoothen the process of globalisation, the following are necessary :

- Removal of quotas and tariffs.
- Liberalisation of Government rules and regulations.
- Freedom to business and industry.
- Removal of bureaucratic formalities and procedures.
- Adequate infrastructure.
- Competition on the basis of quality, price, delivery and customer service.
- Autonomy to public sector undertakings.
- Incentives for research and development.
- Administrative and Government support to industry.
- Development of money markets and capital markets.

11.3 MANIFESTATION OF GLOBALIZATION

If an underdeveloped economy is interested in rapid economic development, the country has to import foreign capital. Since the domestic capital is insufficient, the country has to depend on foreign capital. Foreign capital contributes in many important ways to the process of economic growth and industrialization. The need for foreign capital for a developing country like India can arise on account of the following reasons:

- (i) Domestic capital is inadequate for purposes of economic growth and it is necessary to invite foreign capital.
- (ii) Due to lack of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign capital can show the way for domestic capital.

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- (iii) In the early stages of development, the capital market is underdeveloped. During the period in which the capital market is in the process of development, foreign capital is essential.
- (iv) Foreign capital brings with it technical know-how and business experience which are equally necessary for economic development.

Different Forms of Foreign Investment

The different forms of foreign investment are as follows:

- (i) *Direct foreign investment*: Foreign capital can enter India in the form of direct investments. In the past, companies had been formed in advanced countries with the purpose of operating in India. Sometimes, companies of advanced countries start their subsidiary offices in India. Alternatively, foreigners may subscribe to the stocks and debentures of companies in India.
- (ii) *Foreign collaboration*: Recent years have seen a joint participation of foreign and domestic capital. India has been encouraging this form of import of foreign capital.
- (iii) *Inter-government loans*: After World War II, there was a growing tendency towards direct inter-government loans and grants. Under Marshall Aid, US aid was given to the war-torn European countries to reconstruct their economies. Other developed countries also provided loans and grants to the less developed countries.
- (iv) *Loans from international institutions*: Since World War II, the World Bank and its affiliates have been providing capital to India.

The International Monetary Fund, the World Bank, Aid India Consortium and Asian Development Bank are the major sources of external capital to India.

Government Policy towards Foreign Capital

At the time of Independence, the attitude towards foreign capital was one of fear and suspicion. This was quite natural because of the previous exploitative role played by it in 'draining away' resources from the country. The suspicion and hostility found expression in the Industrial Policy of 1948 which though recognising the role of private foreign investment in the country, emphasized that its regulation and control was necessary in the national interest. Because of this attitude, foreign capitalists were dissatisfied and, the flow of import of capital goods reduced. As a result, the Prime Minister had to give the following assurances to the foreign capitalists in 1949.

1. *No discrimination between foreign and Indian capital*: The Government of India will not make any discrimination between foreign and Indian capital.
2. *Full opportunities to earn profits*: The foreign interests operating in India would be permitted to earn profits without subjecting them to undue controls.

Only such restrictions would be imposed which also apply to the Indian enterprise.

3. *Guarantee of compensation:* In case of nationalization of foreign enterprises, compensation will be paid on a fair and equitable basis.

Policy Regarding Foreign Investment (1991)

The Industrial Policy 1991 announced by the government accepted the fact that foreign investment is essential for modernization, technology upgradation and industrial growth of India. The policy, therefore, was to encourage foreign capital to come to India. The main features of the policy were:

- (i) Approval would be given for direct foreign investment up to 51 per cent, foreign equity in high priority industries clearance would be available if foreign equity covers foreign exchange requirements for imported capital goods.
- (ii) The payments of dividends would be monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.
- (iii) To provide access to international markets, majority foreign equity holding up to 51 per cent equity would be allowed for trading companies primarily engaged in export activities.
- (iv) Automatic permission would be given for foreign technology agreements in high priority industries up to a lump sum payment of ₹ 1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to a total payment of 8 per cent of sales over a 10 per cent from the date of agreement or 7 years from commencement of production.

The Government of India liberalized its policy towards foreign investment in 1991 to permit automatic approval for foreign investment up to 51 per cent equity in 34 industries. The Foreign Investment Promotion Board was also set up to process applications in cases not covered by automatic approval. During 1992–93 several additional measures were taken to encourage direct foreign investment, portfolio investment, NRI investment, etc. These measures were:

1. The dividend-balancing condition earlier applicable to foreign investment up to 51 per cent equity was no longer applied except for consumer goods industries.
2. Existing companies with foreign equity can raise it to 51 per cent subject to certain prescribed guidelines. Foreign direct investment has also been allowed in exploration, production and refining of oil and marketing of gas. Captive coal mines can also be owned and run by private investors in power.
3. NRI investment up to 100 per cent of equity is also allowed in export houses, trading houses, hospitals, sick industries, hotels and tourism related industries.

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4. Provisions of the Foreign Exchange Regulation (FERA) have been liberalised as a result of which companies with more than 40 per cent of equity are also now treated at par with fully Indian-owned companies.

5. Foreign companies have been allowed to use their trade marks on domestic sales.

In January 1997, this limit was raised to 74 per cent in case of foreign investors and 100 per cent for NRIs.

As a result of the measures taken by the Government during August 1991 and August 1998, the government approved total foreign investment of the order of ₹ 173,510 crore, about 137 times of the foreign investment of ₹ 1270 crore during the period between 1981–90.

All these measures were taken to promote the inflow of foreign capital by granting a large number of concessions. This is in sharp contrast to the policy pursued during the first four decades of planning. This indicates that the government has been quite successful in changing the climate for the inflow of foreign investment.

Sources of foreign direct investment

The largest source of FDI to India over the period of 1991–2000 has been the USA and its share in total FDI approved has been 22 per cent. The second position was occupied by Mauritius with its share in FDI during that period of 12 per cent. However, it should be noted here that Mauritius based investments are nothing but US investments. They are routed through Mauritius because of tax advantages. Since the tax rates prevailing in Mauritius are amongst the lowest in the world, many MNCs prefer to route their investments to India through Mauritius.

Prior to the 1990s, India had to depend on a few developed Western countries for capital. During the 1990s, a number of other countries took interest in investing in India. These included countries like Italy, Australia, South Korea, Singapore, Malaysia, etc. Many other countries like Israel, Thailand, Saudi Arabia, South Africa whose names did not appear in the FDI list prior to 1991, have increased their share over the years.

11.4 GLOBALIZATION OF INDIAN BUSINESS

The importance of strategy has been accepted in the history of business in India as well as abroad. In fact, strategy is more important than ever, particularly for organizations that want to differentiate themselves from others.

Obstacles to Globalization of Indian Companies

An Indian company may use different strategies such as export, joint ventures, acquisitions and contractual agreement to attain globalization. However, there are

many hurdles faced by the Indian companies in attaining globalization. These hurdles are related to following areas:

- There is a great deal of complexity in government policies and procedures.
- Certain political changes create problems in adopting modern technologies.
- An Indian product is seen as a poor quality product in the international market.
- Lack of raw materials and advanced production resources such as machines is another major problem.
- There are a large number of small size firms which are not able to compete with large companies of the country.
- Small firms have lack of experience in the international business.
- There are limited research and development technologies.
- There is tough competition among domestic companies.

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Factors Encouraging Globalization of Indian Firms

Although there are a number of difficulties, some factors also help Indian companies in attaining globalization. They are as follows:

- **Human resources:** A large number of technical and scientific human skills are available in India. Labour costs in India are also lower than that in other countries.
- **Growing domestic market:** Some Indian companies that have obtained a good position in the Indian domestic market can easily enter the global market to extend their business in foreign market.
- **Expanding markets:** High population in India has resulted in the expansion of the domestic market that provides many business opportunities to Indian the companies.
- **Non-Resident Indians (NRI):** A large number of NRIs may help in attaining globalization for Indian companies because they are resourceful in terms of capital, skills and experience.
- **Competition:** Growing competition among different domestic and foreign companies provoke Indian companies to enter in foreign market.

Globalization Strategies Followed by Indian Companies

Indian companies, which are doing business in India, need to follow various strategies to achieve globalization and enter foreign markets. These globalization strategies are:

- Development of export
- Foreign investment

- Mergers and acquisitions
- Joint venture

Let us now study these strategies in detail.

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1. Development of export

In comparison to other developing countries, India has a large share in the foreign market for certain products. As a result, it can easily take advantage of this share and export products to foreign countries. However, India has not been able to take advantage of its large market share in foreign markets because of the lack of an effective export development strategy. If appropriate export development strategies are built, then India can increase its export of different products. In case of specific products, which India could easily export, other developing countries have benefited. These countries started exporting at a much later time than India. In India, fourteen product groups were determined to help in the development of export. However, certain problems such as inadequacy of product capabilities and quality have caused slow development in export.

India needs to do value-added export in order to obtain profits. For example, India should export tobacco in cigarette form instead of raw form. If India exports 20 million kg of tobacco in raw form then the export earnings are ` 100 crore. On the other hand, if India exports tobacco filled in cigarettes, then its export earnings will be ` 400 crore. India exports agricultural products in bulk; as a result, the earnings obtained from exporting agricultural products are not high. Value-added export is significant in case of export of products such as pepper, cardamom and tea.

The products exported by India are sold at low prices in foreign markets. As a result, a large amount of marketing efforts and quality improvement is required so that Indian products sell at high prices in foreign markets. In addition, Indian companies need to import technology or collaborate with foreign companies in order to increase the price of their products in foreign markets.

2. Foreign investments

Indian companies have not been able to make great investment in foreign countries because of government regulations and lack of global orientation. However, in recent times, there has been an increase in economic liberalization and global orientation. Indian companies have started establishing manufacturing units in foreign countries in collaboration with foreign companies. This has helped Indian companies in improving their international business. Companies in India have also started making investments on acquisition of foreign companies. Many small and large Indian companies have made a globalization strategy for investing money in foreign countries. These investments have been made not only to increase the product base of the companies but also to consolidate their business in the domestic market. For example, the Ballapore Industries of the Thapars established a paper mill in Indonesia. The investment of the company has been around ` 1,800 crore. In

addition, the Ballapore Industries of the Thapars have also set up a plantation on 2,50,000 hectares of land to provide pulp for the paper mill. They also export the excess pulp to India keeping in mind the shortage of pulp in future.

3. Mergers and acquisitions

Merger and acquisition is an important global strategy for Indian companies that allows them to enter foreign markets. An important advantage that is provided through mergers and acquisitions is that easy access to foreign market becomes possible. They also help in easy distribution of products in foreign markets. The Vijay Mallya's UB group obtained the acquisition of a British company called Wiltshire Brewery, which had 300 pubs functioning all over Britain. The distribution of brands of beer such as Kingfisher and Kalyani, manufactured by UB group, became easier with this acquisition. Other Indian companies have also started making acquisition of foreign companies to increase their international business and enter foreign markets.

4. Joint venture

Joint venture is also an important global strategy employed by Indian companies to enter foreign markets and improve their international business. This global strategy has been successfully employed by various pharmaceutical companies such as Ranbaxy and Lupin. The joint venture global strategy helps Indian companies consolidate their business in the domestic market along with increasing their international business.

Check Your Progress

1. Define globalization.
2. What is the need for foreign capital for a developing country like India?

11.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Globalization describes the process by which events, decisions, and activities in one part of the world come to have significant consequences for individuals and societies in quite distant parts of the globe.
2. The need for foreign capital for a developing country like India can arise on account of the following reasons:
 - (i) Domestic capital is inadequate for purposes of economic growth and it is necessary to invite foreign capital.
 - (ii) Due to lack of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign capital can show the way for domestic capital.

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(iii) In the early stages of development, the capital market is underdeveloped. During the period in which the capital market is in the process of development, foreign capital is essential.

(iv) Foreign capital brings with it technical know-how and business experience which are equally necessary for economic development.

11.6 SUMMARY

- The emergence of the global economy was the result of private initiative rather than carefully orchestrated national manoeuvres; yet today, it determines the course of national economic policies.
- The argument in favour of integrating the Indian economy with the global economy has long been put forward by the IMF and the World Bank as the answer to the failure of hitherto followed economic policies.
- Independent India inherited an inward-oriented policy and in the early years of planning, an import substitution regime with anti-export bias was considered to be quite appropriate.
- External environment is going to be more dynamic and complex. There will be less social protection for inefficiency.
- Technological disruption: While new digital “technologies” (robotics, digital services, global platforms) are emerging which are beginning to impact productivity, they will not be able to create the same virtuous cycle of rapid economic growth through trade of goods to create a new global growth pole.
- If an underdeveloped economy is interested in rapid economic development, the country has to import foreign capital. Since the domestic capital is insufficient, the country has to depend on foreign capital.
- The Industrial Policy 1991 announced by the government accepted the fact that foreign investment is essential for modernization, technology upgradation and industrial growth of India.
- The largest source of FDI to India over the period of 1991–2000 has been the USA and its share in total FDI approved has been 22 per cent. The second position was occupied by Mauritius with its share in FDI during that period of 12 per cent.
- The importance of strategy has been accepted in the history of business in India as well as abroad. In fact, strategy is more important than ever, particularly for organizations that want to differentiate themselves from others.
- Indian companies, which are doing business in India, need to follow various strategies to achieve globalization and enter foreign markets.

- Indian companies have not been able to make great investment in foreign countries because of government regulations and lack of global orientation.
- Joint venture is also an important global strategy employed by Indian companies to enter foreign markets and improve their international business. This global strategy has been successfully employed by various pharmaceutical companies such as Ranbaxy and Lupin.

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11.7 KEY WORDS

- **Direct Foreign Investment:** It is a type of investment in which the company being invested in is located in a different country than the investor.
- **Liberalization:** It refers to a relaxation of government restrictions, usually in such areas of social, political and economic policy.
- **Joint venture:** It is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task.

11.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. List the features of a globalized economy.
2. What are the important reasons for globalization?
3. Mention the necessary conditions for ensuring the process of globalization.
4. Identify the various sources of foreign investment.

Long Answer Questions

1. 'India's globalization efforts are hindered by the lack of a favourable international environment.' Explain the statement.
2. What has been the Government of India's policy towards foreign investment in India?
3. What do you think are the main obstacles in the process of globalization of Indian companies?
4. Explain the strategies adopted by Indian companies to enter foreign markets and achieve globalization.

11.9 FURTHER READINGS

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UNIT 12 FOREIGN DIRECT INVESTMENT AND MULTINATIONAL CORPORATIONS

*Foreign Direct Investment
and Multinational
Corporations*

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Structure

- 12.0 Introduction
- 12.1 Objectives
- 12.2 Foreign Direct Investment: Concept
 - 12.2.1 Advantages, Disadvantages and Determinants of FDI
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- 12.3 Multinational Corporations (MNCs)
 - 12.3.1 Meaning
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 - 12.3.3 MNCs in India and Control over MNCs
- 12.4 Answers to Check Your Progress Questions
- 12.5 Summary
- 12.6 Key Words
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- 12.8 Further Readings

12.0 INTRODUCTION

In the previous unit, you studied about the phenomena named globalization. This unit will introduce you to the concept of FDI and MNCs. Foreign Direct Investment (FDI) has emerged as a major driver of the Indian economy. Foreign companies invest in India with the objective of taking advantage of cheap labour cost, distinctive investment policies such as tax exemptions and so forth. On the other hand, the country where foreign investment is being made takes advantage on account of generation of employment and accomplishing technical expertise. It is also to be noted that several Indian enterprises have gradually embarked on the global path and lead to the advent of the Indian multinational companies.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Analyse the concept of Foreign Direct Investment (FDI)
- Evaluate India's policy towards FDI
- Discuss the merits and demerits of Multinational Corporations (MNCs)

*Self-Instructional
Material*

12.2 FOREIGN DIRECT INVESTMENT: CONCEPT

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Foreign direct investment is one of the most effective methods of cross-border investing. A foreign national may want to invest in a country offering new markets, higher returns or cheaper factor costs.

Generally, there are two kinds of cross-border investments, which are mentioned as follows:

- **Foreign Direct Investment (FDI):** Investments made by a company or entity based in one country, into a company or entity based in another country
- **Foreign Portfolio Investment (FPI):** Investments undertaken for the purpose of returns without any burden of decision-making

United Nations Conference on Trade and Development (UNCTAD) defines FDI as an ‘investment made to acquire lasting interest in enterprises operating outside of the economy of the investor.’

Foreign direct investment is an important source of capital for a country. It is especially important for developing countries where the rate of capital formation is low and the requirement for capital is high. FDI is a method by which the residents of a country may invest in another country. FDI, along with providing returns, also has decision-making rights in the entity where the investment is made. FDI often entails acquiring a factory or facility or even starting one with the intention of forming a base in that country.

FDI leads to investing directly in the production process or any other business (retail or service sector) of any country other than the one where the investor resides. FDI entails the transfer of ownership along with the transfer of other factors like management and technology. FDI investments worldwide have seen a downturn following the financial crisis and the recessionary trends in the world economy.

FDI is the flow of long-term capital from one economy to another. FDI flowing in and out of an economy is reflected in the Balance of Payments (BoP) of that country. The FDI is placed in the second account of the BoP, the capital account. The income generated through FDI investment is reflected in the current account.

Table 12.1 Difference between FDI and FPI

Basis of Difference	Foreign Direct Investment (FDI)	Foreign Portfolio Investment (FPI)
Management and Control	Involved in management and ownership control	No active involvement in management. Investment instruments are more easily traded and do not represent controlling stake
Liquidation of investment	Difficult to liquidate interest or pull-out	Interest easily liquidated and easy to pull-out
Liquidity	Investments have low liquidity	Highly liquid investments
Origin	Undertaken by multinational corporations	Diverse sources like mutual funds, equity and debt instruments as well as pension funds
Investment	Investment of financial and non-financial (technology and management skills) assets	Only financial investment
Volatility	Low level of volatility	High level of volatility

Source: www.diffen.com/difference/FDI_vs_FPI

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Types of Foreign Direct Investment

Foreign direct investment can take place in the following ways:

1. **Vertical:** When a company invests in a different country in the same industry but in a process that is either after or before the one it is currently involved in, it is a case of vertical FDI. There are two categories of vertical FDI, which are as follows:
 - **Backward Vertical:** It is the investment in procedures that bring the company a step closer to the actual raw materials. For example, a readymade clothes manufacturer of China buys a textile factory in India.
 - **Forward Vertical:** It is the investment in procedures that bring the company a step closer to the direction of the market it caters. For example, the readymade garments manufacturer of China buys a retail chain dealing in readymade garments in Australia.
2. **Horizontal:** The company invests in the same activity it has been conducting in the home country. For example, readymade garments manufacturer invests in a garment manufacturing factory in Germany.

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3. **Conglomerate:** This is an investment into an unrelated field. This type of FDI carries a double element of risk as not only is the company entering a new country but it is also investing in a field which might not be related to its core competencies. Therefore, the company encounters twice the amount of barriers. Investing in a new country and diversification cannot be considered complementary strategies. They are, in fact, most often thought of as alternative strategies.
4. **Greenfield entry:** When a company invests and establishes facilities as well as elements from the initial stage, it is called a Greenfield entry. For example, if the garment manufacturer were to start a facility by buying land, hiring people, building the factory, installing machinery and ultimately manufacturing garments, it is called a Greenfield entry.
5. **Foreign takeovers:** The company takes over an already functional facility and does not have to go through the effort of establishing one themselves. For example, the manufacturer from China may takeover a garment manufacturing unit in South Africa.

12.2.1 Advantages, Disadvantages and Determinants of FDI

Determinants of FDI

A firm, while selecting countries as investment destinations must evaluate the country on the following factors:

- **Resource base:** Availability of raw material, complementary factors of production, physical infrastructure, availability of skilled workforce, and availability of business- related services.
- **Market conditions:** Economic and political climate, taxation policies, incentives, trade policy, market size, market growth, regional integration, cost of capital input, wage rate, cost of logistics.

Benefits of FDI

The benefits that accrue to the host country from FDI include the following:

- **Access to superior technology:** Foreign firms bring superior technology to the host countries while investing. The extent of benefits depends upon the technology spillover to other firms based in the host country.
- **Increased competition:** The investing foreign firm increases industry output, resulting in overall reduction in domestic prices, improved product or services quality, and greater availability. This intensifies competition in host economies, resulting in net improvement in consumer welfare.
- **Increase in domestic investment:** It is found that capital inflows in the form of FDI increase domestic investment so as to survive and effectively respond to the increased competition.

- **Bridging host countries' foreign exchange gaps:** In most developing countries, the levels of domestic savings are often insufficient to support the capital accumulation to achieve growth targets. Besides, the level of foreign exchange may be insufficient to purchase imported inputs. Under such situations, the FDI helps in making available foreign exchange for imports.

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Drawbacks of FDI

In most countries, public opinion towards foreign enterprises is not very favourable and FDI is feared due to its impact on domestic firms, the economy, and culture. The major drawbacks of FDI are as follows:

- **Market monopoly:** Multinational corporations are far more advanced than domestic companies, owing to their large size and financial power. In some sectors, this has led to MNC monopolies, thus impeding the entry of domestic enterprises and harming consumers. An MNC's ability to operate at a large scale and invest heavily in marketing and advertising and R & D activities differentiate their products and makes entry of new firms far more difficult as they are unable to make similar investments in R & D and marketing strategies.
- **Crowding-out and unemployment effects:** FDI tends to discourage entry and stimulates exit of domestic entrepreneurs, often termed as the crowding-out effect. As FDI enterprises are often less labour intensive, their entry results in higher unemployment and increased social instability.
- **Technology dependence:** MNCs often function in a way that does not result in technology-sharing or technology-transfer, thereby making local firms technologically dependent or technologically less self-reliant.
- **Profit outflow:** Foreign investors import their inputs and use the host country as a processing base, with little value-added earnings in the host country. A large proportion of their profits may be repatriated.
- **Corruption:** Large foreign investors often bribe government officials and distort market forces.
- **National security:** With MNCs holding a dominant position in sensitive industries, such as telecommunications, and the supply of core equipment and software for the information technology (IT) industry, there is a danger that the strategic interests of the host country may be compromised.

12.2.2 India's Policy Towards FDI

The Department of Industrial Policy & Promotion is the nodal Department for formulation of the policy of the Government on Foreign Direct Investment (FDI). It is also responsible for maintenance and management of data on inward FDI into India, based upon the remittances reported by the Reserve Bank of India.

The FDI policy is reviewed on an ongoing basis, with a view to making it more investor-friendly. To attract higher levels of FDI, Government has put in

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place a liberal policy on FDI, under which FDI up to 100%, is permitted, under the automatic route, in most sectors/activities. Significant changes have been made in the FDI policy regime in recent times, to ensure that India remains an increasingly attractive investment destination. The Department plays an active role in the liberalization and rationalization of the FDI policy. Towards this end, it has been constructively engaged in extensive stakeholder consultations on various aspects of the FDI policy.

It is the intent and objective of the Government of India to attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth. Foreign Direct Investment, as distinguished from portfolio investment, has the connotation of establishing a 'lasting interest' in an enterprise that is resident in an economy other than that of the investor.

The Government has put in place a policy framework on Foreign Direct Investment, which is transparent, predictable and easily comprehensible. This framework is embodied in the Circular on Consolidated FDI Policy, which may be updated every year, to capture and keep pace with the regulatory changes, effected in the interregnum. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Press Notes/Press Releases which are notified by the Reserve Bank of India as amendments to the Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000. These notifications take effect from the date of issue of Press Notes/ Press Releases, unless specified otherwise therein. In case of any conflict, the relevant FEMA Notification will prevail. The procedural instructions are issued by the Reserve Bank of India vide A.P. (DIR Series) Circulars. The regulatory framework, over a period of time, thus, consists of Acts, Regulations, Press Notes, Press Releases, Clarifications, etc.

12.3 MULTINATIONAL CORPORATIONS (MNCs)

The emergence of the multinational private corporation as a powerful agent of world social and economic change has been a signal development of the post-War era. Its evolution has been regarded with mixed feelings by the host countries.

12.3.1 Meaning

A multinational corporation is an enterprise which owns or controls producing facilities in more than one country such as factories, mines, oil refineries, distribution channels, etc. The United Nations defined multinational corporations as 'enterprises which control assets—factories, mines, sales offices and the like—in two or more countries.' According to another definition, a multinational company is one with sales above \$100 million with operations in at least six countries and with subsidiaries accounting for at least 20 per cent of its assets. There are about 4,000 companies

qualifying for this definition and these account for as much as 15 per cent of the Gross World Product. It has been estimated that by AD 2000, 200 to 300 of the global giants will account for 50 per cent of the world output.

Most of the multinationals enjoy predominantly oligopolistic market positions and are characterized by the importance of new technologies, special skills or product differentiation and heavy advertising which sustain their oligopolistic nature by making the entry of competitors more difficult.

Almost every large enterprise has foreign involvement of some kind. Whatever its home, it will send agents to other nations, establish representative offices abroad, import foreign materials, export some products, license foreign firms to use its patents or know-how, employ foreign nationals, have foreign stockholders, borrow money from foreign banks and even have foreign nationals on its board of directors. None of these, however, would make an enterprise multinational because none would require a substantial direct investment in foreign assets nor entail a responsibility for managing organizations of people in alien societies. Only when an enterprise confronts the problems of designing, producing, marketing and financing its products within foreign nations does it become truly multinational.

A domestic corporation may become multinational by establishing foreign branches, by operating wholly or partially-owned subsidiaries in other countries or by entering into joint ventures with enterprises in other countries.

It is interesting to note the concentration of multinational corporations in certain fields of industries. Taking USA as the leader of such enterprise, we find that 85 per cent of US investment is concentrated in the following industries: vehicles, chemicals, mechanical and electrical engineering.

If we take the multinationals as a whole, we find that they have established almost complete domination on such industries as rubber tyres, oil, tobacco, pharmaceuticals and motor vehicles.

Concentration in Specific Areas

The geographical distribution of multinational corporation shows an interesting pattern. If we consider the distribution by the origin of enterprise we find that in 1966, about 55 per cent of the multinationals were of US origin, 20 per cent of British origin, while about 25 per cent were of European or Japanese origin.

Multinational operations by private business corporations are comparatively recent in man's history. The companies of merchant traders in medieval Venice and the English, Dutch and French trading companies of the seventeenth and eighteenth centuries were forerunners, but not true prototypes of today's multinational corporation. They were essentially trading rather than manufacturing organizations, with comparatively little fixed investment. And they operated mainly within the colonial territories rather than under the jurisdiction of foreign sovereign states.

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12.3.2 Merits and Demerits

In 1973, the United Nations took note of the growing size of the multinationals and recommended an indepth study of the rise of multinationals and its impact on trade and development of other countries. A group of eminent persons led by Mr L.K. Jha submitted a report on the subject in 1974. Important points made in the report are as follows:

1. International corporations are organizations largely beyond the control of any single government.
2. Their overall goal is worldwide profits without regard for what is best for an individual country.
3. The interests of the country where a subsidiary is established for the development of export markets are subjected to the market interests of the parent company.
4. Parent companies do not make the most modern technology available to their subsidiaries.
5. International corporations prevent the growth of locally owned enterprises by aggressive and unfair competition.

Multinationals are criticized on the following grounds.

First, there is hardly any reason to justify the term multinational, because in most cases only nationals of one country serve on the governing body or board. They operate in several countries and may have employees from many nations, but most policy and investment decisions as well as control is from one centre. It is also pointed out that multinationals do not regard themselves obligated to the interests of the region in which they are located. They neglect the training of the local people for the top management position.

Second, there is also an inherent danger that at the time of crisis, these corporations are capable of diverting vast sums of money from one area to another which could bring about the collapse of the economic system.

Third, the technology that multinational corporations transfer was invented in an environment where capital was abundant and labour was scarce. The reverse is true for the Third World countries which are long on labour and short on capital. So, the technology is not appropriate for the developing countries.

Fourth, Raul Prebisch and Hans Singer speaks of the 'enclave' effect of foreign investment in that the multinational tycoons never become part of the internal economic structure of the less-developed countries.

Fifth, worse than the economic dominance is the cultural devastation of host countries. Operations of these multinationals strike a resounding similarity to the ways of the old imperialists which imposed their own culture on the colonies. They create a small nucleus of parallel culture in the host countries through payment of

considerably higher salaries and perks to the local staff, thereby alienating them from the mainstream.

Sixth, a French critic has said that governments cannot stop inflation partly because they no longer can control huge multinational tycoons whose search for profits and creation of consumer demands are at the base of the problems.

A president of General Motors declared, 'What is good for General Motors is good for America.' But what is good for America may not be good for the host country.

12.3.3 MNCs in India and Control over MNCs

In the changing economic scenario, choosing the path of liberalization, privatization and globalization became imperative for Indian government, particularly due to the deficit in the foreign reserves. In 1991, the Late Shri P.V. Narsimha Rao, the then Prime minister of India, opened the Indian market for foreign multinationals. This has led to making the country one of the most attractive destinations for setting up MNCs.

Before opening up the doors for MNCs, the system of License Raj prevailed in the country, benefitting most of the Indian companies. Therefore, Indian companies feared the tough competition they may have to face with the MNCs, who were not only financially but technologically very strong as well. However, now, after a decade later, Indian companies have not only become able to compete successfully with the MNCs but have also been successful in creating an impressive impact in the global market. Many of the Indian companies have successfully made a notable presence in different parts of the world in diverse fields like automobile, IT and mining.

The changing environment has led to the establishment of many Indian multinational companies. The most powerful MNCs in the world are gradually feeling their presence in the global market. These Indian multinational companies are giving tough competition to the old established giants of the corporate world.

This change is taking place not only in the private sector but in the public sector as well. Many public sector companies have entered the market and are exploring their potentials to tap these opportunities. After the government's decision to opt for globalization and liberalization, these public sector started taking necessary steps to make themselves compatible with the changing economic environment. For example, Indian Oil was protected by regulations preventing the entry of private players in order to become a dominant player in the downstream refining and marketing sector of India. Post liberalization, competition from private players in the domestic market has forced the company to look for revenues from international markets. To this effect, the company has begun to pursue global diversification by targeting exploration opportunities and providing technical services to companies in the Middle East as well as marketing its products across Asia. Indian companies have followed a mixed strategy to establish a global footprint.

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The Indian conglomerates have opted for various routes including joint ventures, technical tie-ups as well as mergers and acquisitions to enter into foreign markets. Many companies have entered the global market by increasing their export base. The Indian MNCs have adopted various mixed strategies to overcome geographic boundaries, such as Greenfield investments or acquisitions overseas, or even a combination of both. Many organizations have opted for the export route and made their export cost effective in comparison to their global competitors. The Indian MNCs also indulged in technical tie-ups with global partners to build capabilities and leverage them in the international markets.

Regulation of Multinationals

Under Section 29 of the Foreign Exchange Regulation Act, it is obligatory for all branches of foreign companies operating in India, as also for Indian companies with 40 per cent and above foreign holdings to obtain general and special permission of the Reserve Bank of India to continue their existence.

In January, 1974, the RBI issued the following guidelines:

1. Branches of foreign companies will be required to convert themselves into Indian companies.
2. Branches and companies engaged in manufacturing activities in sophisticated areas in which India did not have indigenous know-how and which were predominantly export-oriented will be allowed to continue on the basis of the existing approvals, subject to Indian participation not being less than 26 per cent of the equity of the company.
3. Companies engaged in trading activities or in manufacturing activity will be required to bring down their foreign holding to 40 per cent.

Though some units had not paid much attention to the FERA guidelines, many including MICO, Philips, Bayer, India Aluminium and Associated Bearings reduced foreign holdings as a result of expansion and diversification of business. Some companies including Brooke Bond, Hindustan Lever, Metal Box and General Electric are in the process of diluting the share holding by diversification of business. Some companies have diluted the foreign holding by merger.

Government Policy

The policy of the government is to ensure that operations of foreign companies as also those of indigenous concerns conform to the overall socio-economic policy of the country and their activities, including their size of operations are regulated within the policy guidelines announced by the government from time to time. All foreign companies are also subject to the discipline of industrial licensing even in areas where exemptions are available to other categories of industries. Cases of excess production are being brought before the licensing committee for a decision on a case by case basis. In cases where it is established that the capacity installed

by the company was more than the licensed capacity and this resulted in production in excess of licensed capacity, suitable action will be taken as permissible under the law.

Check Your Progress

1. Name the types of FDI.
2. State any two demerits of MNCs.

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12.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The types of FDI are vertical, horizontal and conglomerate.
2. Two demerits of MNCs are the following:
 - (i) There is an inherent danger that at the time of crises, these corporations are capable of diverting vast sums of money from one area to another which could bring about the collapse of the economic system.
 - (ii) It is to be noted that the multinational tycoons never become part of the internal economic structure of the less-developed countries.

12.5 SUMMARY

- Foreign direct investment is one of the most effective methods of cross-border investing.
- A foreign national may want to invest in a country offering new markets, higher returns or cheaper factor costs.
- Foreign direct investment is an important source of capital for a country. It is especially important for developing countries where the rate of capital formation is low and the requirement for capital is high.
- The Department of Industrial Policy & Promotion is the nodal Department for formulation of the policy of the Government on Foreign Direct Investment (FDI). It is also responsible for maintenance and management of data on inward FDI into India, based upon the remittances reported by the Reserve Bank of India.
- The FDI policy is reviewed on an ongoing basis, with a view to making it more investor-friendly. To attract higher levels of FDI, Government has put in place a liberal policy on FDI, under which FDI up to 100%, is permitted, under the automatic route, in most sectors/activities.

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- In the changing economic scenario, choosing the path of liberalization, privatization and globalization became imperative for Indian government, particularly due to the deficit in the foreign reserves.
- Before opening up the doors for MNCs, the system of License Raj prevailed in the country, benefitting most of the Indian companies. Therefore, Indian companies feared the tough competition they may have to face with the MNCs, who were not only financially but technologically very strong as well.
- The Indian conglomerates have opted for various routes including joint ventures, technical tie-ups as well as mergers and acquisitions to enter into foreign markets. Many companies have entered the global market by increasing their export base.
- In 1973, the United Nations took note of the growing size of the multinationals and recommended an in-depth study of the rise of multinationals and its impact on trade and development of other countries.

12.6 KEY WORDS

- **Foreign Portfolio Investment (FPI):** It consists of securities and other financial assets passively held by foreign investors.
- **Multinational Corporation (MNC):** It is a corporate organization which owns or controls production of goods or services in at least one country other than its home country.
- **Greenfield Entry:** When a company invests and establishes facilities as well as elements from the initial stage, it is called a Greenfield entry.

12.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the drawbacks of FDI?
2. List the determinants of FDI.
3. Write a short note on the operation of MNCs in India.

Long Answer Questions

1. Differentiate between FDI and FPI.
2. Critically analyse the effect of FDI on the Indian economy.
3. Discuss the emergence of MNCs in the global scenario.

12.8 FURTHER READINGS

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*Foreign Direct Investment
and Multinational
Corporations*

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*Self-Instructional
Material*

UNIT 13 INTERNATIONAL ENVIRONMENT

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Structure

- 13.0 Introduction
 - 13.1 Objectives
 - 13.2 International Environment: Meaning and Concept
 - 13.2.1 World Bank
 - 13.3 International Monetary Fund (IMF)
 - 13.4 The General Agreement on Tariffs and Trade (GATT)
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13.0 INTRODUCTION

In the previous unit, you studied about the merits and demerits of Foreign Direct Investment (FDI) and MNCs in India. In this unit, you will study about the various economic and cultural factors which influence the international business environment. In addition, you will also study about some of the prominent international institutions such as the International Monetary Fund (IMF), the World Bank, the General Agreements on Tariffs and Trade (GATT) and the World Trade Organization (WTO) among others.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning and concept of the international environment
- List the objectives of the International Monetary Fund (IMF)
- State the salient features of the General Agreements on Tariffs and Trade (GATT)
- Analyse the significance of the World Trade Organization (WTO)

13.2 INTERNATIONAL ENVIRONMENT: MEANING AND CONCEPT

The international business environment includes political, legal, socio-cultural and ethical environments. The political and legal environments play an important role in international business. A firm cannot ignore the political situations and legal formalities existing either at the home or host country if it has to operate successfully in the international business environment. The socio-cultural and ethical environments vary in different countries. In order to operate successfully in international business, managers have to be familiar with the socio-cultural and ethical environments of the home country as well as that of the host country.

Besides international business environment, you will learn about various international economic groupings and institutions. Some of the international institutions that will be dealt with in this unit are WTO, World Bank, IMF and GATT, among others.

International Trade Environment

The political environment of a country has a great impact on the operations of international business units. It is determined by the extent to which various sections of society, such as individuals, media, businesses and industry have a say in the affairs of governance. Democracy is a political system in which either the citizens themselves, or their elected representatives, as in a parliamentary democracy, take part in policy-making. The type of democracy a country follows plays an important role in the establishment of a company in a foreign country. On the other hand, in a totalitarian system, political power is in the hands of only one individual or party, who implement policies.

An economic system can be defined as the set of principles and techniques by which a society decides and organizes the ownership and allocation of different types of economic resources. Economic system is basically a mechanism which deals with the production, distribution and consumption of goods and services in a particular society. Economic system can be classified into following categories:

- **Centrally planned economy (CPE):** In a CPE, it is a central authority, in most cases the government, which decides how to produce and distribute goods and services, usually following a certain economic or political agenda.
- **Market-based economy:** In a market-based economy, it is market forces that allow businesses and firms to decide how to invest and produce. This system allows freedom and choice to both producers and consumers, who then decide on the basis of how far they can maximize their wealth.

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Primary Economic Indicators

When a firm contemplates operating in another country, it has to take note of a set of primary economic indicators. The host country's primary economic indicators will enable the firm to determine the following:

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- How much demand there is for the proposed product
- How much it will cost to produce the product
- How much can be earned from it
- How efficiently the earnings can be sent back to the home country

Demand, cost, earnings and ease of transfer of profit depend on a number of variables, such as income and distribution of wealth in a population, rate of price rise, availability of resources and a skilled workforce, the industrial and fiscal policies the government implements and the country's overall strength in terms of foreign exchange, trade and balance of payments.

Income and wealth

A country's income level is best determined by its per capita income. The World Bank has classified all countries into three groups-low-income, middle-income and high-income. Table 13.1 shows the per capita income for the three groups.

Table 13.1 Per Capita Income Classification for Different Countries

Country Classification	Per Capita Income
Low-income	Up to \$755
Middle-income	\$756- 9,265
High-income	\$9,265 or above

A country's income level has significant implications for firms planning to do business there as it determines consumer behaviour. Low-income countries will not be a good market for high-priced goods, and similarly, consumers in high- or middle-income countries will be choosier about the quality of a product rather than its price. Multinationals also favour manufacturing products in low-income countries, due to the easy availability of cheap labour, and then selling them in high- or middle-income countries. Distribution of wealth can also determine if there is a market for a particular product. Even in a low-income country, if the distribution of wealth is so uneven that only ten per cent of the population holds sixty per cent of the wealth, there could be a market for high-priced products.

Price rise

The demand for a product and its cost of production also depends on the rate of inflation in the country. If the rate of inflation in a country is high, the real income of

its citizens will be low, leading to lower purchasing power. In other words, you can say that the rate of inflation in a country is inversely proportional to the purchasing power of the consumers. The rate of inflation in a country also influences the cost of production. If the rate of inflation is high in a country, then the cost of production will also be higher.

Workforce and material resources

Cost and convenience of production depends on easy availability of a trained workforce and material resources. A country with a high level of education and abundance of raw materials will provide greater human and material resources than a country that has neither.

Economic and industrial policies

Multinationals prefer countries that have beneficial economic and industrial policies, such as low taxes and duties, and favourable rates of interest or credit.

Foreign exchange

As multinationals want to transfer their profits to their home countries, it makes sense for them to operate in countries that have liberal fiscal policies and a favourable ratio of export-import, current account balance and GDP, and current receipt and GDP.

The Human Cultural Environment

The social environment is concerned with the social attitudes and cultural values of different societies. As attitudes and values form the essence of a society's essence, they often drive not only demographic and economic changes but also political/legal and technological changes. It is a challenge for firms to understand the meaning of attitudinal and cultural changes in societies across the globe.

A significant workforce trend in many countries concerns diversity. In India, a large number of the young population of men and women are expected to participate in the workforce in 2010. In the US, for example, 76.3 million women are expected to be in the labour force by 2011. In addition, a large percentage of new entrants into the work-force will be ethnic minorities. As a result, the workforce will become increasingly diverse.

In the US, approximately 46 per cent of the workforce is composed of women. In Sweden, it is 50 per cent; Japan, 41 per cent; and Mexico, 37 per cent. In the US, women hold 17 per cent of the managerial jobs. In Sweden, 17 per cent are held by women and in Japan, it is only 9.4 per cent. But in India, this percentage is even lower.

In Japan, many women head businesses, but they are self-employed. The same is true in the US, but women, excluding those who are self-employed, head approximately 17 per cent of all US businesses.

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In the US, women are paid approximately 76 per cent of the compensation paid to men. In Sweden, it is 77 per cent; in Japan it is 61.6 per cent; and in Mexico it is 68.2 per cent. Thus, while women have experienced employment problems in the US, the barriers to their participation in the workplace in many other countries seem to be greater.

Many women now choose to start their own businesses, as implied earlier, often because of the frustration in dealing with the glass ceiling (a subtle barrier to the advancement of women and ethnic minorities in corporations). In 1982, there were 2.4 million female entrepreneurs in the US; in 1991, that number exceeded 3 million.

In 1994, women owned 7.7 million businesses, more than one-third of all US firms. The number of businesses owned by minority women continues to grow, increasing 153 per cent between 1987 and 1996. The same trend has been observed in other countries such as Japan.

The number of women in the corporate world who are relocating was up to 26 per cent in 1996 from 16 per cent in 1993. Many of these women relocate without their families and thereby lead complex lifestyles while trying to maintain their family life.

Dorrit J. Bern, for example, has had a significant influence on the corporation she leads. She is CEO of Charming Shoppes, Inc., which is headquartered in Philadelphia, but her family lives in Chicago. She maintains an apartment in Philadelphia from Monday to Friday and a family life in Chicago on weekends. Her husband is a consultant and has more flexibility to manage the home and the lives of their three children.

Moreover, the number of single fathers with custody of their children has increased dramatically to 1.86 million in 1996 from 393,000 in 1970. There are still more single mothers at 9.86 million, but single-father families have been growing by 10 per cent annually. Demographers and marketers are noting this change.

The influx of women and the increasing ethnic and cultural diversity in the workforce yield exciting challenges and significant opportunities. Included among these is the need to combine the best of the leadership styles of both men and women for a firm's benefit and to identify ways to facilitate contributions from all the employees of the firm.

An example of a firm attempting to do this is Avon. Four out of the eleven members of the board are women, and over 40 per cent of its global managers are women. Some companies now train women to bring out their leadership potential. Changes in the structure of the organization and in management practices are needed to get rid of existing barriers.

Learning to manage diversity in the domestic workforce can increase a firm's effectiveness in managing a globally diverse workforce, as it acquires more international operations. This kind of commitments to promote and manage diversity enhances a company's performance.

Organization should have a good understanding of the different cultural and institutional attributes of global markets in which they operate or hope to operate. For example, a firm operating in South Korea must understand the value placed on hierarchical order, formality, self control, and on duty rather than rights.

Furthermore, Korean ideology places emphasis on communitarianism, an Asian characteristic. The Korean approach differs from that of Japan and China with its focus on *Inhwa* or harmony.

Inhwa is based on respect for hierarchical relationships and obedience to authority. Alternatively, the approach in China is focused on *Guanxi* or personal relationships and in Japan on *Wa* or group harmony and social cohesion. The institutional context of Korea suggests primary focus on centralized planning by the government. The focus on growth by many South Korean companies is the result of a government policy to promote economic growth in the country.

The cultural and institutional contexts in which firms must operate in global markets can be critical. For example, in India, there was a nationalist campaign which led to the closure of a KFC outlet on grounds of health after inspection. However, executives of several US food companies blamed political posturing related to an upcoming election as the reason for the closure.

Also, those who opposed the opening of KFC were mostly those who were also lobbying against meat eating. KFC was one of the first major fast food giants to open a facility in India. Furthermore, it has been quite successful in Asia with more than 2,200 restaurants operating in that region. Still, even a firm that has been as successful as KFC must carefully and thoroughly analyse the institutional and cultural environment of its global markets.

With the takeover of Hong Kong, China offers potential opportunities but also threats to a number of firms with domestic headquarters outside its borders. Moreover, with Hong Kong a part of China, the latter's growing economic prowess transforms its firms into potentially significant competitors, particularly in labour-intensive industries. As a result, firms operating in such industries worldwide must view the development of Chinese entrepreneurial operations as an environmental threat.

Alternatively, firms that can invest in China may be able to take advantage of the low-cost labour; and China also offers a huge and growing market for products, as evidenced by the success of Procter and Gamble's (P & G) products there. P&G sells approximately 50 per cent of the shampoo used in China, and its nationwide distribution system may be best in that country.

P&G owes its success to being an early mover in China, and its aggressiveness has paid dividends. It has been successful even though its prices are sometimes 300 per cent higher than those of the local brands. The development of the Chinese economy is one that must be analysed carefully by firms operating in many industries regardless of their home country.

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Influence on Trade and Investment Patterns

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‘Culture’ refers to the distinctive way of life of a group of people—their complete ‘design for living’. Culture seems to be the master concept of American anthropologists. For ethnologists, folklorists, anthropological linguists, archaeologists and social anthropologists, culture is always a point of departure or a point of reference if not invariably the point of emphasis.

Culture consists of patterns, explicit and implicit, of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artifacts; the essential core of culture consists of traditional (i.e., historically derived and selected) ideas and especially their attached values; culture systems may, on one hand, be considered as products of action, on the other, as conditioning elements in a future action. Culture has many complex dimensions to define in simple terms. It seems that each anthropologist has defined culture from his own perspective. However, certain anthropological thinkers had agreed on fundamentals, as may be seen from the description provided by Hoebel – ‘Culture is the integrated sum total of learned behavioural traits that are shared by members of a society.’ Culture may be described in reference to three basic concepts. First, culture is a total pattern of behaviour that is consistent and compatible in its components. It is not a collection of random behaviours, but behaviours that are related and integrated. Second, it is a learned behaviour and not biologically transmitted. It depends on environment, not heredity. It can be called the man-made part of our environment. Third, culture may be manifested in the behaviour that is shared by a group of people or a society. It can be considered as the distinctive way of life of a people. Accordingly, a marketing manager of an international firm is supposed to be familiar with the reference groups, social class, consumption systems, family structure and decision-making, adoption and diffusion, market segmentation, and consumer behaviour in order to understand the cultural environment in the host country.

Cultural Factors Affecting International Business

Some of the factors that affect international business, culturally, are:

- Technology and material culture
- Language
- Aesthetics
- Education
- Religion
- Perceptions and Attitudes
- Social Values and Life Style (VALS)
- Social organization
- Political life

13.2.1 World Bank

The World Bank was set up at the same time as the IMF in July 1944. The World Bank is concerned with assisting its member countries to achieve sustained economic growth. It functions as an intermediary for the transfer of financial resources from the more developed to the less-developed countries.

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Objectives

The World Bank was created with the following objectives:

1. To help in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including:
 - (a) The restoration of economies destroyed or disrupted by war.
 - (b) The reconversion of productive resources to peace-time needs.
 - (c) The encouragement of the development of productive facilities to peace-time needs.
 - (d) Encouragement of development of productive facilities and resources in less-developed countries.
2. To promote private foreign investment by means of:

Guarantees or participations in loans and other investments made by private investors and to supplement private investment when private capital is not available on reasonable terms.
3. To promote the long range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging long-term international investment, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.
4. To encourage loans made or guaranteed so that the more useful and urgent projects will be dealt with first.
5. To conduct its operation so as to bring about a smooth transference from a war-time to peace-time economy.

The World Bank's capital is too small to provide for the development need of the entire world. It has therefore set up a number of subsidiary organizations for further finance.

Thus, the Bank was intended to serve as an essential adjunct to the IMF, and in particular to ensure a high and stable level of international investment with a view to promoting the maintenance of a high level of international trade and thus of production and employment.

Membership and Organization

Every member of the IMF is also a member of the World Bank. Any country acquiring the membership of the IMF, automatically becomes member of the World Bank.

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Each member of the World Bank has capital subscription that is similar to its quota in the Fund. The member's subscriptions also measures roughly its voting power. In June 1991, 155 countries were members of the Bank. The World Bank is managed in the same way as the IMF, except the head officer of the Bank is called the President. The Governors and Executive Directors of the two organizations are frequently the same men.

Resources

The World Bank started in 1946 with an authorized capital of \$ 10 billion, divided into 100,000 shares of \$ 100,000 each. The member countries subscribed to it in accordance with their economic position and the size of their quotas in the IMP. A member's total subscription in the capital of the Bank was originally divided into three parts:

- (i) 2% of the subscription to be paid in gold or US dollars.
- (ii) 18% of the subscription to be paid in member's own currency and the remaining 80% subject to call as and when required to meet the Bank's obligations.

Functions

The functions of the World Bank are as follows:

1. *It grants long-term and medium-term loans:* One of the early objectives of the World Bank was to aid reconstruction of war-torn nations, the job is not a matter of history. After an initial period of two years in which the Bank concentrated its loans on Europe's reconstruction needs, the Bank turned its attention to developing countries. Loans are of two types—*Reconstruction Loans* and *Development Loans*.
2. The Bank gives loans to member governments or to private enterprises. In the latter case, the Bank demands a guarantee from the government, the Central Bank and similar organizations of the region in which the project is to be undertaken. Loans are granted on a basis of sound financial and economic analysis; the project must produce an acceptable rate of return.
3. The Bank gives technical advice to the borrowers and for this purpose engage experts.
4. *Economic and Social Research:* In the field of economic and social research, the World Bank conducts research projects and undertakes smaller research studies. World Bank Staff working papers are of great interest among professional economists. The bank undertakes annually a comprehensive analysis of economical and social situation in the developing countries with a view to assess the situation and make the decisions relating to development. The World Development Report (Annual) deals with fundamental problems currently facing the developing countries.

5. The Bank promotes foreign investments by guaranteeing loans made by other organisations. The Bank's duty is to supplement and not to supersede the flow of private risk capital.
6. The World Bank's capital is too small to provide for the development needs of the entire world. It has therefore set up a number of subsidiary organizations for further finance.

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Evaluation

The Bank's loan policy has been criticized on several grounds:

It is alleged that the cost of World Bank loans is high for the developing countries. In addition to the high rates of interest on loans, the borrowing countries have to pay fixed rate commitment charges on undisbursed loan balances. This criticism is true particularly when we know that the World Bank loans are guaranteed by the governments of the borrowing countries and are granted by the project appraisals.

The Bank provides loans mostly for specific projects rather than for general development purposes. Critics argue that loans should be given for general development also and thus, the quantum of non-project loans be raised.

Moreover, as the World Bank is a non-political and non-partisan institution, it is not supposed to discriminate against some countries in favour of certain others. In actual practice, however, the bank has given loans not purely on economic considerations. The countries of Asia and Africa taken together have the largest population area and unexploited economic resources in the world. Their people suffer from immense poverty. The help given to them by the World Bank has been too inadequate. On the contrary, the countries in Latin America and the Caribbean have smaller population and area, but they have received substantial amounts of loans.

Also, it is said that the Bank exercises too much control over the execution of projects for which loans are given. It usually results on unnecessary interference in the internal economic matters of the borrowing countries.

13.3 INTERNATIONAL MONETARY FUND (IMF)

The creation of the International Monetary Fund, briefly called IMF, in the post-Second World War period constitutes an important landmark in the history of international monetary cooperation.

All members of the United Nations organisation excepting the former USSR are members of the IMF.

Objectives

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The objectives of the IMF are as follows:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transaction between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive to national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

The fundamental objective of the IMF is to facilitate the expansion and balanced growth of international trade by promoting exchange stability and establishing a multilateral system of payments. It is also required to make provision of means to correct short-term maladjustments in member's balance of payments.

In essence, the main purpose of establishing the Fund was to achieve external advantages of gold standard without subjecting nations to its internal disadvantages and at the same time maintain the internal advantages of paper standard while bypassing the external disadvantages of paper standard.

Management

The IMF is an autonomous organization affiliated with the United Nations. The head-office of the Fund is located in Washington D.C.

Thirty, of the forty-four countries attended the Bretton Woods Conference are the original members of the Fund. Membership to open to applicant countries on the terms and conditions of the Fund. At the end of July 1994, 179 countries were members of the Fund.

All the powers of the Fund are vested in the Board of Governors. Each member country appoints a governor but the voting powers of Governors vary. The Board consists of twenty-four executive directors of whom six are appointed and the others are elected by member countries. The Board meets twice or thrice each week to consider day-to-day problems.

The chairman of the Board of Executive Directors is the managing director, who is the executive head and head of the staff of the Fund. He holds office for a term of five years.

International Environment

Resources of the Fund

The IMF is financed by the participating countries, each country's contribution is fixed in terms of its quota. A member's total subscription is equal to its quota, which also determines the borrowing rights and the voting strength of a member country.

The quota of each member is payable in the following manner: 15 per cent of the quota or 10 per cent of its gold and dollar holdings is payable in gold or dollars; the rest in member's own currency.

It is important to note that until 1971, the IMF quota and all transactions were expressed in terms of US dollar which had a fixed parity with gold. Since December 1977, Special Drawing Rights (or SDR) has been used as the principal denominator of all IMF transactions and accounts. The currency value of SDR is determined by a standard basket of five specified currencies.

Functions

The fund performs five major functions.

- (i) **It serves as a short-term credit institution:** If any country faces a temporary balance of payments difficulty, the Fund will come to its aid. It does not however, undertake to supply all the foreign exchange that a country may need. All countries are supposed to have their separate monetary and foreign exchange reserves to meet their normal requirements. The Fund is not intended to supplant them but to provide only a second line of defense in case of emergency. The borrowing country has to pay interest and maintain its quota intact.
- (ii) **The Fund provides a mechanism for improving short-term balance of payments position:** To achieve this purpose, its rules provide for orderly adjustment of exchange. No member country can indulge in competitive exchange depreciation, thus introducing the law of the indulgence in international monetary relations. Whenever a country feels that its rate of exchange is out of line with its economy, the rate can be altered but only after due deliberation between the country and the authorities of the fund. Thus, there is provision for the careful determination of the initial rate and its orderly adjustment subsequently.
- (iii) **The Fund provides machinery for international consultations:** It brings together representatives of the principal countries of the world and affords an excellent opportunity for reconciling their conflicting claims. This constructive approach and measure of international cooperation have had not only a stabilising influence on world economy but they have also led to

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the expansion and balanced development of world trade and world production. The Fund has thus contributed to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of the member countries.

- (iv) It provides a reservoir of the currencies of the member countries and enables members to borrow one another's currency.
- (v) It promotes orderly adjustment of exchange rates to promote exchange stability.

13.4 THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

There is an intense opposition to full globalization by both developed and developing countries for different reasons. The existing set up favours developed countries and they prefer to perpetuate it, while developing countries apprehend that under full globalization international economic development will go against their development.

At present, the world is witnessing various regional economic groups. Standard theory deals with a framework of non-discriminatory tariff, trade and investment policies. But the very essence of a regional grouping is the fact that it discriminates against, non-member countries to its own economic advantages. Each member country of the group follows two sets of policies—one for the member countries and other for the non-members, an example of double standards.

A regional grouping has two or more member countries while the remaining countries of the world are treated as non-members.

Economic benefits from a regional grouping are directly dependent upon the level of economic development of the member countries and the size of their external sectors.

A few regional groups are explained as follows:

1. The **South Asian Association for Regional Cooperation (SAARC)** was formed in January 2004. Its seven members are Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka, India and Maldives.

SAARC countries are to institute free trade amongst themselves in ten years, starting from 1 January 2000.

2. The **Organization of Petroleum Exporting (OPEC)** countries is an association of countries which are substantial net exporters of oil and which subscribe to a set of commonly agreed objectives. It is a permanent, intergovernmental organization. Created at the Baghdad Conference on Sept. 10–14, 1960, by five countries – Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, it was joined by eight others: Qatar, Indonesia, Socialist

People, Libyan Arab Jamahirija, United Arab Emirates, Algeria, Nigeria, Ecuador and Gabon. Two countries Ecuador and Gabon left OPEC reducing its membership to eleven countries. It started with its headquarters at Geneva and moved to Vienna, Austria in Sept. 1965.

OPEC produces around 40 per cent of total world output and exercises a substantial control over its international price.

3. The **India-Sri Lanka Free Trade Area (ILFTA)** was signed in December 1998. Its objective is primarily to lower import tariffs against each other in a phased manner.
4. The **Association of Southeast Asian Nations (ASEAN)** was created in August 1967 by five countries: Indonesia, Malaysia, Philippines, Singapore and Thailand. Its objectives and aims are to provide peace, freedom and prosperity for its members and described several areas of mutual cooperation. At the time of signing AFTA, ASEAN membership had increased to six, with the addition of Brunei Darussalam. Four countries – Vietnam, Laos, Myanmar and Cambodia joined later thus raising its membership to ten countries.
5. The **Asia-Pacific Economic Cooperation (APEC)** was established in 1989, though some countries joined it later, the last one being Vietnam. Its current membership includes twenty-one countries comprising both developed and developing countries, viz., China, Australia, Vietnam, Indonesia, South Korea, Malaysia, Japan, Philippines, Indonesia, Russia, New Zealand, Hongkong, Singapore, USA, etc. APEC operates on non-binding commitments. Its membership does not entail any treaty obligations. All decisions are based on negotiations and commitments by member countries on a voluntary basis.
6. The **European Union:** European Union occupies a special position in the country of regional economic blocs. It is one of the most successful regional blocs and accounts for a large proportion of world trade and output. It is an example of member countries successfully overcoming mutual differences for the sake of their collective good. In the process, it has created even supra-national institutions with decision-making powers for member economies to the extent the process is seen as beneficial for the entire community.

European Union is a comprehensive association of some European countries and goes far beyond a conventional customs union. It aims at full integration of the economies of member countries with a common currency, a common central bank, coordinated fiscal and industry policies and other supranational institutions to effectively monitor and administer the Union. It is successively achieving complete integration of the markets for goods and services, labour, capital and other productive resources.

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The European Union has fifteen members, e.g., Sweden, Denmark, Finland, France, Germany, Italy, Spain, Portugal, Greece etc. A significant achievement of EU is the launching of a single currency, the euro, on 1 January 1999 to replace national currencies of the member countries.

The North American Free Trade Agreement (NAFTA): While USA was pressing for bringing into existence the World Trade Organisation on the grounds that the world needed a rule-based free international trade regime and that hitherto left out trade and non-trade issues should be brought under its purview, it was negotiating a free trade area for the North American countries. The North American Free Trade Agreement came into force on 1 January 1994.

NAFTA was signed by the Government of USA, United Mexican States and Canada. Other countries are permitted to join it by subscribing to its aims, objectives, principles and other terms and conditions. The basic objective of NAFTA was to bring into existence a free trade area between the member countries. It is to be noted that a major portion of trade between US and Canada was already sufficiently free and the new agreement was expected to only complete the process of having fully free trade between two neighbours. USA is one of the biggest economies of the world and the other members of NAFTA were expected to gain substantially by the new agreement.

General Agreement on Trade and Tariff (GATT)

An attempt to create an international organization to look after matters of trade and commercial policy were made as early as 1947. Although a charter for an International Trade Organization was drafted at the Havana Conference, it was never ratified due to differences between those who wanted a free multilateral trading system and those who placed emphasis on full employment policy on a national basis. However, the American proposal for a general agreement on tariffs and trade was agreed upon, and many nations signed. So emerged the General Agreement on Tariffs and Trade with no formal organization and no elaborate secretariat. It is through increasing liberalization of world trade and through GATT negotiations that the World Trade Organization emerged in 1995.

The two outstanding features of GATT will be the principle of non-discrimination and the principle of reciprocity with the purpose of promoting fair and free international trade among members. To ensure non-discrimination the members of GATT agreed to apply the principle of MFN (Most Favoured Nation) to all import and export duties. This means that each nation shall be treated as well as the most favoured nation. However, GATT did not prohibit economic integration such as the formation of free trade areas or customs unions, provided that the purpose of such integration was to facilitate trade between constituent territories and not to raise barriers to the trade of others parties.

Protection to domestic industries is given only through customs tariffs, thereby prohibiting import quotas and other restrictive trade practices.

International Environment

The GATT office periodically convened conferences of nations for Multilateral Trade Negotiations called rounds. Several rounds of trade negotiations conducted under the auspices of GATT, resulted in significant reductions in the average level of world trade tariffs.

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The last round of multilateral trade negotiations known as the Uruguay Round, which was the eighth round, centred around three main issues:

- (i) Trade Related Intellectual Property Rights (TRIPs)
- (ii) Trade Related Investment Measures (TRIMs) and
- (iii) Trade in Agricultural Commodities

The Third World Countries have been dissatisfied with GATT negotiations. Liberalization of trade-related intellectual property rights would mean that the less-developed countries would have to compete with the advanced countries or multinational companies. TRIPs covering copyrights, patents and trademarks is likely to harm the indigenous technology and nascent industries—particularly pharmaceutical and drug industry. GATT covers the service sectors as well under TRIMs. This is likely to affect the employment conditions in the developing countries as they will be swamped by professionals from the advanced industrial countries. Agriculture, is another controversial issue under GATT. While the US insisted on free trade in agriculture withdrawal of state subsidies EEC countries particularly France, which heavily subsidize their agriculture objected. The US threatened to use a law called super 301, under which punitive actions is taken against countries which do not follow a free trade regime.

13.5 THE WORLD TRADE ORGANIZATION

The new World Trade Organization (WTO) which replaced the General Agreements in Tariffs and Trade (GATT) came into effect from 1 January 1995, with the backing of at least eighty-five founding members including India. The WTO now comes as the third economic pillar of worldwide dimensions alongwith the World Bank and the IMF.

As many as seventy-seven of the 125 countries which signed the Uruguay round trade accord in April 1994 at a conference in Marrakesh have officially notified GATT that they would join the WTO.

The new trade body—WTO with power to settle trade disputes between nations and to widen the principle of free trade to sectors such as service and agriculture, covers more areas than GATT, whose rules have been in operation for the last fifty years. The WTO envisages the reduction of tariffs by more than one-third and is concerned with further opening of markets. It is expected that the

world trade would be stimulated strongly in the long run as a result of the coming into being of the new trade body—WTO.

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Like GATT, the WTO agreement will regulate the commodities trade, but in addition it will also deal with services across borders like insurance and tourism. The new WTO conditions also protect intellectual property like patents, copyrights and brands. Agriculture and textiles are completely covered by the WTO agreements. The highest WTO body is a ministerial conference which will meet at least once in two years.

The WTO has been entrusted with the following functions:

1. The WTO would facilitate proper implementation of multinational trade agreements.
2. It will review trade policies undertaken by the member countries.
3. It will act as a forum for the negotiation of disputes among the member countries over trade related problems.
4. The WTO will work in cooperation with the IMF and the World Bank.

India's Commitments to WTO

1. **Tariff Lines:** As a member of the WTO, India has bound about 67 per cent of its tariffs lines, whereas prior to the Uruguay Round only 6 per cent of the tariff lines were bound. For non-agricultural goods with a few exceptions, ceiling bindings of 40 per cent ad valorem on finished goods and 25 per cent on intermediate goods, machinery and equipment have been undertaken. The phased reduction to these bound levels is being undertaken over the period March 1995 to the year 2005. In textiles, where reduction will be achieved over a period of ten years, India has reserved the right to revert to duty levels prevailing in 1990, if the integration process, envisaged under the Agreement on Textiles, does not materialize in full. Under the Agreement of Agriculture, India's bound rate ranges from 100 to 300 per cent.
2. **Quantitative Restrictions:** Quantitative restrictions on imports maintained on balance of payments grounds were notified to WTO in 1997 for 2714 tariff lines at the eight digit level. In view of the improvements in India's balance of payments, the Committee on Balance of Payments Restrictions had asked India for a phase out for the quantitative restrictions. An agreement between USA and India was reached which envisaged the phasing out of all quantitative restrictions by India by April 2001. In line with this agreement, India removed quantitative restrictions on 714 items in the Exim Policy announced on 31 March 2000 and on the remaining 715 items in the Exim Policy announced March, 2001.

3. **TRIPs (Trade-related Intellectual Property Rights):** The ruling of the two WTO Dispute Settlement Panels following the complaints made by the USA and the European Union that India had failed to meet its commitments under Article 70.8 and Article 70.9 made it obligatory for the Government of India to make appropriate amendments to the Patents Act, 1970 by April 1999. The Patents (Amendment) Act, 1999 was passed by the Parliament in March 1999 to provide for exclusive marketing Rights. In respect of plant varieties, a decision has been taken to put in place a sui generis system as it is perceived to be in our national interest.

As far as copyrights and related rights are concerned, the Copyright Act, 1957, as amended in 1994 takes care of our interest and meets the requirements of the TRIPs Agreement except in the case of terms of protection of performers' rights. A Bill to increase this term to fifty years was passed by the Parliament in December 1999.

4. **TRIMs (Agreement on Trade-related Investment Measures):** Under the TRIMs agreement, developing countries have a transition period of five years upto 31 December 1999 during which they can continue to maintain measures in consistent with the Agreement provided these are duly notified. The Government of India notified two TRIMs viz., that related to local content requirements in the production of certain pharmaceutical products and dividend balancing requirement in the case of investment in twenty-two categories consumer items.
5. **GATS:** Under the General Agreement on Trade in Services (GATS), India has commitments in thirty-three activities. Foreign service providers will enter these activities. According to the Government of India, the choice of the activities has been guided by considerations of national benefit.
6. **Customs Valuation Rules:** India's legislation on Customs Valuation Rules, 1998, has been amended to bring it in conformity with the provisions of the WTO Agreement on implementations of Article GATT of 1994 and the Customs Valuation Agreement.

Benefits to India

1. The World Bank and the GATT secretariat have estimated that the income effects of the implementation of the Uruguay Round package will add between 213 and 274 billion US dollars annually to world income. According to the Government of India, since our country's existing and potential export competitiveness lies in clothing, agriculture, fishery products and processed food, it is logical to believe that India will obtain large gains in these sectors.
2. The phasing out of the MFA (Multi-Fibre Arrangement) by 2005 will benefit India as the exports of textiles and clothings will increase.

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3. The third benefit that India expects relates to the improved prospects for agricultural exports as a result of likely increase in the world prices of agricultural products due to reduction in domestic subsidies and barriers to trade. While on the one hand, earnings from agricultural exports are likely to increase, on the other hand India has ensured that all major programmes for the development of agriculture will be exempted from the disciplines in the Agricultural Agreement. Thus, the operation of the public distribution system will not be affected by the provisions of the Agreement; agricultural subsidies granted by developing countries need not be withdrawn till such time they remain within the prescribed limits specified in the Agreement; and protection necessary for developing the agricultural sector in the underdeveloped countries might be continued. In fact, India hopes that the reduction of subsidies in the USA and the European Community will enable it to increase its earnings from agricultural exports.
4. The Uruguay Round Agreement has strengthened multilateral rules and disciplines. The most important of these relate to antidumping, subsidies and countervailing measures, safeguards and disputes settlement. This is likely to ensure greater security and predictability of the international trading system and thus create a more favourable environment for India in the new world economic order.

Disadvantages to India

The most important advantage of the new world economic order claimed by its supporters is that it will increase the volume of trade substantially and as a result, India's export earnings will expand considerably. However, the estimates of quantitative gains by India may prove wrong. The gains expected by the Government of India on account of tariff reductions on goods may also not materialize as the number of goods of export increase to India is very small.

The most serious disadvantages to India are likely to flow from the Agreements pertaining to the TRIPs, TRIMs and services.

Protection of intellectual property rights—patents, copyrights, trademarks, etc., has been made more stringent in the Uruguay Round. This has been done to protect the interests of multinational corporations and developed countries as the Agreement on TRIPs is highly weighted in favour of patent-holders. As correctly pointed out by Muchkund Dubey, intellectual property rights protection is anti-competition and anti-liberalization and goes against the spirit of opening up the world economy and global integration. It is to be noted that the TRIPs Agreement goes against the Patent Act of India 1970 in almost all important areas. Under the Indian Patents Act, only process patents can be granted in food chemicals and medicines. TRIPs Agreement provides for granting product patents also in all these areas. TRIPs Agreement provides that the general term of a patent shall be twenty years. The Indian Patents Act provides for a general terms of the fourteen years for both product as well as process patents.

Managing World Trade

International Environment

Managing Globalization: The role of the World Trade Organization in the world economy are:

1. The Parliamentary Assembly notes with satisfaction the major achievements of the World Trade Organisation since its establishment in 1995 since the Assembly's last statement on WTO activities in its Resolution 1101 (1996). Even though implementation of the Uruguay Round, launched in 1995, has on the whole proceeded satisfactorily, the failure to inaugurate a new round at Seattle in 1999 dealt a serious blow to the world's efforts to strengthen and adapt the global trading system on a basis of greater openness and universally shared principles.
2. The Assembly welcomes the agreement reached in Doha (Quarter) in November 2001, for the pursuit of new WTO negotiations on a broad range of subjects related to international trade and investment. The Doha Development Agenda' is especially important in order to instil new confidence in a world economy seriously affected by the terrorist attacks against the USA on 11 September.
3. The new negotiations are all the more necessary as world trade grew by only 2 per cent in 2001 compared to a 12 per cent increase in 2000. Although European trade still shows comparatively healthy growth, especially in central and eastern Europe, and in the Russian Federation, this situation cannot be expected to continue in the absence of a strong, world wide recovery. The better can only come above if rapid progress is made with new negotiations and if earlier Uruguay commitments are fully realized.
4. The Assembly notes with concern the violent protests that have marred many recent international conferences including the Seattle WTO Summit in 1999. Whilst recognising the widely felt anxiety about globalization and calling for intensified dialogue between all parties concerned, the Assembly nevertheless condemns violence in all its forms and holds the right to peaceful reunion, as enshrined in the European convention on Human Rights to be sacrosanct and to require full respect also by the opponents of globalization.
5. Developing countries, many of which have made important economic progress, thanks to more open, rule-based trade made possible by the WTO are the first to suffer from any slowdown in world trade such as that observed in 2001. So, avoid being marginalized in the world economy, especially through a widening 'digital gap' in information and communication technologies, they must enjoy better access to the markets of richer countries across the whole range of products and services. Furthermore, Council of Europe member states should increase their funding for WTO efforts to help developing countries implement at administrative level, their various WTO commitments.

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6. The Assembly notes with satisfaction the emphasis is given in the Qatar Ministerial Declaration to the interests and concerns of developing countries, and in particular the provisions made to allow these countries better access to patented drugs needed to fight epidemics such as Aids.

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Check Your Progress

1. Mention the two categories of an economic system.
2. When was the International Monetary Fund (IMF) established?
3. What are the cultural factors affecting international business?
4. Name the organization which replaced the General Agreements on Tariffs and Trade (GATT).

13.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Economic system can be classified into the following categories:
 - Centrally planned economy (CPE): In a CPE, it is a central authority, in most cases the government, which decides how to produce and distribute goods and services, usually following a certain economic or political agenda.
 - Market-based economy: In a market-based economy, it is the market forces that allow businesses and firms to decide how to invest and produce. This system allows freedom and choice to both producers and consumers, who then decide on the basis of how far they can maximize their wealth.
2. The International Monetary Fund (IMF) was established in July 1944.
3. Some of the factors that affect international business, culturally, are:
 - Technology and material culture
 - Language
 - Aesthetics
 - Education
 - Religion
 - Perceptions and Attitudes
 - Social Values and Life Style (VALS)
 - Social organization
 - Political life

4. The World Trade Organization (WTO) which came into effect in 1995 replaced the General Agreements on Tariffs and Trade (GATT).

13.7 SUMMARY

- The international business environment includes political, legal, socio-cultural and ethical environments. The political and legal environments play an important role in international business.
- The political environment of a country has a great impact on the operations of international business units. It is determined by the extent to which various sections of society, such as individuals, media, businesses and industry have a say in the affairs of governance.
- Cost and convenience of production depends on easy availability of a trained workforce and material resources. A country with a high level of education and abundance of raw materials will provide greater human and material resources than a country that has neither.
- The social environment is concerned with the social attitudes and cultural values of different societies.
- The World Bank was set up at the same time as the IMF in July 1944. The World Bank is concerned with assisting its member countries to achieve sustained economic growth.
- Every member of the IMF is also a member of the World Bank. Any country acquiring the membership of the IMF, automatically becomes member of the World Bank.
- The creation of the International Monetary Fund, briefly called IMF, in the post Second World War period constitutes an important landmark in the history of international monetary cooperation.
- The IMF is financed by the participating countries, each country's contribution is fixed in terms of its quota. A member's total subscription is equal to its quota, which also determines the borrowing rights and the voting strength of a member country.
- There is an intense opposition to full globalization by both developed and developing countries for different reasons. The existing set up favours developed countries and they prefer to perpetuate it, while developing countries apprehend that under full globalization international economic development will go against their development.
- The two outstanding features of GATT will be the principle of non-discrimination and the principle of reciprocity with the purpose of promoting fair and free international trade among members.

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- The new World Trade Organisation (WTO) which replaced the General Agreements in Tariffs and Trade (GATT) came into effect from 1 January 1995, with the backing of at least eighty-five founding members including India.
- The most important advantage of the new world economic order claimed by its supporters is that it will increase the volume of trade substantially and as a result, India's export earnings will expand considerably.

13.8 KEY WORDS

- **Centrally Planned Economy:** A national financial system where the country's government operates, owns and manages production facilities.
- **Perception:** It is the process of recognizing and interpreting sensory stimuli.
- **OPEC:** The Organization of Petroleum Exporting Countries (OPEC) is a group consisting of 12 of the world's major oil-exporting nations.
- **Balance of Payment:** It is a statement of all transactions made between entities in one country and the rest of the world over a defined period of time, such as a quarter or a year.

13.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write a short note on the international trade environment.
2. List the functions of the World Trade Organization (WTO).
3. Mention the distinctive features of the General Agreements on Tariffs and Trade (GATT).
4. Write a short note on the membership and organization of the World Bank.
5. Write short notes on the following:
 - (a) European Union
 - (b) The South Asian Association for Regional Cooperation (SAARC)

Long Answer Questions

1. 'The social environment is concerned with the social attitudes and cultural values of different societies.' Discuss.
2. Evaluate the criticisms raised against the World Bank's loan policy.
3. Discuss the functions of the International Monetary Fund.
4. Analyse the role of the World Trade Organization in the world economy.

13.10 FURTHER READINGS

International Environment

- Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.
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UNIT 14 CURRENT ISSUES IN BUSINESS ENVIRONMENT AND NATURAL ENVIRONMENT

Structure

- 14.0 Introduction
- 14.1 Objectives
- 14.2 Current Issues in Business Environment: An Introduction
 - 14.2.1 Population
 - 14.2.2 Urbanization
 - 14.2.3 Public Distribution System
- 14.3 Natural Environment: An Overview
 - 14.3.1 Various Aspects of the Natural Environment
 - 14.3.2 Pollution
 - 14.3.3 Environmental Management
 - 14.3.4 Environment Management System
- 14.4 Answers to Check Your Progress Questions
- 14.5 Summary
- 14.6 Key Words
- 14.7 Self Assessment Questions and Exercises
- 14.8 Further Readings

14.0 INTRODUCTION

In this unit, you will be introduced to the current issues of the business environment. The exploitation of natural resources and their depletion has been a major cause of concern all over the world. In this unit, the main focus has been laid upon the problems, issues and maladies faced by India. India is the most populous country of the world and with the impact of population explosion, there is exhaustion of natural resources and ultimately their degradation. Consequently, the hazards posed from these issues have to be identified and thereupon several remedial measures have to be taken up for minimizing their harmful effects. In this direction, the environment management system has been devised which helps a business to improve its environmental performance by taken into account the environmental considerations while taking strategic decisions.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the current issues in business environment
- Prepare an overview of the natural environment
- Explain the various aspects of the natural environment
- Describe the environment management system

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14.2 CURRENT ISSUES IN BUSINESS ENVIRONMENT: AN INTRODUCTION

Let us now study the current issues existing in business environment.

14.2.1 Population

Population size refers to the actual number of individuals in a population. In this section, we will have a look at the population size in India and the factors affecting high growth in population size and the measures to reduce the population size.

As per Census 2011, India constitutes about 2.4 per cent of land mass and houses 17.5 per cent of the world population. The 121 crore population of our country is the combined population of the US, Indonesia, Brazil, Bangladesh, Pakistan and Japan combined. The population size as a concept deals with important pointers like sex composition, distribution of population, rural and urban migration as well as industrial distribution. Further, a very important concept related to population size is demographic transition.

Demographic transition is the transition from a stable population with high mortality and fertility to a stable population with low mortality and fertility. During the transition, population growth and changes in the age structure of the population are inevitable. In India the demographic transition has been relatively slow but steady. As a result, the country has been able to avoid adverse effects of rapid changes in the number and age structure of the population on social and economic development.

Challenges

The challenges to population size in India are as follows:

- To meet all the needs of rapidly growing adolescent and young adult population
- To cater to their increasing expectations for improved quality, spectrum and access to services

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- By meeting their felt needs it will be possible to accelerate demographic and socio-economic transition
- Invest adequately in Human Resource Development (HRD)/skill development
- Provide appropriate employment with adequate emoluments to large work force.

Table 14.1 shows the growth in India's population as well as the compound annual growth rate of India's population from 1891.

Table 14.1 Growth of India's Population from 1891-2011

Census Year	Population in million	Increase or decrease (in millions)	Percentage Increase or Decrease
1891	236		
1901	236	0.0	0.0
1911	252	+16	+5.7
1921	251	-1	-0.3
(1891-1921)		+15	+0.19
1931	279	+28	+11.0
1941	319	+40	+14.2
1951	361	+42	+13.3
(1921-1951)		+110	+1.22
1961	439	+78	+21.6
1971	548	+109	+24.8
1981	683	+135	+24.7
(1951-1981)		+322	+2.14
1991	846	+161	+23.9
2001	1,029	+183	+21.5
2011	1,210	+181	17.64
(1981-2011)			
Compound annual growth rate of population			
1891-1921		0.19	
1921-1951		1.22	
1951-1981		2.15	
1981-1991		2.11	
1991-2001		1.93	
2001-2011		1.64	
Source: Census of India 2001, Series 1, Paper 1 of 2001, Provisional Population Totals. Economic Survey, 2009-10, Census 2011 (Provisional Population Tools)			

Distribution of Population

The distribution of population in India is as follows:

- Uttar Pradesh has the highest total population followed by Maharashtra, Bihar, West Bengal and Andhra Pradesh.
- Top ten states together have about 76 per cent of the total population of India.
- Population is very small in the states like Jammu & Kashmir, Arunachal Pradesh and Uttaraanchal even though they are large states.

- Rajasthan, Jharkhand and peninsular states have moderate to high proportion of population.

Uneven distribution of population in India reflects a close relationship between population and physical, socioeconomic and historical factors.

1. Physical factors including climate, terrain and availability of water affect and determine the pattern of the population distribution. Some examples of this are as follows:
 - The North Indian Plains, deltas and Coastal Plains have higher proportion of population because of suitable climate for agriculture and fertile plains.
 - Mountainous and forested regions of southern and central Indian states, Himalayan states and some of the northeastern states are less populated.
 - Development of irrigation (Rajasthan), availability of mineral and energy resources (Jharkhand) and development of transport network (peninsular states) have resulted in moderate to high proportion of population.
2. Socio-economic and historical factors also impact and determine the distribution of population of India. Some examples are:
 - Traditional settled agriculture and early human settlement has resulted in large population in the river plains and coastal areas of India.
 - Development of transport and better agricultural development has resulted in large population in North Plains.
3. The industrialization and urbanization also influenced the distribution of population.

Rural-Urban Migration

In India, there is a high incidence of internal migration of poor labourers. The poor migrants end up working as casual labourers in the informal sector. This population is also the one that is more susceptible to diseases and stands the risk of not getting access to health services.

Around 14.4 million Indians migrated within India for work purposes either to cities or areas with higher expected economic gains during the 2001 census period. 25 lakh migrants are engaged in plantations or farms, construction sites, brick-kilns, quarries, and fish processing (NCRL, 2001). Many migrants also work as casual labourers in the informal manufacturing units, services or transport sectors. They work as head loaders, rickshaw pullers and hawkers.

Among the migrants who are vulnerable, the Internally Displaced People (IDPs) are estimated to be around 6 lakhs (IDMC, 2006). Internal displacement

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is caused due to conflicts of not just ethnic or religious nature but also of political nature, natural disasters, development projects, etc.

There is separate migration data for males and females, migrant households, return-migrants, the structure of the residence of the migrants' households before and after migration, status of the migrants before and after migration and other details on migration.

Industrial Distribution

Several economists have analysed the changes in industrial distribution of the work force over the entire period from 1961–2000 and have presented their study to the government. Their findings are as follows:

- According to a study done by K. Sundaram (July, 2001), for the total work force, there is a 16 per centage point decline in the share of the agriculture, forestry and fishing sector. This decline is greater than the 10 per centage point decline in the share of this sector in the rural work force and reflects the effect of a shift in the rural-urban composition of the work force towards the latter.
- Of this 16 per centage point decline in the share of the agriculture sector, less than 3 per centage points represent the gain in the share of the manufacturing (and repair services) sector. The construction sector recorded a 3 per centage point gain in its share in the work force.
- The service sector, as a group, recorded a 10 per centage point gain in its (collective) share in the work force. Half of this was accounted for by the trade, hotels and restaurants sector. The transport, storage and communications, and, the community, social and personal services sectors gained 2 per centage points each in their (respective) shares in the work force.

India Labour Market Update (July 2016)

Over the years, employment has grown faster for men and in urban areas. In this regard, male employment grew by 1.9 per cent per annum from 1999-2000 to 2011-12, while female employment increased by just 0.3 per cent on an annual basis.

Over this period, urban areas accounted for 57.2 per cent of the growth in employment, though only 31 per cent of the population live in urban areas (as per the 2011 Population Census). Looking at gender, the labour force participation rate of women is low and a sizable gender gap persists. Moreover, when women work they tend to end up in marginal jobs. One of the most intense debates in recent years has centred on the declining labour force participation rate of women in India, which dropped from 42.7 per cent in 2004-05 to 31.2 in 2011-12. The

latest data from the Labour Bureau indicates a similar participation rate of women in 2013-14 (31.1 per cent).

In India, a large proportion of workforce is still dependent on the agricultural sector (48.9 per cent employment share in 2011-12).

In terms of employment, the share of the services sector in urban areas was 58.7 per cent (2011-12), compared to just 16.1 per cent in rural regions. When urban areas are excluded from these figures, the agricultural sector still accounts for 62.7 per cent of India's employment, although this share has fallen significantly, from 77.6 per cent in 1993-94.

14.2.2 Urbanization

You have seen that continuous urbanization has led to over-urbanization in many Indian cities due to concentration of population in these cities. This over-urbanization reduces the efficiency of the urban centres and creates a large number of problems. Thus, the challenge lies in making our cities optimum in size. But this is easier said than done because the pull factor of the big cities is very strong and people keep on migrating from rural areas in search of a better life. The other reasons for these problems are defective urban planning, apathetic civic administration, rampant corruption, lack of civic sense in our people, etc.

The problems posed by urbanization and over-urbanization in India are as follows:

- **Housing:** The housing needs of our cities are enormous and both the government and the private entrepreneurs have failed to bridge the gap between demand and supply. According to estimates, about half the population in our big metropolitan cities have to do with temporary or no shelters. Many of them live in slums that are not fit for human occupation and many others live in the open (at railway stations, bus stations, on pavements and under bridges or flyovers). The living conditions of such people are much worse than what it was in the rural areas from where they migrated to the cities in search of a new and comfortable life.

This acute problem is caused due to a variety of reasons. First, the severe pressure of population pushes up the demand for housing to very high levels. Second, the shortage of affordable houses keeps large sections of the urban population out of the market for readymade houses. With modest income-levels, it is not possible to buy the highly priced urban homes. Thirdly, the pressure on land and its scarcity pushes up the prices of houses. Even if any agency wants to construct affordable homes, the high input costs does not allow it to do so.

- **Water supply and drainage:** The problem of water scarcity has assumed gigantic proportions in our cities and it has been predicted that the future would be even worse. No city administration is able to provide water round

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the clock. The sad part is that there seems to be no common water policy, which can address this issue in the country. Providing clean drinking and cooking water has to be a priority of the government and the people cannot be made to suffer in respect of such a basic necessity of life.

Drainage facilities in our cities have also taken a hit with the rapid increase in population. The amount of solid waste generated by our cities has grown many times and the old network of sewage pipes is unable to handle the load. This results in clogging of drainage pipes and overflowing of man holes. A comprehensive solid waste management program has to be undertaken by our cities to ensure the beauty and efficacy of our urban areas.

- **Electricity:** The demand for electricity in our cities have gone up by hundreds of times due to the increase in population and the use of new and sophisticated electrical gadgets like computers, air conditioners, television, etc. A higher population needs more lights, fans and street lights. A richer population needs more electricity to run their fancied electrical gadgets.

The demand and supply gap in respect of electricity has risen considerably and despite the best efforts of the government, electricity generation, transmission and distribution has failed to keep pace with the ever-increasing demand.

- **Transportation:** Transportation in our cities is a big challenge for all concerned. The commuters have to cover long distances because most of the working class people live far away from their places of work. They are mostly dependent upon public transport systems like local trains, buses and, of course, the metro trains. These modes of transport are not adequate and, therefore, they always remain heavily crowded. Though the Delhi metro and the new buses in Delhi are pretty comfortable, generally public transport does not provide a pleasant experience. The service providers cannot enhance comfort levels as they are constrained by the fact that they cannot charge high fares because the poor people also use these facilities.

On the other hand, rising income-levels have enabled the rich and middle class to buy more cars and two-wheelers. This has created the problem of traffic jams and raises the issue of efficient traffic management. The number of private vehicles on roads, especially in Delhi, has gone up so high that traffic snarls have become a part of daily routine.

- **Pollution:** Pollution is a major problem faced by our cities. Due to the rapid growth of population, the vehicular traffic has increased manifold resulting in discharge of pollutants from the vehicles. For the same reason, the generation of solid waste has gone up many times and our sewage management system is unable to cope with it. This results in waste matter

flowing on to the streets or flowing into the rivers or lakes in and around our cities.

The air and water pollution in our cities give rise to various ailments, which result in suffering of our people. Besides, they add to the burden on our urban health infrastructure. Studies have shown that the air and water pollution caused by urbanization is coming back to hit us. The incidence of cancer in urban India has increased and the reason being given is the high level of pollutants in our food, water and air.

The level of air pollution in Delhi could be curtailed because of the intervention of the Supreme Court of India. The court directed the Delhi Government to make it mandatory for buses and trucks plying in Delhi to use Compressed Natural Gas (CNG) as their fuel. This has resulted in improving the air quality in Delhi.

- **Sanitation:** The level of sanitation in our cities is abysmal. Though, we have large municipal corporations, their functioning leaves a lot to be desired. Garbage is not disposed on time, drains are not cleaned regularly, roads are not swept daily and people are totally devoid of civic sense. In fact, our cleanliness level could be much higher if only our people did not throw waste all over the city. The corrupt and incompetent municipalities are primarily responsible for the mess in the sanitation situation of our cities. There is no accountability and they manage to go unpunished.
- **Health problems:** It is estimated that about 300 million people in India live in towns and cities. As in other parts of the world, a rapid growth of population has resulted in a significant part of urban population residing in slums in India. About 33 per cent of India's urban population lives in slums. Slums are characterized by overcrowding, poor hygiene and sanitation and the absence of proper civic services. Most of the cities in India face various health challenges of communicable diseases, non-communicable diseases, maternal and child health problems, natural calamities and threat of reemerging and emerging diseases. While the characteristics of each city may vary according to local circumstances, common urban health and social challenges include the following:
 - o Overcrowding
 - o Air pollution
 - o Rising levels of risk factors like tobacco use, unhealthy diet, physical inactivity and the harmful use of alcohol
 - o Road traffic injuries
 - o Inadequate infrastructure, transport facilities
 - o Poor solid waste management systems
 - o Insufficient access to health facilities in slum areas

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- **Transport and traffic problems:** Cities have a high level of accumulation and concentration of economic activities. They are characterized by complex spatial structures that are supported by transport systems. The larger the city, the greater is its complexity. Majority of transport problems are often related to urban areas. Urban productivity depends heavily on the efficiency of its transport system to move labour, consumers and freight between multiple origins and destinations. Also, important transport terminals, such as ports and airports, are located within urban areas. The most notable urban transport problems include the following:
 - o Wasting time of motorists and passengers
 - o Delays, which may result in late arrival for employment, meetings and education, which, in turn, may result in lost business, disciplinary action or other personal losses
 - o Inability to forecast travel time exactly
 - o Wasted fuel leading to air pollution and carbon dioxide emissions due to increased idling, acceleration and braking
 - o Wear and tear on vehicles
 - o Stressed and frustrated motorists, leading to road rage and reduced health of motorists
 - o Obstacles in the passage of emergency vehicles traveling to their destinations.
 - o Spillover effect from congested main arteries to secondary roads and side streets as alternative routes are attempted, which may affect neighborhood amenity and real estate prices.
- **Employment problems:** While the Indian economy continues to clock above eight per cent growth, According to the 61st round of employment and unemployment for July 2004 to June 2005 carried out by the National Sample Survey Organization, the unemployment rate—the number of person unemployed per 1,000 persons in the labour force—was seventeen in the rural areas and forty-five in the urban areas. Moreover, the survey also found that the unemployment rates for females was higher than that for males and was highest among urban females. The survey that covered over 7,999 villages and 4,602 urban blocks (covering 79,306 households in the rural areas and 45,374 households in the urban areas) showed that between 1999–2000 and 2004–05, the unemployment rate remained almost the same for rural males and decreased by one per cent point for urban males. However, this increased by about one per cent points for women in both rural and urban areas.
- **Lack of civic facilities:** Cities in India lack many civic facilities, such as water supply and sanitation, roads and drains, street-lights, collection and

disposal of solid waste, maintenance of public places, burial grounds and crematoria, cattle pounds, registration of births and deaths and maintenance of markets.

(i) Water supply: According to the 54th round of National Sample Survey (NSS) an estimated 70 per cent of urban households reported being served by tap and 21 per cent by tubewell or handpump. 66 per cent of urban households reported having their principal source of drinking water within their premises, while 32 per cent had it within 0.2 km. 41 per cent had sole access to their principal source of drinking water, which means that 59 per cent were sharing a public source. 15 per cent of households do not get sufficient drinking water from their principal source, between April and June, May being the worst month. In the aggregate, 91 per cent of urban households have found the quality of drinking water served by their principal sources to be satisfactory. 18 per cent urban population is using some supplementary source of drinking water, while 96 per cent urban population is storing their drinking water.

The guiding principles for developing an efficient water supply and sanitation programme should be as follows:

- Protection of the environment and safeguarding of health through the integrated management of water resources and liquid and solid waste
- Organizational reforms, promoting an integrated approach and including changes in procedures, attitudes, and behaviour, and the full participation of women at all levels
- Community management of services, backed by measures to strengthen the capacity of local institutions in implementing and sustaining water and sanitation programmes
- Sound financial practices, achieved through better management of existing assets and extensive use of appropriate technologies

(ii) Urban sanitation: The 54th round of NSS reported that 26 per cent of households reported using no latrine, 35 per cent reported using septic tank, and 22 per cent reported using sewerage system. This indicates that as many as 43 per cent of households in urban areas either had no latrines or no connection to a septic tank or sewerage. As regards to waste disposal, 71 per cent of urban households reported removal of household waste by household members, 14 per cent by local authorities, and 12 per cent by private agreement among residents. Forty-seven percent of urban households reported removing of their waste to community dumping spot, and 30 per cent, to individual dumping spots. Ninety per cent of urban households reported concern

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regarding mosquitoes, 66 per cent regarding flies and 50 per cent regarding problems related to foul odour.

- (iii) Treatment of urban waste water:** Three-fourths of surface water resources are polluted and 80 per cent of the pollution is due to by sewage alone. On the other hand, in addition to organic matter sewage contains nitrogen, phosphate and potassium in sufficient quantities, which are essential nutrients for plant growth. Sewage is also viewed as an economic source of methane fuel. Thus it can be a valuable resource after due treatment and processing. Water supply has direct linkage with sewage generation. A survey of 345 towns with population between 50,000 and 100,000, revealed that over 95 per cent of them do not have any waste water treatment facilities, and disposal on land, and direct and indirect use for irrigation is the predominant mode of disposal.

14.2.3 Public Distribution System

It is a framework that is sponsored by a government body and comprises chain of shops given with the task of distributing basic food and non-food commodities to the disadvantaged group of the society at very low prices. The central and state governments together are accountable for regulating the public distribution system. On one hand, the central government is responsible performs the task of procurement, storage, transportation, and bulk allocation of food grains. On the other hand, state governments perform the task of distributing the same to the consumers through the established system of Fair Price Shops. State governments are also responsible for operational responsibilities including allocation and identification of families below poverty line, issue of ration cards, supervision and monitoring the functioning of FPSs system (PDS) is an Indian food security system. In India, the public distribution system is managed by the Government of India (GOI) under the Ministry of Consumer Affairs, Food, and Public Distribution. This system is responsible for distributing sponsored food and non-food stuffs to poor community of India. Some of the items distributed by the food department include staple food grains, like wheat, rice, sugar, and kerosene, through ration shops established in several states across the nation. The Food Corporation of India, a government-owned corporation, acquires and maintains the public distribution system.

The objectives of the public distribution system are as follows:

- (i) To protect the low income groups by guaranteeing the supply of certain minimum quantities of food grains at affordable price.
- (ii) Ensuring equitable distribution.
- (iii) Controlling the price rise of Essential Commodities in the open market.

The Indian government and the Department of Food and Public Distribution have recognized vital aspects of the public distribution system which require improvement for the programme to function more successfully. These domain include the following areas:

- Beneficiary identification, and addressing inclusion/exclusion errors
- Addressing diversions and leakages
- Managing food grain storage and ensuring timely distribution
- Effective accountability and monitoring, and enabling community monitoring
- Mechanisms for grievance redressal
- Ensuring food security

Presently, a major challenge before the public distribution system is reaching of the food grains to the actual recipients without leakages and diversion on the route to grass root level. A huge modernization drive is required to achieve this objective. There is also a need of digitizing the database of beneficiaries and computerization of the entire food supply chain so that government can make the public distribution system more successful. These efforts would make the schemes clear, help eliminate leakages and dishonesty and authorize the beneficiaries to get products as per their right and requirement.

Therefore, it can be ascertained after assessing the public distribution system, that this process faces numerous challenges such as leakages and diversion of food grains, inclusion/exclusion errors, bogus ration cards, lack of transparency; weak grievance redressed and social audit mechanisms, and practicality of Fair Price Shops.

14.3 NATURAL ENVIRONMENT: AN OVERVIEW

Just as important as our cultural heritage, though we often fail to recognize it, is our natural heritage. This includes the land, its forests (what's left of them), its interlinked ecosystems, and its myriad varieties of flora and fauna. We learn vicariously from the laments of western conservationists that development comes at an avoidable price, if only one is alive to the perils of unrestrained industrial growth. Climatic changes across the planet are warning enough that hard days lie ahead for humanity if we do not cooperate with nature instead of conspiring against her. Needless to say, depletion of the earth's natural resources and atmosphere that support life will have disastrous effects on all. Business and industry have a major role to play by seeing to it that their actions reduce environmental impacts to the barest minimum.

The major factors involved in environmentally friendly business operations can be grouped as follows:

- (i) Natural resources and special features of the environment
- (ii) Climatic conditions and weather patterns

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- (iii) Topographic variations
- (iv) Locational factors
- (v) Infrastructural factors, such as roads, ports, etc.

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In the final analysis, business is completely dependent on the environment. No business can survive in climatically inhospitable conditions, even if it were to be established there. Some of the relevant observations are summarized as follows:

- (i) Business and industry are dependent on a vast variety of natural inputs.
- (ii) Oil, forest based produce and mineral wealth come from natural sources.
- (iii) Agricultural activity, which gives us food, comes from the natural environment. No amount of technological inputs can help if the environment is (rendered) incapable of supporting food production.
- (iv) Domestic and international trade is dependent on geographical factors.
- (v) Business and industry flourish due to certain advantages enjoyed from the natural environment.

With growing awareness of the importance of preserving and protecting the natural environment and ecologies of the region, the country's leadership has of late shown a certain amount of interest in this direction. While much remains to be done, business and industry should see it in their own (as well the national) interest to come forward and voluntarily play an active role in environmental preservation.

14.3.1 Various Aspects of the Natural Environment

The environmental movement lays emphasis on reducing the pollution of air, water and land. Our vital and fragile eco-system is today increasingly threatened by commercial exploitation, growing population demands and industrial pollution. The earth's 'Garden of Eden' with its flora and fauna, its rivers and oceans, grasslands and wetlands are fighting for survival.

The survival of man depends upon intelligent and proactive action with respect to environment. Unless effective action is taken to stop population growth, to reduce the threat of war and to prevent further destruction of the planetary biosphere and its living organisms, the early degradation of the human species is a certainty. Greater efforts are needed to protect the natural environment threatened by over-population and misguided technology. Pollution is not a new problem; it is as old as the Industrial Revolution. But in the 20th century pollution has turned out to be the dark side of new engineering feats.

The standard of living of the people in any country depends upon their industry which in turn is largely responsible for environmental pollution. Industry is the main cause of water pollution; it is responsible for 30 per cent of air pollution, it is almost completely responsible for radiation waste, it is the greatest spoiler of the land and also produces most of the undesirable noise.

World War II stimulated industrial growth. There was a search to develop new weapons of warfare. There was a shortage of natural raw materials such as metal, wood, wool and cotton which created the need for new synthetic substances. Thus the plastics industry was born. With the end of the War, many devastated regions needed rebuilding and their inhabitants had to be rescued from starvation. More grain, milk, meat and fruits were required to support a hungry world. Scientists came up with new chemicals to wipe out agricultural pests, to destroy weeds, to fertilize farmland and to fatten cattle and poultry.

Dismal scenario

Any human activity affects the environment, but the inventions that followed the Industrial Revolution and World War II have done more damage to the ecosphere than all the preceding ages put together. The need to enhance food production and feed the world's hungry millions has led to the production of chemical weedicides and pesticides that give with one hand what they take away with the other, mortally wounding the environment. The relentless pressure to energize greater numbers of engines of locomotion, production and mass destruction has unleashed a vast range of new, often non-biodegradable substances—liquid, gaseous or solid—that have sullied the environment practically to the point of no return. The endless wants of a rapacious consumerist society have brought forth inventions that further sully the environment and poison all living things with radioactive and carcinogenic materials. Toxic substances circulating in the earth's air, water and soil mean that no one can hope to escape the effects of global environmental pollution that have destroyed entire eco-systems, ravaged geographies, and—by cutting an ever-widening hole in the ozone layer that blocks lethal ultra-violet radiation—are ensuring that our days as a species appear to be numbered.

What we need is development without destruction of our environment. There are two basic reasons for progressive pollution. The first reason is the increase in population. Second is the increase in material well-being of the people. In fact, a major determinant of the levels of pollution has been the amount people have had to spend for manufactured products. The by-products of these manufactured goods are the pollutants.

Thus continuing degradation of water, air, and land is due to rapid population growth and unsound development practices which do not provide for environmental protection.

Pollution of air and water has become a greater menace to life than even armaments and nuclear weapons. Industrialization is the direct cause of air and water pollution in human environment.

Air pollutants

Air pollution is an old problem. If we live in an industrial city, we know what air pollution is. For many countries, smoke from burning coal is the most harmful

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source of air pollution. Automobiles are the major contributors to air pollution, accounting for 60 per cent of total fuel emissions. Industry takes the next largest share of responsibility with a contribution of 18 per cent. Electric power generating plants contribute 13 per cent. Space heating and garbage disposal contribute 6 per cent and 3 per cent respectively. Among the numerous substances that find their way into air, some 40 compounds are suspected of causing cancer such as asbestos, benzene, mercury etc. In addition to all those pollutants—more than million metric tons of lead are mixed into air every year. Some of this is directly due to industry but most of it is emitted by automobiles. Lead from industries has entered our air, water, soil, and food. Lead in high concentrations is poisonous for the human body, damaging the kidneys and the brain.

The World Health Organization has defined air pollutants as substances put into air by the activity of mankind in concentration sufficient to cause harmful effect to his health, vegetables, property or interfere with the enjoyment of his property. Air pollution may be (i) smoke and fog, together called smog, and (ii) dust, fumes, gases etc.

Water pollution

Water can clear itself of a certain amount of pollution. But if pollution is rampant, it cannot purify itself. Water pollution comes from three main sources: (i) sewage (ii) industrial waste and (iii) agricultural waste.

The spread of diseases due to water pollution is a well-known hazard. Sewage wastes in streams, rivers, lakes and coastal waters create major problems. These wastes may contain pathogenic bacteria and viruses which are a threat to human health.

Noise pollution

Environmental noise pollution is one of the new killers of our society. If we live near a busy airport, we know what noise pollution is. As civilization grows, noise pollution grows. It is said that Julius Caesar banned chariots from the cobblestone streets during evening hours because of the noise they made. One wonders what Julius Caesar would have done if he lived in this 24-hour noisy world. If the present noise level continues, most metropolitan city dwellers may become deaf within a few years.

Dumping habits

Until recently people dumped their trash and refuse on the outskirts of towns. It was taken for granted that everything would eventually decompose into earth, out of which new grass and trees would grow. But forms of plastics, chemicals, poisons and radioactive substances have appeared that do not decompose but remain harmful for thousands of years. Some of the wastes do not die, they just accumulate.

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The causes of environmental degradation are many. The prevailing conditions of poverty and underdevelopment themselves create a situation where people are forced to live in squalor and further degrade their environment. On the other hand, the process of development itself may damage the environment, if not properly managed. In the final analysis, removal of poverty, generation of employment, raising the levels of education and increasing awareness of the people are crucial for protection of environment.

Major tasks

The major tasks for meeting this formidable challenge are:

1. To protect the natural environment.
2. To regenerate and restore degraded ecosystems and increase their productivity and to generate employment through these activities.
3. To decentralise control over nature and natural resources.
4. To develop and share an understanding of nature and natural processes.
5. To formulate a national policy for environment and an appropriate institutional and legal framework in support of the policy.
6. To ensure co-ordinated and integrated governmental action aimed at conserving nature and sustainable use of natural resources.
7. To make individuals and institutions more accountable to the people for their actions impinging on environment and ecosystem, and
8. To monitor the state of environment.

Many of these tasks are already being performed by the Government but much greater effort is called for, if the current trend of environmental degradation is to be reversed.

Broadly, threats to natural environment are of three types—pollution, overuse and destruction. Strategies to meet these threats to natural environment can be preventive or regulatory.

14.3.2 Pollution

In this section, we will discuss the various types of environmental pollution. They are mentioned below:

1. Air Pollution

The Air (Prevention and Control of Pollution) Act, 1981 defines ‘air pollutant’ and with reference to them defines air pollution. ‘Air pollutant’ means any solid, liquid or gaseous substance (including noise) present in the atmosphere in such concentration as may be or tend to be injurious to human beings or other living creatures or plants or property or environment. Air pollution means the presence in the atmosphere of any air pollutant. In this connection, the definition of ‘emission’

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is also relevant. 'Emission' means any solid, liquid or gaseous substance coming out of any chimney, duct or any other outlet. There are 'standards' and legislation that exist for emissions.

Approximately 95 per cent of earth's air occurs in the lower levels, the troposphere. In the natural state, air contains 78 per cent nitrogen, 21 per cent oxygen, 0.4 per cent carbon dioxide plus small amounts of other gases and water vapour. The remaining 0.5 per cent of the planet air occurs in the upper levels, the stratosphere together with gases like ozone.

Air pollutants can be primary or secondary. Primary pollutants are carbon dioxide, nitrogen oxides, sulphur dioxide, carbon monoxide (all formed from the combustion of fossil fuels), CFC and particulate matter. Secondary pollutants are acid rain and ozone. Sulphur dioxide and nitrogen dioxide combine with water in the atmosphere and react with sunlight forming acid droplets. These acid droplets constitute acid rain.

Effects of Air Pollution

The following are the effects of air pollution:

- **Effects on human health:** Years of exposure to air pollutants including cigarette smoke adversely affect the natural defenses of the body and can result in lung cancer, asthma, chronic bronchitis, etc. Many other pollutants may have toxic metals which can cause mutations, reproductive problems or even cancer.
- **Effects on plants:** Air pollutants affect plants by entering the cells through stomata. The damage results in the death of the plant.
- **Effects on aquatic life:** Air pollutants mixing up with rain can cause high acidity in fresh water lakes, which affects aquatic life especially fish. Some of the freshwater lakes have experienced total death of fishes.
- **Effects on materials:** Because of their corrosiveness, particulates can cause damage to exposed surfaces.

2. Noise Pollution

We hear various types of sounds everyday. Sound is a form of mechanical energy emitted from a vibrating source. A type of sound may be pleasant to someone and at the same time unpleasant to others. The unpleasant and unwanted sound is called noise.

The CPCB (Central Pollution Control Board) has recommended permissible noise levels for different locations.

Effects of Noise

The following are the effects of noise:

- **Interferes with man's communication:** In a noisy area, communication is severely affected.

- **Hearing damage:** Noise can cause temporary or permanent hearing loss. It depends on the intensity and duration of sound level. Auditory sensitivity is reduced with noise levels over 90 dB in the mid-high frequency, for more than a few minutes.
- **Physiological and psychological changes:** Continuous exposure to noise affects the functioning of various systems of the body. It may result in hypertension, insomnia (sleeplessness), gastro-intestinal and digestive disorders, etc.

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3. Water Pollution

Water pollution can be defined as an alteration in the physical, chemical or biological characteristics of water, making it unsuitable for the designated use in its natural state.

Water is an essential commodity for survival. We need water for drinking, cooking, bathing, washing, irrigation and for all industrial operations. Water has the property to dissolve many substances in it. Therefore, it can easily get polluted. Pollution of water can be caused by point sources or non-point sources. Major point sources of water pollution are industries, power plants, underground coal mines, offshore oil wells, etc.

Groundwater Pollution and Surface Water Pollution

Groundwater pollution

Groundwater forms about 6.2 per cent of the total water available on planet earth, and is about thirty times more than surface water, i.e., streams, lakes and estuaries. Septic tanks, industry (textile, chemical, tanneries), deep-well injection and mining are mainly responsible for ground water pollution which is irreversible. Ground water pollution with arsenic, fluoride and nitrate pose serious health hazards.

Surface water pollution

The major sources of surface water pollution are as follows:

- Sewage
- Industrial effluents
- Synthetic detergents
- Agrochemicals
- Oil
- Waste heat

Effects of Water Pollution

The following are some of the important effects of various types of water pollutants:

- Oxygen-demanding wastes
- Nitrogen and phosphorus compounds (nutrients)

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- Pathogens
- Toxic compounds
- Waterborne diseases
- Reduction in dissolved oxygen in water resources

Pesticides in drinking water ultimately reach humans and are known to cause various health problems. DDT, aldrin, dieldrin, etc., have therefore, been banned. Recently, in Andhra Pradesh, people suffered from various abnormalities due to the consumption of endosulphan contaminated cashew nuts.

4. Thermal Pollution

Thermal pollution can be defined as the presence of excessive heat in the water which can cause undesirable changes in the natural environment.

Heat producing industries like thermal power plants, nuclear power plants, refineries and steel mills are the major sources of thermal pollution.

Effects of Thermal Pollution

The following are the effects of thermal pollution:

- The dissolved oxygen content of water is decreased as the solubility of oxygen in water is decreased at high temperature.
- High temperature becomes a barrier for oxygen penetration into deep cold waters.
- Toxicity of pesticides, detergents and chemicals in the effluents increases with the increase in temperature.
- The composition of flora and fauna changes because the species which are sensitive to increased temperature due to thermal shock, will be replaced by temperature tolerant species.
- Metabolic activities of aquatic organisms increase at high temperatures and require more oxygen.
- Discharge of hot water near the shores can disturb spawning and can even kill young fishes.
- Fish migrations are affected due to the formation of various thermal zones.

5. Marine Pollution

The main sources of marine pollution are: i) rivers, which bring pollutants from their drainage basins ii) catchment areas, and, coastlines where human settlements in the form of hotels, industry, agricultural practices have been established and iii) oil drilling and shipping.

Most of the rivers join the ocean. The pollutants which these rivers carry, from their drainage basins, are finally poured into the sea. These include sewage

sludge, industrial effluents, synthetic detergents, agrochemicals, solid wastes, plastics, metals and waste heat released by industries.

In the sea, the pollutants get diluted and the organic matter is further broken down as in river water. Still, many pollutants, especially the recalcitrant ones, remain unchanged or are partially degraded causing marine pollution.

Tankers and other shipping means, industries like petroleum, refinery, lubrication oil using industry, metal industry and paint industry, automotive wastes refineries, ship-accidents and offshore production add to marine pollution.

Oil in sea water can spread over a large area of the sea and remain dispersed or get adsorbed by sediments. It can cause adverse effects on marine life.

6. Soil Pollution

Soil is the upper layer of the earth's crust which is formed by weathering of rocks. Organic matter in the soil makes it suitable for living organisms to thrive. Dumping of various types of materials, especially domestic and industrial wastes, causes soil pollution.

Domestic wastes include garbage, rubbish material like glass, plastics, metallic cans, paper, fibres, cloth rags, containers and paint varnishes. Leachates from dumping sites and sewage tanks are harmful and toxic which pollute the soil.

Thermal power plants generate a large quantity of 'fly ash'. Huge quantities of these wastes are dumped on soil, thus contaminating them.

Industrial wastes also contain some organic and inorganic compounds that are refractory and non-biodegradable.

Soil also receives excreta from animals and humans. The sewage sludge contains many pathogenic organisms, bacteria, viruses and intestinal worms which cause pollution in the soil.

Effects of Soil Pollution

Sewage and industrial effluents which pollute the soil ultimately affect human health. Various types of chemicals like acids, alkalis, pesticides and insecticides found in the industrial discharges affect soil fertility by causing changes in its physical, chemical and biological properties.

Some of the persistent toxic chemicals accumulate in the food chain and ultimately affect human health. Sewage sludge has many types of bacteria, viruses and intestinal worms which may cause various types of diseases.

7. Nuclear Hazards

Radioactive substances are present in nature. They undergo natural radioactive decay, in which unstable isotopes spontaneously give out fast moving particles, high energy radiations or both, at a fixed rate, until a new stable isotope is formed.

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These particles and rays pass through paper and wood, but can be stopped by concrete wall, lead slabs or water. Damage caused by the different types of radiations depends on the penetration power and the presence of the source inside or outside the body.

8. Solid Waste Management

Higher standard of living of ever increasing population has resulted in an increase in the quantity and variety of waste generated. It is now realized that if waste generation continues indiscriminately, then very soon it would be beyond rectification.

Management of solid waste has, therefore, become very important in order to minimize the adverse effects of solid wastes. Solid waste (waste other than liquid or gaseous) can be classified as municipal, industrial, agricultural, medical, mining waste and sewage sludge.

14.3.3 Environmental Management

Environmental management in relation to business can be defined as managing the triple-bottom line—a process by which companies manage their financial, social and environmental risks; obligations; and opportunities. These three impacts are sometimes referred to as profits, people and planet.

However, this approach relies on an accounting-based perspective and does not fully capture the time element that is inherent within business sustainability. Business sustainability represents resiliency over time—businesses that can survive shocks because they are intimately connected to healthy economic, social and environmental systems. These businesses create economic value and contribute to healthy ecosystems and strong communities.

Environmental management and business sustainability require firms to adhere to the principles of sustainable development. According to the World Council for Economic Development (WCED), sustainable development is development that ‘meets the needs of the present without compromising the ability of future generations to meet their own needs.’ So, for industrial development to be sustainable, it must address important issues at the macro level, such as: economic efficiency (innovation, prosperity and productivity), social equity (poverty, community, health and wellness and human rights) and environmental accountability (climate change, land use and biodiversity).

Energy Management

Energy management is a part of environmental management. Environmental management offers research and opinions on use and conservation of natural resources, protection of habitats and control of hazards, spanning the field of applied ecology without regard to traditional disciplinary boundaries.

The environmental management activities at a firm are guided by the selection of an environmental strategy. This strategy drives alignment of the environmental management systems, programs, and tools that will be used. Environmental strategies can be said to occupy four levels of sustainability: compliant, market driven, engaged, and shaping the future.

Four Strategy Levels

- **Compliant:** A firm decides it will be in compliance with all environmental, health, and safety regulations. This is the minimum level of environmental strategy a firm can adopt.
- **Market-driven:** A firm responds not only to regulatory requirements, but also reacts to its customers' environmental expectations by providing leading product/service and operational performance.
- **Engaged:** A firm is not only in compliance, but also understands its environmental market opportunities and proactively uses that knowledge to create engagements with the value chain and other stakeholders to identify opportunities faster.
- **Shaping the future:** A firm develops products and services for current and future market conditions, addressing unmet societal needs by proactively integrating economic growth, environmental health and safety, and social well-being into its operations and business practices.

(Source: Adapted from Fava, J. et. al., 1998)

The relationship of business implications (e.g. efficiency, compliance, liability reduction, cost savings or avoidance, and revenue generation) to environmental strategy is shown in Figure 14.1. As a firm moves from a compliant strategy to a more sustainable strategy, different implications result.

	Business Implication		
	Costs	Savings	Revenue
Shape the Future			
Engaged			
Market Driven			
Compliant			

Fig. 14.1 Business Implication on the Strategy Implemented

(Adapted from Fava et al, 2001)

A compliant strategy, for example, is often viewed as a cost and often includes only strategic elements aimed at meeting the legal requirements as efficiently as possible. In a market-driven strategy, a firm has integrated pollution prevention and customer/consumer or reactive market considerations into the design of its

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products or processes, which results in cost savings or cost avoidance. On the other end, shaping the future strategy may generate revenue by viewing the environment from a strategic perspective to identify new business opportunities, and greener products.

Strategy is essential, but not sufficient, businesses also need environmental management systems, programmes and tools.

Organizations use various approaches and tools to integrate environmental considerations into their everyday decision processes. Environmental approaches and tools can be described as operating at a management system level, a program level, or a tool level.

Environmental management systems are broad, flexible frameworks for managing an organization's environment-related activities. They are usually tailored to a specific organization's environmental strategy, business model, and environmental responsibilities. Management systems addressing similar needs can vary significantly from one organization to another, based on differentiation arising from their respective business models and environmental strategies.

Programmes are a level below management systems and are often used to carry out the strategic intent of the organization. Programmes generally have a higher degree of specificity, and common program elements often appear among organizations in the same industrial sector.

Tools are used to support environmental systems and programs. Environmental tools are highly specialized and are often created with rigorous scientific methodology.

1. Water Resource Management

Community-based water resource management has been in limelight for quite some time now. Several examples can be quoted nationally and internationally where community members have joined hands to manage this precious resource for its sustainable use. A notable example from India is that of Dr Rajendra Singh who won the Magsaysay Award in 2001 for his exemplary efforts in community development and water conservation and management in the state of Rajasthan.

Water resources should be protected because of the following reasons:

- To ensure the availability of fresh, clean drinking water for future generations
- To conserve energy, which is otherwise used for the pumping, delivery and treatment of water
- To preserve fresh water habitats for local wildlife and migrating waterfowl
- To reduce the need to build new dams and other water diversion infrastructures
- To reduce per capita water consumption

However, the present problem is not the lack of availability of water. The issues are more of lack of optimal management, better distribution mechanism and reduction of leakage. These issues have to be treated with utmost urgency, or else the nation will have to resort to expensive solutions or live with the burden of hampered growth.

Some optimum solutions include the following innovative and futuristic management techniques:

- Minimum use of water
- Water recycling
- Reusing waste water for industrial uses
- Ensuring a higher degree of efficiency in the management of water use in irrigation
- Desalination in coastal areas
- Recharging of the groundwater level by means of artificial aquifer recharging and recovery

2. Forest Resource Management

Forest resource management involves the sustainable management of forests by using comprehensive social, economic and environmental goals. Forests are important ecosystem resources, and several attempts have been made to protect them to provide a sustainable resource for the future generations.

The Chipko Movement is one of the most famous and commendable efforts in the area of protecting forests. The concept of people's participation in management of forests is not new to India. The country historically has great traditions of protecting and managing forests as common resources. Every village, hamlet and community ensured that the utilization of natural resources including forests did not exceed the ecological carrying capacity. The economic and political colonization of the country adversely affected the traditions of conservation of sustainable utilization of resources.

The forests and the people, which grew under the mutually beneficial relationships, suffered together, as the growing population put an ever-increasing demands on the resources. The forest wealth gradually depleted and the people and forests were caught in the vicious circle of ecological and economic deprivation. Post independence, forestry practices also continued to neglect the need for forest conservation practices and people's involvement in the process. For nearly four decades after independence, the process of commercial exploitation and degradation of the forest continued.

During the eighties, the satellite imageries sounded the alarm bell by pointing to the fact that less than 14 per cent of the country's area was under forest cover

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as against the desired figure of 33 per cent. Good tree cover was found in few isolated patches only and large parts of the forest areas were suffering from various degrees of degradation.

These warning signs of impending ecological crises led to serious review of the approaches to the management conservation and utilization of forests. Although, the 1952 forest policy aimed at forest coverage of one-third of the total land area of the country, due to various constraints, no efforts were made to attain this. Diversion of vast stretches of forestland was made for non-forest use; the biological diversity was considerably affected as also the good tree cover and the forest area.

Joint Forest Management

The importance of forests for the ecological and economic stability of the country was realized by conservationists, foresters, and the government, which necessitated the re-examination of the policy, laying emphasis on the conservation and sustainable utilization of our forest resources.

The National Forest policy of 1988 brought about significant changes in the existing forest management policies and practices. One of the main recommendations was the involvement of people in forest conservation and management as the major means of putting off the impending ecological crises and providing the benefits of these efforts directly to the people. It was realized that conservation and proper management of forests was not possible without active participation of the local people. Efforts were accordingly initiated in the seventies to involve local people in this task. This approach of involving the local people in the protection and management of forests is commonly referred to as joint forest management (JFM).

3. Energy Resource Management

Energy resource management can be defined as the process of monitoring, controlling and conserving energy in any setting. India is currently facing a problem of inadequate energy. This is especially true of several villages in the country where electricity remains a mere dream. It is in such a scenario that corporate as well as non-governmental organizations are undertaking monumental efforts to popularize the harnessing of solar energy. For instance, in rural Odisha, solar power has ensured that the fates of many villages has undergone rapid transformation—homes are lit after dark, fields are irrigated using solar power and mobile telephone towers keep the hinterlands connected.

The concept of energy resource management is still in its nascent stage in India as against the ever-increasing energy requirements of the rapidly growing economy. The country produces about 2.4 per cent of its energy needs and consumes about 3.4 per cent. It is ranked eleventh on the production list and sixth

on the consumption list. These numbers have increased by 50 per cent in the last few decades.

Poor communities residing in far flung areas lack access to energy resources that are available to their urban counter parts. In such scenario making energy accessible to them becomes one of the challenging and ethical responsibilities of the state and other counterparts engaged in development activities.

4. Biodiversity Resource Management

Biodiversity refers to variation of life forms within a given species, ecosystem, biome, or an entire planet. It can be defined as the variety and diversity that exist among living organisms of all species, genera and ecosystems. The Convention on Biological Diversity defines biodiversity as ‘the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are a part; this includes diversity within species, between species, and of ecosystems’.

The biodiversity that this country has been blessed with is evident in the fact that it plays host to two of the world’s eighteen ‘biodiversity hotspots’ — located in the Western Ghats and the eastern Himalayas. The forest cover in these areas is very dense, diverse and replete with pristine beauty. According to the government reports, the country is estimated to have more than of 45,000 species of plants and 81,000 species of animals. These represent 7 per cent of the world’s flora and 6.5 per cent of its fauna. This has gone up to 49,219 species of plants and 81,251 species of animals, representing 12.5 per cent and 6.6 per cent of the world’s flora and fauna respectively. Furthermore, the Thar Desert and the Himalayas are two regions rich in biodiversity in India. The Chilika Lake, in Odisha, is also an important wetland area of global importance that is rich in biodiversity.

The last century has seen considerable damage being done to the biodiversity of the planet, caused by factors such as the following:

- Increasing level of human population
- Increasing levels of consumption
- Decreasing efficiency of use of resources

Trade in wildlife, such as the elephant tusk, rhino horn, snake skin and crocodile hide, has led many species to the brink of extinction. This has caused a loss of balance to the food chain, thereby affecting both flora and fauna.

To solve this problem, the government has set up biosphere reserves in different parts of the country to help conserve the biological diversity prevalent in different ecosystems. Some of these have been set up in the Nilgiris, Nicobar, Manas, Sunderbans and Dibru Saikhowa. NGOs are also involved to create awareness.

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14.3.4 Environment Management System

We know that ecosystems are gradually becoming fragile owing to development activities. Over-utilization of ecosystem resources beyond its carrying capacity has clearly reflected that sustainability can only be achieved for human need and not greed. However, several initiatives in the area of sustainable development have facilitated the movement towards protecting the environment and businesses are increasingly taking active part in the process partly due to their commitment towards responsive business and partly owing to stringent legislations.

Several tools have come into being to deal issues related to environment. One of the tools that has secured significant place in this regard is the environmental management system (EMS).

The concept of an EMS evolved in the early nineties and its origin can be traced back to 1972, when the United Nations organized a Conference on the Human Environment in Stockholm and the United Nations Environment Program (UNEP) was launched (Corbett & Kirsch, 2001). These early initiatives led to the establishment of the World Commission on Environment and Development (WCED) and the adoption of the Montreal Protocol and Basel Convention.

In 1992, the first Earth Summit was held in Rio-de-Janeiro (Jiang & Bansal, 2001), which served to generate a global commitment to the environment. In the same year, BSI Group published the world's first environmental management systems standard, BS 7750. This supplied the template for the development of the ISO 14000 series in 1996, by the International Organization for Standardization, which has representation from committees all over the world (ISO) (Clements 1996, Brorson & Larsson, 1999). As of 2010, ISO 14001 is now used by at least 223 149 organizations in 159 countries and economies.

EMS is a management tool that can help a business increase its awareness of, and its control over environmental impacts. It is a framework developed by an organization to help improve its environmental performance by taking environmental considerations into account when making decisions and managing risks. It can be applied to a single site, to a division that operates at many sites, or to a company as a whole. This flexibility can be particularly useful in industries where companies may be involved at many different levels, and where the associated environmental impacts may vary widely.

An EMS is defined by ISO as: 'part of the overall management system, that includes organizational structure, planning activities, responsibilities, practices, procedures, processes and resources for developing, implementing, achieving and maintaining the environmental policy' (ISO 1996 cited in Federal Facilities Council Report 1999); (Figure 14.2).

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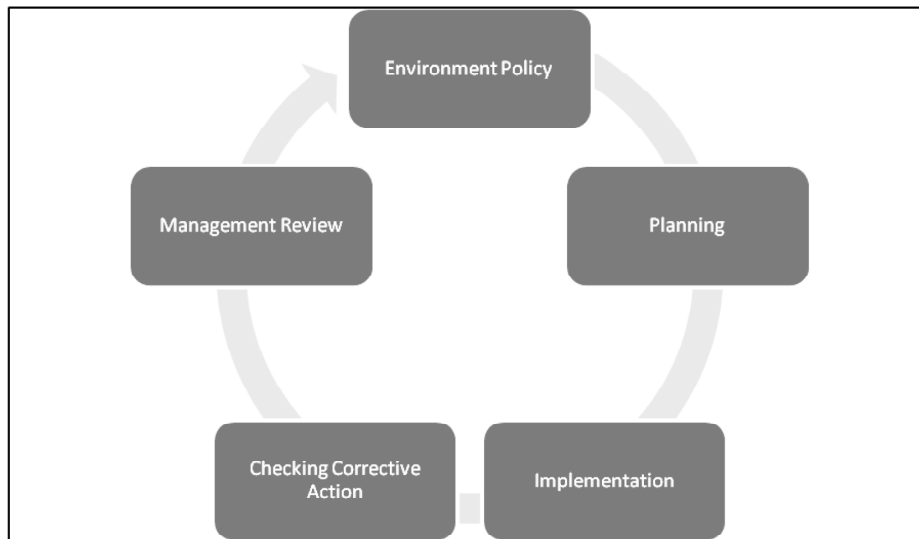


Fig. 14.2 Framework for Environment Management System

Source: http://www.hkveritas.com/hk/Environmental_Management_System_ISO_14001_2004.html

Two most popular schemes for EMS include ISO 14001 and the eco-management and audit scheme (EMAS).

ISO 14001

The International Organization for Standardization (ISO), based in Geneva, is one of the key international voluntary standards bodies. ISO has a rigorous process for standards development. When a new standard is proposed, it must be approved either by a technical committee or by the technical management board of ISO. Once a technical committee is established, it may establish subcommittees and working groups to carry out the work. ISO has a general rule that all standards be reviewed at least every five years.

Eco-management and Audit Scheme

The eco-management and audit scheme (EMAS) is a voluntary environmental management instrument, which was developed in 1993 by the European Commission. It enables organizations to assess, manage and continuously improve their environmental performance. The scheme is globally applicable and open to all types of private and public organizations. In order to register with EMAS, organizations must meet the requirements of the EU EMAS-Regulation. Currently, more than 4,600 organizations and more than 7,900 sites are EMAS registered.

Registration under EMAS is on a site-by-site basis, rather than covering entire organizations. Originally EMAS was confined to industrial operations, but as part of a wide-ranging revision of the regulation, adopted in March 2001, all sectors of economic activity are now included.

In order to register with EMAS, an organization must comply with the following implementation steps (Article 4 of the EMAS-Regulation; Figure 14.3):

EMAS is a comprehensive and demanding premium label, whose implementation requires some financial and personnel resources. In return, EMAS provides organizations with many advantages that can easily outweigh these costs.

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Fig. 14.3 Implementation Steps to Register with EMAS

The costs of EMAS include the following (Figure 14.4):

- Fixed costs
- External costs
- Internal costs



Fig. 14.4 Costs of EMAS

The benefits of EMAS that in the long run outweigh the cost include the following:

- Environmental and financial performance through a systematic framework, for example, increased resources, energy efficiency, and waste reduction.
- Risk and opportunity management, for example, legal compliance, regulatory relief.
- Credibility, transparency and reputation, for example, environmental statement, key performance indicators, verification and validation through independent environmental verifiers.
- Employee empowerment and motivation, for example, improved involvement of staff, higher awareness, often leading to innovations.

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Check Your Progress

1. List the major factors involved in environmental friendly business operations.
2. Mention the various sources of marine pollution.
3. Name two popular schemes included under environment management system.
4. What are the main sources of water pollution?

14.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The major factors involved in environmental friendly business operations can be grouped as follows:
 - (i) Natural resources and special features of the environment
 - (ii) Climatic conditions and weather patterns
 - (iii) Topographic variations
 - (iv) Locational factors
 - (v) Infrastructural factors, such as roads, ports and so forth.
2. The main sources of marine pollution are: (i) rivers, which bring pollutants from their drainage basins (ii) catchment areas, and, coastlines where human settlements in the form of hotels, industry, agricultural practices have been established and (iii) oil drilling and shipping.
3. Two popular schemes included under environment management system are ISO 14001 and the Eco-Management and Audit Scheme (EMAS).
4. The three main sources of water pollution are (i) sewage (ii) industrial waste and (iii) agricultural waste.

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14.5 SUMMARY

- Population size refers to the actual number of individuals in a population. In this section, we will have a look at the population size in India and the factors affecting high growth in population size and the measures to reduce the population size.
- Demographic transition is the transition from a stable population with high mortality and fertility to a stable population with low mortality and fertility.
- In India, there is a high incidence of internal migration of poor labourers. The poor migrants end up working as casual labourers in the informal sector. This population is also the one that is more susceptible to diseases and stands the risk of not getting access to health services.
- You have seen that continuous urbanization has led to over-urbanization in many Indian cities due to concentration of population in these cities. This over-urbanization reduces the efficiency of the urban centres and creates a large number of problems.
- Needless to say, depletion of the earth's natural resources and atmosphere that support life will have disastrous effects on all. Business and industry have a major role to play by seeing to it that their actions reduce environmental impacts to the barest minimum.
- The environmental movement lays emphasis on reducing the pollution of air, water and land. Our vital and fragile eco-system is today increasingly threatened by commercial exploitation, growing population demands and industrial pollution.
- Pollution of air and water has become a greater menace to life than even armaments and nuclear weapons. Industrialization is the direct cause of air and water pollution in human environment.
- Air pollution means the presence in the atmosphere of any air pollutant.
- Soil is the upper layer of the earth's crust which is formed by weathering of rocks.
- Organic matter in the soil makes it suitable for living organisms to thrive. Dumping of various types of materials, especially domestic and industrial wastes, causes soil pollution.
- Radioactive substances are present in nature. They undergo natural radioactive decay, in which unstable isotopes spontaneously give out fast moving particles, high energy radiations or both, at a fixed rate, until a new stable isotope is formed.
- Environmental management in relation to business can be defined as managing the triple-bottom line—a process by which companies manage their financial,

social and environmental risks; obligations; and opportunities. These three impacts are sometimes referred to as profits, people and planet.

- Community-based water resource management has been in limelight for quite some time now.
- Over-utilization of ecosystem resources beyond its carrying capacity has clearly reflected that sustainability can only be achieved for human need and not greed.

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14.6 KEY WORDS

- **Demographic Transition:** It is the transition from a stable population with high mortality and fertility to a stable population with low mortality and fertility.
- **Thermal Pollution:** It can be defined as the presence of excessive heat in the water which can cause undesirable changes in the natural environment.
- **Biodiversity:** It refers to variation of life forms within a given species, ecosystem, biome or an entire planet.

14.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write a short note on the distribution of population in India.
2. Identify the various aspects of the natural environment.
3. List the major sources of surface water pollution.
4. Write a short note on environmental management in relation to business.
5. Write short notes on the following:
 - (a) Water resource management
 - (b) Energy resource management
 - (c) Forest resource management

Long Answer Questions

1. Discuss the challenges to population size in India.
2. Describe the problems posed by urbanization and over-urbanization in India.
3. Discuss the importance of the Public Distribution System.
4. Explain the various types of environmental pollution existing in India.
5. Analyse the significance of environment management system.

14.8 FURTHER READINGS

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