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# ONLINE PROGRAMMES

## Master of Business Administration

II - Semester

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## BUSINESS ENVIRONMENT

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## Business Environment

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## INTRODUCTION

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### NOTES

A business enterprise is a part of society and the business environment has a direct relationship with the policy of the enterprise. The environment may impose several constraints on the enterprise as it has a tremendous impact and influence. The enterprise on the other hand, has very little control over its environment. Therefore, the success of an enterprise depends to a very large extent on its adaptability to the environment, i.e., its ability to identify itself with the environment and fit in with the environmental framework. According to Hicks, 'The firm can adjust to the environment, or if it has the ability, change the environment.'

The significance of the study of the business environment are the following:

- The study of the business environment helps an organisation to develop its broad strategies and long-term policies.
- It enables an organisation to analyse its competitors' strategies and thereby formulate effective counter strategies.
- Knowledge about the changing environment will keep the organisation dynamic in its approach.
- Such a study enables the organisation to foresee the impact of the socioeconomic changes at the national and international level on its stability.
- Finally, as a result of the study, executives are able to adjust to the prevailing conditions and thus influence the environment in order to make it congenial to business.

This book, *Business Environment*, is divided into fourteen units that follow the self-instruction mode with each unit beginning with an Introduction to the unit, followed by an outline of the Objectives. The detailed content is then presented in a simple but structured manner interspersed with Check Your Progress Questions to test the student's understanding of the topic. A Summary along with a list of Key Words and a set of Self-Assessment Questions and Exercises is also provided at the end of each unit for recapitulation.

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**BLOCK - I**  
**BASICS OF BUSINESS ENVIRONMENT**

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*An Overview of Business  
Environment*

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**UNIT 1 AN OVERVIEW OF  
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**1.0 INTRODUCTION**

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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 the importance of scanning the environment.

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**1.1 OBJECTIVES**

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

- List the dynamic factors of environment
- Analyse the importance of scanning the environment
- Define macro environment and micro environment

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## 1.2 BUSINESS ENVIRONMENT: INTRODUCTION

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Suppose your objective is to become a successful manager. Your success as a manager depends on a number of factors and these constitute your work environment. As a manager you do not work in vacuum, but in an environment. When you take decisions you cannot neglect the limitations of your environment. As a business manager, you have to constantly review your business environment.

Environment refers to the sum of all factors — economic, political, social and cultural — which are external to and beyond the control of the individual business enterprises and their management. Environment furnishes the macro-contexts, while the business firm is the micro-unit. The environmental factors are a ‘given’ within which the firm operates. The environmental factors are numerous and complex. Some of these factors are static while others are dynamic. Environmental factors generally vary from country to country. The environment found in India may not be found in the USA or the UK, and vice versa.

Environment may be local, national and international. Again, environment may be market environment and non-market environment. When the business environment is influenced by market forces like demand, supply or competition, it is referred to as market environment. When business environment is influenced by social customs, government laws, religious taboos, it is referred to as non-market environment.

Also, business environment is influenced by economic and non-economic factors. Economic environment is shaped by the monetary policies, tax policies, economic policies, industrial policies, etc., of the country concerned.

The non-economic environment is shaped by political, social, cultural and historical factors.

It is necessary to examine the business environment because it will enable the manager to know which factors are helping or hindering the success of his business. If he could identify the factors which hinder his success in business, he will adopt an alternative course of action.

There are various techniques of scanning business environments.

First, identify the particular environment. Then find out what are the elements of such an environment and analyse them. Since the environmental factors are macro variables, they are beyond the control of a particular firm.

- The first technique of scanning is changing the economic activity, i.e., adjusting the means to the ends or the ends to the means.
- Second, change the decision-making process of the firm. When input is the constraining factor, the firm’s decision variable is the output, and when output is the constraining factor, the firm’s decision variable is the input.

### 1.2.1 Importance of Scanning the Environment

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.

##### 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

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

### 4. PESTLE Analysis

PESTLE analysis helps in analysing the environmental factors that highly affect organizational strategies. You will study the PESTLE analysis in detail in Unit 2.

#### 1.2.2 Concept of Business 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.

### 1.2.3 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. 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'. 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.

- 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.
- 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

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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: Share of wallet, generic competition, product variants, brand competitors.
- 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.

### 1.2.4 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.

- (i) 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, training, etc., 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.

- (ii) **Identification of weakness:** The study of the internal environment indicates not only the strengths but also the weaknesses of the organization. A firm may be strong in specific areas, and weak in some other areas. The firm should recognize the weaknesses and correct them as quickly as possible.
- (iii) **Identification of opportunities:** An analysis of the external environment aids the organization in identifying market opportunities. The business firm should make every possible effort to grab the opportunities as and when they come.
- (iv) **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.
- (v) **Exploitation of business opportunities:** The environment opens new opportunities for business expansion. Study of the environment is essential discovering and exploiting such opportunities fully.
- (vi) **Keeping business enterprise alert:** Environment study keeps the business unit alert in its approach. The problems and prospects of business can only be fully understood with the study of the business environment. This enables an enterprise to face problems with confidence and secure the highest benefits of business opportunities available.
- (vii) **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.
- (viii) **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 problems boldly and also benefit from positive situations.
- (ix) **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.
- (x) **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.

## NOTES

## NOTES

(xi) **Ensuring survival and growth:** The business environment informs about suitable changes to be affected in policies, aiding the business to grow and prosper.

(xii) **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.

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### 1.3 TYPES OF BUSINESS ENVIRONMENT

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Let us now discuss the types of business environment.

#### Internal Environment

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

- Man
- Materials
- Machines
- Management of Time
- Money

#### 1. 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, unpunctuality 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 working 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 can be achieved.

#### 2. Materials

Without materials, human resource is useless. 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 as long as the supply does not arrive. Even if it arrives, but if the quality is poor, the

production is affected badly. Quality compromised is business compromised. Poor quality of materials often ruins entrepreneurship.

### **3. Machines**

The metal contraptions called machines have made man fulfill almost effortlessly various dreams of creating things that make 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 or 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.

### **4. Management of time**

Time management is an aspect of business that has been employed by effective and successful business ventures to optimize delivery. Unpunctuality 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 or lack of adequate materials for production of goods or services. 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 ensure business sustainability. Compromising time is equal to a business venture shooting itself in the foot.

### **5. 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 the collapse of enterprises in history. The quantity and quality of money expended in enterprises is directly related to the fruitfulness of the same over time. The accounts department has been revolutionized 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**

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.

## **NOTES**

## NOTES

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.

If one were to define the **macro environment**, Hill and Jones' version is worth recalling: 'The macro environment consists of the broader economic, social, demographic, political, legal and technological setting within which the industry and the company are placed.'

### Check Your Progress

1. What are the components of the macro environment?
2. Define ETOP.

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## 1.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. 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. These factors include all the external environmental forces affecting the manner in which a company operates.
2. 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.

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## 1.5 SUMMARY

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- Environment refers to the sum of all factors — economic, political, social and cultural — which are external to and beyond the control of the individual business enterprises and their management.
- Environment may be local, national and international. Again, environment may be market environment and non-market environment.
- The non-economic environment is shaped by political, social, cultural and historical factors.
- There are various techniques of scanning business environments.
- 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.
- 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 existence more worthwhile. Machines have replaced man in tilling, planting and harvesting.
- 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.
- 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.
- 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.

## NOTES

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### 1.6 KEY WORDS

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- **Environmental Scanning:** 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.
- **SWOT Analysis:** It is the process of carefully inspecting the business and its environment through the various dimensions of strengths, weaknesses, opportunities, and threats.

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### 1.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. What is business environment?
2. What is the importance of scanning the business environment?

3. What is micro environment?
4. What is macro environment?

## NOTES

### Long-Answer Questions

1. Discuss the essential components of the micro environment.
2. Explain the five Ms of the internal environment.
3. Describe the various techniques of environmental analysis.

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### 1.8 FURTHER READINGS

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# UNIT 2 FUNDAMENTAL ISSUES CAPTURED IN PESTLE

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*Fundamental Issues  
Captured in PESTLE*

## NOTES

### Structure

- 2.0 Introduction
- 2.1 Objectives
- 2.2 Fundamental Issues Captured in PESTLE: An Overview
  - 2.2.1 Political Environment
  - 2.2.2 Economic Environment
  - 2.2.3 Social Environment
  - 2.2.4 Technological Environment
  - 2.2.5 Legal Environment
  - 2.2.6 Ecological Environment
- 2.3 Opportunities and Threats as Environmental Issues to be Addressed by Businesses
- 2.4 Answers to Check Your Progress Questions
- 2.5 Summary
- 2.6 Key Words
- 2.7 Self Assessment Questions and Exercises
- 2.8 Further Readings

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## 2.0 INTRODUCTION

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PESTLE is an acronym and it is used as an analytical tool. It stands for the Political, Economic, Social, Technological, Legal and Environmental factors which influence the business environment of an organization.

This unit will discuss PESTLE analysis. 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.

## NOTES

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, 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.

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### 2.1 OBJECTIVES

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

- Describe the use of PESTLE analysis
- Discuss the fundamental issues captured in PESTLE
- Identify the opportunities and threats as environment issues to be addressed by businesses

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### 2.2 FUNDAMENTAL ISSUES CAPTURED IN PESTLE: AN OVERVIEW

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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.

*Fundamental Issues  
Captured in PESTLE*

### **2.2.1 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 BJP), 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 political and legal environment exerts its influence on business through the following:

- Legal obligations for business that determine its decisions and actions.
- Political and ideological postures that underlie defence and strategic positions, have a bearing on business moves vis-à-vis trade pacts, inimical terms with certain countries that restrict scope for trade and economic relations, negative features of international trade that impinge on business initiatives, and regional alliances that foster mutual cooperation and development.
- Internal strife by aggrieved sections of society that hamper economic activity and development in certain parts of the country; controversial and destabilizing issues can divide society on the lines of caste, sex or religion, thus disrupting normal life, bringing economic activity to a virtual halt and causing civil unrest and loss of national property.
- Political philosophies that stabilize or disrupt economic progress, disbalance the stock markets, encourage nepotism and graft, tolerate bureaucratic inefficiency, foster a nexus between politicians and bureaucrats, and seriously erode the moral fabric of the nation.
- Reaction times of the three pillars of democracy as regards the need to address burning (and long pending) issues crippling progress across various fronts including social justice, public health, poverty eradication, employment generation and rise in the standard of living of the people of the Republic.
- Foreign policy initiatives that strengthen the nation, hold out hope for betterment of the common man, instil a sense of national pride in citizens, and project a positive image of the country and its leadership to other nations of the world.

### **NOTES**

## NOTES

It goes without saying that policies and decisions of the government should encourage business by creating conditions that act as a tonic for the tired economic system, instead of enacting illogical laws and imposing conditions that act as barriers to progress.

### 2.2.2 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 firms to make business decisions. Overall, it is only those firms that can judge the trends in the economy that survive and prosper over long periods. In India, we have seen the meteoric rise of companies like Reliance Industries, Bharti Enterprises, Satyam and Infosys—new age companies that eclipsed many older, bricks-and-mortar business groups like those of the Modis, Jaipurias, Shrirams and Mafatlals, whose fortunes were on the wane. Only the Tata and Birla Groups retained their respectability if not their exclusivity. Since a firm's long-term survival depends upon correctly reading the economic trends, it would be useful to examine in some detail the various components of the economic scenario, as follows:

- (i) **Economic system:** A country's economic model, i.e., socialist, capitalist, mixed economy, etc., has a vital bearing on a firm's capacity to exploit its opportunities. India followed a socialistic pattern of economy for several decades, but it did not bring rapid development. Even the experiment with a mixed economy has not fared too well, with the result that from 1991, the country has seen the government making a strategic retreat from several economic activities, to focus on its role in governance and regulation. With the noticeable cutback in bureaucratic control following liberalization, the private sector has shown remarkable initiative in taking the economy forward, encouraged by several reserved sectors like civil aviation and petro- and gas prospecting / processing being thrown open to all on an equal footing. The growth of a resurgent middle class with ample disposable incomes, and the emergence of a new wealthy class seems to indicate that the economy is well set to vindicate the Goldman Sachs Report that India will be an economic superpower by 2050.

- (ii) **Economic policies:** The government plays a regulatory and supervisory role in the economic system, through the following means: Annual budgets, economic plans, industrial policies, wage and price controls, etc.
- (iii) **Economic growth:** The economic performance and growth of domestic industry and business is heavily dependent on the growth of the economy as a whole, since greater all-round prosperity engenders increased levels of expenditure spending as well as investment, which results in good velocity of circulation of money in the economy and encourages exports. In contrast, depressed economic conditions would lead to less production, erode savings and result in inflationary conditions—a condition known as ‘stagflation’.
- (iv) **Interest rates:** The Reserve Bank of India, the apex bank that monitors and controls the economy, uses interest rates as one of its prime means of controlling money supply, promoting savings as well as investment, and curbing inflation.
- (v) **Currency exchange rates:** National currencies are valued against each other at certain rates of exchange. The costlier the Dollar is against the rupee, the more exports gain in rupee terms. Rupee devaluation, therefore, is beneficial for exporters, but not for importers, a property of the exchange mechanism that the Indian economy has taken advantage of in the past, when foreign exchange reserves of the country were abysmally low and exports needed to be boosted, while imports had to be strictly curbed.

## NOTES

### International Economic Environment

Given the globalization of the Indian economy, it has now become more prone to react to international economic events, something that it was earlier insulated from. Factors such as those enumerated below have assumed prominence in the new economic climate: Global perspective in strategic decisions, appreciation of cultural diversity, export value, quality control WTO restrictions, etc.

#### 2.2.3 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 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.

## NOTES

### Demography

Demography refers to people, specifically factors usually covered by our decennial census, some of which are:

- Population in terms of numbers, or decline/growth over a period
- Composition in terms of age, sex, family size, and so on
- Economic strata
- Caste, religion, political affiliations
- Educational status, and so on

All these demographic factors are of direct interest to business, because demand for goods and services stems from the population of the country. India has a vast market that is growing rapidly. There are several reasons for this, but the major reasons are political stability, liberalized economy, huge natural resources, a population whose average age is twenty-five, with fifty per cent of the populace being less than thirty years of age. Fragmentation of the joint family system, with nuclear families due to economic resurgence, a rural heartland that is showing signs of prosperity, and well-educated women entering the workforce are some of the reasons for rising levels of prosperity.

#### 2.2.4 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 process, 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.

#### 2.2.5 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 the decision to start a business in India. One has to take an online Digital Identification number and then 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 one has 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.

## NOTES

### **2.2.6 Ecological Environment**

Just as our cultural heritage is important, so is our natural heritage. This includes the land, its forests, 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. 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:

- Natural resources and special features of the environment
- Climatic conditions and weather patterns
- Topographic variations
- Locational factors
- Infrastructural factors such as roads, ports, etc.

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

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## **2.3 OPPORTUNITIES AND THREATS AS ENVIRONMENTAL ISSUES TO BE ADDRESSED BY BUSINESSES**

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Environmental scanning means an analysis of the environmental variables. A business manager operates in an environment and not in a vacuum. At the same time, environmental scanning points towards interaction among environmental factors. Environmental scanning is a step towards corporate planning.

### **Need and Technologies of Environmental Scanning**

We have already pointed out the need for environmental scanning. Now we shall discuss the techniques of the same.

## NOTES

William F. Glueck has mentioned the following techniques of environment scanning:

- (i) Verbal and written information
- (ii) Search and scanning
- (iii) Spying
- (iv) Forecasting and formal studies

Another important technique of environment analysis is SWOT analysis. Corporate managers analyse the Strengths (S), Weaknesses (W), Opportunities (O) and Threats (T) that exist for the organization in the context of its environment. SWOT analysis is a systematic identification of these factors and the strategy that reflects the best match between them. It is based on the assumption that an effective strategy maximizes a business's strengths and opportunities but at the same time, minimizes its weaknesses and threats. This simple assumption has powerful implications for successfully choosing and designing an effective strategy.

Environmental analysis provides the information to identify key opportunities and threats in the firm's environment.

**Opportunities:** An opportunity is a favourable situation in the firm's environment. Identifying previously neglected market segments, changes in competition, technological changes and improved buyer or supplier relationships might be opportunities for the firm.

**Threats:** An unfavourable situation, threat is key hindrance to the growth of the firm. The entry of a new competitor, slow market growth, increased bargaining power of main buyers or suppliers, major technological change and changing regulations could be threats to a firm's future success. For example, consumer acceptance of home computers was a major opportunity for IBM. Understanding the key opportunities and threats facing a firm helps managers identify realistic options from which to choose an appropriate strategy.

The second fundamental focus in SWOT analysis is identifying key strengths and weaknesses.

**Strength:** A strength is a resource, skill or other advantage, relative to competitors and the needs of market a firm serves. A strength is a distinctive competence that gives the firm a comparative advantage in the market place. Financial resources, market leadership and buyer/supplier relations are examples of strengths.

**Weaknesses:** A weakness is a limitation or deficiency in resources, skills and capabilities that impede effective performance. Facilities, financial resources, management capabilities, marketing skills and brand image might be sources of weaknesses.

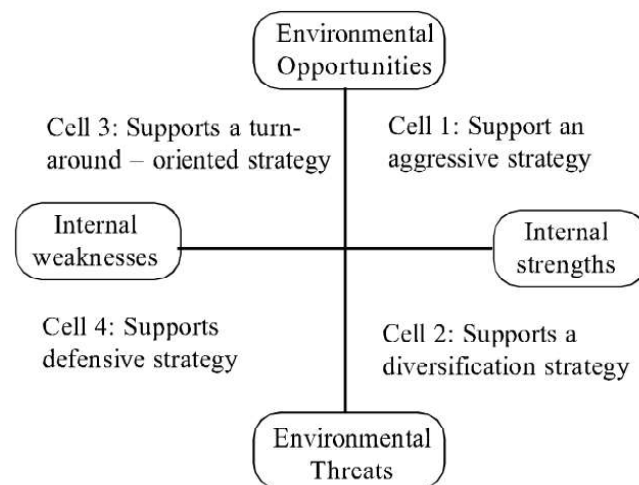
SWOT analysis can be used in at least two ways in strategic choice decisions. The most common application provides a logical framework guiding systematic discussions of the business' situation, alternative strategies and ultimately the choice of strategy. What one manager sees as an opportunity, another may see as a

potential threat. Systematic SWOT analysis ranges across all aspects of a firm's situation. As a result, it provides a dynamic and useful framework for choosing a strategy.

A second application of SWOT analysis is shown in Figure 2.1. Key external opportunities and threats are compared to internal strengths and weaknesses in a structured approach. The objective is identification of one of the four distinct patterns in the match between the firm's internal and external situations.

Certain patterns are represented by the four cells in our figure. Cell 1 is the most favourable situation, the firm faces several environmental opportunities and has numerous strengths that encourage pursuit of such opportunities. This condition suggests growth-oriented strategies to exploit the favourable match. Cell 4 is the least favourable situation, with the firm facing major environmental threats from a position of relative weakness. This condition calls for strategies that reduce involvement in the products/markets examined using SWOT analysis. In Cell 2, a firm with key strengths faces an unfavourable environment. In this situation, strategies would use current strengths to build long-term opportunities in other products/markets. A business in Cell 3 faces impressive market opportunity but is constrained by several weaknesses.

## NOTES



**Fig. 2.1** A Second Application of SWOT Analysis

A host of external and uncontrollable factors influence a firm's choice of direction and action and ultimately its organizational structure and internal processes. The firm functions as a part of the environment and has no existence apart from the environment. By exploiting the opportunities present in the environment, the firm achieves its growth objectives. Again, it is in the environment that it finds its threats, which have to be faced successfully, if it has to achieve its objectives. The external environment has to be divided into two categories—the remote environment and the more immediate operating environment.

**NOTES**

**Methods and Techniques of Environmental Analysis**

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:

- 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

**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.



## **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:

1. Strategy planners first observe the events and trends of the organization.
2. From the above observation they broadly consider important issues that may affect the organization, using environment appraisal.
3. A report is created by summarizing these issues, their effects and different scenarios to show the implementation of these strategies.
4. 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.

## **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:

- 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:

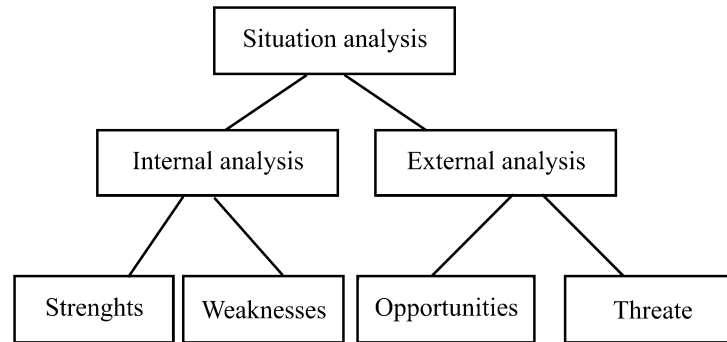
- Customers and clients
- Competitors
- Market trends
- Suppliers

## **NOTES**

## NOTES

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

Figure 2.2 shows the SWOT analysis process.



*Fig. 2.2 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 good a 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

*Fundamental Issues  
Captured in PESTLE*

## NOTES

### Check Your Progress

1. Name the three pillars of government.
2. What does legal environment of business denote?

## 2.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The three pillars of the government are (i) Legislature (ii) Executive (iii) Judiciary.
2. 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.

## 2.5 SUMMARY

- 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.
- The economic and political systems of a country are mutually dependent, the one reflecting the ideologies of the other.
- The economic framework is that within which the firm functions, plays a crucial role in its efforts to thrive, grow and beat its competitors.
- The Reserve Bank of India, the apex bank that monitors and controls the economy, uses interest rates as one of its prime means of controlling money supply, promoting savings as well as investment, and curbing inflation.
- Legal environment of business means all factors relating to laws and legal orders which affect business and its working.
- Just as our cultural heritage is important, so is our natural heritage. This includes the land, its forests, its interlinked ecosystems, and its myriad varieties of flora and fauna.

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## 2.6 KEY WORDS

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- **Demography:** It is the statistical study of human populations especially with reference to size and density, distribution, and vital statistics.
- **Stagflation:** It is a condition of slow economic growth and relatively high unemployment, or economic stagnation, accompanied by rising prices, or inflation.

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## 2.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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### Short-Answer Questions

1. Define PESTLE analysis.
2. How does the PESTLE analysis help in analysing the organizational strategies?
3. Name the factors involved in PESTLE analysis.

### Long-Answer Questions

1. How does the economic environment influence the decision-making process of business organizations?
2. Examine the significance of the social environment on business decisions.
3. How has the advent of technology impacted the business environment?

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## 2.7 FURTHER READINGS

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- Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.
- Gupta, C.B. 2014. *Business Environment*, Eight Edition. New Delhi: McGraw Hill Education.
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## UNIT 3 POLITICAL ENVIRONMENT

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### NOTES

#### Structure

- 3.0 Introduction
- 3.1 Objectives
- 3.2 Government and Business
- 3.3 Political Systems
- 3.4 Political Stability and Political Maturity as Conditions of Business Growth
- 3.5 Role of Government in Business
  - 3.5.1 Entrepreneurial Role
  - 3.5.2 Catalytic Role of Government
  - 3.5.3 Supportive and Competitive Roles of Government
  - 3.5.4 Regulatory Role of Government
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- 3.6 Answers to Check Your Progress Questions
- 3.7 Summary
- 3.8 Key Words
- 3.9 Self Assessment Questions and Exercises
- 3.10 Further Readings

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### 3.0 INTRODUCTION

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The political environment of a country affects its economic environment. The economic environment, in turn, affects the performance of a business organization. India being the largest democracy of the world enjoys a federal form of government. The political environment in India is largely influenced by factors such as policies of the government and the ideologies of various political parties. This unit will introduce you to the role of the government in business through the growth and development of the public sector and the significance of political stability and political maturity as conditions of business growth.

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### 3.1 OBJECTIVES

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

- Discuss the participation of government in business
- Define political system
- Examine political stability and political maturity as conditions of business growth
- Describe the role of government in business

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## 3.2 GOVERNMENT AND BUSINESS

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### NOTES

Government participates in business through public sector enterprises. 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.

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.

### Rationale for the Public Sector

The rationale for the public sector is discussed in the following points.

- (i) **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 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, over-unionized islands of mediocrity that generated aught but huge losses—dinosaurs that had run out of time and relevance.

- (ii) 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.
- (iii) 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.
- (iv) 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.
- (v) 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.

## NOTES

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### 3.3 POLITICAL SYSTEMS

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#### NOTES

The term ‘political system’ consists of two words—political and system. The first word ‘political’ refers to the subsistence and role of state in empirical terms. The second word ‘system’ entails a set of parts in interdependence as well as in operation. According to G. A. Almond, a system constitutes ‘the interdependence of parts and a boundary of some kind between it and its environment.’ In this context, Easton says that a political system allocates values by means of its policies that are binding on the society by virtue of being authoritative.

A policy is visibly authoritative when the feeling exists that it must, or it ought to, be obeyed whether it is formal or effective. It must be accepted as binding. In the words of Almond, political system involves the feature of ‘comprehensiveness’ which means that when we speak of the political system, we include in it all the interactions (inputs and outputs) which affect the use or the treat of the use of physical coercion. By ‘interdependence’ we mean that a change in one subset of interactions produces changes in all other concerned subsets. Finally, the existence of ‘boundaries’ means that where other systems end, political system begins. The result is that while the word ‘political’ signifies and attempts to separate a certain set of interactions in a society in order to relate it to other sets, by ‘system’ we mean an attribution to a particular set of properties of these interactions.

We have various definitions of political system:

- A political system comprises an inclusive set of institutions, interest groups (e.g., lobby groups, political parties and trade unions), the relationships among these institutions and the political standards and rules governing their functions (constitution, election law and so on).
- A political system consists of the members of a social organization (group) who are in power.
- A political system is a theoretical concept on which the government formulates policies and makes them more organized in administration.
- A political system ensures order and sanity in the society and simultaneously enables some other institutions to have their complaints and grievances put across during the course of social existence.
- A political system essentially possesses two properties: a set of inter-reliant components and boundaries towards the environment with which it interacts. According to D. M. Wood, the term ‘political system’ refers to the study of state and government in the empirical dimensions and also from an interdisciplinary standpoint. Thus, political system becomes a set of inter-related variables conceived to be politically relevant and treated as if they could be separated from other variables not immediately relevant to politics. A set of concepts considered to make up a political system is advanced not to help one to understand the government and



politics of a particular country but to aid in understanding the government and politics of any country of the world.

In academic discourse, there are three reasons for using the term ‘political system’. First, the word ‘state’ does not facilitate us in understanding all political situations. As a concept, the state came into common use during the 16th and 17th centuries. Second, the concept of state is not adequate for social analysis, as this has been mainly used like a social myth in the struggle for national unity and sovereignty. Third, this concept does not have satisfactory kind of definition. In this way it’s clear that a change from the study of state and government to the study of political system should be attributed to the shift in the emphasis from the formal political institutions to that of the real political processes. It has occurred due to certain developments indigenous to the discipline of political science in which writers have sought to study the state and government in relation to the role of ‘extra governmental’ agencies.

Beer and Ulam describe political system as ‘a structure that performs a certain function for a society.’ It includes an arrangement for making decisions which have ‘legitimacy’, because the members of a society accept them as being in conformity with their conceptions of authority and purpose.

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### **3.4 POLITICAL STABILITY AND POLITICAL MATURITY AS CONDITIONS OF BUSINESS GROWTH**

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Political stability and political maturity as conditions of business growth can be described under the following headings.

#### **Sovereign Risk**

India is a vibrant parliamentary democracy and has been one since its political independence from British rule more than sixty years ago. There is no serious revolutionary movement in India; hence, there is no conceivable possibility of the state collapsing. Sovereign risk in India is therefore zero for both ‘foreign direct investment’ and ‘foreign portfolio investment.’ It is however advisable to avoid investing in the extreme north-eastern parts of India because of terrorist threats. Kashmir in the northern tip is also a troubled area, but investment opportunities in Kashmir are anyway restricted by law.

#### **Political Risk**

India suffered political instability for a few years due to the failure of any party to win an absolute majority in Parliament. However, political stability has returned since the previous general elections in 1999. However, political instability did not change India’s economic course though it delayed certain decisions relating to the economy.

## **NOTES**

## NOTES

The political divide in India is not one of policy, but essentially of personalities. Economic liberalization (which is what foreign investors are interested in) has been accepted as a necessity by all parties including the Communist Party of India (Marxist).

As for terrorism, no terrorist outfit is strong enough to disturb the state. Except for Kashmir in the north and parts of the north-east, terrorist activity is either non-existent or too weak to be of any significance. It would take an extreme stretching of the imagination to visualize a Bangladesh-type state-disrupting revolution in India or a Kuwait-type annexation of India by a foreign power.

Thus, political instability in India, in practical terms, posed no risk to foreign direct investors, because no policy framed by a past government has been reversed by any successive government so far. One can find a comparison in Italy which has had some forty-five governments in fifty years, yet overall economic policy remains unchanged. Even if political instability is to return in the future, chances of a reversal in economic policy are next to nil. Hence, political risk in India is practically non-existent.

### **Risk of Foreign Sanctions**

The threat of foreign, sanctions affect the business environment enormously. Usually, sanctions are imposed on nations who flout international norms and laws. For example, India did not seem to be in the good books of the United States government due to its nuclear weapons and missiles development policy. However, US President Bill Clinton's state visit to India in 2000 was a massive hit. Subsequent to the visit, visits between the two countries at different levels took place, and the US government has all but come to terms with the reality of a nuclear-armed India.

### **Commercial Risk**

Commercial risk exists in business in any country. Not each and every product or service can be readily sold; hence, it is necessary to study the demand/supply situation for a particular product or service before making any major investment. There is a large number of market research firms in India (including our own) studying the demand/supply situation for any product/service and advise the potential investor accordingly in exchange of a professional fee.

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## **3.5 ROLE OF GOVERNMENT IN BUSINESS**

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Let us now analyse the role of government in business.

### **3.5.1 Entrepreneurial Role**

Encouragement to entrepreneurship is an extremely important role of any government which is concerned with the future economic health of its country. That is why there is a strong relationship between economic growth and the ease

of doing business in a country. If the government of a country is entrepreneurial, the country's business environment would be progressive. It has nothing to do with the political system of the country. It may be observed that non-democratic governments are sometimes more successful at understanding the advantage of entrepreneurship. The countries with less bureaucratic formalities for doing business naturally attract more businessmen. In the interest of their domestic economies, politicians must take an active role in making the reforms needed to help fuel entrepreneurship.

Traditional bureaucratic governments favour and encourage the people with tendencies to defend their position, oppose change, erect authority, expand their sphere of control and protect the schemes irrespective of their relevance to present conditions. Briefly speaking, such governments promote the feeling of status quo among the people. On the other hand, an entrepreneurial government initiates more efficient and effective ways of managing systems and organizations. It recognizes the importance of discarding old and irrelevant programmes and methods and encourages taking timely and necessary action. Entrepreneurial governments are creative and innovative. They are business oriented. They do not hesitate to privatize wherever it makes realistic sense and where private operators can provide the same service much more efficiently.

### **3.5.2 Catalytic Role of Government**

Sometimes, governments do not play a direct role in business activities. They play the role of catalysts. They believe in steering rather than rowing. Government should be a catalyst for the development of business environment; it cannot compensate or substitute for its absence. Governments, as effective catalysts, do not do anything directly for business. They encourage businessmen to do things as their own. Business communities drive their own development; governments facilitate the process. This implies a number of practical activities that are far easier to talk about than to do. In their role as catalysts, governments enable a business community to look realistically at itself. Because businessmen are well conditioned to focus on their problems, facilitators (governments) emphasize analytic tools and exercises that help the community to identify and recognize strengths and capacities which they may have overlooked or ignored in the past. Governments connect business people with each other and their existing resources. In doing so, they emphasize inclusiveness.

### **3.5.3 Supportive and Competitive Roles of Government**

The government of a country also plays the supportive and competitive role in the development of business. The primary economic role of the government is to create an enabling environment where competitive private activity can flourish. For example, the government, in its effort to protect the consumer and promote open

## **NOTES**

**NOTES**

competition in the market, requires companies to reveal to the consumer the contents of its products, and its methods of operation and corporate organizations.

The government guards against monopolistic business practices, such as the formation of trusts. It has also to protect its citizens against market failures, which occur when one or all of the following conditions exist:

- When adequate competition does not exist
- Resources are not free to move from one industry to another
- Prices do not reasonably reflect the costs of production
- Buyers and sellers are not well informed

Another important function of the government is to maintain the stability and the well being of the country. For this, it needs to keep a sufficient level of competition in the markets by regulating some monopolists' prices and directing the quality of public services. The objective of the government is to establish the same prices that might exist if there were competition.

**3.5.4 Regulatory Role of Government**

Throughout the globe, governments have been engaged in social and economic regulation of their people's lives. Economic regulations have come into focus because such regulations have been associated with declining productivity rates in several industrialized countries. The governments have also been enacting social regulations. Most of the government regulations involve the setting up and enforcement of standards for conducting legitimate social, political and economic activities. Government regulations are different from those brought out by the management. Management involves the administration of the properties and realms which the government owns. For example, governments manage the national parks and forests; they do not regulate them. On the other hand, toy manufacturing — an activity of private business — is regulated by government, as are the manufacture and sale of many foods and drugs, the production of cars, and the practice of law, medicine, and other occupations.

**3.5.5 Control Role**

The relationship between the government and business enterprises should be studied by considering the overall institutional environment at a specific development stage. In China, for instance, the level of economic development and institutional environment is different in the first and the second stage. Thus, the relationship between government and corporate governance should be seen through the dynamic perspective, than the static angle. The view of government control in the corporate field consists of three major arguments.

First, based on the modern theory of firm and corporate governance and the empirical evidence in decades gone by, economists largely agree that government ownership and control of firms does not have clear advantages over private ownership and control under entrenched market institutions and with rational assumptions about the government's behavior. On the other hand, government ownership and control of firms have clear and major disadvantages. The government tends to have political objectives. In some sense, a government that has strong profit motives is a disaster in the making.

Another major problem with the government concerns its ability to commit. A big difference between government and the private sector is its power: a powerful government's commitment is not credible. Finally, there is still an overload problem. A government overwhelmed with too many things compromises its efficiency.

Second, both government and market institutions are not perfect and their development takes time. Given these institutional failures, there are financial reasons (in addition to political reasons) for government control in corporate governance as a second-alternative response in the early stage of economic development. This can be analyzed from two perspectives. Government ownership and control may have relative advantages over private control in the imperfect institutional environment, such as when there is no rule of law in securing property rights, a lack of a functioning capital market, and a no adequate taxation and fiscal institutions. This argument explains why some types (not others) of government ownership of firms have been more successful than private ownership. Furthermore, even if government ownership and control are ineffective, there are still economic arguments for delaying privatization of existing state firms, for e.g., lack of a social safety net, no proper legal framework for corporate governance, and a lack of regulatory institutions for special industries.

Third, because government ownership and control of firms is not the best arrangement, the government should ultimately exit corporate governance. Indeed, the institutional and market environment changes over time, so accordingly does the costs and benefits of government control of firms. But what is the mechanism that allows the government to exit corporate governance and avoid a trap in which the government, to defend its vested interests, refrains from moving away from corporate control? Two factors seem relevant: flexibility of an economy for institutional changes and the proper incentives of government for institutional changes. The incentives for privatization necessitate harder budget constraints and increased competition.

## NOTES

### Check Your Progress

1. What is a political system?
2. Define sovereign risk.

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### 3.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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#### NOTES

1. A political system is a theoretical concept on which the government formulates policies and makes them more organized in administration.
2. Sovereign risk is the chance that a central bank will implement foreign exchange rules that will significantly reduce or negate the worth of its forex contracts.

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### 3.7 SUMMARY

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- 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.
- 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.
- The term ‘political system’ consists of two words—political and system. The first word ‘political’ refers to the subsistence and role of state in empirical terms. The second word ‘system’ entails a set of parts in interdependence as well as in operation.
- Political instability in India, in practical terms, posed no risk to foreign direct investors, because no policy framed by a past government has been reversed by any successive government so far.
- Commercial risk exists in business in any country. Not each and every product or service can be readily sold; hence, it is necessary to study the demand/supply situation for a particular product or service before making any major investment.
- Encouragement to entrepreneurship is an extremely important role of any government which is concerned with the future economic health of its country.
- Government should be a catalyst for the development of business environment; it cannot compensate or substitute for its absence.
- The government of a country also plays the supportive and competitive role in the development of business.
- The relationship between the government and business enterprises should be studied by considering the overall institutional environment at a specific development stage.

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### 3.8 KEY WORDS

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- **Bureaucratic:** It refers to a system of government in which most of the important decisions are taken by state officials rather than by elected representatives.
- **Commercial Risk:** It can be defined as financial risk taken by a seller while extending credit without securing any collateral or recourse.

### NOTES

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### 3.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. How does the government participate in business?
2. Write a short note on the catalytic role of government in business.
3. How has the public sector contributed to the growth and development of Indian society?

#### Long-Answer Questions

1. Discuss the significance of political stability and political maturity as conditions of business growth.
2. 'Entrepreneurial governments are creative and innovative.' Explain the statement.
3. Describe the supportive, control and regulative role of government in business.

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### 3.10 FURTHER READINGS

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- Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.
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## UNIT 4 GOVERNMENT AND ECONOMIC PLANNING

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### NOTES

#### Structure

- 4.0 Introduction
- 4.1 Objectives
- 4.2 Industrial Policies and Promotion Schemes
  - 4.2.1 Promotion Schemes
- 4.3 Government Policy and SSI
- 4.4 Industrial Development Strategies
- 4.5 Interface between Government and Public Sector and Role of Public and Private Sectors
  - 4.5.1 Role of Public Sector
  - 4.5.2 Role of Private Sector
  - 4.5.3 Comparative Cost Dynamics
- 4.6 Answers to Check Your Progress Questions
- 4.7 Summary
- 4.8 Key Words
- 4.9 Self Assessment Questions and Exercises
- 4.10 Further Readings

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### 4.0 INTRODUCTION

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Economic planning has been a fundamental principle of India's development strategy since independence. Since its independence, India has charted a path of planned development, which has on the whole served it well. The development strategy, attitudes and approaches adopted by the central government towards growth and development, as reflected in the Plans, have undergone major transitions over the years in reaction to the objective conditions of the economy and challenges of the moment. In this unit, you will study about the role and initiatives of government with respect to industrial development and the development of small-scale industries.

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### 4.1 OBJECTIVES

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

- Discuss the industrial policy of India
- Identify the industrial promotional schemes launched by the central government
- Analyse the role of the government in the growth and development of small-scale industries
- Describe the industrial development strategies undertaken in India



- Examine the interface between government and public sector
- Discuss the role of public sector and private sector in the industrial development of the economy

## NOTES

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### 4.2 INDUSTRIAL POLICIES AND PROMOTION SCHEMES

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The quest for industrial development started soon after independence in 1947. The Industrial Policy Resolution of 1948 defined the broad contours of the policy delineating the role of the State in industrial development both as an entrepreneur and authority. This was followed by comprehensive enactment of Industries (Development & Regulation) Act, 1951 (referred as IDR Act) that provides for the necessary framework for implementing the Industrial Policy and enables the Union Government to direct investment into desired channels of industrial activity *inter alia* through the mechanism of licensing keeping with national development objectives and goals.

The main objectives of the Industrial Policy of the Government are (i) to maintain a sustained growth in productivity; (ii) to enhance gainful employment; (iii) to achieve optimal utilisation of human resources; (iv) to attain international competitiveness; and (v) to transform India into a major partner and player in the global arena.

The industrial Policy since 1991 has been more for facilitating the industrial development rather than anchoring it through permits and controls. Industrial licensing has, therefore, been abolished for most of the industries and there are only 4 industries at present related to security, strategic and environmental concerns, where an industrial license is currently required:

- Electronic aerospace and defence equipment: all types.
- Industrial explosives including detonating fuses, safety fuses, gunpowder, nitrocellulose and matches.
- Specified Hazardous chemicals i.e. (i) Hydrocyanic acid and its derivatives; (ii) Phosgene and its derivatives and (iii) Isocyanates & Disocyanates of hydrocarbon, not elsewhere specified (example Methyl Isocyanate).
- Cigars and cigarettes of tobacco and manufactured tobacco substitutes.

A number of initiatives have been taken for Ease of doing business for Industrial Licensing, which include online application submission for Industrial License (IL) and Industrial Entrepreneur Memorandum (IEM) on 24X7 basis at eBiz website, increasing initial validity period of Industrial License has been increased to three years from earlier two years with extension of validity upto seven years, simplification of application Forms for Industrial License & Industrial Entrepreneur Memorandum etc.

## NOTES

### Policy for Micro, Small & Medium Enterprises Sector

Government has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 stepping up the investment limit in Plant & Machinery to ₹ 5 crores for small enterprises and ₹ 10 crores for medium enterprises, so as to reduce the regulatory interface with the majority of the industrial units. Over the period Government has pruned the list of items reserved for exclusive manufacture by MSE sector vide Notification No. 998(E) dated 10-04-2015, remaining 20 items which were earlier reserved for exclusive manufacture by MSE Sector has been de-reserved. Presently no item is reserved for exclusive manufacture by MSE Sector.

### Sectors reserved for Public Sector

Consistent with the policy of liberalization of domestic industry, the numbers of industries reserved for public sector have also been reduced. During 2014, private investment in Rail Infrastructure has been permitted. Consequently, at present only two industrial sectors are reserved for public sector:

- (i) Atomic Energy
- (ii) Railway Operations other than construction, operation and maintenance of the certain specified activities:

Accordingly, now private investment (domestic as well as foreign) in construction, operation and maintenance of above has been allowed.

#### 4.2.1 Promotion Schemes

In this section, we will have a look at some of the industrial promotion schemes in India.

##### 1. Make in India

The Government has been taking various initiatives to promote manufacturing with the key objective of improving competitiveness of the private and public sector firms operating in the country, facilitating their integration into the global value chains and enabling them to better compete in global markets. The various objectives of the scheme include:

##### Invest india

The objective of Invest India is to act as the first reference point for target investors and provide sector-and state-specific inputs, and hand-holding support to investors through the entire investment cycle, from pre-investment decision-making to after-care.

##### Ease of Doing Business

The objective of this initiative is to speed up implementation of reforms to bring improvement in the business environment of the country. Department/Ministry wise

action to be taken under each of the parameters has been identified and nodal Departments/Ministries have been assigned for each parameter. Inter-Departmental reviews are convened at regular intervals to ensure implementation of Action Points. On the front of State-level initiatives of business reforms, efforts are being taken to engage those States which due to historical reasons do not have enough incentives to undertake business reforms.

## 2. Start-up India

Startup India is a flagship initiative of the Government of India (launched January 2016), intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities. The Government through this initiative aims to empower Startups to grow through innovation and design. In order to meet the objectives of the initiative, Government of India announced Startup India Action Plan that addresses all aspects of the Startup ecosystem. With this Action Plan the Government hopes to accelerate spreading of the Startup movement: The Action Plan is divided across the following areas:

- Simplification and Handholding
- Funding Support and Incentives
- Industry-Academia Partnership and Incubation

## 3. NEIP

With a view to give a further boost to industrialization in the North Eastern Region, the erstwhile North East Industrial Policy (NEIP), 1997 was revised and a new policy, namely North East Industrial & Investment Promotion Policy (NEIIPP) 2007, was notified w.e.f. 1.4.2007 which will remain in force upto 31.03.2017. Benefits under NEIIPP, 2007 have also been extended, for the first time, to select Service Sector units, Bio-technology units and Power Generating units (up to 10 MW), besides industries in the manufacturing Sector. The objective of the scheme is to boost industrialization in North Eastern Region.

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## 4.3 GOVERNMENT POLICY AND SSI

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A major thrust of the industrial policy pursued in India has been the development and promotion of small and cottage industries along with large industries. The differences between the small-scale and cottage industries are basically two: (a) while small-scale industries are mainly located in urban centres as separate establishments, the cottage industries are generally associated with agriculture and provide subsidiary employment in rural areas and (b) while small-scale industries produce goods with mechanized equipment employing outside labour, the cottage industries involve operations mostly by hand, which are carried on primarily with the help of the members of the family.

## NOTES

## NOTES

Economists advocate that a labour surplus under developed economy is based on a network of dispersed, labour-intensive and small-sized industries. These industries are capital light, skill light, labour intensive and dispersed. They are characterized by 'quick' investment and by carrying the job to the worker they can overcome the difficulties of geographical immobility. In the conditions prevailing in many under-developed countries, the development of small industries may be the most economical way to form of industrialization; it may be more than either large-scale organized industry or cottage industry. It avoids the heavy costs, which are often the result of agglomeration of large labour forces; the overhead capital costs stemming from such agglomerations are often high and do not directly increase productivity. Moreover, small industry represents much less of a break from previously established modes of living and, therefore, is less of a strain than industrialization in the form of large units.

Apart from ideological grounds, there is economic justification for the support and expansion of cottage and small industries in a labour surplus developing economy like India. All the usual arguments favouring the growth of small-scale industries have been noted in the Industrial Policy Resolution of 1956. In relation to cottage and small-scale industries, it states: they provide immediate large-scale employment; they offer a method of ensuring a more equitable distribution of the national income and they facilitate an effective mobilization of resources, capital and skill, which might otherwise remain unutilized. Some of the problems that unplanned urbanization tends to create will be avoided by the establishment of small centres of industrial production all over the country. The Industrial Policy Resolution puts forth following four main arguments in favour of small enterprises:

1. **Employment argument:** The most important economic task before the country is the solution of unemployment problem. The scope for creation of 'wage-employment' is limited as it depends on industrial growth. But there is a large scope for the creation of 'self-employment' and here the small-scale industries can play a significant role. Karve Committee has rightly observed that the principle of self-employment is at least as important to a successful democracy as that of self-government. The argument is based on the presumption that small enterprises are labour intensive and, thus, create more employment per unit of capital employed. Thus, let alone capital goods industries where capital-intensive projects are a necessity, in other spheres of production, small enterprises, which help to enlarge the volume of employment with scarce capital, should be encouraged. A more sophisticated form of this argument is that small industries should be developed because the capital output ratio for such enterprises is lower *vis-a-vis* large-scale enterprises.
2. **Equality argument:** The equality argument suggests that the income generated in a large number of small enterprises is dispersed more widely in the community than income generated in a few large enterprises. In other words, the income benefit of small enterprises is derived by a

large population while large enterprises encourage more concentration of economic power. In this way, small enterprises bring about greater equality of income distribution. However, it is a fact that there is a common tendency for the average wage to be lower in small factories than in large factories. Moreover, the virtual non-existence of trade unions in small factories enable employers to exploit the workers to the maximum.

3. **Latent resources argument:** Small-scale industries are widely dispersed all-round the country and have provided opportunities for young entrepreneurs to venture into a number of new fields.

It is suggested that small industries, by tapping latent resources, encourage the habits of investment in rural areas. This argument is woven out of several strands of thought. One such strand related to the existence of a large number of potential entrepreneurs who have no capacity for promoting or managing large concerns but have the necessary talents for the promotion and management of smaller units. Another strand relates to the existence of large reserves of idle savings which could be channelized into productive uses if the hoarders had the opportunity of establishing business of their own. In a developing economy, rapid economic growth is hardly possible unless methods can be found to mobilize rural savings. This can be done in several ways. The democratic way of mobilizing rural savings, will be to spread investment opportunities all over the country in such a manner that reliance on the forced mobilization of rural savings is minimized and an environment is created in which peasants develop spontaneous habits of thrift and investment.

4. **Decentralization argument:** The primary objective of developing small industries in rural areas is to extend work opportunities, raise incomes and standard of living and to bring about a more balanced and integrated rural economy.

In India, the method adopted for developing cottage and small-scale industry is the construction of industrial estates, usually in small towns. These estates provide factory space and common facilities. At present, there are 346 such industrial estates in India.

Large industries are mostly concentrated in metropolitan cities. The smaller towns and the countryside, in order to benefit from modern industrialization, must encourage small enterprises. Industrialization of the country is complete only if it penetrates into the remote corners of the country. Small industries, by carrying the job to the worker, overcome the difficulties of territorial immobility.

The weak 'spread effects' radiating from the establishment of large scale industries in a country like India has been stressed. It is somewhat reasonable to assume that the 'spread effects' of small industries would be relatively more important. Once a number of small industrial enterprises has sprung up in a locality, it is very likely that there will be a tendency to multiply. Workers' skills and aptitudes

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would be more developed when they work with machines, which have to be attended to in typical small establishments than with automatic machinery operating in big industrial units. They will thus enlarge and improve the skill base of the economy. Smaller establishments may also grow into larger units. The development of large-scale enterprises as a result of the growth processes should be more welcome than that fostered by State direction.

### The MSME Act

The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. The main objective of this Act is to facilitate the promotion and development of and enhancing the competitiveness of micro, small and medium, enterprises and for matters connected therewith or incidental thereto.

### Main features of the Act

- Examining the factors affecting the promotion and development of micro, small and medium enterprises and review of the policies and programmes of the Central Government in this direction.
- Making recommendations for facilitating promotion and development of and enhancing the competitiveness of the micro, small and medium enterprises.
- Advising the Central Government on use of the Fund or Funds constituted under Section 12 of the Act.

The Act provides for the constitution of Advisory Committee at national level to make recommendations with regard to:

- The level of employment in a class or classes of enterprises
- The level of investment in plant and machinery or equipments
- The need of higher investment in plant and machinery or equipment's for technological upgradation, employment generation and enhanced competitiveness
- The possibility of promoting and diffusing entrepreneurships
- The international standards for classification of small and medium enterprises

### Classification of industries into micro, small and medium enterprises

In terms of the MSMED Act, the definition of micro, small and medium enterprises is as under:

- (a) Enterprises engaged in the manufacture or production, processing or preservation of goods as specified below:
  - A **micro enterprise** is an enterprise where investment in plant and machinery does not exceed ₹ 25 lakh.

- A **small enterprise** is an enterprise where the investment in plant and machinery is more than ₹ 25 lakh but does not exceed ₹ 5 crore.
- A **medium enterprise** is an enterprise where the investment in plant and machinery is more than ₹ 5 crore but does not exceed ₹ 10 crore.

In case of the above enterprises, investment in plant and machinery is the original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification in 2006.

- (b) Enterprises engaged in providing or rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006 are specified below.
- A **micro enterprise** is an enterprise where the investment in equipment does not exceed ₹ 10 lakh.
  - A **small enterprise** is an enterprise where the investment in equipment is more than ₹ 10 lakh but does not exceed ₹ 2 crore.
  - A **medium enterprise** is an enterprise where the investment in equipment is more than ₹ 2 crore but does not exceed ₹ 5 crore.

### Recent Policy Initiatives

As per the Annual Report (2017-18) of the Ministry of MSME, the following are the recent policy initiatives in the medium and small-scale industrial sector:

- Ease of Registration Process of MSMEs- Udyog Aadhaar Memorandum
- Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises: Under these guidelines Banks have created a structure for finalising corrective action plan for revival & rehabilitation of MSMEs.
- MSME Data Bank: This data bank will enable the Ministry to streamline and monitor the schemes and pass on the benefits directly to MSMEs. It will also provide the real-time information about the status of MSMEs under various parameters.
- A web-based application module, namely, MyMSME has been launched. This has also been converted into a mobile app. Entrepreneurs will be able to make their applications and track it on their mobile itself.
- Direct Benefit Transfer in the M/o MSME
- Initiation of Digidhan Mission.
- The Ministry has started an MSME internet grievance monitoring system (eSAMADHAN) to track and monitor other grievances and suggestions received in the Ministry.
- To expand and upgrade the network of Technology Centres (Tool Rooms and Technology Development Centres) in the country, Ministry of MSME is implementing Technology Centre Systems Programme (TCSP)

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### 4.4 INDUSTRIAL DEVELOPMENT STRATEGIES

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Strategy is a word which is often used in the modern world. We come across terms like war strategy, election strategy and development strategy. In the context of development planning, strategy refers to a basic long-term policy to realize certain objectives. Planning strategy includes activities such as determination and formulation of policies, selection of appropriate technology, implementation of development programmes, determination of the nature of investment and necessary changes in the financial management and administrative structure.

India has completed its tenth Five Year Plan and the Eleventh Five Year Plan is in progress. 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.

##### ***First Five Year Plan (1951-1956)***

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 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 (1956-1961)***

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 (1961-1966)***

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 year (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 between 1966 and 1969, and the Fourth, Fifth, Sixth and Seventh Five Year Plans.

#### ***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.

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### ***Fifth Five Year Plan (1974-1979)***

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.

To realize these major objectives, the Fifth Plan prescribed an appropriate policy *framework and strategies*. The Fifth Plan was, however, terminated one year earlier than its five-year term. Although the country progressed in economic self-reliance due to *larger export and better domestic production*, the Fifth Plan *failed miserably* to realize the objective of removal of poverty.

It has been observed in the Draft Outline for 1978-83 Plan, the country *is not yet anywhere in sight of the eradication of poverty*. Accordingly the removal of poverty has been retained as one of the major objectives in the Sixth Plan.

### ***Sixth Five Year Plan (1980-85)***

The strategy of the Sixth Five Year Plan centered on food and fuel. With Green Revolution, 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 to 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 thirty-two 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 some 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.

### ***Eighth Five Year Plan (1992-97)***

Between 1990 and 1992, there was economic instability in India and hence, no Five Year Plan was implemented. 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 Eleventh Five Year Plan (2007-2012) and Twelfth Five Year Plan (2012-17).

#### ***Eleventh Five Year Plan (2007-12)***

The 11th five year plan was an ambitious plan with the following goals:

- (i) Increase in income and poverty alleviation
- (ii) Development in the education sector
- (iii) Improvement in the health sector
- (iv) Development of infrastructure

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**Main Objectives of the 11th Five Year Plan (2007-12)**

- Inclusive Growth: Main Theme
- 27 monitorable targets which include:
  - Poverty reduction
  - Boost in Education -(6 per cent of GDP)
  - Greater Employment
  - Better Health care
  - Reduction in Income disparity

A GDP growth rate of 9 per cent with an investment of 36,44,718 crore.(13.64 per cent of GDP)

**Twelfth Five Year Plan (2012-2017)**

The Government of India approved the Twelfth Five Year Plan in October 2012. The success of the Eleventh Five Year Plan encouraged the economists and boosted the prospects of the Twelfth Five Year Plan to a great extent. However, a sudden downfall in the global economic scenario and increasing rate of inflation brought some difficult times for the economists. The objectives of the Eleventh Five Year Plan were speedy and inclusive growth. The steps taken during the plan period resulted in comprehensive growth towards both objectives. However, some weaknesses surfaced during this plan that needed to be taken care of in the Twelfth Plan. Some new challenges also need to be tackled. Some of the challenges originate from the economic transition to a higher and more comprehensive development path, the structural changes that come with it and the expectations it creates. Besides, there are some external challenges that have surfaced due to unfavourable global economic environment as compared to the start of the Eleventh Plan. To overcome these challenges, our planners have to learn from the past experiences and keep a close eye on the world economic scenario.

The Twelfth Plan has to meet the aspirations of millions of young men and women. This cannot be done by following a business-as usual approach. All sections of society – government, farmers, businesses, labour and concerned citizens– have to adopt newer, more effective ways of pursuing their activities, so that we can collectively achieve our lofty goals. The broad vision and aspirations which the Twelfth Plan seeks to fulfil are faster, sustainable, and more inclusive growth.

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**4.5 INTERFACE BETWEEN GOVERNMENT AND PUBLIC SECTOR AND ROLE OF PUBLIC AND PRIVATE SECTORS**

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The interface between government and public sector can be understood through the public sector enterprises in India.

## The Public Sector

The public sector or public enterprises include all governmental activities including public, industrial or 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 the 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; however, there is evidence that the range of income inequality has been reduced. Rather than seeking to achieve 'Socialist' objectives through income redistribution, the architects of the modern Indian economy emphasised the 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 a 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 emphasised that public enterprise was designed to control the 'commanding heights' of the economy. But in recent years, the trends towards increasing liberalization are very much in evidence in India and one gets the impression that the private sector is designed to play an important role in the economy in the coming era.

The public enterprises comprise:

- (i) Public utilities, e.g. the railways, post and telegraphs and irrigation projects
- (ii) Departmental undertakings of the Government, Central as well as State, e.g. post and telegraph, integral coach factory

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- (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

Public sector units generally are of the following four kinds:

- (i) National monopolies like the 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.

### 4.5.1 Role of Public Sector

Public sector enterprises play a dominant and dynamic role in the development of India economy. The major contributions are as under:

1. Strong industrial base
2. Development of infrastructure
3. Removal of regional disparities
4. Public sector and capital formation
5. Earning of foreign exchange
6. Saving of foreign exchange
7. Check over-concentration of economic power
8. Contribution to employment
9. Contribution to Central Exchequer

### 4.5.2 Role of Private Sector

In the private sector, the enterprise is owned by private persons. In the sphere of the private sector, there is the corporate sector with such organizations as public limited companies and private limited companies. Outside the corporate sector, there are many forms of ownership like single entrepreneur and partnership and trade as also cottage industries. Private sector can be divided into the following two parts:

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

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 up 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 also went on to achieve heights of glory and achievement. Meanwhile, several public sector units stultified and decayed, to the point that they had to go the Board for Industrial and Financial Reconstruction (BIFR) way or be disposed of (under the policy of divestment or 'disinvestment').

**Advantages of Private sector:** The benefits of the private sector largely include a stable form and structure, devoid of rigid conformity to rules and regulations and least intervention by government. Moreover, it enjoys the advantage of raising funds in an easy manner, quick decisions are taken, less wastage of resources and so forth. Let us now study the advantages of private sector in detail.

- **More investment in the economy:** There is plenty of scope for increased foreign as well as domestic investment in the private sector as manufacturing and production takes place at a fast pace.
- **Quality products:** There is specialization of goods and products available in the private sector and thus, the private sector stands to gain more as compared with the public sector. This is an advantageous condition for the customers as well as the economy.
- **More employment:** As the pace of production and manufacturing is fast in the private sector, it automatically creates more employment opportunities for both skilled and non-skilled individuals. Hence, it can be understood that the private sector with its massive competition leads to generation of employment.
- **Increased quality of life:** Specialized products and increased competition ensures that companies in the private sector sell quality items at competitive prices. This in turn leads to enhanced quality of life of the people.
- **Accountability:** In addition to profit-making, the private sector companies also are accountable to their shareholders, consequently, they are constantly innovating their products and services.
- **Promotes entrepreneurial ventures:** Private sector and companies play a vital role in the economic development by providing opportunities to the aspiring entrepreneurial talent in the economy.

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- **Increased value of human capital:** Since the production opportunities surges massively as the participation of private sector is promoted, there is also observed a positive value perception of the human capital for the companies to succeed.

### 4.5.3 Comparative Cost Dynamics

Comparative advantage is an economic term that refers to an economy's ability to produce goods and services at a lower opportunity cost than trade partners. A comparative advantage gives a company the ability to sell goods and services at a lower price than its competitors and realize stronger sales margins.

#### Check Your Progress

1. What are the main objectives of the industrial policy of the government?
2. What is the main objective of the Startup India programme?
3. State the differences between small-scale and cottage industries.

## 4.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The main objectives of the Industrial Policy of the Government are (i) to maintain a sustained growth in productivity;(ii) to enhance gainful employment;(iii) to achieve optimal utilisation of human resources; (iv) to attain international competitiveness; and (v) to transform India into a major partner and player in the global arena.
2. Startup India is a flagship initiative of the Government of India (launched January 2016), intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities.
3. The differences between the small-scale and cottage industries are basically two: (a) while small-scale industries are mainly located in urban centres as separate establishments, the cottage industries are generally associated with agriculture and provide subsidiary employment in rural areas and (b) while small-scale industries produce goods with mechanized equipment employing outside labour, the cottage industries involve operations mostly by hand, which are carried on primarily with the help of the members of the family.

## 4.7 SUMMARY

- The Industrial Policy Resolution of 1948 defined the broad contours of the policy delineating the role of the State in industrial development both as an entrepreneur and authority.



- Industrial Policy since 1991 has been more for facilitating the industrial development rather than anchoring it through permits and controls.
- The objective of Invest India is to act as the first reference point for target investors and provide sector-and state-specific inputs, and hand-holding support to investors through the entire investment cycle, from pre-investment decision-making to aftercare.
- Startup India is a flagship initiative of the Government of India (launched January 2016), intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities.
- With a view to give a further boost to industrialization in the North Eastern Region, the erstwhile North East Industrial Policy (NEIP), 1997 was revised and a new policy, namely North East Industrial & Investment Promotion Policy (NEIIPP) 2007, was notified w.e.f. 1.4.2007 which will remain in force upto 31.03.2017.
- Economists advocate that a labour surplus under developed economy is based on a network of dispersed, labour-intensive and small-sized industries. These industries are capital light, skill light, labour intensive and dispersed.
- The primary objective of developing small industries in rural areas is to extend work opportunities, raise incomes and standard of living and to bring about a more balanced and integrated rural economy.
- The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.
- Strategy is a word which is often used in the modern world. We come across terms like war strategy, election strategy and development strategy. In the context of development planning, strategy refers to a basic long-term policy to realize certain objectives.
- The Government of India approved the Twelfth Five Year Plan in October 2012.
- The success of the Eleventh Five Year Plan encouraged the economists and boosted the prospects of the Twelfth Five Year Plan to a great extent.
- The interface between government and public sector can be understood through the public sector enterprises in India.
- Public sector enterprises play a dominant and dynamic role in the development of India economy.
- The foreign exchange problems often emerge as a serious constraint on the programme of industrialization in a developing economy.

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## 4.8 KEY WORDS

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- **Strategy:** It is an action that managers take to attain one or more of the organization's goals.
- **Decentralization:** It refers to a company's top management delegating authority to subunits of the company.
- **Micro enterprise:** It is an enterprise where investment in plant and machinery does not exceed 25 lakh.

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## 4.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

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### Short-Answer Questions

1. Name the various initiatives taken by the Indian government for ease of doing business for industrial licensing.
2. Identify the various industrial promotional schemes launched by the Government of India.
3. State the main features of the MSME Act.
4. List the role of public sector in the development of the Indian economy.

### Long-Answer Questions

1. Discuss India's planning strategy in terms of industrial development.
2. What are the advantages of the private sector?
3. What are the main arguments put forward in favour of development of small-scale industries in India?

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## 4.10 FURTHER READINGS

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**BLOCK - II**  
**ECONOMIC AND INTERNAL ENVIRONMENT**

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*Economic Environment*

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**UNIT 5 ECONOMIC  
ENVIRONMENT**

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**NOTES**

**Structure**

- 5.0 Introduction
- 5.1 Objectives
- 5.2 Phase of Economic Development and its Impact
  - 5.2.1 Phases of Economic Development of India
- 5.3 GDP Trend and Distribution
- 5.4 Economic Growth and Business Opportunities
  - 5.4.1 Capacity Utilisation
- 5.5 Regional Disparities and Evaluation
- 5.6 Global Trade and Investment Environment
  - 5.6.1 Investment Environment
- 5.7 Answers to Check Your Progress Questions
- 5.8 Summary
- 5.9 Key Words
- 5.10 Self Assessment Questions and Exercises
- 5.11 Further Readings

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**5.0 INTRODUCTION**

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Economic environment can be understood as the amalgamation of all factors which affect business due to changing economic policies, economic system and economic conditions. According to data released by the Ministry of Statistics and Programme Implementation, the Indian economy grew by 7.1% in 2017, driven by a rebound in industrial activity, especially manufacturing and construction, and an expansion in agriculture. In this unit, you will study about the phase of economic development and its impact, GDP trend and distribution, economic growth and business opportunities, regional disparities and evaluation and finally, global trade and investment environment.

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**5.1 OBJECTIVES**

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

- Discuss the phases of economic development in India
- Describe the GDP trend during different five year plans

- Examine the existence of regional disparities in India
- List the factors responsible for the growth of global trade

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### 5.2 PHASE OF ECONOMIC DEVELOPMENT AND ITS IMPACT

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Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area. Such actions can involve multiple areas including development of human capital, critical infrastructure, regional competitiveness, environmental sustainability, social inclusion, health, safety, literacy, and other initiatives. Economic development differs from economic growth. Whereas economic development is a policy intervention endeavor with aims of economic and social well-being of people, economic growth is a phenomenon of market productivity and rise in Gross Domestic Product (GDP). Consequently, as economist Amartya Sen points out: ‘economic growth is one aspect of the process of economic development.’

The study of economic development by social scientists encompasses theories of industrial/economic modernization causes, the historical phases or waves of economic development, and the organizational aspects of enterprise development in modern societies. Economic development embraces sociological research on a variety of topics including business organizations, enterprise development, evolution of markets and management, and cross-national comparisons of industrial organization patterns.

#### 5.2.1 Phases of Economic Development of India

There have primarily been two phases in India’s economic development history since independence. These phases were characterized by two different policy regimes. The period of thirty years from 1950–51 to 1979–80 was the phase of socialist experimentation, in which the ‘Indian version of socialism’ was developed and instituted. The second phase of economic development started at the beginning of the 1980s and continues till today. This is the phase of ‘market experimentation,’ in which the oppressive control regime set up during the first phase has been modified and physical controls have gradually been removed.

##### 1. Phase of Indian version of socialism

The defining policy characteristics of this phase of Indian development were the introduction and enhancement of the import substituting Industrialization strategy (ISI), the restriction and elimination of the freedom of economic agents to compete in many industries and sectors and the extension of government into more and wider areas of economic and social activity with a corresponding and progressive neglect of the fundamental job of government.

The phase of Indian Socialism can be further sub-divided into two sub-phases: Phase IA (1951–2 to 1964–65) and Phase IB (1965–66 to 1979–80). Though these sub-phases differ in their rate of growth, the difference in growth is not statistically significant, once the break in growth between phases IA and IB is accounted for. The sub-phases are, however, significant from the policy perspective, as the difference in policy between these two sub-phases helps in refining the policy lessons.

### **Phase IA: Quest for commanding heights**

During this sub-phase, the policy of the Public (government) sector occupying the so-called ‘Commanding heights’ of the economy was devised and implemented. This had the effect of (artificially) creating public monopolies and progressively eliminating competition from many sectors of the economy. This approach was part of the Mahalanobis model of development, whose second pillar was import substituting industrialization.

### **Phase IB: Legislative–bureaucratic socialism**

This phase was characterized by (a) the move from import substituting industrialization to export promotion and from thence to broader import liberalization and (b) the restoration of the freedom to compete followed by a move to restore competition in different sectors and markets.

## **2. Phase of market reforms**

The basic philosophy of economic development that had prevailed since independence began to be questioned in the late seventies. The first harbinger of change was perhaps the braking of the railway strike in 1976 by the avowedly pro-poor Prime Minister Mrs. Indira Gandhi. The change continued with the coming to power in 1977 of the so called ‘right-wing’ political parties such as the Congress (O) and the Jan Sangh/BJP (though some of the coalition partners were Indian socialists the PM was a pro-capitalist opponent of Mrs Indira Gandhi). A questioning of the traditional development approach was implicit in the reports of the P. C. Alexander Committee on Export–Import Policy and the Dagli Committee on Controls and Subsidies. These reports were submitted in 1978, but with the fall of the Janata Dal government in 1979 few reforms materialised. One of the few noteworthy liberalization measures during the Janata regime was the raising of the investment licensing limit under IDR&A to ₹ 3 crore. These committees however crystallised the doubts that many people had begun to have about the previous approach.

Anyone who had any direct experience of controls was aware of the evasion & corruption, rent seeking & rent creation associated with them. Yet few academics and intellectuals either recognised or were willing to admit publicly, that this ‘Indian socialist’ policy framework was undermining the quality of all governing institutions. This included both market complementing institutions such as the revenue

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department (CBDT, CBEC) as well as market subtracting/substituting institutions such as licensing authorities. The decline in the former had long lasting negative effects on economic performance while deterioration of the latter likely increased the rate of growth of the economy during the 1980s.

The phase of market reforms may also be divided into two sub-phases: phase IIA or the phase of basic reforms (1980–81 to 1991–92) and phase IIB or the phase of wider reforms (1992–93 to present).

### **Phase IIA: Basic reforms**

Policy reforms during the first sub-phase of the market reform experimentation were characterized by two themes; the move to an export promotion strategy and the progressive restoration of the freedom of entrepreneurs to compete. The gradual nature of these reforms was referred to by us a decade and half ago as ‘Tinkerisation.’ Subsequent analysis suggests that the pace of reforms during this decade was not so misaligned with the ‘optimal.’ These reforms were driven by necessity (slow export & manufacturing growth), pragmatism (trial and error, incremental change), personal observation of market economies and business drive.

The overall effect of these reforms was to greatly increase the degree of domestic competition in the economy, contrary to what Rodrik and Subramanian (2004) have asserted. These reforms represented a fundamental change in India’s development philosophy. A concrete recognition that the *jungle of controls* put in place during phase I was not contributing to any of the objectives that they were supposed to achieve.

### **Phase IIB: Wider reforms**

Though the main underlying reform themes in the second sub-phase of market reforms were a continuation of those started in the first sub-phase, the direction, emphasis and pace was altered sharply: The move to an export substituting strategy in the previous sub-phase was supplanted by and encompassed within an import liberalisation one. This in turn was embedded within an overall strategy of eliminating restrictions & barriers to competition and progressively promoting competition. Static efficiency and welfare gains also received direct attention.

The BOP crisis of 1990–1991 was turned into an opportunity for wider reforms. The architects of the 1990s reforms clearly understood the shortcomings of the socialist approach and appreciated the positive aspects of the market (a la the Miracle growth economies of East & S.E. Asia).

The economic response to the crises was two fold. One was classical macro-economic management of the **Balance of Payment** (an accounting record of all monetary transactions between a country and the rest of the world) crises. That is a combination of expenditure reduction, through a reduction of the fiscal deficit coupled with expenditure switching through a devaluation of the exchange rate. The second was to change policies that were retarding productivity, private

investment and growth. The underlying approach was to remove controls and restrictions that were either limiting/distorting competition in product markets or limiting access to capital and technology. The scope and content of the reforms was much wider than in the 1980s.

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### 5.3 GDP TREND AND DISTRIBUTION

Economic growth has always been the main objective of Five Year Plans in India. It is defined as an increase in the aggregate output of goods and services in a country within a specified period of time.

Economic growth implies a sustained expansion in economic activities, trade agriculture, industries, etc. over a long period of time. GDP is the indicator of economic growth as it is the market value of all goods and services produced in the country in one year. The growth of the economy, in terms of GDP, in different Five Year Plans is shown in Table 5.1.

*Table 5.1 GDP in Different Five Year Plans*

Plan no.	Period of Plan	Estimated Growth Rate	Actual Growth Rate
I	1951 to 1956	2.1	3.6
II	1956 to 1961	2.5	3.9
III	1961 to 1966	5.6	2.3
IV	1969 to 1974	5.7	3.3
V	1974 to 1979	4.4	4.9
VI	1979 to 1984	5.2	5.5
VII	1985 to 1990	5.0	6.0
VIII	1992 to 1997	5.6	6.7
IX	1997 to 2002	6.5	5.5
X	2002 to 2007	8.0	7.6
XI	2007 to 2012	10.0	-

The First Five Year Plan covering the period of 1951 to 1956 had a target of 2.1 per cent per annum increase in GDP. However, the growth rate of 3.6 per cent was achieved which was higher than the estimated growth rate. Similarly, the actual growth rate was better than the estimated growth rate in the Second Five Year Plan as well. In the Third Five Year Plan, the actual growth rate of 2.3 per cent per annum was much lower than the targeted rate of 5.6 per cent. The Third Plan failed miserably. As a result, the economy found itself in a big trouble. At that time, only vigorous planning could have saved the country. However, contrary to the need of the hour, long-term planning was suspended for next three years.

The Fourth Plan was initiated in 1969 instead of 1966. This Plan also showed a large decline in the actual growth rate which was 3.3 per cent per annum against the estimated growth rate of 5.7 per cent. In the Fifth and the Sixth Five Year Plan, actual growth rate was higher than the estimated growth rate.

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The Seventh Plan aimed at 5.0 per cent per annum increase in GDP, but the actual growth rate was 6 per cent. In the first three years of the Seventh Plan, GDP had increased at the rate of 3.8 per cent per annum. However, during 1988-89 and 1989-90, the growth rate picked up sharply due to bumper harvest and the average annual increase in GDP during the whole of the Seventh Plan period turned out to be 6.0 per cent per annum against the targeted growth rate of 5.0 per cent per annum.

Similarly, in the Eighth Plan, the growth rate was 5.5 per cent per annum in the first two years. However, in the remaining three years, there was 7.0 per cent increase in GDP. Thus, the average rate of increase in GDP turned out to be 6.7 per cent per annum which was higher than the targeted growth rate of 5.6 per cent per annum.

The performance of the economy during the Ninth Plan was poor and proved the supporters of liberalization wrong. It is because, during this Plan, the actual growth rate was 5.5 per cent per annum which was lower than the estimated growth rate of 6.5 per cent per annum.

The Tenth Five Year Plan aimed at achieving the GDP growth rate of 8 per cent per annum, whereas, the actual growth rate of this Plan was 7.6 per cent per annum.

The Eleventh Five Year Plan (2007-2012) provides an opportunity to restructure policies to achieve a new vision based on faster, more broad-based and inclusive growth. It aims at putting the economy on a sustainable growth trajectory with a GDP growth rate of approximately 10 per cent by the end of the Plan period.

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## 5.4 ECONOMIC GROWTH AND BUSINESS OPPORTUNITIES

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India's experiments with market reforms have thrown up lessons about the static and dynamic effects of reforms and of their timing and phasing. These lessons depend on an understanding the nature of the economy that existed in 1979-80. Indian planning and the Indian economy were very different from that of the USSR and the Soviet Bloc, which may be termed communist-socialist economies. India's economy was always a market economy but in 1970s, perhaps one of the most heavily controlled market economies in the World (whence the term Indian version of Socialism). This has to be kept in mind when drawing lessons for other countries.

It is important to distinguish between the static and dynamic effects of reforms. The former affects allocative efficiency, equity and current welfare and the latter affects growth rates of productivity, investment and GDP. Though in principle an improvement in allocative efficiency can lead to an improvement in the investment environment and growth the lags can be relatively long and unpredictable. The common expectation that every reform should result in an increase in the growth rate and/or reduction in poverty, sets up an incorrect benchmark. Thus for instance,



the primary objective of the 1990s income tax reforms was static efficiency and welfare gains (tax payer equity) that are expected to generate a gradual but sustained increase in income tax revenue.

Financial sector reforms also have a substantial static component. The most significant reforms related to the removal of interest rate ceilings on bank lending and a host of associated controls and restrictions affecting nationalized banks. Similarly, introduction of prudential regulations reduce systemic risk but are unlikely to have any visible impact on growth. On the contrary, they may reduce growth in the short run as lenders become more risk averse. The other major reform was the entry of private banks in competition with the Nationalized Banks. The most significant impact of this has been the development of a housing loan market and consumer durable financing. It has also spurred improvement in the quality of service provided to bank customers. Thus allocative efficiency and welfare have improved. As 40 per cent of credit is still allocated according to government guidelines and 70 per cent of the Banking system is owned by the government there has been little competition or innovation (so far) in the supply of credit for production and investment. The spread of credit to new borrowers (small and medium) or the introduction of new methods of evaluation and appraisal are therefore minimal, as are the dynamic effects of these reforms.

Freeing of controls on equity markets has also led to gains in allocation within the existing set of firms and entrepreneurs. Better regulatory systems and procedures have reduced systemic risk and facilitated the flow of external funds (FII) into the equity markets. Though the transaction cost for established/existing entrepreneurs has fallen the access of new entrepreneurs does not appear to have widened significantly. There are two reasons. One is the absence of complementary reforms (company law, limited partnership, SICA/ bankruptcy law). Second, the general deterioration in the quality of the police–legal system reduces the probability of catching and convicting illegal financial behaviour. Regulatory systems are designed to deal with financial grey areas in a situation in which black (criminal/illegal) acts are dealt with by the normal legal system. Because of information asymmetry, the risk of financing new entrepreneurs includes the risk of some of them being financial frauds. Even though the regulatory system has improved, reducing the transaction cost of financing new borrowers, this has been partly offset by the increased risk of fraud. The market for risk capital has therefore not expanded beyond its traditional catchments area, and the dynamic effects that one might expect from capital market reforms are limited. Entry of venture capital and other equity funds with sophisticated evaluation capabilities will eventually overcome the second problem, while policy reform is needed to ensure that the first problem is solved.

The market reforms that appear to have had the strongest dynamic effects in India are those relating to production, investment and external controls. These are best understood through the prism of competition. For this purpose we

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distinguish three aspects of competition: The freedom to compete, the pressure to compete (competitive pressure) and the means and ability to compete. In a normal market economy freedom to compete is taken for granted. India created a system of production and investment controls and in some cases price and distribution controls that restricted or eliminated the freedom of medium-large firms to compete.

### 5.4.1 Capacity Utilisation

Capacity utilization is a largely used Key Performance Indicator (KPI) and operational measure in many organizations in the strategic capacity and business planning functions of many organizations. It can also be used as a measure which helps determine optimum timing of capacity expansions, entry into new markets, market exits, cost curves for different manufacturers and profitability. Moreover, it can also be used in operations and production management to calculate the average marginal cost of production, the split between fixed and variable costs, inventory, manning, overtime costs, and engineering/maintenance costs.

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## 5.5 REGIONAL DISPARITIES AND EVALUATION

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Independent India inherited an economy which was not only slightly backward but also regionally imbalanced. It reflected the distorted pattern of development imposed by the colonial reign to subserve its own interests. Most industrial and commercial activities were concentrated in the metros, that is, Mumbai, Kolkata and Chennai. Other cities like Ahmedabad, Kanpur and Delhi were also experiencing a lot of action. The other regions of the country remained underdeveloped. Getting rid of the existing regional disparities was therefore the primary challenge for the policy makers. The economic reforms that began in the country in 1991 brought about a drastic change in the economic policy regime. The policy of development led and directed by the state gave way to market-led growth. The regulatory mechanism gradually gave way to a policy of liberalization of domestic and external market.

Following the new economic policy, private investment began to flow to the high profit-yielding regions instead of the regions requiring higher investment. More private investment went to the richer states which had better infrastructure. The pattern of investment as well as growth was more concentrated. This led to an interest in the study of regional disparities.

The fiscal capacity of the states varied significantly. The poorer states were incapable of raising enough revenue from their tax and non-tax resources for providing the required level of public services to their people. These fiscal imbalances also got reflected in the differences in per capita expenditure of the states.

The capita revenue capacity of the richer states such as Punjab, Haryana and Maharashtra was much more than that of the poorer states like Bihar and Uttar Pradesh. In fact it was more than double.

The generous transfers by the Finance Commissions failed to remove disparities in revenue capacities of the states in any substantial measure.

Not only were the quality and level of public services and infrastructure much better in the richer states, they also had a much better capacity for investing. They were in a better position to attract funds from the Planning Commission and private investors.

This kind of complexity is the root cause of the persistent and growing inter-regional disparities at the state level in the country.

### **Trends since 1991**

With the skewed investment pattern and resource flow, the pattern of growth has been far from uniform across states. During the eighties, the differences in growth rates of Gross State Domestic Product (GSDP) in different states were not very significant. However, growth rates of GSDP in the poorer states fell in the 1990s as compared to the 1980s, while the growth rates rose in the richer states. Kerala, West Bengal, Gujarat, Karnataka, Tamil Nadu and Madhya Pradesh were the states that gained the most. All these states with the exception of Madhya Pradesh belong to high or medium per capita income category.

While the growth rate of GSDP has been slower in the poorer states, population growth has been faster in these states. As a result, the increase in per capita income has been slower. Not surprisingly, indicators of inter-state disparities in per capita SDP like minimum-maximum ratio and coefficient of variation clearly show that the situation worsened in the 1990s as per the Twelfth Finance Commission's report.

While the Indian economy has progressed to a higher growth path, the growth pattern has been concentrated regionally. Many regions have been overlooked in the race towards higher economic growth.

This uneven growth pattern that is responsible for the demands for creation of separate states in different regions of the country. These regional pressures have led to the creation of three separate states of Uttarakhand, Chhatisgarh and Jharkhand, which were created in 2000 as a result of the bi-furcation of the states of Uttar Pradesh, Madhya Pradesh and Bihar. Similar demands are now coming from other regions of India such as Bundelkhand, Telengana and Vidharbha.

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## **5.6 GLOBAL TRADE AND INVESTMENT ENVIRONMENT**

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After World War II, there has been a continuous and extraordinarily rapid growth in world trade. The increase in world trade has been due to a number of factors. In the post-War years, vigorous expansion of the world economy—partly due to government policies—aimed at ensuring economic growth, has provided the

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principal impulse for growth of world trade. In addition, the gradual liberalization of trade restrictions and import quotas, reduction in customs tariffs, and rigorous export promotion activities have contributed to the growth of world trade.

The central and South Americas and the Commonwealth of Independent States (CIS) represented the best growth in almost ten years. In the 1990s, the output and export growth were higher than the average annual rates. The increased flow of funds from the economically advanced countries to the developing ones also helped in the growth of world trade. The following factors were also responsible for this growth:

- Greater speed and capacity of communications and lower cost of transportation
- Rapid development of multinational corporations (MNCs)
- International Trade Theory covers the various models of international trade which have been evolved to describe the various concepts of the exchange of goods and services across global boundaries. The theories of international trade have gone through several modifications at periodic intervals. The main aim of trade is to optimize the profits from trade for the parties involved in the exchange of goods and services. The basic motivation remains the same irrespective of it being domestic or international trade.

International trade involves across border exchange of goods and services which results in increased cost of trading. Features like tariffs, restrictions, time costs and expenses associated with legal systems of the countries involved in trade make international trade an expensive affair; while the extent of restrictions and legal problems are remarkably low in the case of domestic trade.

International trade theory has always been a favourite domain of research both for the traditional and contemporary economists. The international trade models try to analyse the pattern of international trade and propose methods to optimize profits from trade.

The government's role in trade policy is inevitable for any country. The Government control of foreign trade started in India in the early years of the Second World War, when import control was introduced as a war time measure under the Defence of India Rules, 1940. The primary objective was to conserve foreign exchange resources and to restrict physical imports, so as to reduce the pressure on consumer items, which was however, brought under control. Subsequently, as the foreign exchange resources came under increasing pressure, the list of goods under import control was substantially expanded, covering many capital goods.

Due to the import substitution strategy adopted by the Government and the pressure on the foreign exchange resources, a very restrictive import policy was followed in India until the early 1990s. The serious foreign exchange problem convinced the Government, to increase the exports. Considerable attention has, therefore, been given to export promotion since the Third Five Year Plan.

The period of about three decades, 1961 to 1991, extending from the beginning of the Third Five Year Plan to the eve of the Eighth Plan, is characterised by import restriction and the adoption of a number of measures for export promotion. The early part of this period, witnessed vigorous import substitution efforts. Although there was some liberalisation of the imports since the mid 1980s, imports were, in general, highly restricted. Further, many of the import liberalisation measures were for export promotion.

The results of excessively inward-looking trade strategy on one hand and the need for modernisation and technology up-gradation of the Indian industry on the other, certain policy measures in the direction of trade liberalization were initiated. Trade policy reform has been an integral part of the economic policy reform came in to existence in India since July 1991. The trade policy cannot be viewed in isolation; it should be seen in the context of the overall economic policy. One of the important features of the new economic policy is a move towards a more open economy by liberalizing the foreign investment policy and imports. The redesigning of the policy covers some measures that have been taken .They can be broadly grouped as:

- (a) Realisation of exchange rate policy
- (b) Import liberalisation
- (c) Export incentives
- (d) Simplification of procedural formalities

The salient features of the new economic policy (NEP) of India are:

- i. Abridgement of the role of the public sector.
- ii. Substantial enlargement of the scope of the private sector.
- iii. Substantial enlargement of the private sector by delicensing (with some exceptions) and removing the restriction under the Monopolies and Restrictive Trade Practices (MRTP) Act on expansion, mergers ,amalgamations and takeovers..
- iv. Liberalization of the policy towards foreign capital and technology.
- v. Reform of the trade policy regime.
  - a. Exchange rate adjustment: To make the exchange rate more realistic and to encourage exports and discourage imports, the Rupee was devalued.
  - b. The role of subsidies in export promotion has been substantially reduced by abolishing the cash compensatory support (CCS). It was considered that the CCS was serious drain on the exchequer.
  - c. Liberalisation of imports by substantially eliminating licensing, quantitative restrictions and other regulatory and discriminatory controls.

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- d. Procedural simplification.
- e. Convertibility of the rupee. As a first step towards total convertibility of rupee, a scheme of partial convertibility of the rupee was introduced in March 1992. Accordingly, exporters got 40 per cent of the foreign exchange earnings converted into rupee at the official rate.

India's foreign trade has increased by more than 150 per cent during the decade 1993-2003. It may be indicative of the role played by the liberalize policies of the government – a process that started from 1991. From being a closed economy, India had remained relatively insulated from global developments and hence, had little experience in dealing with them. During the last fifteen years, India has opened up considerably, while simultaneously reforming the financial sector, improving its fundamentals and creating some built in measures to ensure financial stability. The overall approach has given the Indian economy enough flexibility to withstand some major global risks. Indian growth prospects remain bright in the future and any significant correction to global imbalances via abrupt and sharp changes in exchange rates and international interest rates will be taken into account.

Further, India's foreign trade has shown an impressive growth after the economic liberalization started in mid-1991. It gathered momentum at the beginning of the millennium with the trade (both export and import) showing around 20 per cent growth per year.

During the last 25 years, India's exports have increased more than 17 times, from US\$ 18.1 billion in 1990-91 to US\$ 309 billion in 2014-15, and India's imports have increased 19 times, from US\$ 23.5 billion in 1990-91 to US\$ 447 billion in 2014-15. India's share in global exports has moved up from mere 0.6 percent in early nineties to 1.7 percent currently. Likewise, India's share in global imports has increased from around 0.6 percent during early nineties to 2.4 percent currently. In the first decade of this period (1990-91 to 1999-2000), India's exports grew at a CAGR of 8.1 percent and imports at 8.7 percent. The real surge was witnessed in the next decade (2000-01 to 2009-10), when exports grew at 16.8 percent and imports at 21.5 percent annually. This trend continued until 2011-12, after which there has been a steady decline in trade owing to global slowdown. In 2014-15, exports dipped by 1.8 percent while imports dipped by 0.4 percent. For the first 11 months in financial year 2015-16, exports as well as imports have seen a sharp decline. While exports are lower by 16.7 percent y-o-y, imports have declined by 14.8 percent y-o-y.

### 5.6.1 Investment Environment

The role of foreign direct investment (FDI) in the accelerated economic growth of India is an important one. In recognition of this importance, Government of India initiated a number of economic and financial reforms in the early 1990s. As a result of these policy initiatives, FDI is encouraged in almost all the economic activities under the Automatic Route.

A circular issued in 2011 by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India, states that ‘it is the intent and objective of the Government to promote foreign direct investment through a policy framework which is transparent, simple and clear, and reduces regulatory burden’.

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### Who can invest in India?

- A non-resident entity (other than a citizen of Pakistan or an entity incorporated in Pakistan) can invest in India, subject to the FDI Policy. A citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI Policy, only under the Government Route.
- NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, provided the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.
- OCBs have been derecognized as a class of investors in India with effect from September 2003. Erstwhile OCBs which are incorporated outside India and are not put under adverse notice of the Reserve Bank of India can make fresh investment under FDI Policy as incorporated non-resident entities with the prior approval of the Government of India if the investment is through Government Route, and with the prior approval of the Reserve Bank of India if the investment is through Automatic Route.
- An FII may invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII to 10 per cent of the capital of the company and the aggregate limit for FII investment to 24 per cent of the capital of the company. This aggregate limit of 24 per cent can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned provided a resolution is passed by its Board of Directors followed by passing a special resolution to that effect by the General Body. The aggregate FII investment, in the FDI and Portfolio Scheme, should be within the above caps.
- The Indian company which has issued shares to FII under the FDI Policy for which the payment has been received directly into company account should report these figures separately in the prescribed form so that the details could be reconciled for statistical/monitoring purposes. A daily statement in respect of all transactions (except derivative trade) has to be submitted in soft copy in the prescribed format directly to the Reserve Bank of India to facilitate monitoring the overall ceiling/sectoral cap/statutory ceiling.
- As per FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, no person other than registered FII/NRI can trade in capital of Indian companies in the Indian Stock Exchanges directly.

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- A SEBI registered FVCI (Foreign Venture Capital Investor) may contribute up to 100 per cent of the capital of an IVCU (Indian Venture Capital Undertaking) and may also set up a domestic asset management company to manage the fund. All such investments can be made under the automatic route. A SEBI registered FVCI can also invest in a domestic venture capital fund registered under the SEBI (Venture Capital Fund) Regulations, 1996.

### Types of instruments

- Indian companies can issue equity shares; fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulations. Other types of preference shares/debentures of which funds have been received on or after 1 May 2007 are considered as debt. Accordingly, all norms applicable for ECBs (external commercial borrowings) relating to eligible borrower, recognized lenders, amount and maturity, end-use stipulations, etc., shall apply.
- The inward remittances received by the Indian company vide issuance of DRs and FCCBs (foreign currency convertible bonds) are treated as FDI and counted towards FDI.
  - o Indian companies can raise foreign currency resources abroad through the issue of FCCB/DR (ADRs/GDRs), in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.
  - o A company can issue ADRs/GDRs provided it is eligible to issue shares to persons resident outside India under the FDI Policy. At the same time, an Indian listed company which is not eligible to raise funds from the Indian capital market is not eligible to issue ADRs/GDRs.
  - o Unlisted companies, which have not yet accessed the ADR/GDR route for raising capital in the international market would require prior or simultaneous listing in the domestic market while seeking to issue such instruments.
  - o There are no end-use restrictions except for a ban on deployment of such funds in real estate or the stock market. There is no monetary limit up to which an Indian company can raise ADRs/GDRs.
  - o Voting rights on shares issued in terms of the scheme are as per the provisions of the Companies Act. Voting rights in the case of banking companies will be in accordance with the provisions of the Banking Regulation Act and the directions issued by the Reserve Bank of India from time to time.



- o Erstwhile OCBs who are not eligible to invest in India and entities which are prohibited by SEBI from buying, selling or dealing in securities are not eligible to subscribe to ADRs/GDRs issued by Indian companies.
- o The pricing of ADR/GDR issues and of sponsored ADRs/GDRs are in terms of the provisions of the Scheme of Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993; and guidelines issued by the Government of India and directions issued by the Reserve Bank of India, from time to time.

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### Entry route for investment

- The Automatic Route and the Government Route are the two routes through which investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares of an Indian company. The **Automatic Route** does not require any approval from the Reserve Bank of India or Government of India. For investment, **Government Route** requires prior approval of the Government of India through FIPB. Proposals for such investments as laid down in the FDI Policy from time to time are considered by the FIPB.

### Entry conditions on investment

- In certain sectors/activities investments can be permitted to be made by non-resident Indians in the capital of the resident entity with entry conditions. Such entry conditions are specified in various sectors/activities.
- In addition to entry conditions, the investments/investors need to conform to all relevant sectoral laws, regulations, etc., together with the national security/internal security related conditions as contained in relevant statutes or notifications of the Government and the regulations by the State Governments/Union Territories in relation to the subjects in their legislative domain.
- In the following activities/sectors FDI is not allowed:
  - o Retail Trading (except single branded product retailing).
  - o Lottery Business.
  - o Gambling and Betting.
  - o Business of Chit Fund.
  - o Nidhi Company.
  - o Trading in Transferable Development Rights (TDRs).
  - o Real Estate Business or Construction of Farm Houses.

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- o Manufacturing of Cigars, Cheroots, Cigarillos and Cigarettes, of Tobacco or Tobacco Substitutes.
- o Activities/Sectors not opened to private sector investment including Atomic Energy and Railway Transport.

In addition to foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited in Lottery Business and Gambling and Betting activities.

- Investments can be made by non-residents in the capital of a residential entity only to the extent of the percentage of the total capital as provided in the FDI Policy. In other words, while investments are not allowed in the activities/sectors noted above, there are restrictions/caps on the investment in certain other sectors/activities which are detailed in the FDI Policy.

### Check Your Progress

1. Define economic development.
2. What is international trade?

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## 5.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area.
2. International trade involves across border exchange of goods and services.

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## 5.8 SUMMARY

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- Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area.
- The study of economic development by social scientists encompasses theories of industrial/economic modernization causes, the historical phases or waves of economic development, and the organizational aspects of enterprise development in modern societies.
- There have primarily been two phases in India's economic development history since independence. These phases were characterized by two different policy regimes.

- Economic growth has always been the main objective of Five Year Plans in India.
- It is defined as an increase in the aggregate output of goods and services in a country within a specified period of time.
- The Eleventh Five Year Plan (2007-2012) provides an opportunity to restructure policies to achieve a new vision based on faster, more broad-based and inclusive growth.
- India's experiments with market reforms have thrown up lessons about the static and dynamic effects of reforms and of their timing and phasing.
- Independent India inherited an economy which was not only slightly backward but also regionally imbalanced.
- International trade theory has always been a favourite domain of research both for the traditional and contemporary economists. The international trade models try to analyse the pattern of international trade and propose methods to optimize profits from trade.
- The role of foreign direct investment (FDI) in the accelerated economic growth of India is an important one. In recognition of this importance, Government of India initiated a number of economic and financial reforms in the early 1990s.

## NOTES

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### 5.9 KEY WORDS

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- **Socialism:** It is an economic system where everyone in the society equally owns the factors of production.
- **Balance of Payment:** It summarizes all transactions that a country's individuals, companies and government bodies complete with individuals, companies and government bodies outside the country.
- **Capacity Utilization:** It is a largely used Key Performance Indicator (KPI) and operational measure in many organizations in the strategic capacity and business planning functions of many organizations.

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### 5.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. What is the main objective of studying the GDP trend?
2. Write a short note on the existence and evaluation of regional disparities in India.

3. What are the factors responsible for the growth of global trade?
4. List the sectors in which FDI is not allowed.

## NOTES

### Long-Answer Questions

1. Analyse the latest trends in GDP growth.
2. Examine the widening of business opportunities with reference to economic growth and development of the Indian economy.
3. Who all can invest in India?

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### 5.11 FURTHER READINGS

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# UNIT 6 FINANCIAL SYSTEM AND BUSINESS CAPITAL

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*Financial System and  
Business Capital*

## NOTES

### Structure

- 6.0 Introduction
- 6.1 Objectives
- 6.2 Financial System and Business Capital
  - 6.2.1 Structure of a Financial System
  - 6.2.2 Business Capital
- 6.3 Monetary Policy
- 6.4 Fiscal Policy
- 6.5 Financial Market Structure
  - 6.5.1 Money Market
  - 6.5.2 Capital Market
- 6.6 Stock Exchange
  - 6.6.1 Regulations Related to Stock Exchange
- 6.7 Types of Industrial Finance
  - 6.7.1 Corporate Securities
  - 6.7.2 Types of Debt Securities
  - 6.7.3 Debentures and Bonds
- 6.8 Industrial Financial Institutions and their Role
- 6.9 Risk-Cost-Role of Banks
- 6.10 Answers to Check Your Progress Questions
- 6.11 Summary
- 6.12 Key Words
- 6.13 Self Assessment Questions and Exercises
- 6.14 Further Readings

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## 6.0 INTRODUCTION

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The primary role of a financial system in any economy is to mobilize resources for industrious investment. An efficient financial system provides the means to arrange resources to activities that will provide the highest rate of return for investors. These resources enhance economic growth, enable enterprises to become more productive and consequently generate employment opportunities. This unit will introduce you to the financial system and business capital, monetary and fiscal policies, financial market structure, stock exchange and its regulations, industrial finance, and the industrial financial institutions.

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## 6.1 OBJECTIVES

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

- Identify the components of a financial system
- Define business capital

## NOTES

- Discuss the monetary and fiscal policies
- Describe the financial market structure
- Examine the regulations related to stock exchange
- Discuss the types of industrial finance
- Describe the role of various industrial financial institutions

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## 6.2 FINANCIAL SYSTEM AND BUSINESS CAPITAL

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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.

### 6.2.1 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.
- **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.

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.

### **6.2.2 Business Capital**

Business capital refers to the financial resources required for a business enterprise to produce goods or services to offers to its customers. Capital is vital for a business to maintain its operations.

Usually, business capital is available in the form of equity or debt. Some enterprises sell equity, an ownership portion of the company (or stock), in exchange for a financial investment. While other enterprises procure capital through debt, which is in the form of business loans and credit that the company must repay in the future.

Even though business capital generally covers the assets owned by the company, including real estate, inventory, and equipment yet it can be applied to anything that can generate wealth for the company, including items such as patents, brand names and books of business. Basically, business capital is anything the company could sell to make money if needed. In the accounting world, business capital strictly refers to the value of the business according to its balance sheet. However, in marketing terms, business capital extends to public perception of the brand and other related intangibles like goodwill.

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## **6.3 MONETARY POLICY**

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Money is one of the greatest inventions of mankind and the existence of a monetary economy has done much to enhance the material welfare of the human race. Yet in actual operation it has become more and more painfully evident that money does not always perform its functions properly. Refusing to remain as a useful slave, money has often behaved as a tyrant imposing arbitrary redistribution of wealth and income among the various classes of people. It has, therefore, been felt that money should be made to behave properly. This raises the question of defining the ideal behaviour of money. Once we can define this ideal behaviour of money, the problem of defining monetary policy becomes easy.

The term monetary policy is used to denote the policy of the government regarding money matters. The government must determine the objectives of monetary management.

## **NOTES**

## NOTES

1. **Falling Price Level:** Marshall showed preference for a falling price-level. Periods of rising prices contain within themselves seeds of future disasters. With falling prices, though the businessmen get less, the wage-earners get more. In a progressing economy, a slowly falling price level may be the ideal monetary policy so that the benefits of economic progress might be enjoyed by all those whose money incomes are fixed by contract or customs.

2. **Stable Price Level:** Rising prices and falling prices are both bad and therefore, the stable prices are the best. Since money is a store of value, variations in its value cause unnecessary loss or confer unfair advantages both of which are against the principle of natural justice. Moreover, stable price would secure social justice; it would ensure justice between debtors and creditors and between wage earners and employers.

3. **Generally Rising Price Level:** The case in favour of a slowly rising price level rests on the fact that it acts as a great incentive to enterprise. When prices rise, the expenses of businessmen do not rise as much as prices. Hence, during such periods businessmen can make huge profits. Prospects of profits would stimulate them to increase production. Thus, rising prices would secure full employment of workers than could otherwise be obtained. In a community characterized by varying degrees of unemployment, a slowly rising price level may be, as Keynes observed, a better monetary policy than mere price stability. According to Robertson, industrial progress in the nineteenth century has been made possible because of the stimulus given by rising prices.

Rising prices conflict with the principle of social justice. Periods of rising prices lower the real value of money incomes of wage earners and the investing classes. It is not desirable that wage earners should be made to suffer in order to provide incentive to businessmen. Moreover, rising price might lead to overinvestment, speculative boom and ultimate collapse.

4. **Neutral Money:** In view of the defects of stable prices, Prof. Hayek has proposed that the ideal monetary policy is that which interferes as little as possible with the operation of non-monetary forces. When there is no money and the barter system prevails, ratios of exchange would be established between different goods. The aim of monetary policy is to see that the same ratios of exchange prevail even under money economy. The introduction of money should not 'distort' the situation that should have obtained under barter. In other words, money should be neutral in its effects on prices. This could be secured not by stability of prices, but by the stability in the quantity of money in circulation.



5. **Avoidance of Cyclical Fluctuations:** Many economists are of opinion that business fluctuations are caused by monetary factors and can be remedied by monetary weapons. Bank credit can be regulated by the Central Bank by variation of bank rate, open market operations, etc. Through these weapons, the central bank can restrict credit to choke off a boom and expand credit to avoid recessions. However, according to Keynes, business cycles are not caused by monetary factors, and hence, purely monetary weapons cannot prevent them. Although, monetary policy can reduce the range of business fluctuations—make booms and slumps less severe.
6. **Stability of External Value of Currency:** The monetary policy of a country must aim at securing stability of the rate of foreign exchange. Stable exchange rates are highly important for countries like UK whose economic prosperity depends upon foreign trade. The pre war gold standard was managed for the purpose of securing exchange stability. Stability of exchange rates secured large benefits for the world. It facilitated large-scale movements of goods from one country to another. It also fostered the growth in the volume of international investment. However, stability in the rate of foreign exchange at the cost of internal price stability is not desirable. Nowadays, exchange stability is secured through exchange control. Exchange stability is not inconsistent with internal price stability. The external and internal values of money are two aspects of the same thing. There is no reason why both cannot be kept stable by efficient management.
7. **Full Employment and High Rate of Economic Growth:** The objective of monetary policy should be full employment of all available resources and a high rate of economic growth. If private expenditure is not adequate to achieve and maintain full employment, the deficiency must be made up by public expenditure. There will be no inflation so long as there are unemployed resources, which interfere as little as possible with the operation of non-monetary forces. When there is no money and the barter system prevails, ratios of exchange would be established between different goods. The aim of monetary policy is to see that the same ratios of exchange prevail even under money economy. The introduction of money should not ‘distort’ the situation that should have obtained under barter. In other words, money should be neutral in its effects on prices. This could be secured not by stability of prices, but by the stability in the quantity of money in circulation. If the supply of effective money is kept constant then there can be no distortion of the real ratios of exchange through changes in the quantity of money. The price level would then vary inversely with productive power.

## NOTES

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## 6.4 FISCAL POLICY

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### NOTES

Fiscal policy refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing. The total volume of expenditure in the community can be increased by the right type of fiscal policy. Though, the fiscal techniques were discovered and first made use of during the depression of the 1930, the techniques are capable of being applied equally effectively in times of inflation.

Fiscal measures to achieve full employment or to avoid depression include (1) compensatory tax policy and (2) government expenditure policy.

1. The traditional view regards that taxation is for revenue only and the opposite view expressed by the Keynesian school is that taxation is for maintaining an adequate volume of public expenditure. All taxes bring about some reduction in the level of consumption or investment, and thus, affect the level of national income. Since, the level of employment depends on the level of total expenditure, it is always necessary to maintain that level of total expenditure which assures full employment. Experience has shown that, private consumption expenditure and private investment expenditure, if left uncontrolled, cannot be relied upon for maintaining a level of expenditure which is appropriate to a state of full employment. During depression, the policy should be to substitute public spending for deficient private spending and to reduce taxation to encourage private spending. During boom conditions, a maximum of taxation is necessary to defend the economy against price inflation. The general purpose of counter-cyclical taxation is to encourage private consumption and investment when national income is below the full employment level, and to break consumption and investment when full employment has been reached and further spending can result only in inflation.
2. It is held that the government should maintain a state of full employment by means of what is called compensatory spending. When prices go on falling and depression sets in, it is necessary for the government to go on injecting more and more money in order to offset the increasing disappearance of private funds from flow of spending. When prices go on rising and inflationary conditions appear, the government should reduce public expenditure to contain inflation. At this stage, the government should have surplus budgets in order to stave off inflation. The main purpose of compensatory spending is to fill up the gap between full employment expenditure and actual expenditure. If private consumption and investment expenditures are not appropriate for full employment, the government should spend huge sums of money to make good the deficiency in total spending.

## Short-run and Long-run Fiscal Policy

Modern fiscal policy involves the process of shaping taxation and public expenditure in order to (1) reduce the fluctuations of trade cycle and (2) to contribute towards the maintenance of a growing, high-employment economy free from excessive inflation or deflation. When private investment and consumption spending create an inflationary (or deflationary) gap, it is the task of fiscal and monetary policy to offset the gap in the attempt to preserve price stability and full employment. The objective of fiscal policy is to achieve growth and full employment without inflation.

## NOTES

Fiscal weapons refer to taxation and expenditure policies. In this connection, modern economy is blessed with important 'built-in stabilizers.' Without any discretionary action, tax receipts change automatically when income changes, thereby reducing the size of the multiplier and serving to wipe out part of any disturbance. Because the automatic stabilizers never fully offset instabilities of an economy, scope is left for discretionary programmes. The principal weapons of discretionary fiscal policy are (1) varying public works and other expenditure programmes, (2) varying transfer-expenditure programmes, and (3) varying tax rates cyclically.

Public works policy involves such time lags in getting under way as to make their use to combat short recession undesirable. Discretionary variations in transfer expenditures and in tax rates have greater short-run flexibility. When people dropped the notion that government budget had to be balanced every year, they thought that the budget would be balanced over the business cycle—with boom-time surpluses just matching the depression deficits. However, it is now realized that only by coincidence would the prosperity years just balance the recession years. If we are faced by secular stagnation with private saving and investment schedules tending much of the time to produce deflationary gaps, fiscal policy may succeed in maintaining stable high employment only by having a long-term increase in the public debt. If we are in for chronic exhilaration with demand so brisk as to lead much of the time to inflationary gaps, then active fiscal policy will have a bias towards surplus financing and a secular downward trend in the public debt. In connection with budget deficit or surplus, some new concepts are introduced. First, there is the important concept of 'fiscal drag or dividend.' Second, there is the concept of the 'full employment budgetary surplus' (or deficit) as contrasted with the actual surplus or deficit. Fiscal drag or dividend is the name for the automatic growth in tax revenues in an economy with a progressive tax structure and steady over-all growth. Unless needed to fight an inflationary gap, fiscal drag has to be offset by (1) government expenditure increase on public goods deemed vital, and (2) tax-rate cuts that increase people's disposable incomes and expenditures in the private sector.

## NOTES

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## 6.5 FINANCIAL MARKET STRUCTURE

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Let us now study the financial market structure which consist of money market and capital market.

### 6.5.1 Money Market

Money market is a market for short-term financial assets that are close substitutes of money. Short-term here means that the duration is less than one year. A money market instrument is liquid and can be quickly turned into money at a low cost. It provides an avenue for equilibrating short-term surplus funds of lenders and requirements of borrowers.

Money market is basically a telephone market as all the transactions are carried out through telephonic communication. Subsequently, they are confirmed by written communications and exchange of respective instruments. This market consists of many sub-markets such as the inter-bank call money, bill discounting, treasury bills, Certificates of deposits (CDs), Commercial papers (CPs), Repurchase Options/Ready Forward (REPO or RF), Inter-Bank Participation Certificates (IBPCs), Securitized Debts, Options, Financial Futures and Forward Rate Agreements (FERA).

Money market is generally expected to perform three broad functions. These are to:

- Provide an equilibrating mechanism to even out demand and supply of short-term funds
- Present a focal point for central bank intervention for influencing liquidity and general level of interest rates in the economy
- Provide a reasonable access to providers and users of short-term funds to fulfil their borrowing and investment requirements at a realistic price (Vaghul, 1987).

### Features of a Money Market

The following are some of the features of a money market:

- It is a market meant purely for short-term funds/financial assets.
- It deals with short-tenor papers ranging from one day to one year.
- This market mostly rests on those financial assets which can be converted easily into cash without much diminution in value and which have low transaction costs.
- Usually, most transactions in this market take place through telephonic communication due to the urgent nature of the transaction.
- Mostly, the lenders and borrowers deal directly, without any intermediaries or dealers, to save time and cost.

- The money market is not a single homogenous market. It comprises various submarkets specialized in one type of finance.
- The Government, central bank, financial institutions and commercial banks dominate this market.

### **Post-Liberalization Period**

The money market in India witnessed significant progress particularly from the mid-1990s. The existing money market instruments were refined and new instruments were introduced. A number of structural and instrument-specific measures were taken by the Reserve Bank to add depth and liquidity to the market. Following the recommendations of Narasimhan Committee, the call money was transformed into a pure inter-bank market in a phased manner. The process started in 1999 and got completed in August 2005. The money market reforms that had taken place during this period are given below:

- Rupee derivatives like Interest Rate Swaps (IRS) and Forward Rate Agreements (FRA) were introduced in 1999 to deepen the money market and provide hedging facility to the market participants

### **6.5.2 Capital Market**

Capital markets are the pathways that help in converting savings into investment. The capital markets are the markets where debt and equity instruments are bought and sold. The capital markets serve as the platform for the investors to channelize their savings into the instruments of their choice. On the other hand they provide the users of those funds an arena where they may market their instruments and raise funds. Thus, the providers of the funds (investors with savings) meet the users of funds in the capital markets to transact and exchange the funds for instruments and vice-versa. The investors include the retail investors as well as the institutional investors. The users of capital include companies or businesses, governments as well as individuals.

### **Importance of Capital Markets in an Economy**

An efficient capital market is a market where the security prices reflect all information about the security in real time. The presence of efficient capital markets is an essential requirement for the development of an economy. This is due to the fact that efficient capital markets aid capital formation in the country which is a basis for production activities. The higher the rate of capital formation, the higher will be the rate of industrialization in the country. Also as the industrialization increases the productivity and consequently the national income would increase. The importance of efficient capital markets are as follows:

1. Aid capital formation
2. Provide liquidity
3. Act as the link between the savers and investors

## **NOTES**

## NOTES

4. Encouragement for savings
5. Encouragement for investment
6. Stability in security prices
7. Essential for economic growth
8. Increase national productivity

**(a) On the basis of the issue of security:** The first classification of the capital markets is based on the issue of securities. This means that the capital markets are classified on the basis of whether the security is being issued for the first time or an existing security is being traded in the markets.

**(i) Primary Markets:** As primary markets are part of the capital market, they facilitate the generation of funds by the businesses as well as the government. The Primary markets are where new securities are issued for the first time. The primary markets are also referred to as New Issue Markets (NIM). The primary market is the center for the issue of two types of stocks:— new issue of stocks that are already trading in the markets and the issue of new stocks into the markets.

The issue of new stock is called Initial Public Offering. The companies may issue shares or debt instruments in this market. The investor gets a security that can be traded while the issuing company gets the funds that are then utilized to fund the company's operations. After the securities are issued, any further sale-purchase transactions take place in the secondary market. The issue of new securities is facilitated by the investment banks which act as underwriters for the new issues. The investors in this market buy securities directly from the issuer.

**(ii) Secondary Markets:** The secondary markets provide the liquidity and facilitate the transactions of purchase and sale of securities that ensure investor confidence. In the secondary markets, the investors can buy securities from other investors who own the security but are interested in selling it. The examples of secondary markets are the stock exchanges on which the shares are traded actively. For example, the Bombay Stock Exchange, London Stock Exchange, NASDAQ, New York Stock Exchange, etc. The stock exchanges provide a centralized and liquid environment for the transactions for investors. This encourages more investors to enter the markets as the markets meet their liquidity requirements. A higher number of investors as well as a more centralized environment increases the liquidity in the secondary markets.

The four major legislations that govern the capital market are:

- The SEBI Act, 1992, which established the SEBI, has four objectives: protecting the interests of investors in securities; developing the securities market; regulating the securities market and other incidental matters connected therewith.
- The Companies Act, 2012, deals with the issue, allotment and transfer of securities, disclosures to be made in public issue, underwriting, borrowing powers, payment of dividend and winding up of companies.
- The Securities Contracts (Regulation) Act, 1956, provides for the regulation of securities trading and the management of stock exchanges.
- The Depositories Act, 1996, provides for the establishment of depositories for the electronic maintenance of demat securities and transfer of their ownership.

## NOTES

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### 6.6 STOCK EXCHANGE

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The stock exchanges provide an organized marketplace for the investors to buy and sell securities freely. The market for these securities is an almost perfectly competitive one because a large number of sellers and buyers participate. The shares listed, however vary broadly in terms of credit rating and often involve carrying cost. The shares however are not really homogeneous like a commodity in a perfectly competitive market. The stock exchanges provide an auction market in which members of the stock exchange participate to ensure continuity of price and liquidity to investors.

The active bidding and the resulting two way auction trading ensure that the bargains struck are the fairest, predetermined by the basic laws of supply and demand.

The efficient functioning of the stock exchange creates a conducive climate for an active and growing primary market for new issues. An active and healthy secondary market in existing securities, leads to a better psychology of expectations; considerable broadening of investment enquiries renders the task of raising resources by entrepreneurs easier. Good performance and outlook for equities in the stock exchanges imparts buoyancy to the new issue market.

#### **Continuous Market**

As seen earlier, the basic function of a stock market is the creation of a continuous market where securities are bought and sold in volume with little variation in the current market price as trades succeed one another. A continuous market provides liquidity through the sale or purchase of securities quickly and easily, at a price that varies little from the previous selling price. The indicators of a continuous market are:

- (i) Frequency of sales
- (ii) Narrow spread between bids and offers

## NOTES

- (iii) Prompt execution of orders
- (iv) Minimum price changes between transactions as they occur

The benefits of a continuous market are that, it creates marketable liquid investments and facilitates collateral lending. Listed shares are good collateral for secured loans although the margin is as high as 50 per cent (which used to be 75 per cent before 1993).

### **Frequency of Sales**

The primary criterion for a good market is whether investors can sell their portfolio-holding quickly with minimal price fluctuation at the time of sale. Liquidity occupies a central place in evaluating the efficiency of an exchange.

The characteristics of a liquid market are depth, breadth and resiliency. A market has depth if the buy and sell orders are forthcoming around the price at which the share is transacting. A market that lacks depth is shallow. The adequate volume of the orders gives breadth to the market, in the absence of which the markets are termed thin. Further, the response of the orders to price changes renders the market resilient.

### **Fair Price Determination**

The prices in the stock market are determined by the interplay of the forces of supply and demand. As seen earlier, active bidding and a two-way auction trading takes place in the stock exchange. The result is as near a market for free trading and free competition as can be found anywhere. The bargains that are struck are at the fairest price, determined by the basic laws of supply and demand.

The functioning of the market has been subject at times to manipulation. The year 1991–92 witnessed large scale bull runs, to push up prices and create artificial value. On the other hand, the prices in the market were at times pushed down by bear raiders without regard to their fundamental values. Manipulation cannot, of course, occur if the exchanges are alert. In the long-run interests of the securities market, such price manipulations should be discouraged.

The performance of the stock exchange is also subject to speculation which at times drives up the prices above the investment worth, and at others below it. The stock market prices were dormant for considerable stretches of time, especially prior to 1987. But since 1988–89 they have been above their investment worth with some of the shares selling at 50–70 times their earnings in 1991.

There is no obvious relationship between book value/par value and market value in the matter of many shares. The massive flow of funds into the stock market, from individual investors (some of whom disinvesting from contract business, transport and other retail trades) and the mutual funds, without any corresponding increase in the supply of scrips led to the surge in demand for shares in the years 1990–91 and 1991–92. This in turn pushed up the price. This



massive flow of funds into the stock market, no doubt motivated by the prospect of capital gains, resulted in a typical situation of too much money chasing too few scrips. Obviously there weren't enough shares to absorb the demand.

Under normal circumstances, one would leave the situation to the forces of the market— what the buyers and the sellers are willing to bid and to offer. But in India, a conscious policy is adapted to make shares attractive to the foreign institutional investors who evaluate our market in relation to other emerging markets. The stabilization of the stock market prices around a reasonable level (for PE Ratios to be at mid teens) would be desirable.

## **NOTES**

### **Aid to Financing Industries**

Listed companies find it helpful to sell further issues of their shares in the primary market based on the good performance of their earlier ones. An active market and a good market price for the company's shares (reflecting the past performance and future prospects) makes the task of raising funds through further issues easier. Rights themselves have an immediate and a wide market in the stock exchanges, provided the price including the premium reflects a fair value. Thus stock exchanges enable a company to market further issues successfully by creating a continuous market for the rights.

### **Other Functions**

The market prices established in stock exchange trading are useful for tax purposes. The stipulation on disclosures and transparency ensure that the investors have access to information on the listed companies, particularly with regard to their financial conditions. This serve to protect the investor's interests by eliminating the dishonest and irregular practices rampant in the brokerage trade.

### **6.6.1 Regulations Related to Stock Exchange**

The Securities Contracts Regulation Act 1956 provides inter alia for the following:

- The recognition of stock exchanges and regulation of their functioning
- The licensing of dealers
- The recognition of contracts
- The control of speculation
- The restriction of the rights of equitable holders of shares
- Empowering the government to compel any public limited company to get its shares listed.

Under the Securities Contracts (Regulation) Act, the government has promulgated the Securities Contracts (Rules, 1957) for carrying into effect the objects of the legislation. The rules are statutory and constitute a code of standardized regulations applicable to all recognized exchanges.

The Securities and Exchange Board of India Act 1992 provides for the establishment of the Securities and Exchange Board of India (SEBI) to protect the investors' interest in securities and to promote and regulate the securities market.

## NOTES

### Securities Contracts (Regulation) Act (SC (R)A) 1956

- (i) SC(R)A permits the functioning of only those stock exchanges which have been recognized by the Union Government in any notified state or area. The Act vests the Government with wide powers of supervision and control. Recognition is accorded only if the government is satisfied that the rules and by-laws of the stock exchange conform with the conditions prescribed for ensuring fair dealings and protection of investors. Further, the government has to be satisfied that such recognition is in the interests of the public and the trade.

SEBI decided on 10 December 1996 that recognition to new stock exchanges, if considered necessary in the interest of the public and of the trade could be allowed. But the trading is to be only on-line screen-based and the establishment of the clearing house will follow within 6 months.

- (ii) The rules and by-laws of the stock exchange have to be first approved by the government. In the interest of ensuring uniformity, the government insists that the exchanges seeking recognition should conform to the model rules and by-laws.

Changes in rules can be affected only with the consent of the government. Any changes in the control of contracts in securities or any other aspect of the trading activities has to be first sanctioned by the government. The government on its own (suo moto) can make or amend any rules or by-laws of a recognized stock exchange, if it is in the interests of the trade and the public.

- (iii) The SC(R)A confers on the government drastic powers to:

- make inquiries into the affairs of a recognized stock exchange and its members
- to supersede the governing body and takeover the properties of a recognized stock exchange
- to suspend its business and withdraw recognition in the interest of the trade and the public

Where there are no stock exchanges, SC(R)A empowers the government to license dealers in securities and prescribe the conditions subject to which they deal in securities.

- (iv) Under the SC(R)A, only contracts entered into through, with or between members of recognized stock exchanges are legal. The Act also empowers the government to control speculation, to declare sale or purchase of

specified securities in any notified area or state except to the extent and in the manner prescribed. Forward trading in shares was declared illegal in 1969; and trading in options in securities have since been allowed.

- (v) The Act also imposes restrictions on the right of equitable shareholders to recover dividends from the registered shareholders and confers powers on the government to compel any public limited company to get its shares listed on a recognized stock exchange.

## NOTES

### Securities Contracts (Regulation) Rules 1957

To carry into effect the objects of SC(R) Act the Securities Contracts (Regulation) Rules were promulgated. The rules provide inter alia for:

- The procedures to be followed for the recognition of stock exchanges
- The Submission of periodical returns and annual returns by recognized stock exchanges
- Inquiry into the affairs of recognized stock exchanges and their members
- The Requirements for listing of securities

**Recognition of stock exchange** The submission of the application under Section 3 of the SC(R) Act along with a fee of Rs 500 is the first step for a stock exchange seeking recognition. The application should be accompanied by four copies of rules including the Memorandum and Articles of Association where the applicant stock exchange is an incorporated body and by-laws. The government may make enquiries and if required ask for further clarifications. The recognition is subject to the stock exchange complying with the conditions imposed under SC(R) Act and rules from time to time. Application for renewal should be made three months before the expiry date along with a fee of Rs 200.

**Books of account and other documents to be maintained by stock exchanges** Every stock exchange should maintain and preserve the following books of account and documents for a period of five years:

- (i) Minute books of the meetings of
  - (a) members
  - (b) governing body
  - (c) any standing committee of the governing body or general body of members
- (ii) Register of members
- (iii) Register of authorized clerks
- (iv) Register of authorized assistants
- (v) Record of security deposits
- (vi) Margin deposits books
- (vii) Ledgers

- (viii) Journals
- (ix) Cash book
- (x) Bank passbooks

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### Submission of Returns

- (i) Every recognized stock exchange has to furnish the Central Government/ SEBI annually with a report about its activities during the preceding year which shall inter alia contain detailed information about the following matters:
  - (a) Changes in rules and by-laws, if any
  - (b) Change in the composition of governing body
  - (c) Any new committee set up and changes in the composition of the existing one
  - (d) Admissions, readmissions, deaths or resignation of members
  - (e) Disciplinary action against members
  - (f) Nature and number of disputes for arbitration between members and non-members
  - (g) Defaults
  - (h) Action taken to combat any emergency in trade
  - (i) Securities listed and delisted
  - (j) Securities brought or removed from the forward list
- (ii) Furnish audited balance sheet and profit and loss account for the preceding year.

**Submission of periodical returns** Periodical returns have to be submitted by the stock exchange to Central Government/SEBI relating to the following:

- The official rates for the securities listed thereon
- The number of shares delivered through the clearing house
- The making up prices
- The clearing house programmes
- The number of securities listed and delisted during the previous three months
- The number of securities brought on or removed from the forward list during the previous three months
- Any other matter as may be specified by the Central Government/SEBI

**Inquiry into the affairs of stock exchanges or members** The Central Government/SEBI can appoint two or more persons to enquire into the affairs of the governing body of a recognized stock exchange or any of its member. The inquiring authority hands over a statement of issues to the governing body/member

who is then given adequate opportunity to state their case. The inquiring body has to submit its report to the Central Government/SEBI.

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## **6.7 TYPES OF INDUSTRIAL FINANCE**

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### **NOTES**

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 financings.

### **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.

#### **6.7.1 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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### Short-Term Finance

There are several sources of short-term funds, important among which are listed below:

- Internal sources
  - Accrued liabilities
  - Accounts payables
- Market finance
  - Commercial paper
  - Factoring
  - Forfaiting
  - Public deposits
- Inter-corporate deposits
- Bank financing
  - Overdraft
  - Cash credit
  - Bill discounting
  - Note lending
  - Letter of credit
  - Line of credit (fixed or revolving)
  - Export financing
  - Special purpose financing

We have already discussed some of these concepts under Business capital, here will discuss only some of the remaining sources.

#### *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

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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.

**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.

### *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

### **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.

### **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 unit on the types of ownership security is more appropriate for corporate form of business.

#### **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.

#### **2. 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.

#### **3. 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,

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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.

### 6.7.2 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.

#### 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.

#### 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.

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### 6.7.3 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.

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.

**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, floating rate bonds, reverse floaters, asset-backed bonds, catastrophe bonds, etc.

Here, only those types of bonds that have bearing on interest payment schemes are listed, while other types are excluded.

#### **Hybrid Securities**

Some securities are designed to carry mixed features of ownership securities and debt securities. Some important hybrid securities are briefly discussed below.

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## 6.8 INDUSTRIAL FINANCIAL INSTITUTIONS AND THEIR ROLE

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### NOTES

In the initial years after Independence, considering the socio-economic situation prevalent at that time, the Government felt that the economic development of the country and the standard of living of the people were linked with growth and productive activities, which were possible only with the help of the provision of long-term financial assistance to industries. However, for this purpose there were no financial institutions except the commercial banks which were taking care of only short and medium-term finance. This is the genesis for the establishment of development banks in India.

Development banks are multipurpose institutions which provide financial and promotional services to the industries. They provide medium and long-term credit to industrial undertakings, discover investment projects, undertake the preparation of investment project reports, provide technical advice and managerial services, and assist the management of the industrial units. These banks provide financial assistance and other services for the following:

- Development of traditional commodity sectors like jute, sugar, textiles, cement, steel, etc. (industrial sector)
- Development of such manufacturing activity which are substitutes for the existing imports (import substitution)
- Development of such sectors which produce goods for export purposes (export promotion)
- Promotion of entrepreneurship development, pollution control, energy conservation, generation of direct and indirect opportunities of employment and also institution building in related areas

There is a network of development banks in India for providing financial and promotional support to industries. A brief overview of each of such development bank is given below.

### **Industrial Finance Corporation of India (IFCI)**

IFCI was set up in 1948 as per the Industrial Finance Corporation of India Act, 1948 with the objective of providing medium and long-term finance to industries in India specifically in situations where accommodating normal banking system is not appropriate or taking recourse to capital issue methods is not considered practicable. The authorized capital of the corporation was ₹ 10 crore initially which rose to ₹ 20 crore by the Amendment Act of 1972. IDBI contributes 50 per cent of this capital and the remaining is provided by the commercial banks, cooperative banks, insurance company investment trusts, etc.

### **Services of IFCI**

- Financial assistance is provided for setting up of new industrial projects and expansion, diversification, renovation or modernization of the existing units.

- Assistance is provided to any limited company, cooperative society incorporated or registered in India and engaged in manufacturing, shipping, mining, preservation or processing of goods, generation and distribution of electricity or any other form of power, hotel industry, etc.
- Financial assistance is provided in the form of a) rupee loans, b) subloans in foreign currencies, c) guaranteeing of deferred payment of machinery purchase internally or imported from abroad, foreign currency loans raised from abroad, rupee loans raised from banks or state cooperative banks or the market, d) underwriting or direct subscription of shares and debentures of public limited companies.
- Guidance is provided to new, tiny, small, medium-scale entrepreneurs in project identification, formulation, implementation, operation, market studies, etc.
- Merchant banking services with its head office at Delhi and bureau in Mumbai are provided.
- Undertaking assignment for capital restructuring and amalgamation of loan syndication with other financial institutions and trusteeship assignments.

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### **State Financial Corporations (SFCs)**

State Financial Corporations were formed by the enactment of the State Financial Corporations Act in 1951 to supplement the work of the Industrial Finance Corporation by providing medium and long-term credit to industrial undertakings, which fall outside the normal activities of commercial banks. These corporations confine their activities, as far as possible, only to such areas which are outside the scope of the Industrial Finance Corporation. The share capital of SFC was fixed and should not exceed ₹ 2 crore contributed by public (25 per cent) and the state government, the Reserve Bank, the scheduled banks, insurance companies, investment trusts, cooperative banks and other financial institutions (75 per cent). It was raised to ₹ 100 crore by making amendments in the Act in 2000. In addition, they can raise finances with the issue of debentures, borrowings from state governments, RBI, and IDBI guaranteed by the state governments. They are managed by the Board of Directors. Most of the directors are nominated by the concerned state governments, RBI and IFCI.

### **Services of SFCs**

- Granting of loans or advances and subscribing to the debentures of the industrial concerns repayable within a period of not exceeding twenty years
- Guaranteeing loans raised by industrial concerns in the capital market or from scheduled banks or state cooperative banks
- Guaranteeing deferred payments due from any industrial concern in connection with the purchase of its capital goods within India

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- Underwriting the issue of stocks, shares, bonds or debentures by industrial concerns, subject to the provision that the Corporation will be required to dispose of any shares, etc., acquired by it in fulfillment of its underwriting liability within a period of seven years
- Subscribing the stocks, bonds or debentures of industrial concerns out of the funds representing the special class of share capital subscribed by the state government and IDBI in accordance with the provisions of Section 4a of the State Financial Corporations Act, 1951
- Providing maximum amount of loan of ₹ 60 lakh to a single concern
- Granting loans and advances primarily for the establishment of new industries or for the expansion and development of the existing industrial concerns

### **Industrial Development Bank of India (IDBI)**

IDBI was established on 1 July 1964 under the Industrial Development Bank of India Act 1964 as a wholly-owned subsidiary of RBI. With effect from 16 February 1976 the ownership of IDBI was transferred to the Central Government. It is the apex institution in the area of development banking for coordinating in conformity with the national policies, the activities of the institutions engaged in financing, promoting or developing industries. The entire share capital of ₹ 50 crore was held by RBI and subsequently by the Central Government when it was taken over. The authorized capital has been raised to ₹ 1,000 crore and the Central Government may raise it to ₹ 2,000 crore.

### **Services of IDBI**

- Term loans both in rupees and foreign currency
- Underwriting and subscription of shares and debentures
- Guarantees for deferred credits and loans raised from other sources
- Soft loan assistance for modernization
- Matching rupee resources by way of direct loans to industrial units which received import licenses under the Technical Development Fund schemes
- Loan assistance for imports under various assistance fund schemes
- Seed capital assistance through SFCs and SIDCs for new entrepreneurs who do not have adequate financial resources to start new enterprises
- Refinance facilities to state level financial institutions and banks for providing assistance to small and medium industrial projects
- Cent per cent refinance in respect of composite term loan up to ₹ 25,000 sanctioned to artisans, village and cottage industries and SSI units in the tiny sector and projects promoted by SC/ST and physically handicapped

## **Small Industries Development Bank of India (SIDBI)**

The small-scale industrial sector plays a significant role in India as it provides employment to 19 million people, contributes around 40 per cent capital to India's manufacturing sector and constitutes about 35 per cent of the total exports. There were around 35 lakh small-scale units in India by the end of 2002. As a result of its inherent strengths like flexibility, adaptability, innovativeness, employability and also due to economic liberalization and reforms there is ample potential for the improvement of the small-scale industrial sector by providing necessary assistance.

SIDBI was set up as a wholly-owned subsidiary of IDBI in 1990 under the SIDBI Act 1989 enacted by the Parliament for promoting, financing and developing the small, tiny and the cottage sector apart from coordinating with the branches of other institutions engaged in similar activities. It is also responsible for administering the Small Industries Development Fund and the National Equity Fund.

The authorized capital of SIDBI is ₹ 250 crore which could be raised to ₹ 1,000 crore. Consequent upon the amendments in the SIDBI Act, 51 per cent of shareholdings of IDBI in SIDBI has been transferred to SBI, LIC, public sector banks, GIC and other financial institutions owned or controlled by the Government of India apart from 49 per cent of shareholdings of IDBI.

### **Services of SIDBI**

- It provides direct finance under different schemes, such as project finances to set up new projects, finance for acquiring new equipment, infrastructure financing (cost of promotion of sales through exhibitions), and bills discount schemes.
- It provides indirect finance to the intermediaries of the banks and the state level institutions, such as the state industrial development corporations, cooperative banks, state financial corporations, regional rural banks, NGOs, etc. mainly through refinancing and rediscounting.
- It provides seed capital and soft loan assistance under the National Equity Fund and other schemes through specified financial institutions.
- It provides leasing, factoring, etc. services directly to SSI units apart from rendering financial support to the National Small Industries Corporation for providing leasing, hire purchase and marketing services.
- To enhance the inherent strength of SSI units to help in employment generation and rehabilitation of rural poor, SIDBI provides services like training, application/sourcing of new technology, market information.
- It co-promotes the state level venture funds in association with the respective state government.

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### Non-banking Financial Institutions

A non-banking financial company is a company which has the principal business of receiving deposits under any scheme or arrangement of lending in any manner.

As per the RBI Act of 1934, a non-banking financial company means a) a financial institution which is a company, b) a non-banking institution which is a company and which has as its principal business – the receiving of deposits, under any scheme or lending in any manner, c) such other non-banking institution or class of such institutions, as the bank may, with the prior approval of the Central Government, specify.

The institutions which perform a) agricultural operations, b) industrial activities, c) the purchase or sale of goods other than securities or d) the purchase, construction or sale of immovable property as their main business do not fall under the scope of NBFCs.

The NBFCs include the following as per the definition of the Non-banking Financial Companies Direction, 1977.

1. Hire purchase finance companies which take up the activity of hire purchase or financing of such transactions.
2. Equipment leasing companies which take up equipment leasing or financing of such activity.
3. Loan companies that provide finance by making loans or advances or otherwise for any activity other than its own; these do not include equipment leasing companies/hire purchase finance companies or housing finance companies.
4. Investment companies (that undertake acquisition) which include primary dealers who deal in underwriting and Government securities.
5. Residuary Non-banking Company (RNBC) is one which is not covered by any of the above. RNBC may receive deposits under any scheme or arrangement.

The other non-banking financial entities regulated by RBI include the following:

- Mutual Benefit Financing Companies (MBFCs), i.e., *nidhi* companies
- Mutual Benefit Companies (MFCs), i.e., potential *nidhi* companies
- Miscellaneous non-banking companies (MNBCs), namely chit fund companies

### Functions of NBFCs

- 1. Receiving deposits:** The primary function of NBFCs is to mobilize deposits from the public by encouraging the habit of savings among the



public. They mobilize deposits by way of loans or deposits or in any form by offering attractive schemes. The modes of resource mobilization include issue of debentures, unit certificates, savings certificates, subscriptions, etc. The rates of interest offered by NBFCs are comparatively higher and it is identified that the interest rate offered on almost all the deposits is above 13 per cent. They can raise deposits under two groups, namely regulated deposit and exempted deposits. There are some deposits over which ceiling or restrictions are imposed by RBI. NBFCs have to raise deposits under this category subject to restrictions. Hence, they are called regulated deposits. In case of hire purchase and equipment leasing companies, for example, the ceiling over deposit mobilization is limited to ten times of their owned funds. The exempted deposits include borrowings from banks and other financial institutions, money received from Governments and abroad, intercompany borrowings, security deposits, money received from local authorities, etc.

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2. **Lending money:** NBFCs lend money in various forms like hire purchase finance, leasing finance, consumption finance, finance for social activities, etc. The terms of finance are flexible, easy and simple and people who fail to get the facility from banks approach these companies. Above all, they are easily accessible to many.
3. **Investing of money:** The surplus funds available with them are invested in securities.
4. **Providing variety of services:** NBFCs provide diversified services like mutual funds, special forex operations, merchant banking services, counselling, etc. apart from their traditional services. They reduce the risk through diversification.
5. **Providing housing finance:** The Housing Finance NBFCs provide housing finance contributing for the well-being of the society.
6. **Rendering investment advice:** The investing companies provide expert advice in investment of funds as well as supervise investment.

Thus, NBFCs provide easy, flexible, timely financial facility for diversified purposes raising resources in the form of deposits and borrowings apart from offering expert advice to their customers on various fronts. Hence, they gained lot of popularity and also helped the society in a number of ways.

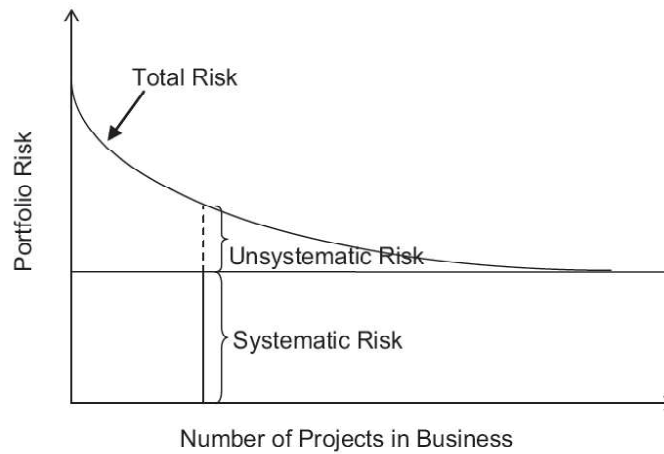
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## 6.9 RISK-COST-ROLE OF BANKS

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Risk can be classified into (a) systematic risk, and (b) unsystematic risk. Figure 6.1 gives an idea of these two types of the risk.

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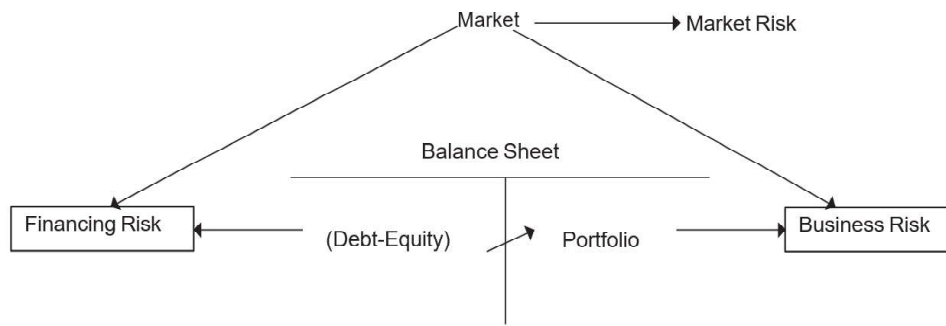
**Fig. 6.1** Effect of Diversification of Total Risk and its Components

A company with a single project is exposed to external vagaries. With the addition of a new project in the business (project portfolio), the total risk may reduce. The process of risk reduction continues for some time with the acceptance of more and more projects in the portfolio. Beyond a point, the overall risk will not be reduced further. This implies that the project portfolio has become balanced. Till the portfolio of the project becomes balanced, the business takes the total risk higher than what is minimum risk under a balanced portfolio. This higher risk is unsystematic risk, which the firm can diversify away. However, systematic risk cannot be diversified away. Product diversification and market diversification both give similar results and reduce the unsystematic risk. A company prefers to launch a product in more than one market in the market diversification programme, whereas in the product diversification strategy the same market is offered more than one products.

When it comes to investment in corporate projects, systematic risk is only a concept. Total risk can be reduced through diversification, but that can rarely touch the level of systematic risk, unlike that in security investment. Security markets are well-developed ones, where with very little cost investors can sell their investments and buy other investments, which would fit best in their portfolios. Also, in security market since unit value of investment is small one can practically invest in small fractions. The process of buying, holding and selling securities at a minimum cost and minimum time and that too in any amount enables the investors to attain a balanced portfolio.

In the project investment area, such ease, flexibility and fractional investment are not imaginable. Despite that, the concept that the risk can be reduced through well-thought diversification is useful in the corporate investment field.

Risk is also classified in different ways, business risk, financial risk and market risk. Figure 6.2 gives the pictorial interfaces among these three types of risks.



**Fig. 6.2** Interfaces among Business Risk, Financing Risk and Market Risk

## NOTES

Financing risk arises out of the debt-equity structure chosen by the company. Knowledge of capital structure theory for setting an appropriate debt-equity target, and designing of securities can jointly influence the total financing risk. The variability in shareholders' net income due to the change in the net operating income (business risk) is called the financial risk.

Market risk gets reflected on the cost of individual funds for the reasons related to market factors. A perfect capital market would offer zero market risk. Imperfection in capital market observes the change in investor psychology and re-allocation of market funds over competing securities. The market process of re-allocation of funds changes the cost of capital of a company, even though the business risk and financial risk of the company may not have changed.

Business risk is that part of the total risk, which occurs due to a particular project portfolio. A diversified portfolio may have a low business risk. Business risk is a function of the product market conditions faced by a firm for all the businesses collectively, and variability of operating income due to those factors. This is also called the project-portfolio risk. The risk arising out of product market conditions and their impact on a single project is called project risk.

Business risk can be divided into two categories, external and internal. External business risk arises out of the external conditions faced by the firm due to circumstances beyond its direct control. Variation in sales quantity, variation in sales price, uncertainty of input price and their productivity, government policy and taxes, and competition are external factors causing business risk. Internal factors emanate from the efficiency of the business. Operating leverage, project design, process control, culture of organizations and such other internal factors determine the impact of variation in external factors on the operating profits of the company. Financial risk can also be divided into two categories, external and internal. Interest rate is largely caused by external factors, whereas degree of financial leverage is caused by financing decision and, therefore, it is internal risk.

The following points have emerged from the above discussion on the types of risk:

- Companies take business risk and financial risk. (Remember, all other risks, like risk due to fire and natural calamity, are insured by the companies.)

## NOTES

- Market risk affects all the businesses in general, and that gets reflected in financial risk through adjustment in the cost of capital. (Remember, that the debt-equity structure is a dynamic decision; the structure has to be reset for attaining the minimum overall cost of funds, whenever market risk changes.)
- Business risk contains two parts in it, systematic risk and unsystematic risk.
- Unsystematic risk represents the imbalance in the portfolio of projects.
- Unsystematic risk cannot be totally removed through diversification especially in case of corporate projects, because projects are not in perfect market conditions. But, it can surely be reduced through thoughtful diversification, without reducing average return. This is called the portfolio effect.

### Role of Banks

In managing risk, banks must decide which risks to take, which to transfer and which to avoid altogether. Market risks are easily transferred, largely through swaps and other derivative products. A financial institution must accept a particular kind of risk only when it believes that it has a comparative advantage in accepting that risk. In recent years, leading banks have paid much attention to measuring credit risk and have made significant profit, by employing innovative and sophisticated risk modeling techniques as well as by consolidating their more traditional practices.

#### Check Your Progress

1. Name the essential components of a financial system.
2. List the features of a money market.
3. What is a capital market?
4. State the indicators of a continuous market.

## 6.10 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The essential components of a financial system are the following:
  - Financial institutions
  - Financial markets
  - Financial instruments and services
2. The following are some of the features of a money market:
  - It is a market meant purely for short-term funds/financial assets.
  - It deals with short-tenor papers ranging from one day to one year.

- This market mostly rests on those financial assets which can be converted easily into cash without much diminution in value and which have low transaction costs.
  - Usually, most transactions in this market take place through telephonic communication due to the urgent nature of the transaction.
  - Mostly, the lenders and borrowers deal directly, without any intermediaries or dealers, to save time and cost.
3. The capital markets are the markets where debt and equity instruments are bought and sold. The capital markets serve as the platform for the investors to channelize their savings into the instruments of their choice.
  4. The indicators of a continuous market are the following:
    - (i) Frequency of sales
    - (ii) Narrow spread between bids and offers
    - (iii) Prompt execution of orders
    - (iv) Minimum price changes between transactions as they occur

## NOTES

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### 6.11 SUMMARY

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- 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.
- 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.
- The term monetary policy is used to denote the policy of the government regarding money matters.
- Fiscal policy refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing. The total volume of expenditure in the community can be increased by the right type of fiscal policy.
- Modern fiscal policy involves the process of shaping taxation and public expenditure in order to (1) reduce the fluctuations of trade cycle and (2) to contribute towards the maintenance of a growing, high-employment economy free from excessive inflation or deflation.
- Money market is a market for short-term financial assets that are close substitutes of money. Short-term here means that the duration is less than one year. A money market instrument is liquid and can be quickly turned into money at a low cost.
- The money market in India witnessed significant progress particularly from the mid-1990s. The existing money market instruments were refined and new instruments were introduced.

## NOTES

- The stock exchanges provide an auction market in which members of the stock exchange participate to ensure continuity of price and liquidity to investors.
- A continuous market provides liquidity through the sale or purchase of securities quickly and easily, at a price that varies little from the previous selling price.
- Short-term funds are required for meeting working capital needs. They are usually required for a period up to one year.
- 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.
- 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.
- Development banks are multipurpose institutions which provide financial and promotional services to the industries.
- IDBI was established on 1 July 1964 under the Industrial Development Bank of India Act 1964 as a wholly-owned subsidiary of RBI.
- A non-banking financial company is a company which has the principal business of receiving deposits under any scheme or arrangement of lending in any manner.

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### 6.12 KEY WORDS

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- **Financial Institution:** A financial institution is a public or private institution that collects funds from the public or other institutions and invests them in financial assets.
- **Business Capital:** The amount of money required for a company to produce goods or services to offer to its customers is known as business capital.
- **Fiscal Policy:** It refers to the policy in connection with (a) government spending, (b) taxation, and (c) borrowing.

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### 6.13 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. Write a short note on business capital.
2. What are the objectives of monetary management?

3. What is short-run and long-run fiscal policy?
4. How does the stock exchange provide an organized marketplace?
5. What is the main function of industrial financial institutions?
6. Write short notes on the following:
  - (i) IDBI
  - (ii) IFCI
  - (iii) SIDBI

## NOTES

### Long-Answer Questions

1. Evaluate the importance of capital markets in an economy.
2. Discuss the regulations related to stock exchange.
3. Describe the types of industrial finance.
4. What are the functions of Non-Banking Financial Institutions?

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### 6.14 FURTHER READINGS

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- Cherunilam, Francis. 2009. *Business Environment*. New Delhi: Himalaya Publishing House Pvt. Ltd.
- Gupta, C.B. 2014. *Business Environment*, Eight Edition. New Delhi: McGraw Hill Education.
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## UNIT 7    ROLE OF CENTRAL BANK AND FISCAL SYSTEM

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### NOTES

#### Structure

- 7.0 Introduction
- 7.1 Objectives
- 7.2 Banks and Financial Institutions
- 7.3 Fiscal System: Government Budget and Taxation Measures
  - 7.3.1 Fiscal Deficit and Inflation
  - 7.3.2 Taxation Measures
- 7.4 Foreign Capital and Multinational Corporations
- 7.5 Export-Import Policy
  - 7.5.1 Export-Import Policy 2015-2020
- 7.6 Foreign Exchange and Business Development
- 7.7 Answers to Check Your Progress Questions
- 7.8 Summary
- 7.9 Key Words
- 7.10 Self Assessment Questions and Exercises
- 7.11 Further Readings

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### 7.0    INTRODUCTION

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The Central Bank is the most important banking institution in the country. India's Central Bank is the Reserve Bank of India.

Tax reforms are likely to expand revenue base in fast growing economies like India but they will be most effective when accompanied by lowering of fiscal deficit and effective management of expenditure. In this unit, you will study about the role of Reserve Bank of India (RBI), government budget taxation measures, concept of fiscal deficit and inflation, the role of FDI in development of economy, highlights of the EXIM policy 2009-14 and the role of foreign exchange in business development.

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### 7.1    OBJECTIVES

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

- Discuss the role of Reserve Bank of India (RBI)
- Define government budget taxation measures
- Describe fiscal deficit and inflation
- Analyse the role of FDI in development of economy
- List the highlights of the EXIM policy 2009-14
- Discuss the role of foreign exchange in business development



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## 7.2 BANKS AND FINANCIAL INSTITUTIONS

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Indian economy is largely dependent on the Indian banking system. The banking system has been quite effective, the most important of all being, its extensive reach, even to the remote corners of the country. Banks as well as financial institutions play a very significant role in the economy of a country, foremost being catering to the need of credit for all sections of society. An effective banking system is required to for the economy of a country to function properly.

### NOTES

#### Central Banking in India (Reserve Bank of India)

The pattern of central banking in India was based on the Bank of England. England had a highly developed banking system in which the functioning of the central bank as a banker's bank and their regulation of money supply set the pattern. The central bank's function as 'a lender of last resort' was on the condition that the banks maintain stable cash ratios as prescribed from time to time. The effective functioning of the British model depends on an active securities market where open market operations can be conducted at the discount rate. The effectiveness of open market operations however depends on the member banks' dependence on the central bank and the way it influences interest rates. Later models, especially those in developing countries showed that central banks play an advisory role and render technical services in the field of foreign exchange, foster the growth of a sound financial system and act as a banker to government.

The Reserve Bank of India (RBI) is the supreme monetary authority responsible for controlling the banking system in the country. It was established in 1935 in accordance with the provisions of the Reserve Bank of India Act, 1935. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India. It was nationalized on the basis of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948. As a result all shares in the capital of the bank were deemed transferred to the Central Government on payment of a suitable compensation. The central office of the Reserve Bank is established at Mumbai and the bank has 22 regional offices, most of which are in state capitals. The Banking Regulation Act, 1949, provides the legal framework for regulation of the banking sector by the Reserve Bank of India.

The main functions of RBI are as follows:

- It formulates, implements and monitors the monetary policy with the objective of maintaining price stability and ensuring adequate flow of credit to productive sectors.
- It regulates and supervises the financial system by prescribing the broad parameters of banking operations within which the system must function.
- It manages foreign exchange in order to facilitate external trade and promotes orderly development and maintenance of foreign exchange market in India.

## NOTES

- It issues and exchanges or destroys currency and coins not fit for circulation, so as to give the public adequate quantity of supplies of currency notes and coins and in good quality.
- It performs a wide range of promotional functions to support national objectives.
- It is the banker to the Central and state governments.
- It is the banker to banks by maintaining banking accounts of all scheduled banks.

### **RBI's role in monetary control**

One of the most important functions of the RBI is monetary management—regulation of the quantity of money and the supply and availability of credit for industry, business and trade. The monetary or credit management activities of the bank are of two types: general monetary and credit management functions which encompass the total supply of money and credit and the general level of interest rates. The RBI relies on two types of instruments, the direct and the indirect. The direct instruments of monetary control are reserve requirements, administered interest rates and credit controls; and the indirect instrument of control is open market operations.

### **RBI's role in banking supervision**

The Banking Regulation Act, 1949 empowers the Reserve Bank of India to inspect and supervise commercial banks. These powers are exercised through on-site inspection and off site surveillance.

Till 1993, regulatory as well as supervisory functions over commercial banks were performed by the Department of Banking Operations and Development (DBOD). Subsequently, a new Department of Banking Supervision (DBS) was set up to take over the supervisory functions relating to the commercial banks from DBOD. For dedicated and integrated supervision over all credit institutions, i.e., banks, development financial institutions and non-banking financial companies, the Board for Financial Supervision (BFS) was set up in November 1994 under the aegis of the Reserve Bank of India. For focussed attention in the area of supervision over non-banking finance companies, Department of Supervision was further bifurcated in August 1997 into Department of Banking Supervision (DBS) and Department of Non-Banking Supervision (DNBS). These Departments now look after supervision over commercial banks & development financial institutions and non-banking financial companies, respectively. Both these departments now function under the direction of the Board for Financial Supervision (BFS).

The Board for Financial Supervision constituted an audit sub-committee in January 1995 with the Vice-Chairman of the Board as its Chairman and two non-official members of BFS as members. The sub-committee's main focus is upgradation of the quality of the statutory audit and concurrent / internal audit

functions in banks and development financial institutions. Some of its activities include: On-site inspection, off-site monitoring, corporate governance, initiatives and directions, etc.

### **Bank rate and discount rate**

**Bank rate** has been defined in Section 49 of the Reserve Bank of India Act, 1934 as the standard rate at which (the Bank) is prepared to buy or rediscount bills of exchange or other commercial papers eligible to purchase under the Act. It is the rate at which the central bank lends funds as a 'lender of the last resort' to banks against approved securities, purchases and discount-eligible bills of exchange. The effect of change in the discount rate is to make the cost of securing funds from the central bank cheaper or more expensive, bring about changes in the structure of interest rates and serve as a signal to the money market of the relaxation or restraint of credit policy. Its effectiveness depends on the dependence of commercial banks on the central bank for additional resources.

A rise in the cost of borrowing from the central bank would result in a corresponding levering up of rates, increasing the cost of credit and consequently reducing the volume. Before changing the bank rate, the market should be conditioned. For instance, before raising the rate, the surplus liquidity in the market should be absorbed. The effect of bank rate change on the structure of interest rates depends on market interpretation of how durable the change is, and the degree of integration of the money and capital markets. The effect on Long-term rates is appreciable owing to infrequent changes and their expected long tenure. Initially, financial accommodation from the Reserve Bank was largely provided at the bank rate. In the absence of a genuine bill market, application of bank rate was confined to Ways and Means Advances to state governments and advances to primary cooperative banks for SSIs and state financial corporations, besides penal interest rates on shortfalls in reserve requirements.

### **RBI as the banker to government**

The RBI is the banker to the Government of India statutorily and to state governments by virtue of agreements entered into with them. The Bank accepts money on deposit, withdrawal of funds by cheques, receipt and collection of payments to the government and transfer of funds by various means throughout India. The terms and conditions on which the bank acts as a banker to the Central and State Governments are set out in separate agreements which the bank has entered into with them. Under the agreement, the RBI is required to transact the general banking business of the Central Government and keep accounts in its books. The Central Government earlier maintained a minimum cash balance of ₹ 50 crore. Whenever the balance fell below it, the account was replenished by the creation of treasury bills known as ad hocs which are held in the Issue Department.

### **NOTES**

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## 7.3 FISCAL SYSTEM: GOVERNMENT BUDGET AND TAXATION MEASURES

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### NOTES

We have already discussed fiscal policy in Unit 6. In this section, let's study the government budget and taxation measures.

#### Government Budget

A government budget is a legal document that is often passed by the legislature, and approved by the chief executive—or president. For example, only certain types of revenue may be imposed and collected. The two basic elements of any budget are the revenues and expenses. In the case of the government, revenues are derived primarily from taxes. Government expenses include spending on current goods and services, which economists call government consumption; government investment expenditures such as infrastructure investment or research expenditure; and transfer payments like unemployment or retirement benefits.

In India, the budget documents presented to Parliament include the Annual Financial Statement (AFS), Demands for Grants (DG), Appropriation Bill, Finance Bill and Fiscal Policy Strategy Statement for the financial year. In addition to these, individual Departments/Ministries also prepare and present to Parliament their Detailed Demands for Grants, Outcome Budget, and their Annual Reports. The Economic Survey which highlights the economic trends in the country and facilitates a better appreciation of the mobilization of resources and their allocation in the Budget is brought out by the Economic Division of Department of Economic Affairs, Ministry of Finance. The Economic Survey is presented to Parliament in advance of the Union Budget.

To monitor the performance management of various Ministries/Departments, Result Framework Document (RFD) system has been adopted by the Government. The RFD system is being implemented in the various Ministries/Departments in phased manner. Performance Management in the Government is a new concept which determines the performance index based upon the agreed objectives, policies, programs and projects/schemes. To ensure the success in achieving the agreed objectives and implementing agreed policies, programs and projects, the RFD also includes a commitment for required resources and necessary operational autonomy.

#### 1. Annual Financial Statement (AFS)

Annual Financial Statement (AFS), the document as provided under Article 112, shows estimated receipts and expenditure of the Government of India for a year in relation to estimates and expenditures for the previous year. The receipts and disbursements are shown under the three parts, in which Government Accounts are kept viz., (i) consolidated fund, (ii) contingency fund and (iii) public account. Under the Constitution, Annual Financial Statement distinguishes expenditure on revenue account from other expenditure. Government Budget, therefore, comprises

Revenue Budget and Capital Budget. The estimates of receipts and expenditure included in the Annual Financial Statement are for the expenditure net of refunds and recoveries, as will be reflected in the accounts.

- (i) **Consolidated fund:** The existence of the Consolidated Fund of India (CFI) flows from Article 266 of the Constitution. All revenues received by Government, loans raised by it, and also its receipts from recoveries of loans granted by it form the Consolidated Fund. All expenditure of Government is incurred from the Consolidated Fund of India and no amount can be drawn from the Consolidated Fund without authorization from Parliament.
- (ii) **Contingency fund:** Article 267 of the Constitution authorizes the Contingency Fund of India which is an imprest placed at the disposal of the President of India to facilitate Government to meet urgent unforeseen expenditure pending authorization from Parliament. Parliamentary approval for such unforeseen expenditure is obtained, post-facto, and an equivalent amount is drawn from the Consolidated Fund to recoup the Contingency Fund. The corpus of the Contingency Fund as authorized by Parliament presently stands at ₹ 500 crore.
- (iii) **Public account:** Moneys held by Government in Trust as in the case of Provident Funds, Small Savings collections, income of Government set apart for expenditure on specific objects like road development, primary education, Reserve/Special Funds etc. are kept in the Public Account. Public Account funds do not belong to Government and have to be finally paid back to the persons and authorities who deposited them. Parliamentary authorization for such payments is, therefore, not required, except where amounts are withdrawn from the Consolidated Fund with the approval of Parliament and kept in the Public Account for expenditure on specific objects, in which case, the actual expenditure on the specific object is again submitted for vote of Parliament for withdrawal from the Public Account for incurring expenditure on the specific object.
- (iv) **Revenue budget:** Revenue Budget consists of the revenue receipts of Government (tax revenues and other revenues) and the expenditure met from these revenues. Tax revenues comprise proceeds of taxes and other duties levied by the Union. The estimates of revenue receipts shown in the Annual Financial Statement take into account the effect of various taxation proposals made in the Finance Bill. Other receipts of Government mainly consist of interest and dividend on investments made by Government, fees, and other receipts for services rendered by Government. Revenue expenditure is for the normal running of Government departments and various services, interest payments on debt, subsidies, etc. Broadly, the expenditure which does not result in creation of assets for Government of India is treated as revenue expenditure. All grants given to State Governments/Union Territories and other parties are also treated as revenue expenditure even though some of the grants may be used for creation of assets.

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## NOTES

(v) **Capital budget:** Capital Budget consists of capital receipts and capital payments. The capital receipts are loans raised by Government from public, called market loans, borrowings by Government from Reserve Bank and other parties through sale of Treasury Bills, loans received from foreign Governments and bodies, disinvestment receipts and recoveries of loans from State and Union Territory Governments and other parties. Capital payments consist of capital expenditure on acquisition of assets like land, buildings, machinery, equipment, as also investments in shares, etc., and loans and advances granted by Central Government to State and Union Territory Governments, Government companies, Corporations and other parties.

### 2. Demands for Grants

Article 113 of the Constitution mandates that the estimates of expenditure from the Consolidated Fund of India included in the Annual Financial Statement and required to be voted by the Lok Sabha are submitted in the form of Demands for Grants. The Demands for Grants are presented to the Lok Sabha along with the Annual Financial Statement. Generally, one Demand for Grant is presented in respect of each Ministry or Department. However, more than one Demand may be presented for a Ministry or Department depending on the nature of expenditure.

### 3. Appropriation Bill

Under Article 114(3) of the Constitution, no amount can be withdrawn from the Consolidated Fund without the enactment of such a law by Parliament. After the Demands for Grants are voted by the Lok Sabha, Parliament's approval to the withdrawal from the Consolidated Fund of the amounts so voted and of the amount required to meet the expenditure charged on the Consolidated Fund is sought through the Appropriation Bill.

### 4. Finance Bill

At the time of presentation of the Annual Financial Statement before Parliament, a Finance Bill is also presented in fulfillment of the requirement of Article 110 (1)(a) of the Constitution, detailing the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget. A Finance Bill is a Money Bill as defined in Article 110 of the Constitution. It is accompanied by a Memorandum explaining the provisions included in it.

### 5. Fiscal Policy Strategy Statement

The Fiscal Policy Strategy Statement, presented to Parliament under Section 3(4) of the Fiscal Responsibility and Budget Management Act, 2003, outlines the strategic priorities of Government in the fiscal area for the ensuing financial year relating to taxation, expenditure, lending and investments, administered pricing, borrowings and guarantees. The Statement explains how the current policies are

in conformity with sound fiscal management principles and gives the rationale for any major deviation in key fiscal measures.

### 7.3.1 Fiscal Deficit and Inflation

The difference between the government's total expenditure and its total receipts (excluding borrowing) is called fiscal deficit. The elements of the fiscal deficit are as follows:

- Revenue deficit, which is the difference between the government's current (or revenue) expenditure and total current receipts (i.e., excluding borrowing)
- Capital expenditure

The fiscal deficit is financed by borrowing from the RBI (which is also called deficit financing or money creation) and market borrowing (i.e., from the money market).

#### A fiscal deficit does not necessarily lead to inflation

Two arguments are usually given to connect a high fiscal deficit to inflation. The first argument is based on the fact that the portion of the fiscal deficit which is financed by borrowing from the RBI results in an increase in the money stock. Some believe that a higher money stock automatically brings inflation as 'more money chases the same goods'. However, this is an unsubstantiated argument. There are two flaws in this argument.

- (i) It is not the 'same goods' which the new money stock chases as output of goods may raise due to the increased fiscal deficit. If any economy has unutilized resources, output is held in check by the lack of demand and a high fiscal deficit may be followed by greater demand and greater output.
- (ii) The pace with which money 'chases' goods is not stable. It varies owing to changes in other economic variables. Thus, even if a part of the fiscal deficit translates into a larger money stock, it need not lead to inflation.

The second argument to associate fiscal deficits with inflation is that in an economy in which the output of some important goods cannot be increased, the increase in demand due to a larger fiscal deficit will raise prices. This argument is also criticized on the following grounds:

- (i) This argument is evidently irrelevant for the economy with abundant supplies of foodgrains and foreign exchange.
- (ii) Even if some particular goods are in short supply, rationing and similar strategies can halt any rise in price.

### 7.3.2 Taxation Measures

India has a well-developed tax structure with clearly demarcated authority between Central and State Governments and local bodies. Central Government levies

## NOTES

## NOTES

taxes on income (except tax on agricultural income, which the State Governments can levy), customs duties, central excise and service tax. Value Added Tax (VAT), stamp duty, state excise, land revenue and profession tax are levied by the State Governments. Local bodies are empowered to levy tax on properties, octroi and for utilities like water supply, drainage etc.

Indian taxation system has undergone tremendous reforms during the last decade. The tax rates have been rationalized and tax laws have been simplified resulting in better compliance, ease of tax payment and better enforcement. The process of rationalization of tax administration is ongoing in India.

### Direct taxes

In case of direct taxes (income tax, wealth tax, etc.), the burden directly falls on the taxpayer.

- **Income tax:** According to Income Tax Act 1961, every person, who is an assessee and whose total income exceeds the maximum exemption limit, shall be chargeable to the income tax at the rate or rates prescribed in the Finance Act. Such income tax shall be paid on the total income of the previous year in the relevant assessment year.
- **Corporate tax:** A company has been defined as a juristic person having an independent and separate legal entity from its shareholders. Income of the company is computed and assessed separately in the hands of the company. However the income of the company, which is distributed to its shareholders as dividend, is assessed in their individual hands. Such distribution of income is not treated as expenditure in the hands of company; the income so distributed is an appropriation of the profits of the company.
- **Capital gains tax:** A capital gain is income derived from the sale of an investment. A capital investment can be a home, a farm, a ranch, a family business, work of art etc. In most years slightly less than half of taxable capital gains are realized on the sale of corporate stock. The capital gain is the difference between the money received from selling the asset and the price paid for it. Capital gain also includes gain that arises on 'transfer' (includes sale, exchange) of a capital asset and is categorized into short-term gains and Long-term gains.

### Indirect taxes

Indirect taxes include excise duty and customs duty.

- **Excise duty:** Central Excise duty is an indirect tax levied on goods manufactured in India. Excisable goods have been defined as those, which have been specified in the Central Excise Tariff Act as being subjected to the duty of excise.



- **Customs duty:** Custom or import duties are levied by the Central Government of India on the goods imported into India. The rate at which customs duty is leviable on the goods depends on the classification of the goods determined under the Customs Tariff. The Customs Tariff is generally aligned with the Harmonized System of Nomenclature (HSL). In line with aligning the customs duty and bringing it at par with the ASEAN level, government has reduced the peak customs duty from 12.5 per cent to 10 per cent for all goods other than agriculture products. However, the Central Government has the power to generally exempt goods of any specified description from the whole or any part of duties of customs leviable thereon. In addition, preferential/concessional rates of duty are also available under the various Trade Agreements.
- **Service tax:** Service tax was introduced in India way back in 1994 and started with mere 3 basic services viz. general insurance, stock broking and telephone. Today the counter services subject to tax have reached over 100. There has been a steady increase in the rate of service tax. From a mere 5 per cent, service tax is now levied on specified taxable services at the rate of 12 per cent of the gross value of taxable services. It is to be noted that all the above taxes have been subsumed within GST.

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### Goods and Services Tax (GST)

The idea of a Goods and Services Tax (GST) for India was first mooted sixteen years back, during the Prime Ministership of Shri Atal Bihari Vajpayee. In March 2011, Constitution (115th Amendment) Bill, 2011 was introduced in the Lok Sabha to enable levy of GST. However, due to lack of political consensus, the Bill lapsed after the dissolution of 15th Lok Sabha in August 2013. However, the Bill was again introduced in 2015 and was passed by the Lok Sabha and Rajya Sabha in 2016. The Constitutional amendment paved way for introduction of Goods and Services Tax in India. GST was launched with effect from 1st July 2017 by PM Modi.

GST (Goods and Services Tax) is the biggest indirect tax reform of India. GST is a single tax on the supply of goods and services. It is a destination based tax. GST has subsumed taxes like Central Excise Law, Service Tax Law, VAT, Entry Tax, Octroi and so forth. GST is one of the biggest indirect tax reforms in the country. GST is expected to bring together state economies and improve overall economic growth of the nation.

GST is a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. It will replace all indirect taxes levied on goods and services by states and Central. Businesses are required to obtain a GST Identification Number in every state they are registered.

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## 7.4 FOREIGN CAPITAL AND MULTINATIONAL CORPORATIONS

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### NOTES

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 which 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 the 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.
- (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 have been formed in advanced countries with the purpose of operating in India. Sometimes, companies from 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 the Second World War, 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 the Second World War, 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.

### **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 would be available if foreign equity covered foreign exchange requirements for imported capital goods.
- (ii) The payments of dividends would be monitored through the RBI 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 seven years from commencement of production.

### **Foreign Direct Investment (FDI) and Collaboration**

The largest source of FDI to India over the period of 1991–2000 has been the US 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 by 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 among 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, and so on. 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.

### **FDI inflows to India during 1991-2012**

FDI, being a non-debt capital flow, is a leading source of external financing, especially for the developing economies. It not only brings in capital and technical know-how but also increases the competitiveness of the economy. Overall it supplements domestic investment, much required for sustaining the high growth rate of the country. Since 2000, significant changes have been made in the FDI

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policy regime by the government to ensure that India becomes an increasingly attractive and investor-friendly destination.

Cumulative amount of FDI inflows from April 2000 to December 2011 stood at US\$ 240.06 billion, out of which FDI equity inflows amounted to US\$ 157.97 billion. FDI inflows declined globally in 2009 and 2010. While India was able to largely insulate itself from the decline in global inflows in 2009-10, FDI flows moderated in 2010-11. For India to maintain its momentum of GDP growth, it is vital to ensure that the robustness of its FDI inflows is also maintained. FDI inflows rose to US\$ 24.19 billion during April-December 2011, an increase of 50.8 per cent compared to the corresponding period of the previous year.

According to the latest data of the Department of Industrial Policy and Promotion (DIPP), FDI in 2017-18 grew by only 3% to \$44.85 billion. Foreign inflows in the country grew by 8.67% in 2016-17, 29% in 2015-16, 27% in 2014-15, and 8% in 2013-14. However, FDI inflows recorded a negative growth of 38% in 2012-13. Foreign direct investment (FDI) in India seems to be petering out with the inflows growth rate recording a five-year low of 3% at \$44.85 billion in 2017-18.

FDI is important as India would require huge investments in the coming years to overhaul its infrastructure sector to boost growth. Decline in foreign inflows could put pressure on the country's balance of payments and may also impact the value of the rupee.

### **Procedure for receiving FDI in an Indian company**

An Indian company may receive Foreign Direct Investment under the two routes as given under :

#### **(i) Automatic route**

FDI up to 100 per cent is allowed under the automatic route in all activities/sectors except where the provisions of the consolidated FDI Policy, paragraph on **'Entry Routes for Investment'** issued by the Government of India from time to time, are attracted.

FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

#### **(ii) Government route**

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Indian companies having foreign investment approval through FIPB route do not require any further clearance from the Reserve Bank of India for receiving inward remittance and for the issue of shares to the non-resident investors.

The Indian company having received FDI either under the Automatic route or the Government route is required to report in the Advance Reporting Form, the details of the receipt of the amount of consideration for issue of equity instrument viz. shares/fully and mandatorily convertible debentures / fully and mandatorily convertible preference shares through an AD Category –I Bank, together with copy/ies of the FIRC evidencing the receipt of inward remittances along with the Know Your Customer (KYC) report on the non–resident investors from the overseas bank remitting the amount, to the Regional Office concerned of the Reserve Bank of India within 30 days from the date of receipt of inward remittances.

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### **Multinational Corporations**

The emergence of the multinational corporation (MNC) 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.

An **MNC** is an enterprise that owns or controls producing facilities in more than one country, such as factories, mines, oil refineries, distribution channels, and so on. The United Nations (UN) 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.

MNCs account for one-fifth of the world’s output, excluding socialist economies. Their production in recent years has been growing at the rate of 10 per cent a year, nearly twice the growth rate of the world output and half as much as the world trade. The estimated level of production of the multinationals exceeds 750 billion dollars a year, which is greater than the GNP of any country other than the US. Therefore, multinationals are gigantic in size.

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. Wherever 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,

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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 the US 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 MNCs 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 of origin. The companies of merchant traders in medieval Venice and the English, Dutch and French trading companies of the 17th and 18th centuries were forerunners, but not true prototypes of today's MNC. 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.

### **Organizational forms**

A multinational business corporation may adopt one of the two basic organizational forms—(i) a world corporation form in which domestic and foreign operations are merged or (ii) an international division form in which foreign business is done in separate national divisions, apart from domestic operations.

MNCs plough back their profits on a significant scale. This removes, to some extent, the basis of the charge that they indulge in economic drain. But some countries also feel that ploughing back of profits is not a good solution because it increases the foreign stake in a country's economy and polity.

The potential contribution of multinationals to the development of poorer countries is large. Its realization depends mainly on the development of stable governments in those countries and their actions to encourage private investment. Any developing country that offers political stability, respect for contracts, financial responsibility and equitable taxation will attract investment, foreign and domestic. The remarkable evolution of such regions as Hong Kong and Taiwan testify to this truth.

Private business investment is superior to governmental aid as an instrument of development because it combines transfer of managerial and technical assistance with that of capital. General dissatisfaction with bilateral governmental aid makes it important to expand the flow of business investment. While measures to limit or to insure against risks will help to enlarge this flow, they will not remove the root causes of international tensions. The foreign subsidiary of the American corporation will still be charged with 'exploitation' of local resources and making too much profit. When it pays higher than the prevailing wages and benefits to its employees, their higher living standards provoke envy and resentment amongst others.

The political and social effects of MNCs in developing countries are not as clear as their economic effects. The process of development is inherently unsettling to a society. By producing shifts in the distribution of income and wealth and by redistributing economic power among social classes, development creates political stresses. Often these tensions can be relieved by peaceful political reforms; not infrequently they are followed by more or less violent upheavals. Indeed, being an agent of change, the foreign corporation is seen in the developing country as a threat to privileged positions in the traditional society. However, some leading development economists have counselled Latin American countries that their best interests would be served by compelling foreign firms to sell affiliates to local owners or to the government. They argue that the foreign affiliates stunt the growth of local enterprise. While nationalistic pride may be bolstered by such a policy, its cost in slower development appears to be high.

The cultural consequences of American corporate penetration in the developing countries can be plainly seen in the ready acceptance by natives of soft drinks, packaged foods, automobiles, electrical appliances and much of the paraphernalia of American life. At a more fundamental level, it is likely that the status and value systems, the social attitudes and behavioural patterns, the arts and the essential cultural foundations of many of these countries will also undergo profound changes. These should ultimately reduce barriers of communication between people and lay a common basis for a stable world order.

MNCs are carriers of new values and ideas that threaten the old ways, which have served the people of developing countries well. MNCs introduce 'the idea of meritocracy instead of aristocracy, of rewarding talent instead of status, of distinguishing people by ability instead of by colour or sex'.

Fear of 'loss of control' of their national destinies because of massive foreign private investment has caused many developing countries to enact laws for screening such investment in the future. The case for home country controls is not necessarily based on charges of 'abuses' or 'exploitations' by multinationals. The case for home country controls over multinational business enterprises is based on the reality that the goals of the multinational firms and the goals of host country are not identical.

A developing country should lay emphasis on exporting manufactures. This view reflects the vision that a modern country needs industry and that the small

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domestic markets of most developing countries will impose high costs unless industrial products are exported. Developing countries complain frequently that multinational firms usually prohibit exports by their foreign subsidiaries.

### Evaluation

Multinationals are criticized on the following grounds:

- To begin with, 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 MNCs transfer was invented in an environment where capital was abundant and labour was scarce. The reverse is true for the third world countries which have abundance labour and shortage of capital. So, the technology is not appropriate for the developing countries.
- Fourth, Raul Prebisch and Hans Singer speak 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 the 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 had 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.

### Government policy towards MNCs

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 by 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 is 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.

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### **7.5 EXPORT-IMPORT POLICY**

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Reforms in trade policy that begun in 1991 have considerably changed the scenario in foreign trade and led to a shift from inward-looking to an outward-looking policy. With the liberalization process that is taking place currently in this sector, the protection provided to the Indian industry has come down considerably. This is because the government has taken recourse to a massive removal of import tariffs and allowed a liberal regime of imports of goods whose imports were earlier either banned or restricted.

#### **Highlights of Foreign Trade Policy (EXIM Policy) 2009–14**

The highlights of Foreign Trade Policy (EXIM Policy) 2009–14 may be presented under the following heads:

#### **Higher support for market and product diversification**

1. Incentive schemes under Chapter 3 have been expanded by way of addition of new products and markets.
2. 26 new markets have been added under Focus Market Scheme (FMS).
3. Incentive available under FMS raised from 2.5% to 3%.
4. Incentive available under Focus Product Scheme (FPS) raised from 1.25% to 2%.
5. Widens scope for products to be included for benefits under FPS. Additional engineering products, plastic and some electronics get a look in.
6. Market Linked Focus Product Scheme (MLFPS) expanded by inclusion of products like pharmaceuticals, textile fabrics, rubber products, glass products, auto components, motor cars, bicycle and its parts, .etc. Benefits to these products will be provided, if exports are made to 13 identified markets (Algeria, Egypt, Kenya, Nigeria, South Africa, Tanzania, Brazil, Mexico, Ukraine, Vietnam, Cambodia, Australia and New Zealand).
7. Common simplified application form introduced for taking benefits under FPS, FMS, MLFPS and VKGUY.
8. Higher allocation for Market Development Assistance (MDA) and Market Access Initiative (MAI)

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9. To aid technological upgradation of export sector, EPCG Scheme at Zero Duty has been introduced.
10. Jaipur, Srinagar and Anantnag have been recognised as 'Towns of Export Excellence' for handicrafts; Kanpur, Dewas and Ambur for leather products; and Malihabad for horticultural products.
11. Export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced by 50%.
12. Taking into account the decline in exports, the facility of Re-fixation of Annual Average Export Obligation for a particular financial year in which there is decline in exports from the country, has been extended for the 5 year Policy period 2009–14. Support for Green products and products from North East
13. Focus Product Scheme benefit extended for export of 'green products' and some products from the North East.

### Status holders

14. To accelerate exports and encourage technological upgradation, additional Duty Credit Scrips shall be given to Status Holders @ 1% of the FOB value of past exports. The duty credit scrips can be used for procurement of capital goods with Actual User condition. This facility shall be available for sectors of leather (excluding finished leather), textiles and jute, handicrafts, engineering (excluding Iron & steel & non-ferrous metals in primary and intermediate form, automobiles & two wheelers, nuclear reactors & parts, and ships, boats and floating structures), plastics and basic chemicals (excluding pharma products) [subject to exclusions of current beneficiaries under Technological Upgradation Fund Schemes (TUFS)]. This facility shall be available up to 31 March, 2011.
15. Transferability for the Duty Credit scrips being issued to status holders under paragraph 3.8.6 of FTP under VKGUY Scheme permitted on condition that scrips would be utilized for the procurement of cold chain equipments only.

### Stability/ continuity of the Foreign Trade Policy

16. To impart stability to the Policy regime, Duty Entitlement Passbook (DEPB) Scheme is extended beyond 31-12-2009 till 31.12.2010.
17. Interest subvention of 2% for pre-shipment credit for 7 specified sectors has been extended till 31.3.2010 in the Budget 2009–10.
18. Income Tax exemption to 100% EOUs and to STPI units under Section 10B and 10A of Income Tax Act, has been extended for the financial year 2010–11 in the Budget 2009–10.
19. The adjustment assistance scheme initiated in December, 2008 to provide enhanced ECGC cover at 95%, to the adversely affected sectors, is continued till March, 2010.

### **Marine sector**

20. Fisheries have been included in the sectors which are exempted from maintenance of average EO under EPCG Scheme, subject to the condition that Fishing Trawlers, boats, ships and other similar items shall not be allowed to be imported under this provision. This would provide a fillip to the marine sector which has been affected by the present downturn in exports.
21. Additional flexibility under Target Plus Scheme (TPS) / Duty Free Certificate of Entitlement (DFCE) Scheme for Status Holders has been given to Marine sector.

### **Gems and jewellery sector**

22. To neutralize duty incidence on gold Jewellery exports, it has now been decided to allow Duty Drawback on such exports.
23. In an endeavour to make India a diamond international trading hub, it is planned to establish “Diamond Bourse(s)”.
24. A new facility to allow import on consignment basis of cut & polished diamonds for the purpose of grading/ certification purposes has been introduced.
25. To promote export of Gems & Jewellery products, the 13 value limits of personal carriage have been increased from \$ 2 million to US\$ 5 million in case of participation in overseas exhibitions. The limit in case of personal carriage, as samples, for export promotion tours, has also been increased from US\$ 0.1 million to US\$ 1 million.

### **Agriculture sector**

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

### **Leather sector**

27. Leather sector shall be allowed re-export of unsold imported raw hides and skins and semi finished leather from public bonded ware houses, subject to payment of 50% of the applicable export duty.
28. Enhancement of FPS rate to 2%, would also significantly benefit the leather sector.

### **Tea**

29. Minimum value addition under advance authorization scheme for export of tea has been reduced from the existing 100% to 50%.
30. DTA sale limit of instant tea by EOU units increased from 30% to 50%.
31. Export of tea has been covered under VKGUY Scheme benefits.

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**Pharmaceutical sector**

32. Export Obligation Period for advance authorizations issued with 6–APA as input increased from existing 6 months to 36 months.
33. Pharma sector extensively covered under MLFPS for countries in Africa and Latin America; some countries in Oceania and Far East.

**Handloom sector**

34. To simplify claims under FPS, requirement of ‘Handloom Mark’ for availing benefits under FPS has been removed.

**EOUs**

35. EOUs have been allowed to sell products manufactured by them in DTA upto a limit of 90% instead of existing 75%, without changing the criteria of ‘similar goods’, within the overall entitlement of 50% for DTA sale.
36. To provide clarity to the customs field formations, DOR shall issue a clarification to enable procurement of spares beyond 5% by granite sector EOUs.
37. EOUs will now be allowed to procure finished goods for consolidation along with their manufactured goods, subject to certain safeguards.
38. During this period of downturn, Board of Approvals (BOA) to consider, extension of block period by one year for calculation of Net Foreign Exchange earning of EOUs.
39. EOUs will now be allowed CENVAT Credit facility for the component of SAD and Education Cess on DTA sale.

**Thrust to value added manufacturing**

40. To encourage Value Added Manufactured export, a minimum 15% value addition on imported inputs under Advance Authorization Scheme has now been prescribed.
41. Coverage of Project Exports and a large number of manufactured goods under FPS and MLFPS.

**DEPB**

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

**Flexibility provided to exporters**

43. Payment of customs duty for Export Obligation (EO) shortfall under Advance Authorization / DFIA / EPCG Authorization has been allowed by way of debit of Duty Credit scrips. Earlier the payment was allowed in cash only.
44. Import of restricted items, as replenishment, shall now be allowed against transferred DFIA, in line with the erstwhile DFRC scheme.

45. Time limit of 60 days for re-import of exported gems and jewellery items, for participation in exhibitions has been extended to 90 days in case of USA.
46. Transit loss claims received from private approved insurance companies in India will now be allowed for the purpose of EO fulfillment under Export Promotion schemes. At present, the facility has been limited to public sector general insurance companies only.

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### **7.5.1 Export-Import Policy 2015-2020**

The Export-Import Policy 2015-2020 or the Foreign Trade Policy (FTP) 2015-20 was unveiled by Ms Nirmala Sitharaman, Minister of State for Commerce & Industry (Independent Charge), Government of India on 1 April 2015. Following are the highlights of the FTP:

- FTP 2015-20 provides a framework for increasing exports of goods and services as well as generation of employment and increasing value addition in the country, in line with the 'Make in India' programme.
- The Policy aims to enable India to respond to the challenges of the external environment, keeping in step with a rapidly evolving international trading architecture and make trade a major contributor to the country's economic growth and development.
- FTP 2015-20 introduces two new schemes, namely 'Merchandise Exports from India Scheme (MEIS)' for export of specified goods to specified markets and 'Services Exports from India Scheme (SEIS)' for increasing exports of notified services.
- Duty credit scrips issued under MEIS and SEIS and the goods imported against these scrips are fully transferable.
- For grant of rewards under MEIS, the countries have been categorized into 3 Groups, whereas the rates of rewards under MEIS range from 2 per cent to 5 per cent. Under SEIS the selected Services would be rewarded at the rates of 3 per cent and 5 per cent.
- Measures have been adopted to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation to 75 per cent of the normal export obligation.
- Measures have been taken to give a boost to exports of defense and hi-tech items.
- E-Commerce exports of handloom products, books/periodicals, leather footwear, toys and customised fashion garments through courier or foreign post office would also be able to get benefit of MEIS (for values up to INR 25,000).
- Manufacturers, who are also status holders, will now be able to self-certify their manufactured goods in phases, as originating from India with a view to

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qualifying for preferential treatment under various forms of bilateral and regional trade agreements. This 'Approved Exporter System' will help manufacturer exporters considerably in getting fast access to international markets.

- A number of steps have been taken for encouraging manufacturing and exports under 100 per cent EOU/EHTP/STPI/BTP Schemes. The steps include a fast track clearance facility for these units, permitting them to share infrastructure facilities, permitting inter unit transfer of goods and services, permitting them to set up warehouses near the port of export and to use duty free equipment for training purposes.
- 108 MSME clusters have been identified for focused interventions to boost exports. Accordingly, 'Niryat Bandhu Scheme' has been galvanised and repositioned to achieve the objectives of 'Skill India'.
- Trade facilitation and enhancing the ease of doing business are the other major focus areas in this new FTP. One of the major objective of new FTP is to move towards paperless working in 24x7 environment.

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## 7.6 FOREIGN EXCHANGE AND BUSINESS DEVELOPMENT

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When a business enterprise imports goods from other countries, exports its products to them or makes investments abroad, it deals in foreign exchange. Foreign exchange means 'foreign currency' and includes: (i) deposits, credits and balances payable in any foreign currency; (ii) drafts, travellers' cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency; and (iii) drafts, travellers' cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.

**Foreign exchange** is a form of exchange for the global decentralized trading of international currencies. Financial institutions across the world function as anchors of trading between different types of buyers and sellers round the clock. Foreign exchange plays a very important role in the growth and development of a business. The relative values of different currencies are determined by the foreign exchange market. International trading and investments are largely dependent on the foreign exchange market. Market forces based on trade, investment, tourism and geo-political risk determine the value of any particular currency. For example, every time a foreign tourist visits India, the person must exchange the currency of his or her country for the local currency. Another form of foreign exchange is the process of investment. When an organisation belonging to a foreign country seeks to invest in another, the former will have to make the payments in the local currency.

To carry out such transactions, the system of foreign exchange is very much required. These are some of the reasons why the foreign exchange markets are so much in demand.

The Indian Foreign Exchange Market is made up of the buyers, sellers, market mediators and the Monetary Authority of India. Mumbai, the commercial capital of India, is the main centre of the foreign exchange market. A voluntary association, named Foreign Exchange Dealers Association helps in market regulation

Until 1999, in India, all transactions that include foreign exchange were regulated by Foreign Exchange Regulations Act (FERA), 1973. The main objective of FERA was conservation and proper utilization of the foreign exchange resources of the country. It also sought to control certain aspects of the conduct of business outside the country by Indian companies and in India by foreign companies. It was a criminal legislation which meant that its violation would lead to imprisonment and payment of heavy fine. It had many restrictive clauses which deterred foreign investments.

Indian economy was somewhat modeled on the Russian socialist economy after independence. Until 1991, India still had a fixed exchange rate system, where the rupee was pegged to the value of a basket of currencies of major trading partners. However, since the mid-80s, India started facing a financial crunch, which came to be known as balance of payments. By the end of 1990, India was in a neck-deep economic crisis. The government was close to default when the International Monetary Fund (IMF) came to its rescue. In return, the IMF demanded certain reform policies, which were to be adapted by India. India opened its doors to liberalization. Until 1992, all Foreign Investments in India required previous approval of the government. The Foreign Exchange Regulation Act rarely allowed foreign majority holdings for foreign exchange in India. However, a new Foreign Investment Policy announced in July 1991, declared automatic approval for Foreign Exchange in India for thirty-four industries. These industries were designated with high priority, up to an equivalent limit of 51 percent. The foreign exchange market in India is regulated by the Reserve Bank of India through the Exchange Control Department.

In the light of economic reforms and the liberalized scenario, FERA was replaced by a new Act called the Foreign Exchange Management Act (FEMA), 1999. The Act applies to all branches, offices and agencies outside India, owned or controlled by a person resident in India. FEMA emerged as an investor friendly legislation which is purely a civil legislation in the sense that its violation implies only payment of monetary penalties and fines. However, under it, a person will be liable to civil imprisonment only if he does not pay the prescribed fine within 90 days from the date of notice but that too happens after formalities of show cause notice and personal hearing. FEMA also provides for a two year sunset

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clause for offences committed under FERA which may be taken as the transition period granted for moving from one 'harsh' law to the other 'industry friendly' legislation.

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Broadly, the objectives of FEMA are: (i) To facilitate external trade and payments; and (ii) To promote the orderly development and maintenance of foreign exchange market. The Act has assigned an important role to the Reserve Bank of India (RBI) in the administration of FEMA. The rules, regulations and norms pertaining to several sections of the Act are laid down by the Reserve Bank of India, in consultation with the Central Government. The Act requires the Central Government to appoint as many officers of the Central Government as Adjudicating Authorities for holding inquiries pertaining to contravention of the Act. There is also a provision for appointing one or more Special Directors (Appeals) to hear appeals against the order of the Adjudicating authorities. The Central Government also establish an Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals). The FEMA provides for the establishment, by the Central Government, of a Director of Enforcement with a Director and such other officers or class of officers as it thinks fit for taking up for investigation of the contraventions under this Act.

FEMA permits only authorized person to deal in foreign exchange or foreign security. Such an authorized person, under the Act, means authorized dealer, money changer, off-shore banking unit or any other person for the time being authorized by Reserve Bank. The Act thus prohibits any person who:

- Deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- Make any payment to or for the credit of any person resident outside India in any manner;
- Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;
- Enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person is resident in India which acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

### Check Your Progress

1. List any two functions of the Reserve Bank of India.
2. What is a government budget?
3. Define inflation.



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## **7.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

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1. Two functions of the Reserve Bank of India (RBI) are the following:
  - It formulates, implements and monitors the monetary policy with the objective of maintaining price stability and ensuring adequate flow of credit to productive sectors.
  - It regulates and supervises the financial system by prescribing the broad parameters of banking operations within which the system must function.
2. A government budget is a legal document that is often passed by the legislature, and approved by the chief executive—or president.
3. Inflation means an increase in the cost of living as the price of goods and services rise.

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## **7.8 SUMMARY**

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- Banks as well as financial institutions play a very significant role in the economy of a country, foremost being catering to the need of credit for all sections of society.
- The Reserve Bank of India (RBI) is the supreme monetary authority responsible for controlling the banking system in the country.
- One of the most important functions of the RBI is monetary management—regulation of the quantity of money and the supply and availability of credit for industry, business and trade.
- A government budget is a legal document that is often passed by the legislature, and approved by the chief executive—or president. For example, only certain types of revenue may be imposed and collected.
- India has a well-developed tax structure with clearly demarcated authority between Central and State Governments and local bodies.
- 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.
- FDI, being a non-debt capital flow, is a leading source of external financing, especially for the developing economies.
- The emergence of the multinational corporation (MNC) 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.

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- A multinational business corporation may adopt one of the two basic organizational forms—(i) a world corporation form in which domestic and foreign operations are merged or (ii) an international division form in which foreign business is done in separate national divisions, apart from domestic operations.
- Reforms in trade policy that begun in 1991 have considerably changed the scenario in foreign trade and led to a shift from inward-looking to an outward-looking policy.
- Foreign exchange is a form of exchange for the global decentralized trading of international currencies.

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## 7.9 KEY WORDS

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- **Revenue Budget:** It consists of the revenue receipts of government (tax revenues and other revenues) and the expenditure met from these revenues.
- **Annual Financial Statement:** It is the document as provided under Article 112, shows estimated receipts and expenditure of the Government of India for a year in relation to estimates and expenditures for the previous year.
- **Fiscal Deficit:** The difference between the government's total expenditure and its total receipts (excluding borrowing) is called fiscal deficit.
- **Multinational Corporation:** An MNC is an enterprise that owns or controls producing facilities in more than one country, such as factories, mines, oil refineries, distribution channels, and so on.

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## 7.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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### Short-Answer Questions

1. Write short notes on the following:
  - (i) Contingency fund
  - (ii) Capital budget
2. Write a short note on the implementation of GST in India.
3. What are the different forms of foreign investment?
4. How has FDI contributed to the growth and development of the Indian economy?
5. What has been the Indian government's policy towards MNCs?
6. Define foreign exchange.

### **Long-Answer Questions**

1. Discuss the various roles of the Reserve Bank of India (RBI).
2. 'A fiscal deficit does not necessarily lead to inflation.' Explain the statement.
3. What is the procedure for receiving FDI in an Indian company?
4. What are the criticisms raised against the MNCs.
5. Discuss the highlights of the EXIM policy 2009-14.
6. What is the role of foreign exchange in business development?

### **NOTES**

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### **7.11 FURTHER READINGS**

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## UNIT 8 LABOUR ENVIRONMENT

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### NOTES

#### Structure

- 8.0 Introduction
- 8.1 Objectives
- 8.2 Labour Legislations
- 8.3 Labour and Social Securities
- 8.4 Industrial Relations
- 8.5 Trade Unions
  - 8.5.1 Functions of Trade Unions
- 8.6 Workers Participation in Management
  - 8.6.1 Exit Policy
  - 8.6.2 Quality Circles
- 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

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### 8.0 INTRODUCTION

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Labour policies are devised to maintain economic development, social justice, industrial harmony and welfare of labour in the country. To promote these activities, various reforms and initiatives have been brought upon by the government. For example, 'Unorganised Workers' Social Security Act, 2008 has been enacted. As per the provisions of the Act, a National Social Security Board has been constituted for recommending formulation of social security schemes viz. Life and disability cover, health and maternity benefits, old age protection and any other benefit as may be determined by the Government for unorganized workers. This unit will introduce you to the various labour laws enacted by the Central Government, concept of social insurance, the objectives of industrial relations, trade unions and their role, workers participation in management and the concept of quality circles.

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### 8.1 OBJECTIVES

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

- List the various labour laws enacted by the Central Government
- Define social insurance
- Identify the social security legislations enacted in India
- State the objectives of industrial relations
- Recognize the characteristics of trade unions

- Analyse the importance of trade unions
- Examine workers participation in management

## **8.2 LABOUR LEGISLATIONS**

## **NOTES**

Under the Constitution of India, Labour is a subject in the concurrent list where both the Central and State Governments are competent to enact legislations. As a result, a large number of labour laws have been enacted catering to different aspects of labour namely, occupational health, safety, employment, training of apprentices, fixation, review and revision of minimum wages, mode of payment of wages, payment of compensation to workmen who suffer injuries as a result of accidents or causing death or disablement, bonded labour, contract labour, women labour and child labour, resolution and adjudication of industrial disputes, provision of social security such as provident fund, employees' state insurance, gratuity, provision for payment of bonus, regulating the working conditions of certain specific categories of workmen such as plantation labour, beedi workers etc. This is how we have a large number of labour legislations, which can be categorized as follows:

- (a) Labour laws enacted by the Central Government, where the Central Government has the sole responsibility for enforcement
  1. The Employees' State Insurance Act, 1948
  2. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952
  3. The Dock Workers (Safety, Health and Welfare) Act, 1986
  4. The Mines Act, 1952
  5. The Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labour Welfare (Cess) Act, 1976
  6. The Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labor Welfare Fund Act, 1976
  7. The Mica Mines Labour Welfare Fund Act, 1946
  8. The Beedi Workers Welfare Cess Act, 1976
  9. The Limestone and Dolomite Mines Labour Welfare Fund Act, 1972
  10. The Cine Workers Welfare (Cess) Act, 1981
  11. The Beedi Workers Welfare Fund Act, 1976
  12. The Cine Workers Welfare Fund Act, 1981
- (b) Labour laws enacted by Central Government and enforced both by Central and State Governments
  13. The Child Labour (Prohibition and Regulation) Act, 1986.
  14. The Building and Other Constructions Workers' (Regulation of Employment and Conditions of Service) Act, 1996.

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15. The Contract Labour (Regulation and Abolition) Act, 1970.
16. The Equal Remuneration Act, 1976.
17. The Industrial Disputes Act, 1947.
18. The Industrial Employment (Standing Orders) Act, 1946.
19. The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979.
20. The Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988
21. The Maternity Benefit Act, 1961
22. The Minimum Wages Act, 1948
23. The Payment of Bonus Act, 1965
24. The Payment of Gratuity Act, 1972
25. The Payment of Wages Act, 1936
26. The Cine Workers and Cinema Theatre Workers (Regulation of Employment) Act, 1981
27. The Building and Other Construction Workers Cess Act, 1996
28. The Apprentices Act, 1961
- (c) Labour laws enacted by Central Government and enforced by the State Governments
  29. The Employers' Liability Act, 1938
  30. The Factories Act, 1948
  31. The Motor Transport Workers Act, 1961
  32. The Personal Injuries (Compensation Insurance) Act, 1963
  33. The Personal Injuries (Emergency Provisions) Act, 1962
  34. The Plantation Labour Act, 1951
  35. The Sales Promotion Employees (Conditions of Service) Act, 1976
  36. The Trade Unions Act, 1926
  37. The Weekly Holidays Act, 1942
  38. The Working Journalists and Other Newspapers Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955
  39. The Workmen's Compensation Act, 1923
  40. The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959
  41. The Children (Pledging of Labour) Act 1938
  42. The Bonded Labour System (Abolition) Act, 1976
  43. The Beedi and Cigar Workers (Conditions of Employment) Act, 1966

- (d) There are also Labour laws enacted and enforced by the various State Governments which apply to respective States.

The Ministry of Labour & Employment is mandated to create a work environment conducive to achieving a high rate of economic growth with due regard to protecting and safeguarding the interests of the working class in general and those of the vulnerable sections of the society in particular. The Ministry has been performing its assigned duties through the above stated legislations with the help and cooperation of State Governments.

It needs to be stated that in a dynamic context, laws need to be reviewed from time to time. Hence, review / updation of labour laws is a continuous process in order to bring them in tune with the emerging needs of the economy such as attaining higher levels of productivity & competitiveness, increasing employment opportunities, attaining more investment both domestic and foreign etc.

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### 8.3 LABOUR AND SOCIAL SECURITIES

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The meaning of the term 'social security' varies from country to country. In socialist countries, the nation's goal is complete protection of every citizen. In capitalist countries, a measure of protection is afforded to a needy citizen in consistence with resources of the state. According to the social security (minimum standards) convention (No. 102) adopted by the ILO in 1952, following are the nine components of social security:

- Medical Care
- Sickness Benefit
- Unemployment Benefit
- Old-age Benefit
- Employment Injury Benefit
- Family Benefit
- Maternity Benefit
- Invalidity Benefit
- Survivor's Benefit

#### **Social security in India**

Social security schemes may be of two types:

##### **(a) Social Assistance**

Under this scheme, the state finances the entire cost of the facilities and benefits are provided. Here benefits are paid after examining the financial position of the beneficiary.

**NOTES**

**(b) Social Insurance**

Under social insurance, the State organizes the facilities financed by contributions from both the workers and employers, with or without a subsidy from the State. Here, benefits are paid on the basis of the contribution record of the beneficiary without testing his means.

At present both types of social security schemes are in vogue in India.

**Social Security Legislations in India**

There are various laws and acts that have been passed since Independence to govern the functioning of a company. These provide social security to the employees of the company. Following are some of the important laws and acts:

- The Employees' State Insurance Act, 1948
- The Employees' Provident Fund Act, 1952
- The Workmen's Compensation Act, 1923
- The Maternity Benefit Act, 1961
- The Industrial Disputes Act, 1947

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**8.4 INDUSTRIAL RELATIONS**

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What links labour with management is common interests and objectives. These shared interests make it easy for both parties to adjust to each other. If the employees are satisfied, their relationship with the employer will also be healthy. As employee satisfaction increases, the employee-employer relationship also becomes better and better.

By recruiting a new employee, an employer is adding a new member to his existing family or workforce. By welcoming a new employee aboard, the employer is sowing the seeds of a new relationship. Formation of relationships cannot be escaped since the employers as well as employees have to work closely. Since they have to work in tandem, it is important to manage these relationships to ensure business success. Strong, close-knit and powerful relationships can result in mentally as well as physically healthy and happy employees with a high level of productivity.

**Nature of Industrial Relations**

It need not be emphasized that employers and employees should respect each other. The higher the respect the stronger will be the relationship and commitment levels. While certain employers prefer a more formal approach and maintain a distance from the employee, there are some who are very free and friendly with the employees. In the former case, the fact that there is a hierarchy that needs to be followed is emphasized, in case of the latter, the employees end up being very free and sometimes even casual with the employers. While both approaches have



their positive sides, it is best to adhere to certain limits. The position of the employer should be clearly distinguished from that of the employee. If the line between the two becomes blurred owing to excessive friendliness or openness, things could go wrong.

- **The employer-employee relationship should be based on mutual reliance:** The employer should be able to trust his employee with performing his duties efficiently and help to run the business in a smooth manner. Similarly, the employee should be able to bank on the employer to compensate him well financially for the services offered, so that he is able to run his home and fulfil the needs of his family in a satisfactory manner.
- **The employer-employee relationship should grow and develop with time:** To develop and nurture relationships, it is important for employers to be honest and transparent with their employees and also show some interest in their lives. It is important for an employer to enquire about the well-being of his family and be aware of their needs, interests and goals. Similarly, to nurture a healthy relationships with the employer, the employee can do his bit by discussing his life with his employer and share information about his family with him.
- **The employer-employee relationships should adhere to certain limits:** Although the nature of employee-employer relationship varies with the nature of the industry and business, there are certain boundaries that all companies have set for themselves. It is inappropriate for employers to get romantically involved with any employee. Also, employers have to be cautious about maintaining an impartial relationship with the employees. Favouring one employee too much may cause dissatisfaction amongst the others. Favouritism or partiality can lead to a lot of discontentment at the workplace.

A healthy employee-employer relation can be ensured only if all aspects of the relationship are well rounded — employee-friendly HR policies with clear and standard rules pertaining to performance, demeanour, discipline and clash of interest. Only then can there be a happy, yet disciplined and productive workplace.

- **Legal Issues:** Problems in employer-employee relations arise from various conditions of employment and various aspects of labour law. Issues like harassment at the workplace, discrimination and equal opportunity are some that most employers commonly encounter. It becomes an obligation for employers to not only investigate charges of harassment or discrimination but also come up with a solution to rectify the situation. It is the duty of employers to facilitate work-related adjustments for employees who are differently abled, have been injured or are pregnant.
- **Conflict Management:** When conflicts among employees or between employees and managers take place, managers should take the right steps to solve the disagreements without affecting the existing working relationships. The steps taken should be such that the employees are able to express their

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issues and obtain solutions internally. Managing conflict also gives employers the chance to document issues and the steps for resolving them, which can later be referred to in the future in similar situations.

- **Attendance:** All employees should be willing and committed to adhering to their work schedules. Their regularity at work is beneficial to the employer too; good attendance works in favour of both the employer and the employee. Irregular, lazy and casual employees have an adverse effect on their colleagues too. They cause tension to supervisors. Clearly outlined attendance policies are a must for employers. These policies clearly state the repercussions of absence from work.
- **Disciplinary Action:** Employees exhibiting inappropriate or unacceptable behaviour must be checked. Disciplinary action should be initiated against those who do not perform well or conduct themselves inappropriately. The pace at which discipline is implemented by the employers depends on the manner in which a policy has been violated. For instance, sometimes a simple verbal warning may suffice for a latecomer who is not able to justify his late arrival. However, if he repeatedly arrives late, a written warning may need to be issued to him by the manager. If he still isn't punctual, he will probably have to be given a final warning in writing which can be followed by a termination letter. Such a termination discourages other employees from going slack or being casual.

Employee relations can be improved in so many ways: through better communication, career development, share the vision and put up new challenges.

### Objectives of Industrial Relations

Industrial relations is aimed at the following:

- Protecting the interest of the workers as well as the management through mutual understanding and good-will
- Avoiding strife or conflicts and developing harmony, as all these are necessary to ensure a productive workforce
- Avoiding frequent absenteeism and ensuring high productivity
- Promoting the growth of industrial democracy by including the workers in decision-making and sharing profits with them
- Reducing or completely eliminating strikes and lockouts by offering fair/ reasonable wages, better working conditions and fringe benefits
- Improving the economic conditions of workers
- Making the state itself a key employer
- Vesting proprietary interest of the workers in the industries that employ them

## 8.5 TRADE UNIONS

When a group of employees come together to form an organization with the sole purpose of ensuring and securing various benefits for the employees, it is known as a trade union. It is a continuous association of labourers who earn wages, aimed maintaining and improving their working conditions and living standards. The Trade Union Act 1926 defines a trade union as a ‘combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen, or between employers and employers, or for imposing restrictive condition on the conduct of any trade or business, and includes any federation of two or more trade unions.’

This is a complete definition as it covers the associations of workers as well as employers and the federations of their associations. Here, both temporary and permanent relationships are taken into account. Therefore, it is applicable to employees who are working on contract as well.

The three main relationships outlined in this definition are:

- (i) Between workmen and workmen
- (ii) Between workmen and employers
- (iii) Between employers and employers

Therefore, a trade union is a unified group of employees belonging to a specific industry or sector, whose purpose is to negotiate with employers for better pay, job security, leaves, working hours, etc. To do this, they bank on the collective power of the members of the group. Simply put, a union represents the interests of its members, and may even engage in political activity, where legislation affects their members. Trade unions can be said to be voluntary associations aimed at protecting the economic, political and social interests of their members. Therefore, they have the welfare of their members in mind.

### Characteristics of trade unions

1. Trade union are associations comprising employers or employees or of independent labourers/workers. They may comprise :
  - Employers’ association (e.g. Employer’s Federation of India, etc.)
  - Labour unions in general
  - Friendly societies
  - Unions of intellectual labour (e.g, All India Teachers Association)
2. Trade unions are formed on a continuous basis. They are neither casual nor temporary, but permanent bodies that exist throughout the year.
3. Trade unions are formed to promote the economic, political and social interests of their members. Their main concern is, however, economic.

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4. Collective action and team work is their main strength. They are able to negotiate better collectively and have more bargaining power as a group.
5. Trade unions developed and progressed rapidly since their initiation. Despite their main focus being the economic benefits of workers, they have managed to work towards increases the status of workers as an important component of industry.

### **Objectives and importance**

It is clear to all that the very purpose of trade unions is to protect and promote the interests of their members. Their main aim is to ensure that workers are not discriminated against and do not have to suffer injustice or unfair labour practices. Some of their activities include:

#### **(i) Representation**

Trade unions also represent individual workers in case they face some issue or complexities at work. If an employee complains of being ill-treated or of injustice, he can request the trade union to intervene and sort out the issues with the managers or employers. Legal representation is also offered to members, usually to help them obtain financial assistance for treatment of work-related injuries or legal assistance in cases where they have to take their employer to court.

#### **(ii) Negotiation**

When representatives of the trade union discuss matters that affect the workers, with the management of an organization, it is called negotiation. When differences arise between the employers and the employees, who are members of the union, negotiations help to arrive at a solution to these differences. Salaries/wages, hours of work, leaves and alterations in working practices are the types of issues that usually require negotiation. Some workplaces enter into a legal agreement involving the management and the union, clearly saying that the union has the right to negotiate with the employer. In such organizations, it is accepted that the unions are meant for collective bargaining.

### **Reasons for joining trade unions**

Significant issues that force employees to join a union are as follows: Better bargaining power, no discrimination, sense of security, sense of participation, sense of belongingness, better relationships etc.

### **Importance of trade unions**

Industrial peace can be ensured if there exists a strong trade union which is also recognised. Collective bargaining and negotiations undertaken by unions have more power and influence. It is the trade unions that ensure proper communication between the management and the employees. They take necessary steps to prevent conflicts or disputes by working towards smoothening out differences between the management and workers. The unions are representatives of the workers in any industry, and strive to protect their interests. They are also instrumental in

getting relevant courses organized for training their members on important subjects. Their efforts are focussed on seeking a safe, secure and healthy working environment for all their members.

### 8.5.1 Functions of Trade Unions

Negotiating for better wages and allowances is the main function of a trade union. Using their collective bargaining power, trade unions also ensure better working conditions for workers. They also rely on pressure tactics, such as strikes, to maintain the right relationship between employees and the employers. They work to protect the interests of the workers.

The functions of trade unions can be broadly classified as follows:

- (i) Militant functions
- (ii) Fraternal functions

**Militant Functions:** This function includes activities that help workers have a better position at their workplace. These activities are aimed at ensuring for the workers fair wages, comfortable work conditions, better treatment from employers, etc. If these things are not achieved through collective bargaining and negotiations, they resort to other drastic measures, such as going slow, calling a strike, planning a gherao, etc. Not surprisingly, these functions are also called militant or fighting functions. Therefore, the militant functions of trade unions help achieve the following for the workers:

- Higher wages
- Improved working conditions
- Better status as a part of industry
- Protection against unfair practices/injustice and victimization

**Fraternal Functions:** These activities by trade unions are aimed at helping members during crises and to improve efficiency. Trade unions promote a spirit of cooperation and friendly industrial relations, for which they educate their members and try to foster a suitable culture. The morale of the workers is kept up through various welfare measures. These activities also instil self-confidence in the workforce. They also arrange to provide legal assistance to members, if a situation so requires. The welfare measures undertaken as part of fraternal functions include schools for children, library, reading-rooms, provision for sports/games, and other recreational activities, etc. Some trade unions even publish their own newsletters and magazines. Of course, a great deal of these activities are dependent on the funds available. Funds are collected via membership fee, donations from external entities and through the competency of their leaders. Thus, the fraternal functions of trade unions help achieve the following for the workers:

- Improvement of morale
- Generation of self-confidence
- Sincerity and discipline among workers

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- Growth opportunities
- Protection against discrimination (especially to women)

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## 8.6 WORKERS PARTICIPATION IN MANAGEMENT

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One of the important requirements of industrial relation is industrial democracy. Worker's participation in management (WPM) is essentially a step in promoting industrial democracy. This is the modern trend in industrial world both in developed and developing countries. This is a concept of extending democracy of political systems in government to the industries.

The form, structure and the content of WPM vary with social norms and nature of government in each country. WPM takes the shape of self-management, co-determination, worker director and joint management councils. Despite variation in interpretation, all agree that participation means sharing the decision making power between management and workers.

Participate may protect the interests of both parties. But more than this protection, participation is a system of checks and balances which prevents exploitations and provides equity and fairness. This requires great awareness, education and conceptual skill from both the parties, to make WPM, a success.

### **Industrial democracy through WPM achieves the following:**

- Performance of both groups is evaluated objectively.
- Respect workers as free persons of equal value.
- Rule of law and natural justice.
- Discipline through self-control and self-direction
- Morale, motivation and a sense of belongingness.
- Productivity and high quality in work.
- Better compensation.

In other words, the objectives of WPM are as follows:

- To enlighten and involve workers to know better about their role in meeting the organizational objectives.
- To know about importance of productivity and quality aspects in sustenance and growth of the organization.
- To help improve the supervisor-worker relations and management union relations.
- To involve workers in subjects like safety and environment care.
- To assist in team building and HRD activities.

- To develop a culture of self-involvement to reduce vigilant supervision.
- To improve employee pride, morale and integrity.

### Level of Participation

The following are the levels of participation listed in hierarchical ascending order:

#### (a) Informative Participation

This is merely information sharing of major aspects like product mix, productivity, balance sheet etc. Workers are not allowed close scrutiny of accounts.

#### (b) Consultative Participation

Here workers are consulted on such aspects like welfare, work methods, safety programmes. Worker's body or joint councils can make recommendation. It is left to management to accept the recommendations or not.

#### (c) Associative Participation

Here, the consultation is extended to more areas. In addition, management has a moral responsibility to implement recommendation made by joint councils.

#### (d) Administrative Participation

Here, management having accepted the recommendations of joint councils refers alternatives of implementation plans or strategies for the consideration of the councils to suggest the best one. Here authority of decision making is delegated.

#### (e) Decisive Participation

Here decisions are taken jointly by management and workers on all important matter concerning the firm. Here both are equally responsible and accountable for the success or failure based on such decision. This, in a true sense, is the sharing of "profits" and "pains".

A number of analysis have shown that significant changes of human behavior is possible rapidly if persons who are expected to change are allowed to decide "what" and "how" about such changes.

### 8.6.1 Exit Policy

The exit policy covers all the employees of a company or organization. If an employee resigns or gets terminated:

- The individual is required to serve a notice period of at least one month. (even when this is not mentioned in the letter of appointment). In case, the employee leaves the organization before completing one month then the employee has to pay the company an amount equivalent to salary for the unserved notice period).

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- When the notice period is mentioned in the letter of appointment, then also the time period is one month except for high-level designations. For HOD, VP and above designations, Notice period written in the letter of appointment will apply.
- While serving the notice period, the individual needs to cooperate in smooth handover of his current responsibilities. The company reserves the right to extend the notice period if the employee goes on leave notice period.
- The individual needs to handover assets of the company to the respective departments, clear dues and submit no dues certificate to HR department before leaving the company. This will be helpful in further processing the experience certificate & full and final settlement.
- The exit interview can be conducted if required for development needs of the company.

**8.6.2 Quality Circles**

Quality Circles became extremely popular in the 1980s, particularly in the aerospace, automobile, steel and consumer goods industries. Although, the term ‘quality circles’ has declined in popularity, the incidence of such groups has grown. Quality circles are almost always featured in TQM programmes. A quality circle consists of a small number of volunteers, typically eight to ten employees from the same department who meet for a few hours each week to examine productivity and quality problems. QC members identify a problem, study it and present their recommendations for change and improvement to a committee of higher management.

Thus, TQM is a set of principles and practices whose core ideas include understanding customer needs, getting things right the first time, and striving for continuous improvement.

**Check Your Progress**

1. What is the main aim of a trade union?
2. What is a quality circle?

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**8.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

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1. Their main aim of a trade union is to ensure that workers are not discriminated against and do not have to suffer injustice or unfair labour practices.
2. A quality circle consists of a small number of volunteers, typically eight to ten employees from the same department who meet for a few hours each week to examine productivity and quality problems.



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## 8.8 SUMMARY

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- Under the Constitution of India, Labour is a subject in the concurrent list where both the Central and State Governments are competent to enact legislations.
- The Ministry of Labour & Employment is mandated to create a work environment conducive to achieving a high rate of economic growth with due regard to protecting and safeguarding the interests of the working class in general and those of the vulnerable sections of the society in particular.
- The meaning of the term ‘social security’ varies from country to country. In socialist countries, the nation’s goal is complete protection of every citizen.
- There are various laws and acts that have been passed since Independence to govern the functioning of a company. These provide social security to the employees of the company.
- What links labour with management is common interests and objectives. These shared interests make it easy for both parties to adjust to each other.
- Problems in employer-employee relations arise from various conditions of employment and various aspects of labour law.
- When a group of employees come together to form an organization with the sole purpose of ensuring and securing various benefits for the employees, it is known as a trade union.
- It is clear to all that the very purpose of trade unions is to protect and promote the interests of their members. Their main aim is to ensure that workers are not discriminated against and do not have to suffer injustice or unfair labour practices.
- In democratic set-up like ours workers have gained much strength through unionism and expanded their role in society and economy. The fate of industrial democracy is highly correlated with the role of trade unions.
- One of the important requirements of industrial relation is industrial democracy.
- Worker’s participation in management (WPM) is essentially a step in promoting industrial democracy.
- A quality circle consists of a small number of volunteers, typically eight to ten employees from the same department who meet for a few hours each week to examine productivity and quality problems.

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## 8.9 KEY WORDS

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- **Social Security:** It is a system under which a government pays money regularly to certain groups of people, for example the sick, the unemployed, or those with no other income.

- **Trade Union:** When a group of employees come together to form an organization with the sole purpose of ensuring and securing various benefits for the employees, it is known as a trade union.

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### 8.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. List the labour legislations enacted by the Central Government in India.
2. Name the nine components of social security as per the ILO.
3. State the types of social security schemes.
4. Write a short note on the exit policy.

#### Long-Answer Questions

1. Analyse the nature of industrial relations.
2. Examine the importance of trade unions.
3. Briefly mention the function of trade unions.
4. What has been the contribution of Workers Participation in Management (WPM) in an industrial democracy?
5. What is the significance of quality circle in Total Quality Management?

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### 8.11 FURTHER READINGS

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**BLOCK - III**  
**SOCIAL AND OTHER ENVIRONMENTAL**  
**TECHNOLOGY**

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*Social and  
Technological  
Environment*

**NOTES**

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**UNIT 9    SOCIAL AND**  
**TECHNOLOGICAL**  
**ENVIRONMENT**

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**Structure**

- 9.0 Introduction
- 9.1 Objectives
- 9.2 Social Environment
- 9.3 Technological Environment
- 9.4 Social Factors and their Implications for Business
- 9.5 Cultural Factors and its Impact on Business
- 9.6 Technological Development Phase
- 9.7 Technology Development Phase in the Economy as Conditioner of Business Opportunities
- 9.8 Entrepreneurial Society and its Implications Business
- 9.9 Answers to Check Your Progress Questions
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- 9.12 Self Assessment Questions and Exercises
- 9.13 Further Readings

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**9.0    INTRODUCTION**

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Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place. Since, the environmental factors influence almost every aspect of business, be it its nature, its location, the prices of products, the distribution system, or the personnel policies. Hence, it is important to learn about the various components of the business environment, which consists of the economic aspect, the socio-cultural aspects, the political framework, the legal aspects and the technological aspects etc. In this unit, we will learn about the social and technological environment. We will also learn about the fast growing entrepreneurial society and its implications for business.

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## 9.1 OBJECTIVES

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

- Interpret the concept of social and technological environment
- Recognize the structure and features of societal and technological environment
- Review the implications of social, cultural and technological factors on business
- Describe the concept of technology life cycle
- Analyse the role and significance of technology development phase in an economy

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## 9.2 SOCIAL ENVIRONMENT

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The social environment of business includes social factors like customs, traditions, beliefs, values, social trends, literacy, life expectancy rate and so on. Organizations are at the centre of changes taking place in the social environment. Therefore organizations must be aware of the culture, needs, preferences, purchasing patterns of consumers. Managers must keep themselves updated regarding changes taking place in their immediate social environment. It will help them to establish the best advantage for its customers and employees. The effect of various social factors on business can be understood by understanding the various components of societal structure.

### **The Societal Structure**

The social environment of a business consists of all the societal beliefs, traditions, customs, practices and behaviours. In short, we can say that it is like an artificial world that can be distinguished with the natural environment in which we live. Every society has its own unique distinguished social environment. Though some of the customers, traditions, values, beliefs and behaviours are similar across various cultures but some are not. For example, an Indian travelling to Canada may find many similar practices but not so much if travelling to China.

Customs and traditions define social practices that exist in a society for long may be decades or centuries. For example, the celebration of Diwali, Id, Christmas, and Guru Parv in India offer huge opportunities for companies dealing in greeting cards, sweets, gifts, garments, flowers, and so on.

Beliefs and values refer to concepts that a society holds in high esteem. In India, equality of opportunity, individual freedom, social justice, and national integration are examples of major values appreciated by all of us. In business terms, these values translate into freedom of choice in the market, business's responsibility towards the society and non-discriminatory employment practices.

## **Elements of Societal Structure**

- Attitude of customers towards innovation, life style etc.
- Birth and death rates
- Consumption habits
- Education and literacy rates
- Importance or place of women in workforce
- Population
- Quality of life
- Tradition, customs and habits of people

Social trends refer to changes in the social order of a society. Social change may include changes in nature, social institutions, social behaviours, or social relations. The base of social trends is change in the thought process of humans. These social trends present various opportunities and threats to business firms. For example, it has been noticed that the eating habits and lifestyle of Indians has been drastically changing. People are becoming health conscious. This has provided a huge opportunity to food manufacturers to produce organic, less fatty, and balanced food supplements. Besides this, it offers immense opportunities for gyms, health clubs, spas, and pharmaceutical companies producing health products. This trend has, however, harmed business in other industries like dairy processing, tobacco and liquor. Similarly, the social trend of having nuclear families has fuelled the growth of real estate business in most parts of India.

Literacy rate is the measure of how many individuals in a country can read and write. High literacy rate is directly related to economic development. Literacy leads to rise in number of entrepreneurs. New entrepreneurs provide employment. Employment will increase the purchasing power of people. Increased purchasing will lead to more demands for products and services. Increasing demand for goods and services will prosper business firms. Thus, in short, it is not the literacy rate but all the social factors directly or indirectly affect the fate of business firms.

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## **9.3 TECHNOLOGICAL ENVIRONMENT**

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Technological environment includes the techniques, methods and approaches used to produce goods and services. It also includes the changes taking place by way of innovations and R & D. A business organization has to closely monitor the technological changes taking place in his industry and implement these changes to stay in competition.

Technological environment characteristics are outlined:

- Opportunities are arising out of technological developments.
- Risk and uncertainty is the major feature of technological developments.
- Research and development role to country

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### Technological Structure

Technology and business activities are highly interrelated and interdependent. Technology output available to society through business activities in this way improves the quality of life in the society. Therefore, technology is nurtured by business. Following are some of the prominent aspects of technological environment.

- Developments in IT sector
- Import and export of technology
- Inclination towards paper less work
- Increase in computer literacy
- Scientific improvements
- Technological advances in computers
- Various innovations and inventions

A company which is unable to cope with the technological changes may not survive. Further, the differing technological environments of different markets and countries may call for product modification. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for India, they have to be of 220 volts.

Advances in technology have facilitated product improvements and introduction of new products and have considerably improved the marketability of products. For example, growth of computers and electronics has modified the ways in which companies advertise their products. Other examples are:

- Airline companies have Internet and World Wide Web pages where customers can look for flight times, destinations and fares and book their tickets online.
- Artificial fabric has taken the market of traditional cotton and silk fabrics.
- Cinema tickets are being booked online, for example, [www.bookmyshow.com](http://www.bookmyshow.com)
- Digital watches have replaced the prospects and the business of traditional watches.
- Flat TV replaced closing the business of traditional Colour TV.
- Indian postal department has been replaced by courier companies.
- Manufacturers have flexible manufacturing systems.
- Personal Computers to I-Pads.
- Photo copier and Xerox machines have led to the closure of carbon paper business.
- Retailers have direct links with suppliers who refill stocks whenever required.
- Shift from diesel engines to electric engine.

- Today instead of paper media, marketing is being done on Internet/ World Wide Web multimedia.

The fast changes in technology also create problems for companies as it makes their products obsolete quickly resulting in enhanced R&D expenses. Therefore, a product has a much shorter life today than in the past. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organizations. Nowadays in fact, no firm can afford to persist with the outdated technologies.

## NOTES

### **Indicators of Technological Development**

- Assistance by financial institutions for technological development & up-gradation
- Investment in R&D infrastructure
- Number of students enrolled in science stream
- Total number of technical foreign collaborations
- Total value of foreign outward remittances towards foreign technology like royalties, technical fees etc.
- Government budget on Science & Technology expenditure
- Remuneration to technicians and engineers

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## **9.4 SOCIAL FACTORS AND THEIR IMPLICATIONS FOR BUSINESS**

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Businesses do not exist in a space. Each business, be it small or large has to be vigilant about societal and cultural changes taking place in the respective business line. As social and cultural factors change, organizations must change themselves, their product lines, working methods and selling & distribution techniques. This is must for stay in completion and ahead of their competitors. Following is a list of social factors which impact customer needs and size of markets:

- Age distribution and life expectancy rates
- Attitudes toward customer service and product quality
- Attitudes towards renewable energy
- Attitudes toward green or ecological products
- Attitudes toward imported products and services
- Attitudes toward saving and investing
- Attitudes toward work, career, leisure and retirement
- Average disposable income level

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- Buying habits
- Education level
- Emphasis on safety
- Family size and structure
- Health consciousness
- Immigration and emigration rates
- Lifestyles
- Minorities
- Population growth rate
- Religion and beliefs
- Sex distribution
- Social classes

All these above mentioned factors directly or indirectly affect the business and society as a whole. Sometimes, we do not find their immediate effect on the business but in the long term, these changes can throw an organization out of competition. For example, Nokia which used to be the market leader in Indian cell phone Industry was washed out by the never heard Samsung Mobiles. Otherwise, Samsung was known for consumer electronics in the country.

The social feature focuses on the forces within the society. Families, friends circle, colleagues, media, social networks, and even the neighbours are social factors. These social and cultural factors affect our thinking, attitude, sentiments and interests. So its impact on sales of product and revenues earned is obvious.

The social factors determine our personality and even decide, what type of people are we and what type of people we want to become. One of the best example in this regard in how Indians especially staying in metros are becoming diet and health conscious. Due to this, health centres, yoga centres, health parlour, Gyms are mushrooming every nook and corner of the country. Besides this, there is exceptional demand for organic foods and dairy products.

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## 9.5 CULTURAL FACTORS AND ITS IMPACT ON BUSINESS

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Cultural factors are a set of customs, beliefs, practices, and behaviours that are found to be common to everyone that is living within a definite population. Cultural factors affect the way individuals live their life. Cultural factors have a direct impact on the ideologies and personalities of individuals.

Cultural factors have strong influence on the fate of any business. Considering that every culture is different and the group of individuals forming a culture reacts inversely to diverse products and services; every business whether it is a product



or a service has to keep in view the cultural aspects. Following is the list of cultural factors affecting business in large way:

- Creativity of people
- Dominant communication technology in social groups
- Fashion trends
- Lifestyle
- Participation in cultural events
- Popular actors, music styles, design forms, etc.
- Relative population of local (folk) artists vs. global imported culture,
- Social media influence (blogging, etc) vs traditional media (press, TV, radio),
- Various other determinants of culture.

Cultural factors affect any business in the following ways:

### **Changing Preferences**

Changing consumer preferences is one of the major factors that influence any business. What was in demand 10 years before may not exist today or 5 years down the line. Various styles and significances can destabilize long successful goods and services. For instance, a garment company must continuously be aware of changing preferences when creating new products or it will quickly become outdated.

### **Demographics**

Cultural factors also affect the demography of a particular region. Any slight change in demographics is a significant factor in the business world.

As populations grow old, markets for fashions and consumer electronics may shrink while markets for health and luxury goods may rise. Moreover, changes in the proportion of genders and various racial, religious and cultural groups within a society may also have a substantial effect on the way an organization does its business.

### **Advertising Techniques**

Advertising is also one of the areas of business which is affected directly by the forces of cultural changes. You must have noticed that due to change in societal values, the advertisement of few products such as contraceptives, alcoholic and smoking products which were never talked on Indian television have become very common which sometimes we find difficult to watch with family members. Changes in values and morals are main reasons for this drastic change.

### **Internal Environment**

Internal environment of an organization such as internal decision-making process and hierarchical changes are also affected by the changes in the cultural environment.

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For instance, changing gender roles and nuclear family concept has led to increased acceptability for maternity and even paternity leave with organizations. In addition to it, attitude towards sexual harassment and racial discrimination have changed drastically in the last decade because of socio-cultural changes.

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### 9.6 TECHNOLOGICAL DEVELOPMENT PHASE

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Technology development cycle describes the stages through which technological changes take place. How a technology comes in existence and replaces the existing one are discussed under the technological development phase. The technological life cycle is an important concept in business environment. It defines the process of a new technology through the stages of technological maturity such as research and development (R&D) and scientific demonstration. The technology life cycle has the following four stages:

- (i) Research and development
- (ii) Ascent
- (iii) Maturity
- (iv) Decline

Let us now study these stages in detail.

1. **Research and Development (R&D) Phase:** R & D is the very first stage of a typical technological life cycle (TLC). This is also sometimes known as the 'bleeding edge'. This is the stage when an organization introduces/implements a new technology and, therefore, the incomes from inputs are negative and where the projections of failure are normally high.
2. **The ascent phase:** This is the second stage of technological life cycle. In this stage, out-of-pocket costs have been recovered and the technology has started getting acceptance by going beyond some Point A on the TLC. This stage is therefore, sometimes called as the 'leading edge'.
3. **The maturity phase:** This is the third stage of technological life cycle where an organization's earnings is stable and shows increasing trend, going into saturation, marked by M.
4. **The decline phase:** This is the last stage of a technological life cycle. This is commonly called 'decay' phase as the technology based revenues start continuously falling after a Point D. Ultimately a new technology comes in the market which replaces such fast declining technology.

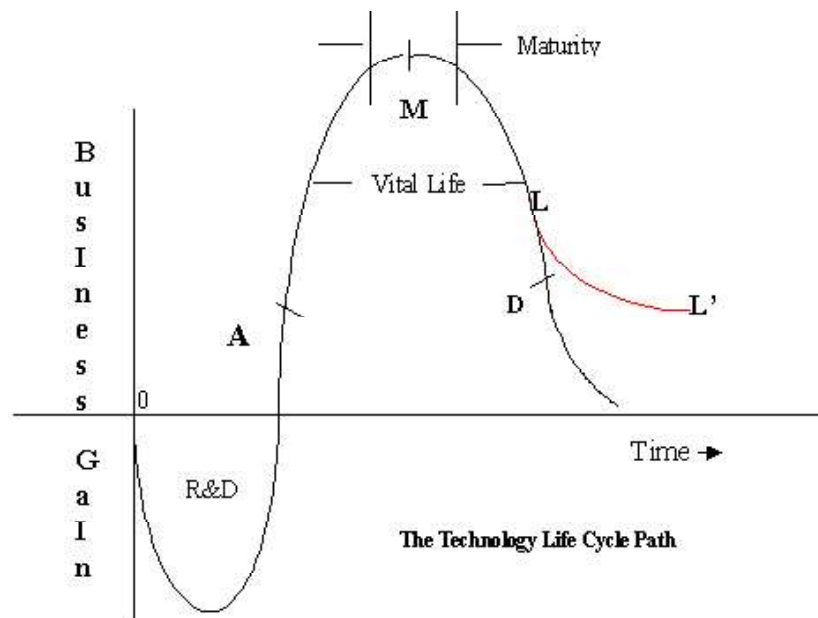


Fig. 9.1 Technology Life Cycle

The implementation of these technologies also has a life cycle with five chronological demographics namely (i) innovators, (ii) early adopters (iii) early majority (iv) late majority and (v) Laggards. Irrespective of type, a product goes through all these five stages until it is finally removed from the market. It is not applicable to all products that go to the final stage. Some products continue to grow and others rise and fall.

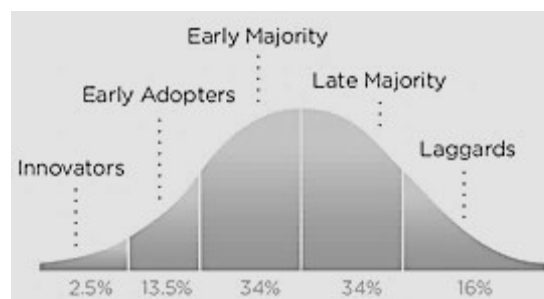


Fig. 9.2 Innovation Adoption Life Cycle

## 9.7 TECHNOLOGY DEVELOPMENT PHASE IN THE ECONOMY AS CONDITIONER OF BUSINESS OPPORTUNITIES

The development of technologies is a multifaceted process; technologies are interrelated in systems, which are intertwined and inter-reliant, both among themselves and with the physical, social and institutional environment. The technological development phase can be regarded as principal source in the

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economy as conditioner of business opportunities. Technological growth and advancement and economic growth are truly related to each other.

During the development phase, the rate of errors and emissions go down and technology matures from its earlier level. Therefore, the levels of technology must rise in order to achieve economic growth and business development. The competitive and rapid growth in any business can be achieved through increasing level of technology. The organizations where the level of technology becomes stable the process of growth comes to an end. Therefore, it is technological progression that keeps the business growth moving and upward. Technology development phase is also the stage where inventions and innovations emerge and result in all round growth.

For example, in sub-Saharan African countries, almost thirty percent of roads are paved, hardly one fourth of the population has access to electricity, and there are less than thirty landlines available per 100 people. Similarly, in Indonesia, seventy five percent of the country has household incomes less than below \$ 70 per month. The combination of poor infrastructure and paucity makes it grim for entrepreneurs to access financial resources and information.

Now look how technological developments bring sea change in the life of a common person. For example, how emergence of mobile phones has been proved to help people to interconnect with each other, access to market trends, sell products across geographic regions, approach new prospects, online transactions, reduce fraud and empowering common people and unprivileged section of the society.

Similar e-wallet such as Paytm, Amazon Pay, Mobikwik, Oxigen and others represent a means to ease the cost of financial transactions and thereby help common people and business men. As the transfer of payment is so quick and reliable, it gives confidence to small and medium-sized businesses to do business and transact freely. This not only increases the efficiency of the marketplace but also removes barriers to growth.

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## 9.8 ENTREPRENEURIAL SOCIETY AND ITS IMPLICATIONS FOR BUSINESS

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Entrepreneurship is the willingness to take risks, develop, own, organize and manage a business from the very scratch. From idea generation to managing the firm, all are included in the concept of entrepreneurship. Today due to technological advancement especially the Internet, knowledge is easily available to all. Further, the new generation is full of ideas. People are coming forward and want to fulfil their dreams with innovative ideas and schemes. Example of Flipkart is before us. How Sachin and Binny Bansal got an idea while working in Amazon to start the similar concept in India. At the age of twenty seven, how both became millionaires. Similarly, example of Paytm, MDH Spices, Haldiram is before us. Gone are the days when people having completed their studies look for jobs. Now job seekers are becoming job

creators. They are developing new ideas and taking the risk of setting up a venture to produce a product or service which satisfies customer needs.

Consequently, entrepreneurial thinking and performing is seen as one of the twenty-first century skill, one of the biggest societal changes that not only individuals but the society as a whole is concerned towards entrepreneurial development. The young generation wants to be successful in life. This is not only applicable to one's own business creation activities but also to intrapreneurship in an established organization. Today when IIM graduates and IITians instead of accepting hefty placement packages want to do something of their own, society and their family members also support them. Entrepreneurs and innovators are handsomely rewarded for their innovations and breakthroughs. Banks have come up to fund their ideas through traditional schemes and seed funds. Many business houses have created funds dedicated to entrepreneurial efforts. Following are the signs that India is becoming an entrepreneurial society.

1. Innovation has been preceding regulation
2. Entrepreneurs and innovators are being rewarded for their innovations and breakthroughs
3. The government is all time high serious.
4. Innovations are pulled into not pushed onto society.
5. Work is becoming more modularized.
6. The society is either prosperous or is on a clear path toward prosperity.

### Characteristics of Entrepreneurship

1. **Systematic Activity:** Entrepreneurship is a systematic activity. It does not arise sudden. It is an outcome of thorough planning, step-by-step action plan and purposeful activities. It has certain unpredictable, talented, and competency requirements that can be acquired, learnt and developed by efforts or experiences of others. Clear understanding of the 'process of entrepreneurship' is must for dismissing the myth that entrepreneurs are born rather than made.
2. **Lawful and Purposeful Activity:** The objective of entrepreneurship is lawful business. It is important to take note of this as one may try to legitimise unlawful actions as entrepreneurship on the grounds that just as entrepreneurship entails risk, so does illicit businesses. Purpose of entrepreneurship is creation of value for personal profit and social gain.
3. **Innovation:** Innovation which means doing something new or something different is a necessary condition to be called a person an entrepreneur. The entrepreneurs are constantly on the look out to do something different and unique to meet the changing requirements of the customers. An entrepreneur, who simply behaves in traditional ways, cannot be an entrepreneur. Innovation involves problem solving and the entrepreneur is a problem solver. An entrepreneur should be innovative enough to bring about

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the change in a product or service or means of production or raw material used in the production. He should innovate and bring about a change in one or more of these aspect. He should innovative enough to recognize the commercial value in his innovation and extract economic advantage from it.

There are ‘n’ number of examples in India and abroad when innovations were blamed to destroy the existing industries. For example, mobile phones destroyed landline industry, computers destroyed typewriter industry, internet especially Google threatened publishing industry, net gains accruing to the economy compensate the loss generated by the inventions.

*Entrepreneur Vs Entrepreneurship*

<b>Entrepreneur</b>	<b>Entrepreneurship</b>
<ol style="list-style-type: none"> <li>1. An entrepreneur is a person or a group of persons, who establish an enterprise, take all the risks, accumulate all the possible resources necessary to carry out production or perform services and creates an innovative product or service.</li> <li>2. Entrepreneurs usually try to innovate new products or services.</li> </ol>	<ol style="list-style-type: none"> <li>1. Entrepreneurship refers to all actions executed by the entrepreneur to establish an enterprise.</li> <li>2. Entrepreneurship is the process of innovating new products or services and streamline the resources required to commercialize these products or services.</li> </ol>

In short, entrepreneurship is all about risk. The measurement of this risk equates to the amount of time and money you invest into your business. However, this risk also tends to relate directly to the rewards involved. An entrepreneur who invests in a franchise pays for someone else’s business plan and receives a respectable income, while an entrepreneur who undertakes groundbreaking innovations risks everything on an assumption that something revolutionary will work in the market. If such a revolutionary is wrong, he can lose everything. However, if he is right, he can suddenly become extremely wealthy.

**Conclusion**

Socio and technological environment is the set of those factors that impact the business operations in an economy. A business firm may have to dramatically change its operating strategy as a result of changes in the technological environment. A business firm has its own social environment different from external extremities. This generally refers to the internal environment of an organization which is simply the culture, customs, beliefs, practices, and behaviours within the restrains of the business. A business firm can control its internal social environment effectively rather than it does with its external social environment.

**Check Your Progress**

1. List the elements of societal structure.
2. What does the technological environment consist of?
3. State the cultural factors which affect business.

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## **9.9 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

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1. The elements of societal structure are the following:
  - Attitude of customers towards innovation, life style etc.
  - Birth and death rates
  - Consumption habits
  - Education and literacy rates
  - Importance or place of women in workforce
  - Population
  - Quality of life
  - Tradition, customs and habits of people
2. Technological environment includes the techniques, methods and approaches used to produce goods and services. It also includes the changes taking place by way of innovations and R & D. A business organization has to closely monitor the technological changes taking place in his industry and implement these changes to stay in competition.
3. The cultural factors which affect business are the following:
  - Creativity of people
  - Dominant communication technology in social groups
  - Fashion trends
  - Lifestyle
  - Participation in cultural events
  - Popular actors, music styles, design forms and so forth

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## **9.10 SUMMARY**

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- Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place.
- The social environment of business includes social factors like customs, traditions, beliefs, values, social trends, literacy, life expectancy rate and so on. Organizations are at the centre of changes taking place in the social environment.
- Social trends refer to changes in the social order of a society. Social change may include changes in nature, social institutions, social behaviours, or social relations.

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- Literacy rate is the measure of how many individuals in a country can read and write. High literacy rate is directly related to economic development. Literacy leads to rise in number of entrepreneurs.
- Technological environment includes the techniques, methods and approaches used to produce goods and services.
- Technology and business activities are to be highly considerable, interrelated and interdependent.
- The social feature focuses on the forces within the society. Families, friend circle, colleagues, media, social networks, and even the neighbours are social factors.
- Cultural factors are a set of customs, beliefs, practices, and behaviours that are found to be common to everyone that is living within a definite population.
- Cultural factors also affect the demography of a particular region. Any slight change in demographics is a significant factor in the business world.
- Technology development cycle describes the stages through which technological changes take place. How a technology come in existence and replace the existing one are discussed under technological development phase.
- The development of technologies is a multifaceted process; technologies are interrelated in systems, which are intertwined and inter-reliant, both among themselves and with the physical, social and institutional environment.
- Entrepreneurship is the willingness to take risks, develop, own, organize and manage a business from very scratch. From idea generation to managing the firm, all are included in the concept of entrepreneurship.
- Socio and technological environment is the set of those factors that impact the business operations in an economy.

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## 9.11 KEY WORDS

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- **Technological Life Cycle:** It defines the process of a new technology through the stages of technological maturity such as research and development (R&D) and scientific demonstration.
- **Entrepreneurship:** It is defined as the capacity and willingness to develop, organize and manage a business venture along with any of its risks in order to make a profit.
- **Out-of-pocket cost:** These are those costs or expenses that require a cash payment in the current period or during a project.



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## **9.12 SELF ASSESSMENT QUESTIONS AND EXERCISES**

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### **Short-Answer Questions**

1. Briefly mention the various factors which comprise the social environment.
2. What are the implications of social factors for business?
3. List the characteristics of entrepreneurship.

### **Long-Answer Questions**

1. Give examples of how technological advancements have impacted the business environment.
2. Discuss the technological development phase.
3. How does the technology development phase in the economy function as conditioner of business opportunities?

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## **9.13 FURTHER READINGS**

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# UNIT 10 TECHNOLOGY ENVIRONMENT

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## NOTES

### Structure

- 10.0 Introduction
- 10.1 Objectives
- 10.2 Technology Policy: Technology Trade and Transfer
  - 10.2.1 National Science and Technology Entrepreneurship Development Board (NSTEDB)
- 10.3 Technology Trends in India: Role of Information Technology and Clean Technology
  - 10.3.1 Recent Technological Developments in India
  - 10.3.2 Clean Technology
  - 10.3.3 Time Lag in Technology
- 10.4 Appropriate Technology
- 10.5 Technology Adoption
  - 10.5.1 Impact of Technology on Globalization
- 10.6 Answers to Check Your Progress Questions
- 10.7 Summary
- 10.8 Key Words
- 10.9 Self Assessment Questions and Exercises
- 10.10 Further Readings

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## 10.0 INTRODUCTION

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Technology environment is defined as the advancements in the field of technology which influence business by inventing or innovating new products or services to satisfy the needs of customers. Let us understand this by taking examples from the present scenario. In the twenty-first century, online transactions are conducted, online shopping is done, bill payment is done online and so forth. In this unit, you will be introduced to the concept of technology transfer, the role of information technology and clean technology, the steps involved in planning for technology adoption, concept of appropriate technology and the impact of technology on globalization.

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## 10.1 OBJECTIVES

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

- Define technology transfer
- Analyse the role of information technology and clean technology
- List the steps involved in planning for technology adoption
- State the impact of technology on globalization

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

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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

#### **10.2.1 National Science and Technology Entrepreneurship Development Board (NSTEDB)**

The National Science & Technology Entrepreneurship Development Board (NSTEDB), established in 1982 by the Government of India under the aegis of Department of Science & Technology, is an institutional mechanism to help promote knowledge based and technology driven enterprises. The Board, having representations from socio-economic and scientific Departments and Institutions aims to convert “job-seekers” into “job-generators” through Science & Technology (S&T) interventions.

#### **Major objectives of NSTEDB**

- To promote and develop high quality entrepreneurship amongst S&T manpower and to promote self-employment by utilising S&T infrastructure.
- To facilitate and launch various promotional services relating to development of entrepreneurship.

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- To network agencies of the support system, academic institutions and Research & Development (R&D) organizations to foster entrepreneurship and self-employment using S&T with special focus on backward areas as well.

The programmes are broadly classified into the following areas:

### **Training programmes**

- Entrepreneurship Awareness Camp (EAC)
- Entrepreneurship Development Programme (EDP)
- Faculty Development Programme (FDP)
- Open Learning Programme in Entrepreneurship (OLPE)
- Technology Based EDP (TEDP)

### **Institutional mechanisms for entrepreneurship development**

- Entrepreneurship Development Cell (EDC)
- Science & Technology Entrepreneurship Development (STED) Project
- Science & Technology Entrepreneurs Park (STEP)
- Technology Business Incubator (TBI)

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## **10.3 TECHNOLOGY TRENDS IN INDIA: ROLE OF INFORMATION TECHNOLOGY AND CLEAN TECHNOLOGY**

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Today India has become one of the strongest in the world in terms of scientific manpower in capability and maturity. Hence, we are in a position not only to understand the technologies that we may have to borrow, but also to create our own technologies with extensive scientific inputs of indigenous origin. Basically we have come a long way since our independence, from mere buyers of technology to those of who have made science and technology as an important contributor for national development and societal transformation. In a world where the powers are determined by their share of the world's knowledge, reflected by patents, papers and so on, the WTO starts to play a crucial role in the economic development. It is important for India to put all her acts together to become a continuous innovator and creator of science and technology intensive products".

### **Business Technology Trends in India**

As organisations enter the evolution from 'Transactional Systems' to 'Engagement Systems', a shift is happening. And engagement requires a way different design point and business model for success. These shifts have massive impacts on the societal, technological, economical, environmental and political landscapes.

According to Constellation Research analysis, the following trends are visible in business environment technology:

- If consumerisation of IT is not enterprise class, the businesses has failed.
- Organizations that master data visualization gain the advantage of speed.
- New growth comes from monetising the complete ownership life cycle.
- Successful organizations are emphasizing on social shifts from B2B/B2C to P2P networks.
- The corporate digital divide is growing larger.
- Market leaders know how to manage innovation.

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### 10.3.1 Recent Technological Developments in India

Let us discuss some latest technological developments in India.

1. **Digital ticket:** After the convenience of booking cinema tickets online, comes the ease of buying tickets on your cellphone. And also paying for it through the phone. Bangalore-based Jigharak is believed to be working on the software application. Not only this, you will be able to book tickets using your personal digital assistant (PDA) or any hand held.
2. **Movies on Demand:** With Tata Sky Direct to Home (DTH) services consumers have much more choice. Not to mention better picture and sound quality, thanks to set-top boxes.
3. **Robots:** AIBO has a cult following in the United States and Japan. Of course, American AIBO buyers tend to be computer geeks who want to hack the robotic dog's programming. Japanese consumers, on the other hand, treat this Sony robot as a pet.

Robots in the US have already taken over domestic tasks like lawn-mowing, vacuum cleaning (the Roomba by iRobot) and window cleaning. iRobot says it has sold hundreds of thousands of units of the Roomba — a self-guided, self-propelled vacuum cleaner that sells for around \$200 — in just one year.

With labour cheap in India, will domestic robots become popular? Not likely in the coming years. However, robots have other uses in our country. Many Indian auto, auto-ancillary majors and machine tool players are using robots to meet global precision standards. Robots have also been used in cardiac surgeries.

4. **RFID:** Radio Frequency Identification (RFID) technology is no longer only about the US and Wal-Mart. Pune University's Jayakar library uses RFID tags on its books as well as library cards; the Chitale Dairy at Bhilwadi in Maharashtra's Sangli district has installed RFID to monitor the feeding patterns of cattle and bisons; Pantaloon Retail India and Shopper's Stop have RFID tags in their factories; more than 45 colleges in Pune have

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introduced student identity RFID cards that allow students access to hostels and monitor their classroom attendance; and ITC uses RFID to track what goes into the manufacturing of its cigarettes.

RFID is not a bar code replacement. While bar codes are better at collecting data in structured places like warehouses (likely to continue for the next five to seven years), RFID tags are expected to be used for data collection in largely chaotic or unstructured business processes like retail environments to hospitals.

5. **GPS:** Telematics, integrated use of telecommunications and informatics, is catching up in the transportation sector. Global Positioning System (GPS) is being used in Karnataka State Road Transport Corporation (KSRTC) buses (pilot project) in Bangalore. Many Indian logistics companies too are using GPS to track vehicle movements and errant drivers.

Vehicle telematics systems are also increasingly being used to provide remote diagnostics; a vehicle's in-built systems will identify a mechanical or electronic problem, and the telematics package will automatically make this information known to the vehicle manufacturer and service organisation. Other forthcoming applications include on-demand navigation, audio and audio-visual entertainment content.

6. **Podcast:** For the uninitiated, imagine a desktop aggregator where you subscribe to a set of feeds. Podcasting works similarly, except that instead of reading, you listen to the content.

### 10.3.2 Clean Technology

Clean technology includes recycling, renewable energy (wind power, solar power, biomass, hydropower, biofuels), information technology, green transportation, electric motors, green chemistry, lighting, Greywater, and many other appliances that are now more energy efficient. It is a means to create electricity and fuels, with a smaller environmental footprint and minimise pollution. To make green buildings, transport and infrastructure both more energy efficient and environmentally benign. Environmental finance is a method by which new clean technology projects that have proven that they are “additional” or “beyond business as usual” can obtain financing through the generation of carbon credits. A project that is developed with concern for climate change mitigation (such as a Kyoto Clean Development Mechanism project) is also known as a carbon project.

While there is no standard definition of “clean technology,” it has been described by Clean Edge, a clean technology research firm, as “a diverse range of products, services, and processes that harness renewable materials and energy sources, dramatically reduce the use of natural resources, and cut or eliminate emissions and wastes.” It notes that “Clean technologies are competitive with, if not superior to, their conventional counterparts. Many also offer significant additional benefits, notably their ability to improve the lives of those in both developed and developing countries”



In the United States, the clean technology industry is largely based in **Silicon Valley**.

### 10.3.3 Time Lag in Technology

There has been considerable time lag between countries in respect of introduction or absorption of technologies. For example, the cable TV came to India only by about the beginning of 1990s. The late introduction and slow expansion affected not only the television business but also the advertising industry and product promotion. A time lag is a fairly long interval of time between one event and another related event that happens after it.

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## 10.4 APPROPRIATE TECHNOLOGY

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Even when a technology is sought to be imported, it has to be seen whether it will suit Indian conditions. The heat, dust, humidity and other climatic conditions in India are obvious points of difference, as are the knowledge levels and attitudes of the persons abroad who might have successfully used the technology. Indians have a different outlook on life, and it takes time for Indian labour to imbibe the attitudinal changes that often go with the new systems, e.g., the Japanese concept of *kaizen* or small, cumulative improvements, or even Toyota's 'automatic' quality system where individual workers are empowered to levels that Indian labour has yet to experience. Moreover, it could be possible that raw materials and other inputs the user countries take for granted might be scarce or even non-existent in India. The condition of our roads, transport bottlenecks, lack of adequate cold chains and other infrastructural inadequacies and bureaucratic bottlenecks could make a huge difference to the efficiency with which the new technologies function in India.

In fact, like any life-form transplanted on alien soil, it needs to acclimatize or adapt to the changed conditions. It must be seen whether any such adaptation is necessary, and if so, whether it is feasible. Labour is cheap and abundant in India, whereas it is just the opposite abroad, and so the imported technology is usually capital intensive, not labour intensive—generally just the reverse of what often suits our local conditions. Besides, the Indian economy is unlikely to be identical to that of the exporting country; the purchasing power of the average Indian is far less than his western counterpart, and the imported technology may push up the price of the finished products beyond his capacity to pay. Hence, the financial aspect is also crucial when it comes to making a decision to import a particular technology, far beyond the 'mere' cost of the technology itself.

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## 10.5 TECHNOLOGY ADOPTION

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Before discussing the issue of technology adoption, absorption and upgradation, it is desirable to discuss the terminology.

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**Adoption**

Adoption is the process under which the various features of technology, which is the subject of transfer, are suitably modified, changed or altered keeping in view the needs of the buyer.

**Adaptation**

This phase comes after technology has been adopted and put into use for production activities. In this stage a number of alterations and modifications are made to suit the conditions.

**Absorption**

Technology is said to be absorbed if it is fully understood, so that it is in a position to be further optimized and upgraded. It involves know-why exercises and basic investigations into the product or process.

**Optimization**

Optimization of technology involves removing of rough edges through R&D and value engineering to bring about savings in the use of material and energy consumption both in product and processes.

**Improvement and Upgradation**

Technology absorption and optimizing capabilities can lead to further exercises in improving the existing products and processes by R&D efforts of industry and other associated research organizations. Technology upgradation exercises lead to industry efforts in extending its know-why capability to a higher range of products.

Of late, the concept of technology adoption has attracted much more attention due to the explosive growth of new technologies such as internet, wireless communications and broad band communications.

‘Technology adoption’ means the successful implementation of technology, and deriving the full potential of technology. The adoption is relatively easy in a new enterprise as compared to an ongoing firm, because there is no existing system in new enterprises while in an ongoing enterprise, the prevailing systems have to be modified and the existing work processes, working environment and culture may have to be changed, which makes it more difficult.

Technology adoption requires gearing up of all the resources such as internal and external infrastructure, human resources, raw materials, and marketing. It has been observed that many technologies that were transferred from developed to developing countries were not successfully adapted, because of the inappropriateness of those technologies for developing countries.

Causes of inappropriateness are discussed here:

- Missing preferences of local markets and consumers
- Technology is based on imported raw materials
- Insufficient skills of local labour
- Not scaled down to local market
- Insufficient use of technology caused by the local labour
- Excessive usage of capital goods and imported equipment

The other general reasons identified were:

- High cost of transfer
- Environmental pollution problems
- Impact due to plant location
- Impact due to energy inputs

### Planning for Technology Adoption

Planning for the implementation of new technology should be thorough and should encompass a relatively long time horizon to assure the stability of the new system. The complex process of introducing a new technology necessitates a practical plan which focuses on employees' needs and deals with issues of concern to them.

The steps in the process of technology adoption plan include the following:

- **Identify the target group:** The target group signifies the customers. This process involves the identification of the customers. The plan can be implemented well if we know the view of the customers.
- **Locate and analyse the resistance to change:** The introduction of new technology in the organization causes the change process in the organization. People can resist change because they are very comfortable with the old values and beliefs.
- **Assess actual ability to change:** It is required to check within the organization whether they are capable of introducing the technology and undergoing a change process.
- **Assess capacity and resources to change:** To check whether one has sufficient resources to undergo the change process.
- **Access perceived priority of change:** The organization has to prioritize the activities of the change process.

#### 10.5.1 Impact of Technology on Globalization

The various methods of globalization of technology are:

- Companies with the latest technology acquire distinctive competencies and gain the advantages of producing high-quality products at low cost. With

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these advantages, these companies enter foreign markets and introduce their latest technology in foreign countries also.

- Companies may have technological collaboration with foreign companies through which technology spreads from country to country.
- Foreign companies allow companies of various other countries to adopt their technologies on royalty payment basis, or on outright purchase basis.
- Companies also globalize the technology through the modes of joint ventures and mergers. Companies spread the latest technology throughout the globe and technology itself makes the global company possible and fastens the process of globalization.

Technology makes a company acquire distinctive competencies over other foreign companies and paves the way for their entrance into foreign markets. In addition, the latest developments in information technology have enabled the global company to develop into a virtual global company.

**Check Your Progress**

1. Name the distinct components of technological progress.
2. In which year was the National Science & Technology Entrepreneurship Development Board (NSTEDB), established?

**10.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

1. There are two distinct components of technological progress. One are the elements that are ‘embodied’ in the original machinery and equipment and the second are the ‘disembodied’ components which are subsequently added by innovation in the recipient country in the fields of production, management, marketing, raw materials etc. known as technology transfer.
2. The National Science & Technology Entrepreneurship Development Board (NSTEDB) was established in 1982 by the Government of India.

**10.7 SUMMARY**

- Technology means scientific knowledge for the manufacture of a product or rendering of a service.
- Technical change is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function.

- 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.
- The National Science & Technology Entrepreneurship Development Board (NSTEDB), established in 1982 by the Government of India under the aegis of Department of Science & Technology, is an institutional mechanism to help promote knowledge based and technology driven enterprises.
- Clean technology includes recycling, renewable energy (wind power, solar power, biomass, hydropower, and biofuels), information technology, green transportation, electric motors, green chemistry, lighting, Greywater, and many other appliances that are now more energy efficient.
- In the United States, the clean technology industry is largely based in Silicon Valley.
- Labour is cheap and abundant in India, whereas it is just the opposite abroad, and so the imported technology is usually capital intensive, not labour intensive—generally just the reverse of what often suits our local conditions.
- Adoption is the process under which the various features of technology, which is the subject of transfer, are suitably modified, changed or altered keeping in view the needs of the buyer.
- Planning for the implementation of new technology should be thorough and should encompass a relatively long time horizon to assure the stability of the new system.

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### 10.8 KEY WORDS

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- **Technical Change:** It is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function.
- **GPS:** It is a satellite navigation system used to determine the ground position of an object.
- **Podcast:** It a program (of music or talk) made available in digital format for automatic download over the Internet.

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### 10.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. Mention the various sources of technology transfer.
2. List the methods of technology transfer.

3. Write a brief note on the National Science & Technology Entrepreneurship Development Board (NSTEDB).
4. What is the significance of clean technology?

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### Long-Answer Questions

1. Describe the recent technological developments that have taken place in India.
2. What is appropriate technology?
3. What is technology adoption? Discuss the steps involved in planning for technology adoption.
4. Analyse the impact of technology on globalization.

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## 10.10 FURTHER READINGS

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## UNIT 11 LEGAL ENVIRONMENT

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### Structure

- 11.0 Introduction
- 11.1 Objectives
- 11.2 Legal Environment as the All Enveloping Factor
- 11.3 Industrial Development and Regulatory Act (IDRA), 1951
- 11.4 Industrial Licensing-Public, Private, Joint and Cooperative Sectors
- 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

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The legal environment implies the rules and regulations which are formulated to regulate the business. In this respect, the rules and regulations cover various aspects such as the health and safety of workers, their wages, safeguarding the interest of consumers, regarding the conservation of natural resources—all these are covered under the legal environment. The rules and regulations framed by the government can either enhance or restrict the business activities. In this unit, you will study the various aspects of the legal environment, the main provisions of the IDRA Act, 1951 and the idea of industrial licensing with reference to public, private, joint and cooperative sectors.

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### 11.1 OBJECTIVES

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

- Discuss the various aspects of the legal environment
- List the main provisions of the IDRA Act, 1951
- Explain industrial licensing with reference to public, private, joint and cooperative sectors

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### 11.2 LEGAL ENVIRONMENT AS THE ALL ENVELOPING FACTOR

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A free-market economy, India has a robust and well-established legal system as well, modelled after that of the United Kingdom. The legal system is responsible for maintaining a balance between the proper functioning of the economy and private businesses.

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Over the years, there has been an increasing consciousness and realisation that environmental quality and economic development are complementary and not mutually exclusive. This is because, with technological advancements, environmental challenges are also on the rise. As a result, there is a need to bring about necessary changes in the industrial and agricultural production patterns, utility services, consumer behaviour and life styles of the people keeping in view our social and developmental priorities for conservation and sustainable use of natural resources. Hence, environmental regulations and standards have been set up by environmental bodies the world round. Indian industry and business too are under increasing pressure of meeting these environmental standards and regulations.

Legal aspects are an indispensable part of a successful business environment in any country. They reflect the policy framework and the mindset of the Governmental structure of that country. They ensure that every company is functioning as per the statutory framework of the country. Every enterprise must take into account this legal setup while framing the basic aims and objectives of its company. This is because, it is necessary for efficient and healthy functioning of the organization and helps it to know the rights, responsibilities as well as the challenges that it may have to face.

In India, the most important law, which regulates all aspects relating to a company, is the Companies Act, 1956. It contains provisions relating to formation of a company, powers and responsibilities of the directors and managers, raising of capital, holding company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, reconstruction and amalgamation of a company and even winding up of a company.

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### 11.3 INDUSTRIAL DEVELOPMENT AND REGULATORY ACT (IDRA), 1951

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Growth of the industrial sector at a higher rate and on a sustained basis is a major determinant of a country's overall economic development. In this regard, the Government of India has issued industrial policies, from time to time, to facilitate and foster the growth of Indian industry and maintain its productivity and competitiveness in the world market.

In order to provide the Central Government with the means to implement its industrial policies, several legislations have been enacted and amended in response to the changing environment. The most important being the **Industries (Development and Regulation) Act, 1951 (IDRA)** that was enacted in pursuance of the Industrial Policy Resolution, 1948. The Act was formulated for the purpose of development and regulation of industries in India by the Central Government.

The main objectives of the Act is to empower the Government:- (i) to take necessary steps for the development of industries; (ii) to regulate the pattern and direction of industrial development; (iii) to control the activities, performance and



results of industrial undertakings in the public interest. The Act applies to the ‘Scheduled Industries’ listed in the First Schedule of the Act. However, small scale industrial undertakings and ancillary units are exempted from the provisions of this Act.

The Act is administered by the Ministry of Industries & Commerce through its **Department of Industrial Policy & Promotion (DIPP)**. The DIPP is responsible for formulation and implementation of promotional and developmental measures for growth of the industrial sector. It monitors the industrial growth and production, in general, and selected industrial sectors, such as cement, paper and pulp, leather, tyre and rubber, light electrical industries, consumer goods, consumer durables, light machine tools, light industrial machinery, light engineering industries etc., in particular. It is also responsible for facilitating and increasing the foreign direct investment (FDI) inflow into the country as well as for encouraging acquisition of technological capability in various sectors of the industry.

The various provisions of the Act are:

- Establishment of a ‘Central Advisory Council’ for the purpose of advising the Central Government on matters concerning the development of the industries, making of any rules and any other matter connected with the administration of the Act. Its members shall consist of representatives of the owners of industrial undertaking, employees, consumers, primary suppliers, etc.
- Establishment of a ‘Development Council’ for the purpose of development of any scheduled industry or group of scheduled industries. This council shall consist of the members representing the interests of the owners, employees, consumers, etc. and persons having special knowledge of matters relating to the technical or other aspects of the industries.
- The development council shall perform the following functions assigned to it by the Central Government: (i) recommending targets for production, co-ordinating production programmes and reviewing progress from time to time. (ii) suggesting norms of efficiency with a view to eliminating waste, obtaining maximum production, improving quality and reducing costs. (iii) recommending measures for securing the fuller utilisation of the installed capacity and for improving the working of the industry, particularly of the less efficient units. (iv) promoting arrangements for better marketing and helping in the devising of a system of distribution and sale of the produce of the industry which would be satisfactory to the consumer. (v) promoting the training of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto, etc.
- The development council shall prepare and transmit to the Central Government and the advisory council a report (annually) setting out what has been done in the discharge of its functions during the financial

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year last completed. The report shall include a statement of the accounts of the development council for that year, together with a copy of any report made by the auditors on the accounts.

- The IDRA empowers the Central Government to regulate the development of industries by means of licensing with suitable exemptions as decided by the Government. Accordingly, the entry into a business or the expansion of an existing business may be regulated by licensing. A licence is a written permission from the Government to an industrial undertaking to manufacture specified articles included in the Schedule to the Act. It contains particulars of the industrial undertaking, its location, the articles to be manufactured, its capacity on the basis of the maximum utilisation of plant and machinery, and other appropriate conditions which are enforceable under the Act.
- If an application for licence is approved and further clearance ( such as that of foreign collaboration and capital goods import) are not involved and no other prior conditions have to be fulfilled, an industrial licence is issued to the applicant. In other cases, a letter of intent is issued, which conveys the intention of the Government to grant a licence subject to the fulfilment of certain conditions such as approval of foreign investment proposal, import of capital goods, etc.
- The Government may order for investigation before the grant of licence to an industrial undertaking. It can make a full and complete investigation if it is of the opinion that in the respect of any schedule industry or undertaking, there has been or is likely to be:- (i) a substantial fall in the volume of output; or (ii) a marked deterioration in the quality of output or an unjustifiable rise in the price of the output. Also, if it is of the opinion that any industrial undertaking is being managed in a manner highly detrimental to the scheduled industry concerned or to the public interest, it orders investigation.
- As a result of such investigations, the Government is empowered to issue directions to the industrial undertaking for all or any of the following purposes:
  - Regulating the production of output by the industrial undertaking and fixing the standards of production;
  - Requiring the industrial undertaking to take such steps as the Central Government may consider necessary to stimulate the development of the industry to which the undertaking relate.
  - Prohibiting the industrial undertaking from resorting to any act or practice which might reduce its production, capacity or economic value;
  - Controlling the prices, or regulating the distribution, of an output for securing its equitable distribution and availability at fair prices.

- The Act also provides that any such directions may be issued by the Central Government at any time when a case relating to any industrial undertaking is under investigation. These directions shall have effect until they are varied or revoked by the Central Government.
- The power of control entrusted to the Central Government under the Act extends to that of the take over of the management of the whole or any part of an industrial undertaking which fails to comply with any of the directions mentioned above. The Government can also take over the management of an undertaking which is being managed in a manner highly detrimental to the scheduled industry concerned or to the public interest. Further, the Central government can take over the management of industrial undertaking owned by a company under liquidation, with the permission of the High Court, if the Government is of the opinion that the running or restarting the operations of such an undertaking is necessary for the maintaining or increasing the production, supply or distribution in the public interest.

Until liberalization, the industrial licence was required for the establishment of a new industrial undertaking, manufacturing of a new item by an existing undertaking, change of location of an industry, substantial expansion of existing capacity and for all other purposes. But the new industrial policy liberalized this and exempted many industries from obtaining industrial licence. Only 6 categories of industries require industrial licensing under the **Industries (Development and Regulation) Act, 1951 (IDRA)**. Such industries file an **Industrial Entrepreneur Memoranda (IEM)** with the Secretariat of Industrial Assistance (SIA), Department of Industrial Policy and Promotion to obtain an acknowledgement.

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#### 11.4 INDUSTRIAL LICENSING-PUBLIC, PRIVATE, JOINT AND COOPERATIVE SECTORS

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The government has to take a series of initiatives in respect of the policies relating to the following areas:

- (i) Industrial Licensing
- (ii) Foreign Investment and Technology Agreements
- (iii) Public Sector Policy
- (iv) MRTP Act

A package for the small and tiny sectors of industry was announced separately.

1. **Industrial Licensing Policy:** Industrial licensing will henceforth be abolished for all industries, except a few industries (18 sectors) which need regulation because of security and strategic concerns, social reasons, chemical hazards, environmental protection and curbing elitist

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consumption. Among these industries are cars, sugar, cigarettes, colour TV and VCRs, white goods like air conditioners, refrigerators and electronic washing machines.

All registration schemes including DGTD are to be abolished, entrepreneurs have to only file an information memorandum on new projects and expansions.

Eight areas, where strategic and security concerns predominate, continue to be reserved for public sector.

The exemption from licensing will be particularly helpful to the many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. As a whole, the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

No industrial approvals will be required for putting up plants in locations other than cities with a population of more than one million. Where the population is more than one million, industries (with the exception of electronics, computer software and printing) will have to set up units outside a 25 km radius, except in prior designated industrial areas.

As per the industrial policy statement, the mandatory convertibility clause will no longer be applicable for term loans from financial institutions for new projects put by large houses.

With the sweeping liberalization measures, the existing procedures have been streamlined accordingly. All existing registration schemes have been abolished.

- 2. Foreign Investment and Technology Agreements:** While freeing Indian industry from official controls, opportunities for promoting investments in India should also be fully exploited. Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore, welcome foreign investment, which is in the interest of the country's industrial development.

In order to invite foreign investment in high priority industries requiring large investment and advanced technology, it has been decided to provide approval for direct foreign investment up to 51 per cent foreign equity in thirty-four groups of high priority industries. These include commercial vehicles and two-wheelers, inorganic fertilizers, chemicals, man-made fibres, drugs and pharmaceuticals, paper, tyres, portland cement, hotels, many food-processing industries, soya products and

industrial and agricultural machinery. There shall be no bottlenecks of any kind in this process. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Foreign equity up to 51 per cent in trading companies which are primarily engaged in export; these companies are to be treated on par with domestic trading and export houses as per the import-export policy.

Special Empowered Board to be set up to negotiate with large international firms for direct investment in select areas; the aim is to attract substantial investment that would provide access to high technology and world markets.

With a view to injecting the desired level of technological dynamism in Indian industry, the government will provide automatic approval for technology agreements related to high priority industries within specified areas, subject to certain conditions. Similar facilities will be available for other industries as well, if such agreements do not require the expenditure of free foreign exchange. Indian companies will be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgement.

- 3. Public Sector Policy:** The public sector has been central to our philosophy of development. Public ownership and control in critical sectors of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

**New Public Sector Policy:** The low rate of return on capital invested has reduced the ability of the public enterprise to regenerate themselves in terms of new investments as well as in new technology development. This resulted in many of the public enterprises becoming a burden rather than an asset to the government. The new Industrial Policy of 1991 has redefined the role of the public sector. Public sector will be in the future restricted to essential infrastructure, goods and services, exploration of oil and mineral resources and manufacture of products, where strategic considerations predominate such as defence equipment.

The number of industries reserved for the public sector has been reduced to eight. The scrapping of the schedule B which contained a list of twelve industries, where public sector was to play a dominant role, is also an important policy change.

The government is thinking of throwing open to the private sector most of the industries reserved for the public sector. In other words, monopoly in any sector has to be abolished.

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4. **MRTP Act:** The principal objectives sought to be achieved through the MRTP Act are as follows:

- (i) Prevention of concentration of economic power to the common detriment.
- (ii) Control of monopolies
- (iii) Prohibition of monopolistic and restrictive and unfair trade practices

With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantages in the international market, the interference of the government through the MRTP Act in investment decision of large companies has become deleterious in its effects on Indian industrial growth. The pre-entry scrutiny of investment decisions by so-called MRTP Companies will no longer be required. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on acquisition and transfer of shares will be appropriately incorporated in the Companies Act.

Thus, the government has decided to take a series of measures to unshackle the Indian industrial economy from the cobwebs of unnecessary bureaucratic control.

**Evaluation:** Captains of industry and apex trade bodies have welcomed the new industrial policy, particularly the decisions to do away with licensing for most industries, liberalization of foreign investment and lifting the threshold limit for MRTP. The new industrial policy is a major step in ushering the country into a new era of development and progress. The new policy will change the structure of Indian industry. It is directed towards making Indian industry internationally competitive. According to the FICCI president, many retrograde restrictions have been either removed or amended and conditions created for a market friendly system, which will enable India to join the international mainstream on the basis of efficiency and competitiveness. The president of the Associated Chamber of Commerce and Industry described the policy as a landmark in the opening up of the Indian Economy. He complemented the government for replacing the command and controlled economy which has been discarded all over the world with competitive and market economy. Market is more important than Marx.

The new policy is pragmatic, bold, innovative, and growth-oriented and the onus now lies with the industry to take advantages of these changes and rise to the occasion before demanding further liberalization.

On the other hand, the new industrial policy come in for some sharp criticism by opposition leaders all over the country. The general reaction was that, the policy was a sell out to the IMF and the World Bank and hit the common man. Former Prime Minister Chandrashekhar assailed the new policy and described it as a total drift from the Gandhian path. He feared the policy would generate more

unemployment. Former Finance Minister Madhu Dandavate said that, by abolishing the limits on MRTP companies, the government had put the small-scale sector in a tight corner. This would seriously affect employment potential and poverty alleviation.

It is to be noted that the role of the public sector and private sector have been discussed in detail in **Unit 4**.

### **Joint Sector**

Based on the recommendations of the Subimal Dutt Committee, the joint sector emerged. The Committee felt the need of having a new sector apart from the public and private sectors in order to ensure the harmonious industrial development of the economy. The factors that stimulated the Dutt Committee and other entities to champion the cause of the joint sector are the following:

- The joint sector provides a unique combination of the merits of the private sector and the public sector.
- The joint sector provides a distinct third possibility for balanced industrial development which complements growth in the other two sectors.
- The joint sector largely served as an extension of the mixed economy, that is, India.

### **1956 Policy Resolution**

Hence, it can be understood that the joint sector presents a combination of costs and resources brought together to finance an industrial undertaking. The Industrial Policy Resolution, 1956, did not distinctly mention the term 'joint sector' yet the idea was mooted in case of particular enterprises.

### **Cooperative Sector**

The beginning of the 20th century in India witnessed the dawn of a new economic institution — cooperatives. Meant to meet credit needs of people, in rural and urban areas, these institutions were purely an outcome of a government initiative to ameliorate economic worries of the colonial citizens of that time.

The Cooperative Credit Societies Act of 1904 and 1912, the Constitutional Reforms in 1919 and the recommendations of various committees such as Royal Commission on Agriculture (1928), Committee on Cooperative Planning (1945), during the British regime contributed a lot in shaping the organisational structure of cooperatives here.

However, the movement lacked spontaneity, as most cooperatives formed were the result of state patronage. Also, the growth of the movement was skewed as bulk of the societies formed were confined to giving credit.

After Independence, cooperatives expanded to all walks of economic life. They continue to receive official patronage. The rural credit cooperatives comprising Primary Agricultural Credit Society (PACS), District Cooperative Central Banks

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(DCCB) and State Cooperative Banks in the short- and medium-term credit structure and Primary Cooperative Agriculture and Rural Development Banks (PCARDB) and State Co-operative Agriculture and Rural Development Banks (SCARDB) in the long-term credit structure assisted and guided by NABARD play a key role in not only purveying credit but also in mopping up local savings.

In fact, the spatial spread of the credit cooperatives have contributed in their own way in moving towards financial inclusion.

**Check Your Progress**

1. What were the main objectives of the Industries (Development and Regulation) Act, 1951 (IDRA) ?
2. State any two salient features of the joint sector.

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**11.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

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1. The main objectives of the Industries (Development and Regulation) Act, 1951 (IDRA) is to empower the Government: (i) to take necessary steps for the development of industries; (ii) to regulate the pattern and direction of industrial development; (iii) to control the activities, performance and results of industrial undertakings in the public interest.
2. Two salient features of the joint sector are the following:
  - The joint sector provides a unique combination of the merits of the private sector and the public sector.
  - The joint sector provides a distinct third possibility for balanced industrial development which complements growth in the other two sectors.

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**11.6 SUMMARY**

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- The legal system is responsible for maintaining a balance between the proper functioning of the economy and private businesses.
- Legal aspects are an indispensable part of a successful business environment in any country. They reflect the policy framework and the mindset of the Governmental structure of that country.
- In India, the most important law, which regulates all aspects relating to a company, is the Companies Act, 1956.
- The Government of India has issued industrial policies, from time to time, to facilitate and foster the growth of Indian industry and maintain its productivity and competitiveness in the world market.



- The Act is administered by the Ministry of Industries & Commerce through its Department of Industrial Policy & Promotion (DIPP).
- Until liberalization, the industrial licence was required for the establishment of a new industrial undertaking, manufacturing of a new item by an existing undertaking, change of location of an industry, substantial expansion of existing capacity and for all other purposes.
- Based on the recommendations of the Subimal Dutt Committee, the joint sector emerged. The Committee felt the need of having a new sector apart from the public and private sectors in order to ensure the harmonious industrial development of the economy.
- The beginning of the 20th century in India witnessed the dawn of a new economic institution — cooperatives. Meant to meet credit needs of people, in rural and urban areas, these institutions were purely an outcome of a government initiative to ameliorate economic worries of the colonial citizens of that time.

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### 11.7 KEY WORDS

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- **Free-Market Economy:** It refers to an economy where the government imposes few or no restrictions and regulations on buyers and sellers.
- **MRTP Act:** The Monopolistic and Restrictive Trade Practice Act was enacted in 1969 to prohibit the concentration of economic power in the hands of a few.

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### 11.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. State the role of the legal environment as an all-enveloping factor.
2. Mention the main provisions of the Industries (Development and Regulation) Act, 1951 (IDRA).
3. Write a short note on the cooperative sector.

#### Long-Answer Questions

1. 'The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy.' Explain the statement.
2. Describe the various steps taken by the Government of India with respect to industrial licensing in 1948.

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## 11.9 FURTHER READINGS

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**NOTES**

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**BLOCK - IV**  
**NEW ECONOMIC POLICY AND LEGAL**  
**ENVIRONMENT**

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*Legal and Ecological  
Environment*

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**UNIT 12 LEGAL AND ECOLOGICAL**  
**ENVIRONMENT**

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**Structure**

- 12.0 Introduction
- 12.1 Objectives
- 12.2 Legal Aspects of Entering Primary and Secondary Capital Markets
- 12.3 Law on Patents
  - 12.3.1 Amendments to the Patents Act, 1970
- 12.4 Law on Consumer Protection
- 12.5 Laws on Environmental Protection
  - 12.5.1 Water Protection Laws
  - 12.5.2 Air Protection Laws
  - 12.5.3 Forests and Wildlife Protection Laws
  - 12.5.4 General Environmental and Ecological Laws
  - 12.5.5 International Agreements on Environmental Issues
  - 12.5.6 An Assessment of the Legal and Regulatory Framework for Environmental Protection in India
- 12.6 Need for Clean Energy and Reduction of Carbon Footprint
  - 12.6.1 Reduction of Carbon Footprint
- 12.7 Answers to Check Your Progress Questions
- 12.8 Summary
- 12.9 Key Words
- 12.10 Self Assessment Questions and Exercises
- 12.11 Further Readings

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**12.0 INTRODUCTION**

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In today's world, business is subject to an increasing number of rules and regulations. Some developed by the judicial system, others imposed by the state legislatures. Legal environment of business included every rule and regulation as it plays a very significant role in the functioning of a business. A good legal environment helps in the proper functioning of a business. This unit discusses the importance of legal environment in the development of a business. The various legal aspects of entering into primary and secondary capital markets are explained in details. Capital market is concerned with raising capital for long-term purposes whereas fresh capital in the form of shares and debentures are raised in the

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primary market. The unit explains the various policy measures and initiatives taken up by the government. Different laws pertaining to patents and trademarks as well as opposition towards the grant of the same are elaborated upon. The unit concludes with a description of the laws associated with environmental protection and the need for clean energy.

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### 12.1 OBJECTIVES

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

- Explain the importance of legal environment as an all-enveloping factor
- Discuss the various aspects of primary and secondary capital markets
- Describe the various laws pertaining to patents and consumer protection
- Identify the various laws on environmental protection
- Discuss the need for clean energy and reduction of carbon footprint

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### 12.2 LEGAL ASPECTS OF ENTERING PRIMARY AND SECONDARY CAPITAL MARKETS

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Capital market is one of the most important segments of the Indian financial system. It is the market available to the companies for meeting their requirements of long-term funds. It refers to all the facilities and the institutional arrangements for borrowing and lending funds. In other words, it is concerned with the raising of money capital for purposes of making long-term investments. The market channelize of a number of individuals and institutions (including the Government) that canalise the supply and demand for long-term capital and the claims on it. The demand for long-term capital comes predominantly from private sector manufacturing industries, agriculture sector, trade and the Government agencies. While, the supply of funds for the capital market comes largely from individual and corporate savings, banks, insurance companies, specialised financing agencies and the surplus of Governments.

The Indian capital market is broadly divided into the gilt-edged market and the industrial securities market.

- The gilt-edged market refers to the market for Government and semi-government securities, backed by the Reserve Bank of India (RBI). Government securities are tradeable debt instruments issued by the Government for meeting its financial requirements. The term gilt-edged means 'of the best quality'. This is because the Government securities do not suffer from risk of default and are highly liquid (as they can be

easily sold in the market at their current price). The open market operations of the RBI are also conducted in such securities.

The industrial securities market refers to the market which deals in equities and debentures of the corporates. It is further divided into primary market and secondary market.

### **Regulatory Framework**

In India, the capital market is regulated by the Capital Markets Division of the Department of Economic Affairs, Ministry of Finance. The division is responsible for formulating the policies related to the orderly growth and development of the securities markets (i.e., share, debt and derivatives) as well as protecting the interest of the investors. In particular, it is responsible for (i) institutional reforms in the securities markets, (ii) building regulatory and market institutions, (iii) strengthening investor protection mechanism, and (iv) providing efficient legislative framework for securities markets, such as Securities and Exchange Board of India Act, 1992 (SEBI Act 1992); Securities Contracts (Regulation) Act, 1956; and the Depositories Act, 1996. The division administers these legislations and the rules framed thereunder.

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### **12.3 LAW ON PATENTS**

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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 objective 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;
- (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;

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- (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 the 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)

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)

## 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)

## Opposition Proceedings to Grant of Patents

The subsequent paragraphs discuss the 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 a petition opposing the grant of a patent within four months from the date of advertisement on the specified grounds that included (i) the invention for which patent has been claimed was publicly known or publicly used in India; (ii) the invention is obvious and does not involve an inventive step; (iii) the invention is not patentable under in Patents Act, 1970, (iv) the complete specification wrongly mentions the source of geographical origin of biological material used in the invention, and (v) the invention on which the patent is claimed forms part of the traditional knowledge whether in India or elsewhere. The controller shall consider and dispose of such representation

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

**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 stated above (under opposition before grant of patent).

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)

### **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)

**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 twenty 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 an 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).

## **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)

## **Rectification of Register by Appellate Board**

The Appellate Board may, on the application of any aggrieved person, make an order for the making, variation or deletion of any entry in the Register of Patents as

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it may think fit. Before making such order, notice of any application made by an aggrieved party to the Appellate Board shall be given to the controller.

Any order of the Appellate Board for rectifying the register shall be served upon the controller in the prescribed manner, who shall, upon receipt of such order, rectify the register accordingly. (Sec. 71)

### **Register to be Open for Inspection**

The register of patents shall at all convenient times be open for inspection by the public. Certified copies of any entry in the register shall be given to any person on payment of the prescribed fee.

The register shall be *prima facie* evidence of any matters required or authorized to be entered therein. (Sec. 72)

### **Use of Inventions for Purposes of Government**

The Central Government is empowered to use any invention for purposes of Government. The Government shall give royalty or fee as per terms agreed upon. If the terms are not mutually agreed to these can be decided by High Court. (Sec. 100)

### **Acquisition of Patent by Government**

The Central Government can acquire an invention or patent, by issue of a notification, for public interest. Compensation shall be paid to the patentee as mutually agreed upon or as decided by the High Court. (Sec. 102)

### **Suits for Infringement of Patents**

The court can grant relief in cases of groundless threats of infringement, including an injunction and damages. (Sec. 106)

In a suit for infringement, the court may grant an injunction and seizure of goods and either damages or an account of profits. (Sec. 108)

### **12.3.1 Amendments to the Patents Act, 1970**

Amendments in the Patents Act (in 1999, 2002, 2005 and 2006) were necessitated by India's obligations under TRIPS, allowing product patents in drugs and chemicals. Another important feature was the introduction of pre-grant representation (opposition) in addition to the existing post-grant opposition mechanism. The pre-grant representation has had success in a short span. A controversial provision of the 2002 amendment was on software patent-ability, which was later withdrawn in another amendment (Patents Act, 1970, as amended by Patents (Amendment) Act, 2005). Patent Rules 2003 were amended in 2005

and again in 2006. Some of the important features of both the 2005 and 2006 Rules are as follows:

- Introduction of reduced time lines
- A fee structure based on specification size and number of claims, in addition to a basic fee.

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### Check Your Progress

1. Define legal environment.
2. What does Companies Act 1956 state?
3. Enlist any three inventions, which are not patentable.
4. How is it possible to apply for patents?
5. How can the government go about acquiring patents?

## 12.4 LAW ON CONSUMER PROTECTION

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

## Consumer of Goods

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

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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.

## 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:

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 any thing 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.

**'Service' defined:** Section 2(1) (O) defines the term 'service' as follows:

'Service' means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information. However, it does not include the rendering of any service free of charge or under a contract of personal service.

The expression 'contract of personal service' means contract to render service in a private capacity to an individual. For example, where a servant enters into a contract with a master for employment, it is a contract of personal service. The rationale for excluding a 'contract of personal service' from the definition of 'service' is that the master can discontinue the service at any time according to his will, he need not approach Consumer Forum to complain about deficiency in service.

**Complaint.** Literally the word 'complaint' means a formal allegation against a party. In the present context, 'complaint' is an allegation made in writing to the National Commission, the State Commission or the District Forum, by a person competent to file it, with a view to obtaining relief provided under the Act.

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### Who Can File a Complaint [Sec. 2(1) (b) and Sec. 12(1)]

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 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 transport company, the insurance company can file a claim against the transport company (*New India Assurance Company Ltd. vs Green Transport Co.*).

### Grounds on Which a Complaint Can be Made [Sec. 2(1)(c)]

The Consumer Protection Act has provided certain grounds on which complaint can be made. A complaint must contain any of the following allegations:

- (i) An ‘unfair trade practice’ or a ‘restrictive trade practice’ has been adopted by any trader or service provider;
- (ii) The goods bought by him or agreed to be bought by him suffer from one or more defects;

- (iii) The services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;
- (iv) A trade or service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price fixed by any law *or* displayed on the goods or any package containing such goods *or* displayed on the price list exhibited by him or agreed between the parties;
- (v) Goods which will be hazardous to life and safety when used, are being offered for sale to the public in contravention of any standards relating to safety of such goods as required to be complied with by any law *or* if the trader could have known with due diligence that the goods so offered are unsafe to the public;

Under the Sale of Goods Act also, there is an implied warranty on the part of the seller to disclose the dangerous nature of goods to the ignorant buyer. If there is breach of this warranty, the buyer is entitled to claim compensation for the injury caused to him.

- (vi) Services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety.

*Note:* The terms ‘unfair trade practice’, ‘restrictive trade practice’, ‘defect’, ‘deficiency’, ‘trader’, etc., as defined under the Act have been discussed after the next heading.

**Time Frame Within Which a Complaint Can be Filed (Limitation Period):** Section 24A provides that a complaint can be filed before the Forums constituted under the Act (District Forum, State Commission or National Commission) within two years from the date on which the cause of action has arisen.

There are no set rules to decide the point of time when cause of action arises. It depends on the facts and circumstances of each case.

It may be noted that the Section further provides that a complaint may be entertained after the expiry of period of limitation specified above, if the complainant satisfies the Consumer Forum that he had sufficient cause for not filing the complaint within the prescribed period. However, the Forum must record its reasons for condonation of delay.

### **Unfair Trade Practice**

Section 2(1)(r) defines ‘unfair trade practice’ as follows:

‘**Unfair trade practice**’ means a trade practice which, for the purposes of promoting the sale, use or supply of any goods or for the provision of any service,

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adopts any unfair method or unfair or deceptive practice including any of the following practice, namely,—

1. The practice of making any statement, whether orally or in writing or by visible representation which, —

- (i) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;
- (ii) falsely represents that the services are of a particular standard, quality or grade;
- (iii) falsely represents any rebuilt, second-hand, renovated, reconditioned or old goods as new goods;
- (iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;
- (v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;
- (vi) makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services;
- (vii) gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof;
- (viii) makes to the public a representation in a form that purports to be —
  - (a) a warranty or guarantee of a product or of any goods or services;  
or
  - (b) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result.

If such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

- (ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;



- (x) gives false or misleading facts disparaging the goods, services or trade of another person.

*Explanation.* For the purpose of this clause, a statement that is:

- (a) expressed on an article offered or displayed for sale, or on its wrapper or container; or
- (b) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or
- (c) contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public.

Shall be deemed to be a statement made to the public by the person who had caused the statement to be so expressed, made or contained.

2. Permits the publication of any advertisement whether in any newspaper or otherwise, for the sale or supply at a bargain price, of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

*Explanation.* For the purpose of this clause, “bargain price” means:

- (a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise, or
  - (b) a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product is advertised or like products are ordinarily sold.
3. Permits: (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole; (b) the conduct of any contest, lottery, games of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest.
  4. Withholding from the participants of any scheme offering gifts, prizes or other items free of charge, on its closure the information about final results of the scheme.

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*Explanation.* For the purpose of this clause, the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time published prominently in the same newspapers in which the scheme was originally advertised.

5. Permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods.
6. Permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services.
7. Manufacture of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services.

### **Consumer Protection Councils**

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.

**Objects of the Central Council** (Sec. 6). In fact, the objects of the Central Council are the various rights of consumers recognised under the Act which are to be promoted and protected by the Council. Thus, the Act (under Section 6) has enumerated some rights of consumers which need to be protected by the Council. These rights of consumers are:

1. Right to safety
2. Right to information

3. Right to choose
4. Right to be heard
5. Right against exploitation
6. Right to education

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### **State Consumer Protection Councils (State Concils)**

The power to establish State Councils is with the States. Section 7 provides that:

1. The state Government shall, by notification, establish with effect from such date as it may specify in such notification, a council to be known as the State Consumer Protection Council (hereinafter referred to as the State Council).
2. The State Council shall consist of the following members, namely:
  - (a) the Minister-in-charge of Consumer Affairs in the State Government who shall be its Chairman;
  - (b) such number of other official or non-official members representing such interests as may be prescribed by the State Government;
  - (c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.
3. The State Council shall meet as and when necessary but not less than two meetings shall be held every year.
4. The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

It may thus be observed that the State Government has been empowered to decide the number and qualifications of the members of the State Council besides the members nominated by the Central Government. The State Government has been further empowered to prescribe the procedure to be followed by the State Council regarding the transaction of its business.

**Objects of the State Council** (Sec. 8). 'The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in Clauses (a) to (f) of Section 6.' Thus, the objects of the State Councils are the same as that of the Central Council discussed above.

### **Consumer Disputes Redressal Agencies**

The Consumer Protection Act, 1986 provides for a three-tier remedial machinery for speedy redressal of consumer disputes. According to Section 9, there shall be established for the purposes of this Act, the following agencies, namely,:

1. Consumer Disputes Redressal Forum to be known as the 'District Forum'.  
It is to be established by the State Government in each district of the State

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by notification. The State Government may, if it deems fit, establish more than one District Forum in a district.

2. State Consumer Disputes Redressal Commission (SCDRC) to be known as 'State Commission.' This is also to be established by the State Government in the State by notification.
3. National Consumer Disputes Redressal Commission (NCDRC) to be known as 'National Commission'. This is to be established by the Central Government by notification.

These Forums have not taken away the jurisdiction of the civil courts but have provided an alternative remedy. Their prime objective is to relieve the conventional courts of their burden which is ever increasing and delaying the disposal of suits due to technicalities. These agencies are quasi-judicial bodies. They are manned by qualified persons and have been vested with considerable powers. They are required to assign reasons for their conclusions. Obligation to give reasons not only introduces clarity but it also excludes, or at least minimises, the chances of arbitrariness.

### **District Forum**

### **National Commission**

The National Commission is the topmost layer in the three-level hierarchy of the Consumer Disputes Redressal Agencies.

### **Composition of the National Commission**

Section 20 elaborates upon the composition of National Commission. It provides that:

1. The National Commission shall consist of:
  - (a) a person who is or has been a judge of the Supreme Court, to be appointed by the Central Government, who shall be its President. But no such appointment shall be made except after consultation with the Chief Justice of India;
  - (b) at least four other members or such higher number of members as may be prescribed, and one of whom shall be a woman.

The provisions as to the qualifications and disqualifications of the members of National Commission are similar to those discussed under the preceding Centre heading: "State Commission".

### **Powers of the Consumer Forums**

For the purpose of adjudicating a consumer dispute, Section 13(4) has vested the Consumer Forums, namely District Forum, State Commission and National

Commission, with certain powers of a civil court. Apart from these powers, the Central Government has provided some additional powers to them under Rule 10 of the Consumer Protection Rules, 1987. Finally Section 14(1) has given them the power to issue orders.

**Powers similar to those of civil court** [Sec. 13(4)]. The Consumer Forums are vested with the powers of a civil court, while trying a suit, in respect of the following matters:

- (i) summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;
- (ii) discovery and production of any document or other material object producible as evidence;
- (iii) receiving of evidence on affidavits;
- (iv) requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;
- (v) issuing of any commission for the examination of any witness; and
- (vi) any other matter which may be prescribed.

Sub-section (5) of Section 13 further provides that every proceeding before the District Forum, the State Commission or the National Commission, as the case may be, shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code (punishment for false evidence and intentional insult or interruption to public servant sitting in judicial proceeding) and the Forums shall be deemed to be civil courts for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (prosecution for contempt and provisions as to offences affecting the administration of justice).

**Additional powers of the consumer forums** (Rule 10 of the Consumer Protection Rules, 1987). The National Commission, the State Commission and the District Forum have the following additional powers:

- (a) Requiring production of any books, accounts, documents, or commodities from any person and getting them examined by an officer specified in this behalf.
- (b) Obtaining information required for the purpose of the proceedings from any person.
- (c) Authorising any officer to enter and search any premises and seize from premises such books, papers, documents and commodities as are required for the purpose of proceedings under the Act.
- (d) On examination of such seized documents or commodities, ordering the retention thereof or returning them to the party concerned.

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**Power to issue order** [Sec. 14(1)]. If, after the proceeding conducted under Section 13 (explained earlier), the National Commission, the State Commission or the District Forum, as the case may be, is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things:

- (a) to remove the defect pointed out by the appropriate laboratory from the goods in question;
- (b) to replace the goods with new goods of similar description which shall be free from any defect;
- (c) to return to the complainant the price, or, as the case may be, the charges paid by the complainant;
- (d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party. The Consumer Protection (Amendment) Act, 2002 has further empowered these Forums to grant punitive damages in such circumstances as it deems fit;
- (e) to remove the defects in goods or deficiencies in the services in question;
- (f) to discontinue the unfair trade practice or the restrictive trade practice or not to repeat it;
- (g) not to offer the hazardous goods for sale;
- (h) to withdraw the hazardous goods from being offered for sale;
- (i) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;
- (j) to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently, provided that the minimum amount or sum so payable shall not be less than 5 per cent of the value of such defective goods sold or service provided, as the case may be, to such consumers, and the amount so obtained shall be credited in favour of such person and utilized in such manner as may be prescribed;
- (k) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;
- (l) to provide for adequate costs to parties.

Sub-section (2) of Section 14 provides that every proceeding is required to be conducted by the President of the Forum and at least one member thereof

sitting together. Where the member, for any reason, is unable to conduct the proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.

Sub-section (2A) of Section 14 provides that every order made under this Section shall be signed by the President and the member or members who conducted the proceedings.

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### Special Powers of the State Commission

Through the Consumer Protection (Amendment) Act, 2002 two new provisions have been added for conferring additional powers on the State Commission in the interest of justice. These provisions are as follows:

1. **Transfer of cases** (Sec. 17A). On the application of the complainant or of its own motion, the State Commission may, at any stage of proceeding, transfer any complaint pending before the District Forum to another District Forum within the state if the interest of justice so requires.

It may thus be noticed that the State Commission has been given the power to transfer cases from one District Forum to another, that too at any stage of proceeding. The transfer of case can be ordered either on the application of the complainant or on its own motion. However, the defendant cannot move for transfer of case.

2. **Circuit Benches** (Sec. 17B). The State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette, from time to time.

### Special Powers of the National Commission

The National Commission too has been conferred additional powers by the Consumer Protection (Amendment) Act, 2002 which are as follows:

1. **Power to set aside ex-parte orders** (Sec. 22A). Where an order is passed by the National Commission *ex-parte* against the opposite party or a complainant, as the case may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice.

It may be observed that the insertion of this new Section will obviously lessen the number of appeals from going to the Supreme Court from the orders of the National Commission.

2. **Transfer of cases** (Sec. 22B). On the application of the complainant or on its own motion, the National Commission may, at any stage of proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one State to a District Forum of another State or before one State Commission to another State Commission.

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3. **Circuit Benches** (Sec. 22C). The National Commission shall ordinarily function at New Delhi and perform its functions at such other place as the Central Government may, in consultation with the National Commission, notify in the Official Gazette, from time to time.

4. **Power to make regulations** (Sec. 30A). The National Commission may, with the previous approval of the Central Government, by notification, make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

In particular, such regulations may make provisions for the cost of adjournment of any proceeding before the District Forum, the State Commission or the National Commission, as the case may be, which a party may be ordered to pay.

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## 12.5 LAWS ON ENVIRONMENTAL PROTECTION

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In the Constitution of India it is clearly stated that it is the duty of the state to 'protect and improve the environment and to safeguard the forests and wildlife of the country'. It imposes a duty on every citizen 'to protect and improve the natural environment including forests, lakes, rivers, and wildlife'. Reference to the environment has also been made in the Directive Principles of State Policy as well as the Fundamental Rights. The Department of Environment was established in India in 1980 to ensure a healthy environment for the country. This later became the Ministry of Environment and Forests in 1985.

The constitutional provisions are backed by a number of laws – acts, rules, and notifications. The EPA (Environment Protection Act), 1986 came into force soon after the Bhopal Gas Tragedy and is considered an umbrella legislation as it fills many gaps in the existing laws. Thereafter a large number of laws came into existence as the problems began arising, for example, Handling and Management of Hazardous Waste Rules in 1989.

Over the years, together with a spreading of environmental consciousness, there has been a change in the traditionally-held perception that there is a trade-off between environmental quality and economic growth as people have come to believe that the two are necessarily complementary. The current focus on environment is not new-environmental considerations have been an integral part of the Indian culture. The need for conservation and sustainable use of natural resources has been expressed in Indian scriptures, more than three thousand years old and is reflected in the constitutional, legislative and policy framework as also in the international commitments of the country.



Even before India's independence in 1947, several environmental legislation existed but the real impetus for bringing about a well-developed framework came only after the UN Conference on the Human Environment (Stockholm, 1972). Under the influence of this declaration, the National Council for Environmental Policy and Planning within the Department of Science and Technology was set up in 1972. This Council later evolved into a full-fledged Ministry of Environment and Forests (**MoEF**) in 1985 which today is the apex administrative body in the country for regulating and ensuring environmental protection. After the Stockholm Conference, in 1976, constitutional sanction was given to environmental concerns through the 42 Amendment, which incorporated them into the Directive Principles of State Policy and Fundamental Rights and Duties.

Since the 1970s an extensive network of environmental legislation has grown in the country. The MoEF and the pollution control boards (CPCB i.e. Central Pollution Control Board and SPCBs i.e. State Pollution Control Boards) together form the regulatory and administrative core of the sector.

A policy framework has also been developed to complement the legislative provisions. The Policy Statement for Abatement of Pollution and the National Conservation Strategy and Policy Statement on Environment and Development were brought out by the MoEF in 1992, to develop and promote initiatives for the protection and improvement of the environment. The EAP (Environmental Action Programme) was formulated in 1993 with the objective of improving environmental services and integrating environmental considerations in to development programmes.

Other measures have also been taken by the government to protect and preserve the environment.

### **12.5.1 Water Protection Laws**

Water quality standards especially those for drinking water are set by the Indian Council of Medical Research. These bear close resemblance to WHO standards. The discharge of industrial effluents is regulated by the Indian Standard Codes and recently, water quality standards for coastal water marine outfalls have also been specified. In addition to the general standards, certain specific standards have been developed for effluent discharges from industries such as, iron and steel, aluminium, pulp and paper, oil refineries, petrochemicals and thermal power plants. Legislation to control water pollution are listed below.

#### **Water (Prevention and Control of Pollution) Act, 1974**

This Act represented India's first attempts to comprehensively deal with environmental issues. The Act prohibits the discharge of pollutants into water bodies beyond a given standard, and lays down penalties for non-compliance. The Act was amended in 1988 to conform closely to the provisions of the EPA, 1986. It

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set up the CPCB (Central Pollution Control Board) which lays down standards for the prevention and control of water pollution. At the State level, the SPCBs (State Pollution Control Board) function under the direction of the CPCB and the state government.

### **Water (Prevention and Control of Pollution) Cess Act, 1977**

This Act provides for a levy and collection of a cess on water consumed by industries and local authorities. It aims at augmenting the resources of the central and state boards for prevention and control of water pollution. Following this Act, The Water (Prevention and Control of Pollution) Cess Rules were formulated in 1978 for defining standards and indications for the kind of and location of meters that every consumer of water is required to install.

### **12.5.2 Air Protection Laws**

#### **Air (Prevention and Control of Pollution) Act, 1981**

To counter the problems associated with air pollution, ambient air quality standards were established, under the 1981 Act. The Act provides means for the control and abatement of air pollution. The Act seeks to combat air pollution by prohibiting the use of polluting fuels and substances, as well as by regulating appliances that give rise to air pollution. Under the Act establishing or operating of any industrial plant in the pollution control area requires consent from state boards. The boards are also expected to test the air in air pollution control areas, inspect pollution control equipment, and manufacturing processes.

### **12.5.3 Forests and Wildlife Protection Laws**

#### **The Wildlife (Protection) Act, 1972, Amendment 1991**

The WPA (Wildlife Protection Act), 1972, provides for protection to listed species of flora and fauna and establishes a network of ecologically-important protected areas. The WPA empowers the central and state governments to declare any area a wildlife sanctuary, national park or closed area. There is a blanket ban on carrying out any industrial activity inside these protected areas. It provides for authorities to administer and implement the Act; regulate the hunting of wild animals; protect specified plants, sanctuaries, national parks and closed areas; restrict trade or commerce in wild animals or animal articles; and miscellaneous matters. The Act prohibits hunting of animals except with permission of authorized officer when an animal has become dangerous to human life or property or so disabled or diseased as to be beyond recovery (WWF-India, 1999). The near-total prohibition on hunting was made more effective by the Amendment Act of 1991.

## **The Forest (Conservation) Act, 1980**

This Act was adopted to protect and conserve forests. The Act restricts the powers of the state in respect of de-reservation of forests and use of forestland for non-forest purposes (the term non-forest purpose includes clearing any forestland for cultivation of cash crops, plantation crops, horticulture or any purpose other than re-forestation).

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### **12.5.4 General Environmental and Ecological Laws**

#### **1. Environment (Protection) Act, 1986 (EPA)**

This Act is an umbrella legislation designed to provide a framework for the co-ordination of central and state authorities established under the Water (Prevention and Control) Act, 1974 and Air (Prevention and Control) Act, 1981. Under this Act, the central government is empowered to take measures necessary to protect and improve the quality of the environment by setting standards for emissions and discharges; regulating the location of industries; management of hazardous wastes, and protection of public health and welfare.

From time to time the central government issues notifications under the EPA for the protection of ecologically-sensitive areas or issues guidelines for matters under the EPA.

#### **2. The Environment (Protection) Rules, 1986**

These rules lay down the procedures for setting standards of emission or discharge of environmental pollutants. The Rules prescribe the parameters for the Central Government, under which it can issue orders of prohibition and restrictions on the location and operation of industries in different areas. The Rules lay down the procedure for taking samples, serving notice, submitting samples for analysis and laboratory reports. The functions of the laboratories are also described under the Rules along with the qualifications of the concerned analysts.

#### **3. The National Environment Appellate Authority Act, 1997**

This Act provided for the establishment of a National Environment Appellate Authority to hear appeals with respect to restriction of areas in which any industry operation or process or class of industries, operations or processes could not carry out or would be allowed to carry out subject to certain safeguards under the Environment (Protection) Act, 1986.

In addition to these, various Acts specific to the coal sector have been enacted. The first attempts in this direction can be traced back to the Mines Act, 1952, which promoted health and safety standards in coal mines. Later the Coal

Mines (Conservation and Development) Act (1974) came up for conservation of coal during mining operations. For conservation and development of oil and natural gas resources a similar legislation was enacted in 1959.

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### **4. Factories Act, 1948 and its Amendment in 1987**

The Factories Act, 1948 was a post-independence statute that explicitly showed concern for the environment. The primary aim of the 1948 Act has been to ensure the welfare of workers not only in their working conditions in the factories but also their employment benefits. While ensuring the safety and health of the workers, the Act contributes to environmental protection. The Act contains a comprehensive list of 29 categories of industries involving hazardous processes, which are defined as a process or activity where unless special care is taken, raw materials used therein or the intermediate or the finished products, by-products, wastes or effluents would:

- Cause material impairment to health of the persons engaged
- Result in the pollution of the general environment

### **5. Public Liability Insurance Act (PLIA), 1991**

The Act covers accidents involving hazardous substances and insurance coverage for these. Where death or injury results from an accident, this Act makes the owner liable to provide relief as is specified in the Schedule of the Act. The PLIA was amended in 1992, and the Central Government was authorized to establish the Environmental Relief Fund, for making relief payments.

### **6. National Environment Tribunal Act, 1995**

The Act provided strict liability for damages arising out of any accident occurring while handling any hazardous substance and for the establishment of a National Environment Tribunal for effective and expeditious disposal of cases arising from such accident, with a view to give relief and compensation for damages to persons, property and the environment and for the matters connected therewith or incidental thereto.

### **International Agreements on Environmental Issues**

India is signatory to a number of multilateral environment agreements (MEA) and conventions.

Convention on International Trade in Endangered Species of wild fauna and flora (CITES), 1973.

The aim of CITES is to control or prevent international commercial trade in endangered species or products derived from them. CITES does not seek to directly protect endangered species or curtail development practices that destroy their habitats. Rather, it seeks to reduce the economic incentive to poach endangered species and destroy their habitat by closing off the

international market. India became a party to the CITES in 1976. International trade in all wild flora and fauna in general and species covered under CITES is regulated jointly through the provisions of The Wildlife (Protection) Act 1972, the Import/Export policy of Government of India and the Customs Act 1962 (Bajaj, 1996).

Montreal Protocol on Substances that deplete the Ozone Layer (to the Vienna Convention for the Protection of the Ozone Layer), 1987

The Montreal Protocol to the Vienna Convention on Substances that deplete the Ozone Layer, came into force in 1989. The protocol set targets for reducing the consumption and production of a range of ozone depleting substances (ODS). In a major innovation the Protocol recognized that all nations should not be treated equally. The agreement acknowledges that certain countries have contributed to ozone depletion more than others. It also recognizes that a nation's obligation to reduce current emissions should reflect its technological and financial ability to do so. Because of this, the agreement sets more stringent standards and accelerated phase-out timetables to countries that have contributed most to ozone depletion (Divan and Rosencranz, 2001).

India acceded to the Montreal Protocol along with its London Amendment in September 1992. The MoEF has established an Ozone Cell and a steering committee on the Montreal Protocol to facilitate implementation of the India Country Program, for phasing out ODS production by 2010.

To meet India's commitments under the Montreal Protocol, the Government of India has also taken certain policy decisions.

- Goods required to implement ODS phase-out projects funded by the Multilateral Fund are fully exempt from duties. This benefit has been also extended to new investments with non-ODS technologies.
- Commercial banks are prohibited from financing or refinancing investments with ODS technologies.

The Gazette of India on 19 July 2000 notified rules for regulation of ODS phase-out called the Ozone Depleting Substances (Regulation and Control) Rules, 2000. They were notified under the Environment (Protection) Act, 1986. These rules were drafted by the MoEF following consultations with industries and related government departments.

There are also certain important conventions to keep in mind.

1. Basel Convention on Transboundary Movement of Hazardous Wastes, 1989
2. UN Framework Convention on Climate Change (UNFCCC), 1992
3. Convention on Biological Diversity, 1992
4. UN Convention on Desertification, 1994

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### 12.5.6 An Assessment of the Legal and Regulatory Framework for Environmental Protection in India

The extent of the environmental legislation network is evident from the above discussion but the enforcement of the laws has been a matter of concern. One commonly cited reason is the prevailing command and control nature of the environmental regime. Coupled with this is the prevalence of the all-or nothing approach of the law; they do not consider the extent of violation. Fines are levied on a flat basis and in addition, there are no incentives to lower the discharges below prescribed levels.

Some initiatives have addressed these issues in the recent past. The Government of India came out with a Policy Statement for Abatement of Pollution in 1992, before the Rio conference, which declared that market-based approaches would be considered in controlling pollution. It stated that economic instruments will be investigated to encourage the shift from curative to preventive measures, internalize the costs of pollution and conserve resources, particularly water. In 1995, the Ministry of Environment and Forest (MoEF) constituted a task force to evaluate market-based instruments, which strongly advocated their use for the abatement of industrial pollution. Various economic incentives have been used to supplement the command-and-control policies. Depreciation allowances, exemptions from excise or customs duty payment, and arrangement of soft loans for the adoption of clean technologies are instances of such incentives. Another aspect that is evident is the shift in the focus from end-of-pipe treatment of pollution to treatment at source.

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### 12.6 NEED FOR CLEAN ENERGY AND REDUCTION OF CARBON FOOTPRINT

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Clean energy is energy which comes from natural resources such as sunlight, wind, rain, tides, and geothermal heat, which are renewable (naturally replenished). About 16% of global final energy consumption comes from renewables, with 10% coming from traditional biomass, which is mainly used for heating, and 3.4% from hydroelectricity. New renewables (small hydro, modern biomass, wind, solar, geothermal, and biofuels) accounted for another 3% and are growing very rapidly. The share of renewables in electricity generation is around 19%, with 16% of global electricity coming from hydroelectricity and 3% from new renewables.

While many renewable energy projects are large-scale, renewable technologies are also suited to rural and remote areas, where energy is often crucial in human development. As of 2011, small solar PV systems provided electricity to a few million households, and micro-hydro configured into mini-grids serves many more. Over 44 million households use biogas made in household-scale digesters

for lighting and/or cooking, and more than 166 million households rely on a new generation of more-efficient biomass cookstoves. United Nations' Secretary-General Ban Ki-moon has said that renewable energy has the ability to lift the poorest nations to new levels of prosperity.

Climate change concerns, coupled with high oil prices, peak oil, and increasing government support, are driving increasing renewable energy legislation, incentives and commercialization. New government spending, regulation and policies helped the industry weather the global financial crisis better than many other sectors. According to a 2011 projection by the International Energy Agency, solar power generators have produced most of the world's electricity within 50 years, dramatically reducing the emissions of greenhouse gases that harm the environment.

### **Mainstream forms of renewable energy**

Energy which comes from natural resources such as wind, rain, and sunlight is known as renewable energy. Major forms of renewable energy are discussed.

#### **Wind power**

Airflows can be used to run wind turbines. Modern wind turbines range from around 600 kW to 5 MW of rated power, although turbines with rated output of 1.5–3 MW have become the most common for commercial use; the power output of a turbine is a function of the cube of the wind speed, so as wind speed increases, power output increases dramatically. Areas where winds are stronger and more constant, such as offshore and high altitude sites, are preferred locations for wind farms. Typical capacity factors are 20-40%, with values at the upper end of the range in particularly favourable sites.

Globally, the long-term technical potential of wind energy is believed to be five times total current global energy production, or 40 times current electricity demand. This could require wind turbines to be installed over large areas, particularly in areas of higher wind resources. Offshore resources experience average wind speeds of ~90% greater than that of land, so offshore resources could contribute substantially more energy.

#### **Hydropower**

Energy in water can be harnessed and used. Since water is about 800 times denser than air, even a slow flowing stream of water, or moderate sea swell, can yield considerable amounts of energy. There are many forms of water energy:

- **Hydroelectric energy** is a term usually reserved for large-scale hydroelectric dams. Examples are the Grand Coulee Dam in Washington State and the Akosombo Dam in Ghana.

### **NOTES**

## NOTES

- Micro hydro systems are hydroelectric power installations that typically produce up to 100 kW of power. They are often used in water rich areas as a remote-area power supply (RAPS).
- Run-of-the-river hydroelectricity systems derive kinetic energy from rivers and oceans without using a dam.

### **Solar energy**

Solar energy is the energy derived from the sun through the form of solar radiation. Solar powered electrical generation relies on photovoltaics and heat engines. A partial list of other solar applications includes space heating and cooling through solar architecture, daylighting, solar hot water, solar cooking, and high temperature process heat for industrial purposes.

Solar technologies are broadly characterized as either passive solar or active solar depending on the way they capture, convert and distribute solar energy. Active solar techniques include the use of photovoltaic panels and solar thermal collectors to harness the energy. Passive solar techniques include orienting a building to the Sun, selecting materials with favorable thermal mass or light dispersing properties, and designing spaces that naturally circulate air.

### **Biomass**

**Biomass** (plant material) is a renewable energy source because the energy it contains comes from the sun. Through the process of photosynthesis, plants capture the sun's energy. When the plants are burnt, they release the sun's energy they contain. In this way, biomass functions as a sort of natural battery for storing solar energy. As long as biomass is produced sustainably, with only as much used as is grown, the battery will last indefinitely.

In general there are two main approaches to using plants for energy production: growing plants specifically for energy use (known as first and third-generation biomass), and using the residues (known as second-generation biomass) from plants that are used for other things. See biobased economy. The best approaches vary from region to region according to climate, soils and geography.

### **Biofuel**

Biofuels include a wide range of fuels which are derived from biomass. The term covers solid biomass, liquid fuels and various biogases. Liquid biofuels include bioalcohols, such as bioethanol, and oils, such as biodiesel. Gaseous biofuels include biogas, landfill gas and synthetic gas.

### **Geothermal energy**

Geothermal energy is thermal energy generated and stored in the Earth. Thermal energy is the energy that determines the temperature of matter. Earth's geothermal energy originates from the original formation of the planet (20%) and from radioactive decay of minerals (80%). The geothermal gradient, which is the



difference in temperature between the core of the planet and its surface, drives a continuous conduction of thermal energy in the form of heat from the core to the surface. The adjective geothermal originates from the Greek roots geo, meaning earth, and thermos, meaning heat.

The heat that is used for geothermal energy can be stored deep within the Earth, all the way down to Earth's core – 4,000 miles down. At the core, temperatures may reach over 9,000 degrees Fahrenheit. Heat conducts from the core to surrounding rock. Extremely high temperature and pressure cause some rock to melt, which is commonly known as magma. Magma convects upward since it is lighter than the solid rock. This magma then heats rock and water in the crust, sometimes up to 700 degrees Fahrenheit.

From hot springs, geothermal energy has been used for bathing since Paleolithic times and for space heating since ancient Roman times, but it is now better known for electricity generation.

### 12.6.1 Reduction of Carbon Footprint

**Carbon footprint** is a 'measure of the impact of human activities leave on the environment in terms of the amount of green house gases (CHGs) produced, measured in units of carbon dioxide'. It is meant to be useful for individuals and organizations to conceptualize their personal or organizational impact in contributing to global warming.

Reduce your carbon footprint. Whether in coal, oil or gas, carbon is the essential ingredient of all fossil fuels. When these fuels are burned to provide energy, carbon dioxide (CO<sub>2</sub>), a "greenhouse gas", is released to the Earth's atmosphere.

As we've become more dependent on carbon-based fuels, we've seen a rapid increase in the atmospheric concentration of CO<sub>2</sub>; from around 280 parts per million (ppm) before the industrial revolution, to 370 ppm today. If current trends of fossil fuel use continue the concentration of CO<sub>2</sub> is likely to exceed 700 ppm by the end of this century. According to experts, this could lead to global warming of between 1.4 and 5.8°C, which may results in more frequent severe weather conditions and damage to many natural ecosystems. Many believe that it is realistic to promote actions that ensure stabilization of atmospheric CO<sub>2</sub> concentrations at around 500–550 ppm. This is a considerable challenge, given that global energy demand is expected to double between 2000 and 2050.

As carbon footprint is the measure of carbon dioxide during the life of a particular industry, 'life cycle' concept of carbon footprint is familiar. The life cycle concept of the carbon footprint means that it is all-encompassing and includes all possible causes that give rise to carbon emissions. In other words, all direct (on-site, internal) and indirect emissions (off-site, external, embodied, upstream, downstream etc.) need to be taken into account.

## NOTES

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The carbon footprint can be efficiently and effectively reduced by applying the following steps:

- (a) Life Cycle Assessment (LCA) to accurately determine the current carbon footprint,
- (b) Identification of hot-spots in terms of energy consumption and associated CO<sub>2</sub>-emissions,
- (c) Optimisation of energy efficiency and, thus, reduction of CO<sub>2</sub>-emissions and reduction of other GHG emissions contributed from production processes,
- (d) Identification of solutions to neutralise the CO<sub>2</sub> emissions that cannot be eliminated by energy saving measures,
- (e) The last important step includes carbon offsetting; investment in projects that aim at the reducing CO<sub>2</sub> emissions, for instance bio-fuels or tree planting activities.

**C. Calculating carbon footprints** – Carbon footprints are calculated using a method called life cycle assessment (LCA). This method is used to analyse the cumulative environmental impacts of a process or product through all the stages of its life. It takes into account energy inputs and emission outputs throughout the whole production chain from exploration and extraction of raw materials to processing, transport and final use. The LCA method is internationally accredited by ISO 14000 standards.

**D. Carbon footprints of power generation using various technologies-**

- a. Fossil fuelled technologies
- b. Low carbon technologies including biomass, photovoltaic, marine technologies, hydro, wind, etc.

**Check Your Progress**

6. What are the rights of consumers according to the Consumer Protection Councils?
7. Define consumer dispute.
8. What is the main objective of the Forest (Conservation) Act, 1980?

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**12.7 ANSWERS TO CHECK YOUR PROGRESS  
QUESTIONS**

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1. An environment where all legal obligations are taken into consideration and business is carried out keeping in mind the same, is referred to as legal environment.

2. The Companies Act 1956, envisages powers of inspection and investigation of company affairs
3. Three inventions, which are not patentable, are the following, (i) an invention which is frivolous or which claims anything obviously contrary to well-established natural laws. (ii) The mere discovery of a scientific principle or the formulation of an abstract theory or discovery of any living thing or non-living thing occurring in nature, and (iii) a mathematical or business method or a computer program per se or algorithms.
4. Patents can be applied in the following ways, (i) true and first inventor of the invention, (ii) assignee of the person claiming to be the true and first inventor.
5. The Central Government can acquire an invention or patent by issue of a notification, for public interest.
6. The rights of consumers according to the Consumer Protection Councils are the following:
  - Right to safety
  - Right to information
  - Right to choose
  - Right to be heard
  - Right against exploitation
  - Right to education
7. Consumer dispute means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.
8. Forest (Conservation) Act, 1980 was adopted to protect and conserve forests. The Act restricts the powers of the state in respect of de-reservation of forests and use of forestland for non-forest purposes (the term non-forest purpose includes clearing any forestland for cultivation of cash crops, plantation crops, horticulture or any purpose other than re-afforestation).

## NOTES

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### 12.8 SUMMARY

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- Legal environment of business is a regulation that is applicable in all business organizations
- Capital market is one of the most important segments of the Indian financial system, which refers to all the facilities and the institutional arrangements for borrowing and lending funds.
- Primary market is the market used for raising fresh capital in the form of shares and debentures. It provides the company with additional funds thereby contributing directly to the company's funds.

## NOTES

- Secondary market is the market for buying and selling securities of the existing companies.
- The regulatory authority, Securities and Exchange Board of India, (SEBI) was established in order to protect the interests of the investors in securities.
- A patent is a form of intellectual property. 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.
- Consumer refers to any person who buys any goods for a consideration, which has been paid or promised payment.
- Trade, which adopts unfair means for promoting sales, is referred to as unfair trade practice.
- The department of Environment was established in India in 1980 to ensure a healthy environment for the country. The Ministry of Environment and Forests and the pollution control boards, together form the regulatory and administrative core of the sector.
- Prevention and Control of Air Pollution Act, 1981, seeks to combat air pollution by prohibiting the use of polluting fuel and substances.
- The Forest Conservation Act, 1980, was adopted to protect and conserve forests.
- Energy that comes from natural resources such as sunlight and wind is known as clean energy. These are renewable in nature.
- The total set of greenhouse gas emissions caused by an organization, event or production is termed as carbon footprint.

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## 12.9 KEY WORDS

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- **Unfair Trade Practice:** It means a trade practice which, for the purposes of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice.
- **Appellate Jurisdiction:** The State Commission has power to entertain the appeals against the orders of any District Forum within the State, within 30 days from the date of service of the order to the appellant.
- **National Commission:** It is the topmost layer in the three-level hierarchy of the Consumer Disputes Redressal Agencies.
- **Geothermal Energy:** This denotes thermal energy generated and stored in the Earth.
- **Photovoltaic:** It is a semi-conducting material which converts sunlight into electricity.

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## 12.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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### Short-Answer Questions

1. State the differences between primary market and secondary market.
2. What do you understand by the term 'capital market'?
3. Define clean energy.
4. How is patent granted?
5. What is a complaint? How is it lodged?

### Long-Answer Questions

1. Discuss the law on patents.
2. Write a detailed note on consumer of goods.
3. Review the environment protection Acts with special reference to air and wildlife.
4. Explain the concept of geothermal energy.
5. Discuss fossil-fuelled technologies.

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## 12.11 FURTHER READINGS

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### NOTES

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## UNIT 13 NEW ECONOMIC POLICY ENVIRONMENT IN INDIA

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### NOTES

#### Structure

- 13.0 Introduction
- 13.1 Objectives
- 13.2 New Economic Reforms
  - 13.2.1 Liberalization
  - 13.2.2 Privatization
  - 13.2.3 Globalization
- 13.3 New Economic Policy in India
- 13.4 Answers to Check Your Progress Questions
- 13.5 Summary
- 13.6 Key Words
- 13.7 Self Assessment Questions and Exercises
- 13.8 Further Readings

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### 13.0 INTRODUCTION

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In the 1990s the government of India in order to come out of the economic crisis decided to deviate from its previous economic policies and lean towards Privatization. In July 1991 when the devaluation of Indian currency took place the govt. started announcing its new economic polices one after another. Though these polices pertained to different aspects of the economic field they had one thing in common. The economic element was to orient the Indian system towards the world—Liberalization, Privatization and Globalization.

In the presence of a more globalized environment all over the world, the policies of a country acts as a key determinant for getting the real benefits of the same. Particularly for the developing nations, the Government's policies largely affect its economic environments.

After the adoption of the new economic policy in India, the country has reviewed its policies and made it friendlier in almost all the sectors. Here in this policy watch section we have covered the policies formulated by India upon different sectors.

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### 13.1 OBJECTIVES

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

- Define the concepts of liberalization, privatization and globalization
- Analyse efficiency drive through competition
- List the features of liberalization

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## 13.2 NEW ECONOMIC REFORMS

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Economic reforms in India were started by late Prime Minister Rajiv Gandhi. He said, 'The public sector has entered into too many areas where it should not be. We shall open the economy to the private sector in several areas hitherto restricted to it.' Consequently, a number of measures were taken to remove control and open areas to private sector players. However, Rajiv Gandhi did not take a very strong and categorical position on the issue of privatization and globalization, though some liberalization of the economy did take place. It was when Mr. Narasimha Rao took over as Prime Minister in 1991 that a new industrial policy was announced, which marked a sharp departure from the earlier industrial policy of 1956.

There were three aims of the new economic policy—liberalization, globalization and privatization.

### 13.2.1 Liberalization

The main aim of liberalization was to dismantle the excessive regulatory framework which acted as a shackle on freedom of enterprise. Over the years, the country had developed a system of *licence-permit-control raj*. The aim of the new economic policy was to save the entrepreneur the unnecessary harassment of seeking permission from the bureaucracy to start an undertaking.

Similarly, the big business houses were unable to start new enterprises because the MRTP Act had prescribed a ceiling on the asset ownership to the extent of ₹ 100 crore. In case a business house had assets more than ₹ 100 crore, its application was rejected. It was believed that on account of the rise in prices this limit had become outdated and needed reviewing. The second objection by the private sector lobby was that it prevented big business houses from investing in heavy industry and infrastructure, which required lump sum investment. The NDA in its election manifesto had suggested that the asset limit of MRTP companies should be raised to ₹ 1000 crore. The government thought it wise to abolish the limit altogether so that big businesses could establish big projects in the core sectors—heavy industry, petrochemicals, electronics, etc. The Government was of the view that in the context of liberalization, the MRTP limit had become irrelevant and needed to be scrapped.

The major purpose of liberalization was to free the large private corporate sector from bureaucratic controls. It therefore, started dismantling the regime of industrial licensing and control. In pursuance of this policy, the industrial policy of 1991 abolished industrial licensing for all projects except for a small set of 18 industries.

### 13.2.2 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:

## NOTES

## NOTES

(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, co-operative or corporate sector. This can have three forms:

- *Total denationalisation* implies 100 per cent transfer of ownership of a public enterprise to the private sector.
- *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. seventy-four per cent transfer of ownership to the private sector implies a dominant share being transferred. In such a situation, the private sector is in a better position to change the character of the enterprise.
- *Liquidation* implies sale of assets to a person who may use them for the same purpose or for some other purpose. This depends solely on the preference of the buyer.
- *Workers' Cooperative* is a special form of denationalisation. In this form, ownership of the enterprise is transferred to workers who may form a co-operative 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) **Organisational Measures:** These include a variety of measures to limit state control, such as:

- (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 decentralised 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.



(c) **Restructuring:** It is of two types—Financial Restructuring and Basic Restructuring.

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

(d) **Operational Measures:** The efficiency of public sector enterprises depends upon the organisational 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 diversification. 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.

**Aims of Liberalization, Globalization and Privatization:** Liberalization, globalization and privatization are all means to achieve certain ends of the society just as nationalisation and regulatory frameworks were intended to achieve certain goals. These are:

- To achieve a high rate of growth of national and per capita income
- To achieve full employment
- To achieve self-reliance
- To reduce inequality of income and wealth
- To reduce the number of people living below the poverty line
- To develop a pattern of society based on equality and absence of exploitation

## NOTES

## NOTES

The operation of the public sector and the regulatory framework led to certain problems, namely:

- Excessive development of bureaucratic controls acted as shackles on growth
- Overstaffing in public sector enterprises led to an increase in the cost of operation
- Low rate of return on investment in public sector
- Poor work ethic in public sector enterprises due to excessive job security and absence of incentives for better work
- Entry of public sector in areas of consumer goods for which it was never meant. Thus unnecessary expansion resulted in the absence of focus and dilution in the quality of management
- Some public sector enterprises were incurring losses year after year and as such had become a burden on the public exchequer, instead of being an asset to the nation

The measures undertaken are all designed to rectify these problems so that the working of the economy becomes more efficient and its rate of growth improves.

**Review of Economic Reforms:** There is general agreement among all political parties that reforms are a historical necessity and it is not possible to reverse the reform process. Even the Left parties, after the collapse of the former Soviet Union, have accepted the view that reforms in the form of liberalization, privatization and globalization will have to be undertaken. The reforms process has helped to accelerate growth. However, the benefits of growth have not percolated to the poor and weaker sections of the society.

**Higher growth rate achieved:** Since the reform process was initiated the growth rate of the economy has started picking up. The growth rate of GDP slumped to 0.9 per cent in 1991–92, but picked up thereafter. The average growth rate of over 6 per cent during the five years (1992–93 to 1996–97) is an achievement of the reform process. This would result in an average 4 per cent growth rate of per capita GDP.

The Gross Domestic Product (GDP) in India expanded 1.70 per cent in the fourth quarter of 2015 over the previous quarter. GDP Growth Rate in India averaged 1.66 per cent from 1996 until 2015, reaching an all time high of 5.30 per cent in the second quarter of 2009 and a record low of -1.70 per cent in the first quarter of 2009.

**Control of Inflation:** During 1993–94 and 1994–95, the wholesale price index rose by 10.8 per cent and 10.4 per cent respectively. Thereafter, due to strong measures taken during 1995–96, the rate of inflation slowed down to 5 per cent.

The impact of inflation on the common man is measured by the consumer price index. The consumer price index has shown an average rise of over 10 per cent during 1991–1997. This implies the failure of the reform process to control inflation despite the achievement of high growth rate.

**Reform of the Public Sector:** The major aim of economic reforms is to improve the public sector so that the rate of return improves. To remedy the situation, it was necessary that overstaffing of the public sector undertakings be reduced. The government has already taken steps in this direction by its voluntary retirement scheme. It set up the National Renewal Fund to provide compensation for voluntary retirement and also arranged for retraining and redeployment of workers. As a result of the VRS, the employee strength of PSUs has been reduced by 8 per cent.

Another step taken by the government was disinvestment in PSUs. The government has been offering equity of 31 selected public sector enterprises, varying from 5 per cent to 20 per cent to Mutual Funds and Financial Institutions. This is only a token privatization and the government was able to raise ₹ 9793 crore during the four-year period (1991–92 to 1994–95).

Critics describe disinvestment as deficit privatization because the proceeds of disinvestment are being used to reduce the budget deficit. The Common Minimum Programme of the NDF Government stipulated that the proceeds of disinvestment would be used in two vital areas—health and education.

On the whole, the reforms of PSUs have not gathered as much momentum as expected. Disinvestment has been piecemeal and the funds so raised are being used to reduce budget deficits rather than strengthen the PSUs. In addition, labour problems, political and bureaucratic interference have not been effectively used. Since it is not possible to privatise a large component of the public sector, it would be advisable to reform it.

**Large dose of Foreign Capital to help Indian Economy:** The reforms process, especially its emphasis on globalization, was intended to accelerate the growth process by attracting a larger dose of foreign capital. However, the efforts of the state met with only partial success. The data reveal that during 1991–92 to 1995–96, total investment flows of the order of \$ 1,174 billion were made, out of which portfolio investment was of the order of \$ 8.05 billion and direct foreign investment accounted for barely \$ 3.69 billion.

Critics point out that mainly 39 per cent of foreign investment is in the non-priority sector. The entry of multinationals in consumer goods only displaces Indian labour and capital employed in the production of these commodities.

**Reform Process and the Foreign Trade Scenario:** The reform process has led to growth of exports but simultaneously, it has also led to a larger growth of imports. As a result, the trade gap has not been reduced.

### 13.2.3 Globalization

Globalization intends to integrate the Indian economy with the world economy. Globalization is considered to be an important element in the reforms package. It has four parameters:

- Reduction of trade barriers so as to permit free flow of goods and services across national frontiers;

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## NOTES

- Creation of an environment in which free flow of capital can take place;
- Creation of an environment permitting free flow of technologies among nation-states; and
- Creation of an environment in which free movement of labour can take place in different countries of the world.

The advocates of globalization limit the definition of globalization to only three components viz.; unhindered trade flows, capital flows and technology flows. They insist that the developing countries accept their definition of globalization and conduct the debate on globalization within the boundaries set by them. But many economists in developing countries believe that this definition is incomplete. If the ultimate aim of the globalization movement is to integrate the world into one global village, then the fourth component of unrestricted movement of labour cannot be left out.

### **Rationale behind Economic Reforms**

The rationale for privatization in various countries can generally be classified under three heads: pragmatism, a commercial point of view, and ideological compulsions. Pragmatism was born of hard facts: the mammoth public sector units had failed to deliver on counts of efficiency and output both, thereby belying the faith in them to establish the foundations of sound economic growth. While a few of them did manage to produce good results, they generally showed a marked decline from the 1970s, though a handful did well after the 1980s. Fewer still managed to yield fairly decent returns on investment, dividends that were disproportionate to the enormous amounts of time and money invested in them. As such, they were not pulling their weight in the economy, and needed to be overhauled drastically.

Second, the organizational culture in PSUs militated against good management, and it was felt that privatization would revitalize them by letting them be run on commercial lines typified by the private sector approach to industrial activity, including clipping the wings of powerful, much politicized trade unions that severely impeded the progress of the PSU juggernauts.

Third, and as a corollary to the above, on account of historical reasons, the government was accustomed to getting its work done the easy way, i.e., by official diktat; its autocratic, 'power distance', impersonal style of functioning made it difficult for it 'connect' meaningfully with its key managerial personnel and motivate them to effect commercial viability. This was unfortunate, given the fact that there were many highly capable managers within the ranks of the PSUs.

In keeping with the socialistic pattern of functioning, private enterprise had long laboured under the stigma of profiteering at public expense. If the private sector can at all be accused of making money at public expense, it also cannot be denied that it was merely responding in the only way it could, given the monopolistic and monolithic structure installed by the very government that now clamoured for efficiency and productivity in PSUs. In fact, by squandering the opportunities that had been handed to it on a platter, the public sector—not its private sector cousin—

was the main culprit for the low productivity, poor return on investment and callous disregard for national priorities such as poverty eradication (job reservation was never more than a mere sop to appease political sentiments, barely scratching the surface of the problem) that had brought the nation to a stage where it had to contend with a series of financial crises, and which badly tarnished its image. On the other hand, the private sector had flourished mightily despite—or perhaps because of—a system that gave it (on a *quid pro quo* basis, let it be admitted) protection from competition through licensing and other privileges.

It was left to the government of PV Narasimha Rao and his Finance Minister Dr. Manmohan Singh to take the bull by the horns and introduce what is today known as the liberalized regime. By beginning the long-overdue task of revamping the economy in line with global trends, unshackling it from bureaucratic control, lowering trade tariffs and allowing foreign conglomerates into the country, they served notice on a complacent public sector to perform or perish. It was the start of a process whereby several unviable or redundant PSUs went under the hammer or were referred to the BFIR, while the more efficient ones were encouraged to adopt the MOU route that gave them freedom to function on commercial lines, in return for full accountability. Several PSUs that had been ailing under tight government controls, over-staffing and trade union militancy such as NTPC, National Fertilisers and Hindustan Organic Chemical Ltd., immediately took humane but firm measures to effect smart turnarounds that left the critics dumbfounded. Going further, dilution of the policy of sector-wise reservations generally gave both sectors the freedom to establish enterprises where earlier, entry was mutually exclusive. In the final analysis, the long-term health of the economy would depend heavily on how the better PSUs like Indian Oil Corporation (the lone Indian corporate in the Fortune 500 list) and GAIL happen to fare. In weeding out the inefficient PEs and reengineering the good ones, the government can at last concentrate on its *real* function—governance, support, inspiration and guidance—leaving commercial activity to those better equipped and empowered to undertake it.

## NOTES

### Objectives of Privatization

- Improvement of the economic-performance of assets
- De-politicalization of economic decisions
- Reduction in public outlays, taxes and borrowing requirements
- Promotion of popular capitalism through wider ownership of assets
- Promotion of equity

### Check Your Progress

1. What was the major purpose of liberalization under the New Economic Policy, 1991?
2. What is privatization?
3. What is the main aim of liberalization?

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## 13.3 NEW ECONOMIC POLICY IN INDIA

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### NOTES

Under the New Industrial Policy, the industries have been freed to a large extent from the licenses and other controls. In order to encourage modernization, stress has been laid upon the use of latest technology. A great reduction has been effected in the role of the public sector.

Efforts have been made to encourage foreign investment. Investment decision by companies has been facilitated by ending restrictions imposed by the MRTP Act. Similarly, Foreign Exchange Regulation Act (FERA) has been replaced with Foreign Exchange Management Act (FEMA).

### 1. New Industrial Policy

Some important points of the New Industrial Policy have been highlighted here

- (a) **Abolition of Licensing:** Before the advent of the New Industrial Policy, the Indian industries were operating under strict licensing system. Now, most industries have been freed from licensing and other restrictions.
- (b) **Freedom to Import Technology:** The use of latest technology has been given prominence in the New Industrial Policy. Therefore, foreign technological collaboration has been allowed.
- (c) **Contraction of Public Sector:** A policy of not expanding unprofitable industrial units in the public sector has been adopted. Apart from this, the government is following the course of disinvestment in such public sector undertaking. (Selling some shares of public sector enterprises to private sector entrepreneurs is called disinvestment. This is a medium of privatisation.)
- (d) **Free Entry of Foreign Investment:** Many steps have been taken to attract foreign investment. Some of these are as follows:
  - In 1991, 51% of foreign investment in 34 high priority industries was allowed without seeking government permission.
  - Non-Resident Indians (NRIs) were allowed to invest 100% in the export houses, hospitals, hotels, etc.
  - Foreign Investment Promotion Board (FIPB) was established with a view to speedily clear foreign investment proposals.
  - Restrictions which were previously in operation to regulate dividends repatriation by the foreign investors have been removed. They can now take dividends to their native countries.
- (e) **MRTP Restrictions Removed:** Monopolies and Restrictive Trade Practices Act has been done away with. Now the companies do not need to seek government permission to issue shares, extend their area of operation and establish a new unit.

- (f) **FERA Restrictions Removed:** Foreign Exchange Regulation Act (FERA) has been replaced by Foreign Exchange Management Act (FEMA). It regulates the foreign transactions. These transactions have now become simpler.
- (g) **Increase in the Importance of Small Industries:** Efforts have been made to give importance to the small industries in the economic development of the country.

## NOTES

### 2. New Trade Policy

Trade policy means the policy through which the foreign trade is controlled and regulated. As a result of liberalisation, trade policy has undergone tremendous changes. Especially the foreign trade has been freed from the unnecessary controls.

The age-old restrictions have been eliminated at one go. Some of the chief characteristics of the New Trade Policy are as follows:

- (i) **Reduction in Restrictions of Export-Import:** Restrictions on the exports-imports have almost disappeared leaving only a few items.
- (ii) **Reduction in Export-Import Tax:** Export-import tax on some items has been completely abolished and on some other items it has been reduced to the minimum level.
- (iii) **Easy Procedure of Export-Import:** Import-export procedure has been simplified.
- (iv) **Establishment of Foreign Capital Market:** Foreign capital market has been established for sale and purchase of foreign exchange in the open market.
- (v) **Full Convertibility on Current Account:** In 1994-95, full convertibility became applicable on current account. Here it is important to clarify the meaning of current account and full convertibility. Therefore, this has been done as follows:
  - **Current Account:** Transactions with the foreign countries are placed in two categories: (i) transaction with current account, for example, import-export, (ii) Capital account transactions, like investment.
  - **Full Convertibility:** In short, full convertibility means unrestricted sale and purchase of foreign exchange in the foreign exchange market for the purpose of payments and receipts on the items connected with current account. It means that there is no government restriction on the sale and purchase of foreign exchange connected with current account.

On the other hand, sale and purchase of foreign exchange connected with capital account can be carried on under the rates determined by the Reserve Bank of India (RBI).

## NOTES

### 3. Fiscal Reforms

The policy of the government connected with the income and expenditure is called fiscal policy. The greatest problem confronting the Indian government is excessive fiscal deficit. In 1990-91, the fiscal deficit was 8 per cent of the GDP. (It is important to understand the meaning of fiscal deficit and GDP.)

- (i) **Fiscal Deficit:** A fiscal deficit means that the country is spending more than its income.
- (ii) **Gross Domestic Product (GDP):** The GDP is the sum total of the financial value of all the produced goods and services during a year in a country. Generally, the financial deficit is calculated in the form of GDP's percentage. Presently, the government of India is making efforts to take it to 4 per cent.

#### Solutions of Fiscal Deficit

In order to handle the problem of fiscal deficit, basic changes were made in the tax system. The following are the major steps taken in this direction:

- The rate of the individual and corporate tax has been reduced in order to bring more people in the tax net.
- Tax procedure has been simplified.
- Heavy reduction in the import duties has been implemented.

### 4. Monetary Reforms

Monetary policy is a sort of control policy through which the central bank controls the supply of money with a view to achieving the objectives of the general economic policy. Reforms in this policy are called monetary reforms. The major points with regard to the monetary reforms are given below:

- Statutory Liquidity Ratio (SLR) has been lowered. (A commercial bank has to maintain a definite percentage of liquid funds in relation to its net demand and time liabilities. This is called SLR. In liquid funds, cash investment in permitted securities and balance in current account with nationalised banks are included.)
- The banks have been allowed freedom to decide the rate of interest on the amount deposited.
- New standards have been laid down for the income recognition for the banks. By recognition of income, we mean what is to be considered as the income of the bank. For example, should the interest on the bad debt be considered as the income of the bank directions have been issued in this context?
- Permission to collect money by issuing shares in the capital market has been granted to nationalised banks.
- Permission to open banks in the private sector has also been granted.



## 5. Capital Market Reforms

The market in which securities are sold and bought is known as the capital market. The reforms connected with it are known as capital market reforms. This market is the pivot of the economy of a country. The government has taken the following steps for the development of this market:

- Under the Portfolio Investment Scheme, the limit for investment by the NRIs and foreign companies in the shares and debentures of the Indian companies has been raised. (Portfolio Investment Scheme means investing in securities.)
- In order to control the capital market, the Securities and Exchange Board of India (SEBI) has been established.
- The restriction in respect of interest on debentures has been lifted. Now, it is decided on the basis of demand and supply.
- The office of the Controller of Capital Issue which used to determine the price of shares to be issued has been dispensed with. Now, the companies are free to determine the price of the shares.
- Private sector has been permitted to establish Mutual Fund.
- The registration of the sub broker has been made mandatory.

## 6. Phasing out Subsidies

Cash Compensatory Support (CCS) which was earlier given as export subsidy has been stopped. CCS can be understood with the help of an example.

If an exporter wants to import some raw material which is available abroad for 100, but the same material is available in India for 120 and the governments wants the raw material to be purchased by the exporter from India itself for the protection of indigenous industries, the government is ready to pay the difference of 20 to the exporter in the form of subsidy. The payment of 20 will be considered as CCS. In addition to this, the CCS has been reduced in case of fertilizers and petro products.

## 7. Dismantling Price Control

The government has taken steps to remove price control in case of many products. (Price Control means that the companies will sell goods at the prices determined by the government.) The efforts to remove price control were mostly in respect of fertilizers, steel and iron and petro products. Restrictions on the import of these products have also been removed.

### Check Your Progress

4. State any two steps that the government has taken in capital market reform.
5. Write any two steps taken by the government to liberalize industrial policy.

## NOTES

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## 13.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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### NOTES

1. The major purpose of liberalization under the New Industrial Policy of 1991 was to free the large private corporate sector from bureaucratic controls. It therefore, started dismantling the regime of industrial licensing and control.
2. Privatization is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking.
3. The main aim of liberalization was to dismantle the excessive regulatory framework which acted as a shackle on freedom of enterprise.
4. The government has taken the following steps for the development of this market:
  - Under the Portfolio Investment Scheme, the limit for investment by the NRIs and foreign companies in the shares and debentures of the Indian companies has been raised. (Portfolio Investment Scheme means investing in securities.)
  - In order to control the capital market, the Securities and Exchange Board of India (SEBI) has been established.
5. The two steps taken among others to liberalize industrial policy are:
  - Abolition of Licensing
  - Freedom to Import Technology

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## 13.5 SUMMARY

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- There were three aims of the new economic policy—liberalization, globalization and privatization.
- The main aim of liberalization was to dismantle the excessive regulatory framework which acted as a shackle on freedom of enterprise.
- The major purpose of liberalization was to free the large private corporate sector from bureaucratic controls.
- 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.
- 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.

- Liberalization, globalization and privatization are all means to achieve certain ends of the society just as nationalisation and regulatory frameworks were intended to achieve certain goals.
- Globalization intends to integrate the Indian economy with the world economy. Globalization is considered to be an important element in the reforms package.
- Under the New Industrial Policy, the industries have been freed to a large extent from the licenses and other controls. In order to encourage modernization, stress has been laid upon the use of latest technology. A great reduction has been effected in the role of the public sector.
- In the New Economic policy, efforts have been made to encourage foreign investment. Investment decision by companies has been facilitated by ending restrictions imposed by the MRTP Act. Similarly, Foreign Exchange Regulation Act (FERA) has been replaced with Foreign Exchange Management Act (FEMA).

## NOTES

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### 13.6 KEY WORDS

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- **Fiscal Deficit:** A fiscal deficit means that the country is spending more than its income.
- **Price Control:** It means that the companies will sell goods at the prices determined by the government.

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### 13.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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#### Short-Answer Questions

1. What is liberalization?
2. What was the purpose of the government to follow liberalization?
3. Name any five industries in which industrial licensing is compulsory.
4. What are the three forms of privatization?

#### Long-Answer Questions

1. Write in detail about the New Economic Policy.
2. What are the aims of liberalization, privatization and globalization?
3. Why was globalization important for the Indian economy?
4. Discuss the steps taken by India towards globalization.

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## 13.8 FURTHER READINGS

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### NOTES

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## UNIT 14 PRIVATIZATION

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### Structure

- 14.0 Introduction
- 14.1 Objectives
- 14.2 Liberalization
- 14.3 Privatization
- 14.4 Globalization
- 14.5 Impact of Globalization on Business Development
  - 14.5.1 Globalization and Enhanced Opportunities and Threats
- 14.6 WTO and its Role in Economic Development
- 14.7 International Monetary Fund (IMF) and its Role in Economic Development
- 14.8 World Bank and its Role in Economic Development
- 14.9 Answers to Check Your Progress Questions
- 14.10 Summary
- 14.11 Key Words
- 14.12 Self Assessment Questions and Exercises
- 14.13 Further Readings

### NOTES

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### 14.0 INTRODUCTION

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The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. In order to boost industrialization and accelerate economic growth, the government took revolutionary steps like state ownership on certain categories of industries, economic planning, and reduced role of private sector. The government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted in a mixed response. There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was very slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced radical changes in its economic policy in 1991 with the following objectives.

The main objectives of India's development plans were:

- a) To build on the gains already made.
- b) To correct the weaknesses that may have crept in.
- c) To maintain a sustained growth in productivity and gainful employment.
- d) To attain international competitiveness.
- e) To protect the interest of workers.
- f) To enhance support to small scale sector.
- g) To provide incentives for industrialization of backward areas.

## NOTES

In accordance with economic planning, the government gave a lead role to the public sector for infrastructure industries whereas the private sector was broadly given the responsibility of developing consumer goods industry. At the same time, the government imposed several restrictions, regulations and controls on the working of private sector enterprises. India's experience with economic planning has delivered mixed results. In 1991 the economy faced a serious foreign exchange crisis, high government deficit and a rising trend of prices despite good crops. As a part of economic reforms, the Government of India announced a new industrial policy on July 24, 1991. The broad features of this policy were:

- a) Automatic permission was now granted for technology agreements with foreign companies.
- b) Disinvestment was carried out in case of many public sector industrial enterprises.
- c) Foreign Investment Promotion Board (FIPB) was set up to promote and channelise foreign investment in India.
- d) Many of the industries reserved for the public sector under the earlier policy, were opened for private sectors too. The role of the public sector was limited only to four industries of strategic importance.
- e) Policy towards foreign capital was liberalised. The share of foreign equity participation was increased and in many industries 100 per cent Foreign Direct Investment (FDI) was permitted.
- f) The areas reserved for public sector under compulsory licensing were reduced from twenty nine to six. These industries are Defence products, Atomic Energy, Atomic metal, Coal & Lignite, Mineral Oils, Railway Transport.

This policy abolished industrial licensing in most of the cases, allowed private participation in most industries, disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board (FIPB) was set up to channelise foreign capital investment in India. Small-scale sector was assured all help and accorded due recognition. In short, the new industrial policy has liberated Indian industry from the shackles of the licensing system (liberalization), drastically reduced the role of the public sector (privatization) and encouraged foreign private participation in India's industrial development (globalization). Let us discuss the developments under heads, privatization and globalization. It is to be noted that liberalization has been discussed in Unit 13.

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### 14.1 OBJECTIVES

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

- Understand the concept of privatization and globalization
- Discuss the various constructs of privatization and globalization

- Explain the various opportunities and threats due to globalization
- Describe the nature, significance of functions of international bodies such as WTO, IMF and World Bank
- Interpret the role played by WTO, IMF and World Bank in the global economic development.

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## 14.2 LIBERALIZATION

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The main objective of industrial policy 1991 was to free the country's industrial economy from the unnecessary bureaucratic control and to introduce liberalization with a view to integrate the Indian economy with the global economy. The policy also aimed at removing restrictions on direct foreign investment and also to free the domestic entrepreneurs from the restrictions of MRTP Act. The policy signalled the end of the licence-permit-quota raj. Liberalization of the Indian industry has taken place with respect to:

Liberalization means deregularization of the industrial sector by cutting down to the minimum administrative interference in its operation so as to allow free competition between market forces.

**Liberalization**

As discussed in unit 13, liberalization is the process of making the economy more liberal, or freer. It means deregularization of the industrial sector by cutting down to the minimum administrative interference in its operation so as to allow free competition between market forces.

- abolition of licensing policy except some specified industries (where security and strategic concerns prevail).
- freedom in deciding the scale of business activities i.e., now no more restrictions on expansion or contraction of business activities,
- freedom in fixing the prices of goods services,
- making it easier to attract foreign capital and technology to India,
- reduction in tax rates and lifting of unnecessary controls over the economy,
- removal of restrictions on the movement of goods and services, and
- Simplifying procedures for imports and exports.

Through the liberalization process, the Indian economy has opened up new vistas and started interacting with the world in a big way. The entry provisions for foreign companies have been relaxed. The transfer provisions for new and advanced technologies are made simpler. Customers are getting quality goods. New avenues for employment have come up. The number of multinationals is on rise. This has resulted in stiff competition and increased industrial efficiency. In a nutshell, liberalization has helped India in achieving a high growth rate, easy

availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

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### 14.3 PRIVATIZATION

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The revolution of privatization started in 1980 and spread to many parts of the world. Many developing countries started privatizing their public sector enterprises. India was no exception to it. The new industrial policy of 1991 aimed at giving greater role to the private sector in the nation building process and a reduced role to the public sector. This was a reversal of the development strategies adopted by India policy makers from 1951 to 1990. To achieve the objective of privatization, government redefined the role of the public sector in the New Industrial Policy, adopted the policy of planned disinvestments of the public sector and decided to refer the loss making and sick enterprises to the Board of Industrial and Financial Reconstruction (BIFR). The term disinvestment is a process of transferring public ownership to the private sector. Simply saying, selling public enterprises to private parties. It results in dilution of stake of the government in the public enterprise. If there is dilution of government ownership beyond 51 percent, it would result in transfer of ownership and management of the enterprise to the private sector.

#### Benefits of Privatization

1. Increased overall efficiency
2. Improved management & decision making
3. Substantial reduction in budgetary deficit
4. Recovery of government fund
5. Reduction in political and bureaucratic interferences
6. Better industrial relations management; etc.

#### Aspects of Privatization and impact on business

As discussed earlier, privatization is an attempt of changing the relationship between the government and the private sector to improve the role of the private sector in the functioning of the national economy as a whole. Therefore, 'privatization' reduces the government's interference in directly maintaining and running the economic activities of a nation. In a developing country like India, privatization has seen as a way to increase, improving quality, reducing per unit cost, reducing public expenditure and raising cash to reduce public debt. Privatization in India has both the positive and negative aspects, discussed as follow.

#### Positive Aspects of Privatization

1. The centuries old colonial process and procedures which is still being followed in government offices will introduce a well-defined organizational structure and responsible governance.



2. Customer service will get enhanced.
3. The weaknesses in the public system such as corruption, misuse of government funds, misuse of official powers, bribery or red tapism will come to an end.
4. Quick adaptation of technology and innovation.
5. Performance linked recruitment, selection and promotion procedure will replace flattery and jack based old system which has encrypted in to the system.
6. Privatization will bring competition in the industry and ultimately common people will be benefitted.
7. Working environment will become healthy, competitive and cleaner.
8. Overall efficiency of the public sector when handled by private organizations will go up. For example, TCS under public private partnership (PPP) provided an accessible technology platform for passport services to 200 million Indian citizens.

## NOTES

### Negative Aspects of Privatization

There is no doubt that privatization has blessed our Indian economic environment but it does not mean that it has no negative aspects on the economy and common man. Following are the negative aspects of privatization.

1. Opportunities for foreign direct Investment (FDI) and foreign institutional investors (FII) is not healthy for any economic system in the long run as it destroys the domestic trade and commerce.
2. Due to enhanced competition, though the common people are benefitted but local traders loose their business and employment causing different type of loss to the economy.
3. If privatization is introduced in service retailing like Air India, railways, then people can be exploited and charged high in absence of government monitoring.
4. Trade unions/labour unions will loose its importance and their grip with members due to the rigorous policies of private organizations.
5. Excessive exploitation of natural resources may be threatening to the nation if sectors such as mining is privatized.

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## 14.4 GLOBALIZATION

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The term globalization means adjustment of national economy with that of the world economy. It is conversion of a national market into international mobility of factors of production. In others words, it may be described as the integration of national economy with that of global economy. An important attribute of globalization is the increasing degree of openness, which has three dimensions, i.e.; international

## NOTES

trade, international investment and international finance. Till 1991, the Government of India had followed a policy of strictly regulating imports in value and volume terms.

Globalization means ‘integrating’ the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries. To achieve these objectives of globalization, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment and encouragement of foreign technology. These measures are expected to achieve a higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

These regulations were with respect to (a) licensing of imports, (b) tariff restrictions and (c) quantitative restrictions. The new economic reforms aimed at trade liberalization were directed towards import liberalization, export promotion through rationalisation of the tariff structure and reforms with respect to foreign exchange so that the country does not remain isolated from the rest of the world. Globalization involves an increased level of interaction and interdependence among the various nations of the global economy. Physical geographical gap or political boundaries no longer remain barriers for a business enterprise to serve a customer in a distant geographical market. This has been made possible by the rapid advancement in technology and liberal trade policies followed by governments. Through the policy of 1991, the Government of India moved the country to the path of globalization.

### **Benefits of Globalization**

- Increase Productivity & Higher Living Standards
- Increase in Trade & Goods and Services
- Provide New Opportunities for Growth
- Globalization of Financial Markets
- Increased Flow of foreign Market Capital
- Impact on Poverty
- Increase the Level of Interdependence and Competitiveness
- Induce Domestic Firms to Improve Technology

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## **14.5 IMPACT OF GLOBALIZATION ON BUSINESS DEVELOPMENT**

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The new industrial policy of 1991, characterised with liberalization, privatization and globalization (LPG Model) has made a significant impact on the working of enterprises in business and industry. The series of reforms undertaken with respect to industrial sector, trade and financial sector have made Indian economy more

efficient. The reforms have ushered in a remarkable change in the Indian mind-set. The Indian corporate sector has come face-to-face with several challenges due to government policy changes. These challenges can be explained as follows:

- (i) **Extended competition:** With the abolition of industrial licensing and entry of foreign firms, competition for Indian firms has increased drastically especially in service industries like banking, insurance, telecommunications, airlines, etc. which were earlier reserved for the public sector.
- (ii) **Demanding customers:** Today customers have become demanding. Their likings and disliking are changing very fast. The primary reason is that they are well informed and technology savvy. Increased competition in the market has given wider choice to customers. The quality of goods and services is exceptionally high.
- (iii) **Fast changing technological environment:** Increased competition forces the firms to develop new ways to survive and grow in the market. New technologies make it possible to improve machines, process, products and services. The rapid changes in information technology solutions and innovations have changed the way we used to live in the society. Internet is the new language of communication.
- (iv) **Necessity for change:** In the pre-1991 era, the economy was regulated and therefore, firms could have relatively stable policies and practices. But after, 1991, with the openness of economy, the market forces have become turbulent and therefore, firms need to continuously modify their operations to stay in the competition.
- (v) **Need for developing human resource:** There is nothing wrong to say that in the pre liberalised era, Indian corporate has suffered with inadequately trained personnel. The new market forces and frequently changing business equations require people with higher competence and greater commitment. Hence the need for developing human resources has been recognised and companies are spending on the training and development of their employees.
- (vi) **Market orientation:** Gone are the days when firms used to produce first and go to the market for sale later. In other words, industry was primarily production oriented and customers' view was secondary. But in the fast changing economy, this seller market has been transformed into buyer market. Now companies cannot think of producing goods without studying and analysing the market trends. Today if a company is launching any new model of a car or mobile, it is because of the consumer feedback.
- (vii) **Loss of budgetary support to the public sector:** The central government's budgetary support for financing the public sector outlays has declined drastically over the past few years. The public sector enterprises (PSEs) have realised that, in order to grow and stay in competition, they will have to be efficient and generate their own resources for the purpose.

## NOTES

## NOTES

In short, the new industrial policy has brought radical changes in the economic environment of the country. The government's policy of LPG has been positive and Indian business and industry has shown great resilience in dealing with the new economic order. The Indian corporate has developed strategies and adopted business processes and procedures to meet the challenge of competition. They have become more customer-focused and adopted measures to improve customer relationship and satisfaction.

### **14.5.1 Globalization and Enhanced Opportunities and Threats**

Globalization wave has made this world very small. Everything has come close to each other. Things are produced in one country and consumed in another. Orders and payment are received in fractions of seconds. Everything is possible on the click of mouse or the tip of the finger on the smart phone. Countries have come close to each other and instead of fighting with each other, are doing business with the rest of the world. Quality of the goods has exceptionally gone up. Things are becoming cheaper and safer. But side by side, it has affected the social, cultural, psychological and political scenario of the world. It has changed the mindset of the people and the way they react. Besides this, natural sources are getting depleted all over the world. Following are the enhanced opportunities and threats as posed by the globalization in a developing country like India:

#### **Opportunities Presented by Globalization**

##### **(a) Economically**

Globalization has led to boom in employment figures across all the sectors of the economy. There is exceptionally rise in the investment figure in the financial projects of the country. At the outset, globalization has resulted in the free trade between various nations. No countries can produce and import goods and services without paying heavy tariffs and import duties. This has resulted in the availability of vast nationalities of goods everywhere in the world.

##### **(b) Culturally**

Because of globalization, a lot of information is shared across the world. Various cultures can be understood and acknowledged on global level. Countries which never had anything in common before are sharing and negotiating on a global scale now. All of this leads to the blending of cultures where people from different cultures are more interested in knowing about each other. This leads to increased tolerance among the people; ignorance is shed and social handicaps like racism is contained.

##### **(c) Politically**

Due to globalization, politics is now addressed on a global platform rather than on the domestic front. It means, all the major political decisions taken by a country are taken in consideration of its impact on its neighbours and business partners.

The basic philosophy behind this phenomenon is that when everything is shared together socially, culturally and economically then why not the political decisions are taken keeping the benefit of the whole world in mind. Consequently, the issues such as depletion of natural resources, global warming, degrading ecosystems, rising pollution in seas and oceans are addressed on the political level as it affects the entire world.

### **Threats Posed by Globalization**

#### **(a) Economically**

One of the major threats posed by ‘globalization’ is that it has increased the wall between the rich and poor. The richer are becoming richer and poor are becoming poorer year after year. There is sharp increase in the opportunities for the managerial positions and top investors but the adversity has fallen on workers and lower staff. Their job is becoming tougher day by day. As due to rising population in the developing countries like India and China, the labour is easily available so they are being exploited. Further, due to people migrating from one country to another in search of job, workers are paid very low and that is without any additional perks and non-monetary benefits. Even if the employment opportunities are being outsourced to developing countries, the ultimate power lies in the hands of the developed countries. It means that the profits are not equally shared and most of it remains with the developed nations. The goods produced in one country are easily available in another country so the cultural distinctiveness is lost.

#### **(b) Culturally**

In a globalized era, as the media has become very dominant, people suffer the evils of sensationalization. The media of the powerful economies has the influence to mingle the information to every place of the world, which means they are the decider which information is to be shared and what should be the outlook of the general people. It also destroys the uniqueness of the cultures by westernizing everything. Developing countries and third world nations are increasingly adopting the western ways as they feel substandard about their own culture. The upcoming population is increasingly becoming unacquainted with the shades of their own culture. Globalization also has resulted in to increased epidemics and transmissible diseases as travelling is relatively accessible to all.

#### **(c) Politically**

This is hardly an accepted fact that globalization has resulted in developing and third world nations to follow the erstwhile colonized system but in a much sophisticated form, for instance, these nations form their political decisions according to the proposals, influences and pressures of the more developed nations, so that they can retain their standing in the global scenario. The developed economies misuse some nations for their own benefits.

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## 14.6 WTO AND ITS ROLE IN ECONOMIC DEVELOPMENT

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### NOTES

The WTO was established on the recommendations of Uruguay round of General Agreement on Trade and Tariffs (GATT 1986-93). All the member countries unanimously signed an agreement in April 1994 in Morocco for establishing a new global organization for promoting free trade, non-discrimination, open, fair and undistorted competition. The objective was to support promotion of trade and commerce in developing countries. Besides this, solving trade disputes between two or more countries and offering a platform for multilateral trade negotiations, it has got global status similar to that of the World Bank (WB) or the International Monetary Fund (IMF). Following are the unique functions of WTO:

1. To administer the 'Dispute Settlement Procedure' so as to handle trade disputes among member countries.
2. To continuously monitor trade policies for the benefit of member nations.
3. To facilitate the administration, implementation, and operation of the WTO trade agreements, such as multilateral trade agreements and plurilateral trade agreements.
4. To liaison and cooperate with various international organizations like the IMF and the World Bank with the objective of attaining greater consistency in global economic policy-making.
5. To offer a forum for negotiations among its member countries relating their multilateral trade relations.
6. To provide training and technical assistance to the members of the developing countries as and when asked for.
7. To assist member countries, work in cooperation with the IMF and the World Bank.

### Quick Facts about WTO

Location	: Geneva, Switzerland
Head	: Roberto Azevedo (Director General)
Established On	: Jan 1, 1995
Created By	: Uruguay Round Negotiations held during 1986-94
Membership	: 164
Secretariat Staff	: 625

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## 14.7 INTERNATIONAL MONETARY FUND (IMF) AND ITS ROLE IN ECONOMIC DEVELOPMENT

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The International Monetary Fund (IMF) is a global body representing 189 countries working to foster international monetary cooperation, to protect financial stability, to simplify global trade, to promote employment and sustainable economic growth, and control poverty around the world. IMF was created in the year 1945, and is governed by and accountable to the 189 countries that make up its near-global membership.

### Organization and Management of the IMF

Like any international body of UN, the IMF is run, controlled, and managed by the Board of Governors, and Executive Board and an international staff. As a matter of practice, every member nation appoints its representative to the Board of Governors. All the members meet once a year and take decision on important issues such as election of new members or changing quotas. The executive board is assigned to the management of day to day affairs. The board comprises twenty four executive directors who oversee the execution of policies established by the member governments through the Board of Governors. The IMF is generally headed by the Managing Director who is elected by the Executive Board for five years term. The primary function of IMF is to make certain the stability of the international monetary system. Besides this, IMF is entrusted for the following functions:

Following are the functions of IMF:

1. To encourage 'international monetary cooperation' by providing mechanism for financial support and cooperation on international monetary problems.
2. To assist for balanced regional growth and by promoting and maintaining high levels of employment and real income and to the development of the productive resources of member countries.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To help in the formation of a 'multilateral system of payments' by eliminating restrictions on the foreign exchange which obstruct the growth of world trade.
5. To boost confidence of 'member nations' by offering the general resources of the fund temporarily available to them under sufficient safeguards.
6. To curtail the length and lessen the 'degree of disequilibrium' in the international balance of payments of member nations.

### NOTES

## NOTES

7. To supervise the international monetary system by closely monitoring the monetary and exchange rate policy of member countries, issuing policy recommendations.
8. To act as a 'resource centre' for international cooperation and providing technical assistance to member nations.
9. To maintain 'stable exchange rate' to prohibit multiple exchange rates.
10. To prevent deflation and opening up of the economy by removing barriers of the trade, if any.

This is to be remembered that unlike the World Bank, the International Monetary Fund (IMF) is not a 'development agency'. Therefore, in place of providing 'development aid', IMF offers monetary support to tide over BOP difficulties to its members.

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### 14.8 WORLD BANK AND ITS ROLE IN ECONOMIC DEVELOPMENT

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The World Bank is an international body formed to help emerging economies to reduce poverty. Contrary to its name, world bank in actual is a body that comprises two development institutions. One arm is the International Bank for Reconstruction and Development (IBRD). The second is the International Development Association (IDA). The bank capital is introduced by its 189 member nations.

#### Objectives and Function

The primary objective of World Bank is to provide financial grants, interest free credit, low-interest loans to its member nations for improving state of infrastructure, education and health. The countries that require funds to modernize their financial sector, agriculture, and natural resources management can approach World Bank. The World Bank specified purpose is to "bridge the gap between poor and rich nations." This is achieved by using developed countries resources into poor country growth. The World Bank also strives to achieve sustainable poverty reduction as its long term vision. The following is the role of the World Bank in the economic development of the world.

1. To overcome poverty by stimulating infrastructure and trade growth, especially in the African continent.
2. To assist countries emerging from wars, one of the main reasons of extreme poverty.
3. To provide country specific solution to assist middle-income countries remain out of poverty.
4. To motivate and educate governments to prevent climate change. It helps them control contagious diseases, particularly malaria and AIDS.



5. To manage international financial crises and promote free trade as and when required.
6. To work with the 'Arab League' on trilateral agenda of (i) improving education, (ii) building infrastructure, and (iii) providing micro-loans to small businesses.
7. To share its know-how with developing and third world economies and to publicize its knowledge via published reports and its interactive online database.

## NOTES

*Table 14.1 Difference between IMF and the World Bank*

Sl. No.	Basis of Difference	IMF	World Bank
1	Focus on	Economic Stability	Economic Growth
2	Size	2300 staff members	7000 staff members
3	Organizational Structure	It is a single organization with four credit lines.	It has two major institutions, namely International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).
4	Membership	188 countries	IBRD - 188 countries IDA - 172 countries
5	Operations	Provides assistance	Facilitates lending
6	Objective	To deal with all the issues related to the financial sector and macroeconomics.	To lessen poverty and promote the long term development of the economy.
7	Promotes	It generally promotes the sense of cooperation and stability	Helps less developed countries by providing long-term financing for development of projects.
8	Assistance Mode	Add to the currency reserves of its member countries through allocation of Special drawings rights (SDRs).	Promotes private organisations in developing countries through International Finance Corporation (IFC) which is a sub-part of the IMF.

## Conclusion

With the fast changing business environment, rising income levels, favourable demographic patterns and by the entry of FDI and FIIs, the economic environment of business is changing its shape speedily. Further, large number of factors such as the growth of mall culture, emergence of nuclear family concept, new business opportunities, e-commerce and liberalization, privatization and globalization (LPG) the Indian economy is witnessing a paradigm shift from sellers' market to buyers' market. Further, the business cycle is another economic condition that is very significant for a business unit.

**NOTES**

**Check Your Progress**

1. List two benefits of privatization.
2. List the functions of WTO.
3. In which year was the International Monetary Fund established?

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**14.9 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS**

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1. Two benefits of privatization are the following:
  - Increased overall efficiency
  - Improved management and decision making
2. The functions of WTO are the following:
  - To administer the 'Dispute Settlement Procedure' so as to handle trade disputes among member countries.
  - To continuously monitor trade policies for the benefit of member nations.
  - To facilitate the administration, implementation, and operation of the WTO trade agreements, such as multilateral trade agreements and plurilateral trade agreements.
  - To liaison and cooperate with various international organizations like the IMF and the World Bank with the objective of attaining greater consistency in global economic policy-making.
  - To offer a forum for negotiations among its member countries relating their multilateral trade relations.
3. The International Monetary Fund was established in the year 1945.

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**14.10 SUMMARY**

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- The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government.
- Foreign Investment Promotion Board (FIPB) was set up to channelize foreign capital investment in India. Small-scale sector was assured all help and accorded due recognition.
- The main objective of industrial policy 1991 was to free the country's industrial economy from the unnecessary bureaucratic control and to introduce liberalization with a view to integrate the Indian economy with the global economy.

- Liberalization is the process of making the economy more liberal, or freer. It means deregularization of the industrial sector by cutting down to the minimum administrative interference in its operation so as to allow free competition between market forces.
- The revolution of privatization started in 1980 and spread to many parts of the world. Many developing countries started privatizing their public sector enterprises.
- The term globalization means adjustment of national economy with that of the world economy. It is conversion of a national market into international mobility of factors of production.
- Globalization means ‘integrating’ the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries.
- The new industrial policy of 1991, characterised with liberalization, privatization and globalization (LPG Model) has made a significant impact on the working of enterprises in business and industry.
- Globalization wave has made this world very small. Everything has come close to each other. Things are produced in one country and consumed in another. Orders and payment are received in fractions of seconds.
- One of the major threats posed by ‘globalization’ is that it has increased the wall between the rich and poor.
- The WTO was established on the recommendations of Uruguay round of General Agreement on Trade and Tariffs (GATT 1986-93).
- Like any international body of UN, the IMF is run, controlled, and managed by the Board of Governors, and Executive Board and an international staff.
- The World Bank is an international body form to help emerging economies to reduce poverty.
- The primary objective of World Bank is to provide financial grants, interest free credit, low-interest loans to its member nations for improving state of infrastructure, education and health.

## NOTES

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### 14.11 KEY WORDS

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- **Liberalization:** It is the process of making the economy more liberal, or freer. It means deregularization of the industrial sector by cutting down to the minimum administrative interference in its operation so as to allow free competition between market forces.
- **Globalization:** It means ‘integrating’ the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries.

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## 14.12 SELF ASSESSMENT QUESTIONS AND EXERCISES

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### NOTES

#### Short-Answer Questions

1. How has the Indian economy benefitted by the adoption of liberalization policy of the government?
2. List the benefits of globalization.
3. Write a short note on the impact of globalization on business development.
4. Briefly mention the composition of WTO.

#### Long-Answer Questions

1. Discuss the merits and demerits of privatization.
2. Describe the opportunities and threats presented by globalization.
3. Analyse the role of IMF and the World Bank in economic development.

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## 14.13 FURTHER READINGS

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