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BUSINESS ENVIRONMENT

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DDE – WHERE INNOVATION IS A WAY OF LIFE

BUSINESS ENVIRONMENT

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TEXT BOOK:

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UNIT –I

CONCEPTS OF BUSINESS ENVIORNMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Nature and scope of business
- Objectives and characteristic features of business
- Meaning and nature of business environment
- Features of business environment
- Significance of business environment
- Factors influencing business environment

Unit Structure

Lesson 1.1 – Nature of Business

Lesson 1.2 – Features of Business Environment

Lesson 1.3 – Factors influencing Business Environment

Lesson 1.1

Nature of Business

Meaning of Business

The word business technically means a state of being busy. Every person is engaged in some kind of occupation. The primary aim of this entire person is to earn their livelihood while doing some work.

All creative human activities relating to the production of goods or services for satisfying human wants are known as business. It is also a gainful procedure through which individuals and groups exchange goods and services. Human activities may be categorized as economic and non economic. Every day we come across the word 'business' or 'businessman' directly or indirectly. Business has become essential part of modern world.

Business is an economic activity, which is related with continuous and regular production and distribution of goods and services for satisfying human wants. All of us need food, clothing and shelter. We also have many other household requirements to be satisfied in our daily lives. We meet these requirements from the shopkeeper. The shopkeeper gets from wholesaler. The wholesaler gets from manufacturers. The shopkeeper, the wholesaler and the manufacturer are doing business and therefore they are called as Businessmen.

Thus, the term business means continuous production and distribution of goods and services with the aim of earning profits under uncertain market conditions.

Concept of Business

Business has a wider meaning beyond goods, services and profit. A business does not become a business without a customer. Therefore any definition of business is complete only when it includes the customer in it. The customer determines what a business is. The revenue of business comes from the customer, when he pays for the goods or services of the business. No business can exist without customer.

The existence of a business depends on its customers. Therefore it can be said that the purpose of business is to create and retain customers. To fulfill this purpose a business enterprise should concentrate on two basic functions (1) marketing and (2) innovation.

The first function of business is marketing, which is a specialized activity which covers the entire business. All activities in a business balanced according to the needs of market. Therefore marketing includes identifying the needs of the customers, planning the product or service and selling the goods at price which satisfies the customer.

The second function of business in customer creation is innovation. Products available to customers are continuously improving due to technology. Therefore a business must strive for improving the quality of product and reducing the price continuously to stay ahead of competition.

Technology helps the business to innovate design, production and marketing techniques. Investment in technology will ultimately reduce cost and bring in more profit. Innovation is possible in every aspect of business. There can be innovation in distribution methods, advertising, selling and every other area of business. Thus business is not restricted to only dealing with goods and services. Creating customer, marketing and innovation are more important aspects of business

Definition of Business

Business may be defined as any economic activity on a continuous basis which involves production or purchase of goods for sale, transfer or exchange goods, or supply of services for the purpose of earning profit.

Stephenson defines business as, "The regular production or purchase and sale of goods undertaken with an objective of earning profit and acquiring wealth through the satisfaction of human wants."

According to **Dicksee**, "Business refers to a form of activity conducted with an objective of earning profits for the benefit of those on whose behalf the activity is conducted."

Lewis Henry defines business as, "Human activity directed towards producing or acquiring wealth through buying and selling of goods."

Objectives of business

Every business enterprise has certain objectives which regulate and generate its activities. Objectives are needed in every area where performance and results directly affect survival and prosperity of a business. Various objectives of business may be classified into four broad categories as follows:

1. Economic Objectives:
2. Social objectives
3. Human Objectives
4. National Objectives

1. Economic Objectives:

Business is basically an economic activity. Therefore, its primary objectives are economic in nature. The main economic objectives of business are as follows:

(i) Earning profits:

A business enterprise is established for earning some income. It is the hope of earning profits that inspires people to start business. Profit is essential for the survival of every business unit. Just as a person cannot live without food, a business firm cannot survive without profit. Profits enable a businessman to stay in business by maintaining intact the wealth producing capacity of its resources.

Profit is also necessary for the expansion and growth of business. Profits ensure continuous flow of capital for the modernisation and extension of business operations in future. Profit also serves as the barometer of stability, efficiency and progress of a business enterprise.

(ii) Creating customers:

Profits are not created by God or by the force of nature. They arise from the businessman's efforts to satisfy the needs and wants of customers. A businessman can earn profits only when there are enough customers to buy and pay for his goods and services. In the words of Drucker, "There is only one valid definition of business purpose; to create a customer.

The customer is the foundation of business and keeps it in existence. It is to supply the customer that society entrusts wealth-producing resources to a business enterprise." No business can succeed without providing customers value for their money. Business exists to satisfy the wants, tastes and preferences of customers.

In order to earn profit, business must supply better quality goods and services at reasonable prices. Therefore, creation and satisfaction of customers is an important economic objective of business. Business creates customers through advertising and salesmanship. It satisfies the needs of customers by producing the required goods and services and by creating utilities.

(iii) Innovations:

Business is an organ of dynamism and change. In these days of competition a business can be successful only when it creates new designs, better machines, improved techniques, new varieties, etc. Modern science and technology have created a great scope for innovation in the business world.

Innovation is not confined to the invention of a new machine. It comprises all efforts made in perfecting the product, minimizing the costs and maximizing benefits to customers. It involves improvements in management, production, selling servicing, methods of personnel and accounting, etc. Business firms invest money, time and efforts in Research and Development (R&D) to introduce innovations.

They develop new technology; introduce new designs and new tools and processes to minimize costs and to satisfy ever increasing wants of customers. In order to create customers, business has to explore new markets and attract more customers. It has also to retain old customers by providing better services to them.

2. Social objectives

Business does not exist in a vacuum. It is a part of society. It cannot survive and grow without the support of society. Business must therefore discharge social responsibilities in addition to earning profits.

According to Henry Ford, "the primary aim of business should be service and subsidiary aim should be earning of profit." The social objectives of business are as follows:

(i) Supplying desired goods at reasonable prices:

Business is expected to supply the goods and services required by the society. Goods and services should be of good quality and these should be supplied at reasonable prices. It is also the social obligation of business to avoid malpractices like hoarding, black marketing and misleading advertising.

***(ii) Fair Remuneration to employees**:*

Employees must be given fair compensation for their work. In addition to wages and salary a reasonable part of profits should be distributed among employees in recognition of their contributions. Such sharing of profits will help to increase the motivation and efficiency of employees.

It is the obligation of business to provide healthy and safe work environment for employees. Good working conditions are beneficial to the organisation because these help to improve the productivity of employees and thereby the profits of business.

Employees work day and night to ensure smooth functioning of business. It is, therefore, the duty of employers to provide hygienic working and living conditions for workers.

(iii) Employment Generation:

Business should provide opportunities for gainful employment to members of the society. In a country like India unemployment has become a serious problem and the Government is unable to offer jobs to all.

Therefore, provision of adequate and full employment opportunities is a significant service to society. If unemployment problem increases, the socio economic environment cannot be congenial for the growth of business activities.

(iv) Fair return to investor:

Business is expected to pay fair return to shareholders and creditors in the form of dividend and interest. Investors also expect safety and appreciations of their investment. They should be kept informed about the financial health and future prospects of business.

(v) Social welfare:

Business should provide support to social, cultural and religious organisations. Business enterprises can build schools, colleges, libraries, hospitals, sports bodies and research institutions. They can help non-government organisations (NGOs) like CRY, Help Age, and others which render services to weaker sections of society.

(vi) Payment of Government Dues:

Every business enterprise should pay tax dues (income tax, sales tax, excise duty, customs duty, etc.) to the government honestly and at the right time. These direct and indirect taxes provide revenue to the Government for spending on public welfare.

Business should also abide faithfully by the laws of the country. Thus, businessmen should pursue those policies and take those actions which are desirable in terms of the objectives and values of our society.

3. Human Objectives

Business is run by people and for people. Labour is a valuable human element in business. Human objectives of business are concerned with the well-being of labour. These objectives help in achieving economic and social objectives of business. Human objectives of business are given below:

*i..**Labour welfare:***

Business must recognize the dignity of labour and human factor should be given due recognition. Proper opportunities should be provided for utilizing individual talents and satisfying aspirations of workers. Adequate provisions should be made for their health, safety and social security. Business should ensure job satisfaction and sense of belonging to workers.

ii. Developing human resources:

Employees must be provided opportunities for developing new skills and attitudes. Human resources are the most valuable asset of business and their development will help in the growth of business.

Business can facilitate self- development of workers by encouraging creativity and innovation among them. Development of skilled manpower is necessary for the economic development of the country.

iii. Participative management:

Employees should be allowed to take part in decision making process of business. This will help in the development of employees. Such participation will also provide valuable information to management for improving the quality of decisions. Workers' participation in management will help in industrial democracy.

iv. Labour management cooperation:

Business should strive for creating and maintaining cordial employer - employee relations so as to ensure peace and progress in industry. Employees should be treated as honourable individuals and should be kept informed.

4. National Objectives

National objectives of business are as follows:

(i) Optimum utilisation of resources:

Business should use the nation's resources in the best possible manner. Judicious allocation and optimum utilisation of scarce resources is essential for rapid and balanced economic growth of the country.

Business should produce goods in accordance with national priorities and interests. It should minimize the wastage of scarce natural resources.

(ii) National self-reliance:

It is the duty of business to help the government in increasing experts and in reducing dependence on imports. This will help a country to achieve economic independence. This requires development of new technology and its application in industry.

(iii) Development of small scale Industries:

Big business firms are expected to encourage growth of small scale industries which are necessary for generating employment. Small scale firms can be developed as ancillaries, which provide inputs to large scale industries.

(iv) Development of backward areas:

Business is expected to give preference to the industrialisation of backward regions of the country. Balanced regional development is necessary for peace and progress in the country.

It will also help to raise standard of living in backward areas. Government offers special incentives to the businessmen who set up factories in notified backward areas.

Characteristics of Business

The following are the ten important characteristics of a business

1. Economic activity:

Business is an economic activity of production and distribution of goods and services. It provides employment opportunities in different sectors like banking, insurance, transport, industries, trade etc. it is an economic activity coupled with creation of utilities for the satisfaction of human wants.

It provides a source of income to the society. Business results into generation of employment opportunities thereby leading to growth of the economy. It brings about industrial and economic development of the country.

2. Buying and Selling:

The basic activity of any business is trading. The business involves buying of raw material, plants and machinery, stationary, property etc. On the other hand, it sells the finished products to the consumers, wholesaler, retailer etc. Business makes available various goods and services to the different sections of the society.

3. Continuous process:

Business is not a single time activity. It is a continuous process of production and distribution of goods and services. A single transaction of trade cannot be termed as a business. A business should be conducted regularly in order to grow and gain regular returns.

Business should continuously involve in research and developmental activities to gain competitive advantage. A continuous improvement strategy helps to increase profitability of the business firm.

4. Profit Motive:

Profit is an indicator of success and failure of business. It is the difference between income and expenses of the business. The primary goal of a business is usually to obtain the highest possible level of profit through the production and sale of goods and services. It is a return on investment. Profit acts as a driving force behind all business activities.

Profit is required for survival, growth and expansion of the business. It is clear that every business operates to earn profit. Business has many goals but profit making is the primary goal of every business. It is required to create economic growth.

5. Risk and Uncertainties:

Risk is defined as the effect of uncertainty arising on the objectives of the business. Risk is associated with every business. Business is exposed to two types of risk factors i.e. predictable risk factors and unpredictable risk factors

Predictable risk factors are a) Taxes b) Change in the volume of expected sales c) Cost of supplies and equipment d) Overhead costs e) Salaries f) Cost of goods and services offered

Unpredictable risk factors are a) Changes in trends and tastes of customers. b) Impact of the local economy on customer base. c) Any unexpected action taken by your competitors.

The calculation of management risk is vital to ensure the success of a business firm. Risk management helps in minimizing the risk associated with the business.

6. Creative and Dynamic:

Modern business is creative and dynamic in nature. Business firm has to come out with creative ideas, approaches and concepts for production and distribution of goods and services. It means to bring things in fresh, new and inventive way.

One has to be innovative because the business operates under constantly changing economic, social and technological environment. Business should also come out with new products to satisfy the growing needs of the consumers.

7. Customer satisfaction:

The phase of business has changed from traditional concept to modern concept. Now a days, business adopts a consumer-oriented approach. Customer satisfaction is the ultimate aim of all economic activities.

Modern business believes in satisfying the customers by providing quality product at a reasonable price. It emphasizes not only on profit but also on customer satisfaction. Consumers are satisfied only when they get real value for their purchase.

The purpose of the business is to create and retain the customers. The ability to identify and satisfy the customers is the prime ingredient for the business success.

8. Social Activity:

Business is a socio-economic activity. Both business and society are interdependent. Modern business runs in the area of social responsibility.

Business has some responsibility towards the society and in turn it needs the support of various social groups like investors, employees, customers, creditors etc. by making goods available to various sections of the society. Business performs an important social function and meets social needs. Business needs support of different section of the society for its proper functioning.

9. Government control:

Business organisations are subject to government control. They have to follow certain legislations enacted by the government to run a business. Government ensures that the business is conducted for social good by keeping effective supervision and control by enacting and amending laws and rules from time to time.

Some important business legislations framed by the government are

(i) The Competition Act, 2002

(ii) Foreign Exchange Management Act, 1999

(iii) The Environment (Protection) Act, 1986

(iv) Indian Companies Act, 1956

(v) Consumer protection Act, 1986

10. Optimum utilisation of resources:

Business facilitates optimum utilization of material and non-material resources of the nation and achieves economic progress. The scarce resources are brought to its fullest use for concentrating economic wealth and satisfying the needs and wants of the consumers

Lesson 1.2

Features of Business Environment

Business Environment – Meaning

The term environment has been derived from a French word "Environia" means to surround. It refers to both abiotic (physical or non-living) and biotic (living) environment. The word environment means surroundings, in which organisms live.

Environment and the organisms are two dynamic and complex component of nature. Environment regulates the life of the organisms including human beings. Human beings interact with the environment more vigorously than other living beings. Ordinarily environment refers to the materials and forces that surround the living organism.

Environment is the sum total of conditions that surrounds us at a given point of time and space. It is comprised of the interacting systems of physical, biological and cultural elements which are interlinked both individually and collectively. It influences the growth and development of living forms.

In other words environment refers to those surroundings that surrounds living beings from all sides and affect their lives in toto. It consists of atmosphere, hydrosphere, lithosphere and biosphere. It's chief components are soil, water, air, organisms and solar energy. It has provided us all the resources for leading a comfortable life. No company can survive in market by ignoring the effects of environment. The efficient management analyses the environment and makes changes in organisational policies to integrate its activities with Business Environment.

The complete awareness and understanding of business environment is known as environment scanning. Environment scanning is conducted to find out the influence of different factors and persons on the business transactions.

Environment scanning can be defined as a process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business.

Definition

The word ‘Business Environment’ has been defined by various authors as follows,

“Business Environment encompasses the -climate’ or set of conditions, economic, social, political or institutional in which business operations are conducted.”—Arthur M. Weimer

“Environment contains the external factors that create opportunities and threats to the business. This includes socio-economic conditions, technology and political conditions.” – William Gluck and Jauch

‘‘Business environment is the aggregate of all conditions, events and influences that surround and affect it.”—Keith Davis

“The environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly”. —Reinecke and Schoell.

“The total of all things external to firms and industries that affect the function of the organisation is called business environment.”—Wheeler

“Civilisations require challenges to survive. Thus environment also contains hostilities and dangers that may be overcome by individuals and organisations.”—Arnold J. Toynbee

On the basis of the above definitions, it is very clear that the business environment is a mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.

Nature of Business Environment:

The nature of Business Environment is simply and better explained by the following approaches:

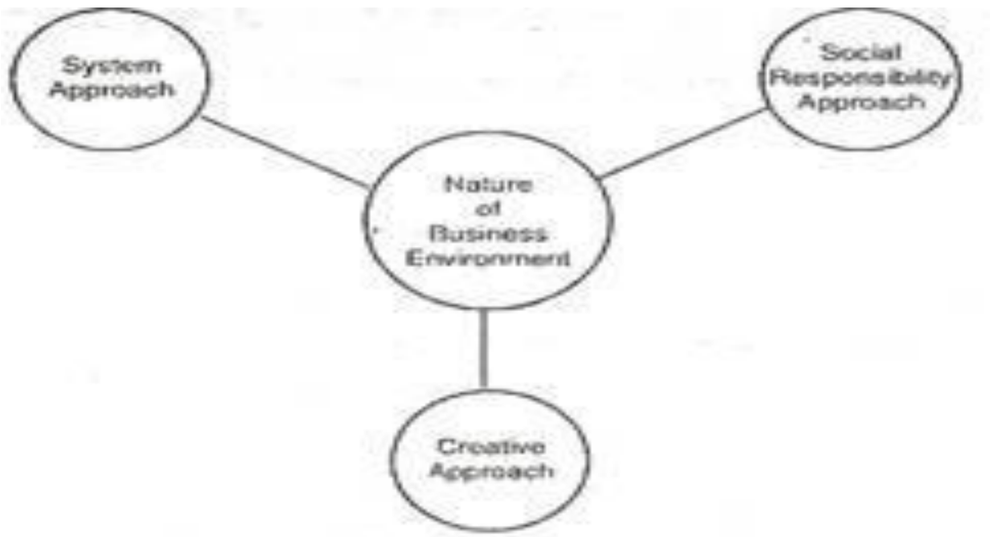

FIG. 1 : NATURE OF BUSINESS ENVIRONMENT

(i) System Approach:

In original, business is a system by which it produces goods and services for the satisfaction of wants, by using several inputs, such as, raw material, capital, labour etc. from the environment.

(ii) Social Responsibility Approach:

In this approach business should fulfill its responsibility towards several categories of the society such as consumers, stockholders, employees, government etc.

(iii) Creative Approach:

As per this approach, business gives shape to the environment by facing the challenges and availing the opportunities in time. The business brings about changes in the society by giving attention to the needs of the people.

Significance of Business Environment:

Business Environment refers to the "Sum total of conditions which surround man at a given point in space and time. In the past, the environment of man consisted of only the physical aspects of the planet Earth (air, water and land) and the biotic communities. But in due course of time and advancement of society, man extended his environment through his social, economic and political function."

In a globalised economy, the business environment plays an important role in almost all business enterprises. The significance of business environment is explained with the help of the following points:

(i) Help to understand internal Environment:

It is very much important for business enterprise to understand its internal environment, such as business policy, organisation structure etc. In such case an effective management information system will help to predict the business environmental changes.

(ii) Help to Understand Economic System:

The different kinds of economic systems influence the business in different ways. It is essential for a businessman and business firm to know about the role of capitalists, socialist and mixed economy.

(iii) Help to Understand Economic Policy:

Economic policy has its own importance in business environment and it has an important place in business. The business environment helps to understand government policies such as, export-import policy, price policy; monetary policy, foreign exchange policy, industrial policy etc.

(iv) Help to Understand Market Conditions:

It is necessary for an enterprise to have the knowledge of market structure and changes taking place in it. The knowledge about increase and decrease in demand, supply, monopolistic practices, government participation in business etc., is necessary for an enterprise.

The Features of Business Environment

The main features of business environment are:

1. All the external forces:

Business Environment includes all the forces, institutions and factors which directly or indirectly affect the Business Organizations.

2. Specific and general forces:

Business environment includes specific forces such as investors, customers, competitors and suppliers. Non-human or general forces are Social, Legal, Technological, Political, etc. which affect the Business indirectly.

3. Inter-relation:

All the forces and factors of Business Environment are inter-related to each other. For example with inclination of youth towards western culture, the demand for fast food is increasing.

4. Uncertainty:

It is very difficult to predict the changes of Business Environment. For example in IT, fashion industry etc. frequent and fast changes are taking place, as environment is changing very fast

5. Dynamic:

Business environment is highly flexible and keep changing. It is not static or rigid. That is why it is essential to monitor and scan the business environment continuously.

6. Complex:

It is very difficult to understand the impact of Business environment on the companies. Although it is easy to scan the environment but it is very difficult to know how these changes will influence business decisions. Sometime change may be minor but it might have large impact. For example, a change in government policy to increase the tax rate by 5% may affect the income of company by large amount.

7. Relativity:

The impact of business environment may differ from company to company or country to country. For example, when consumer organization, Centre for Environmental Studies (CES) published the report of finding pesticides in cold drinks, resulted in decrease in sale of cold drinks, on the other hand it increased the sale of juice and other drinks

Benefits of a Good Business Environment

The understanding and awareness of business environment is must for every businessman as ignorance about business environment can throw the businessman out from the market. Proper understanding and awareness about the business environment brings lots of benefits for the businessman. **Some of the benefits of good business environment are as follows:**

1. ***Enables the Firm to Identify Opportunities and Getting First Mover Advantage:***

The businessmen who are able to understand and scan the opportunities of business environment at early stage they get maximum benefit or they can capture a big share in the market. They can go much ahead of their competitors. For example, when Maruti Company was planning to sign a contract with Suzuki Company of Japan then the Goodlass Nerolac Company was the first company to understand the environment and to find out that very soon there will be a great demand for car painting in India and no paint company in our country was having car paint technology.

So, Nerolac Company made use of this opportunity and signed a contract with Kansai Paint Company to import the car painting technology and when the Maruti started its car manufacture in India then Nerolac company got all the car painting contracts of Maruti company and today also 90% of car paint work of Maruti is done by Nerolac Goodlass Company.

By recognizing and understanding the environment at early stage Nerolac Company got the first mover advantage. Afterwards many more paint companies got the technology of car painting but Goodlass Nerolac got maximum benefit by recognising the opportunities earliest. They got first mover advantage.

2. Helps the Firm to Identify the Threats and Early Warning Signal:

The businessmen who are able to scan and understand the business environment on time get a warning signal to deal with the constraints or the negative policies of business environment. Timely scanning of business environment and the qualitative information which businessmen get is taken as warning signal and changes in the companies are made. For example, on scanning the business environment, the Maruti Udyog Company got the qualitative information that more foreign car manufacturing companies are going to set up their business in India.

They took it as a warning signal and started increasing their production capacity. They increased their production capacity by 3 folds, specially the production of Esteem car which they were manufacturing 65 cars per day increased to 80 cars per day. As a result the sale of Esteem increased to 42,000 cars per year from the earlier sale of 25,400 cars per year. The Maruti Company accepted the entry of foreign car companies as warning signal and increased their production to supply the cars without any waiting period to compete with the new companies.

3. Helpful in Tapping and Assembling Resources:

Businessmen have to supply the goods to market according to the demand in market. To supply output they need input, raw materials etc. They acquire raw materials and other resources keeping in mind the output demanded in the environment.

They select resources according to availability in environment and demand of output in environment. For example, with the demand of flat screen colour T.V. Manufacturers are collecting resources necessary to manufacture flat screen colour T.V. rather than collecting resources of Black and White T.V

They use the scanning report as input to make changes in the output which suits the taste of present day customer.

4. Help to Adjust and Adapt with the Rapid Changes:

Today changes are taking place very fast and these changes have great impact on Business. So it is essential to understand these changes as early as possible. Business environment scanning helps the companies to scan and understand these changes with environment scanning.

Businessmen make changes in their internal environment also to match the external environment. So environment scanning helps in coping with the rapid changes. By scanning business environment the Ambani brothers recognised that today's environment demands quick decision so they shifted from centralisation to decentralisation.

5. Assisting in Planning and Policy Making:

The major strategies or plans and policies in the organisation are formed keeping in mind business environment because the policies and strategies have to be implemented in the presence of environmental factors. So, these must be made keeping in mind the environmental factors. Scanning of environmental factors helps in finding out the opportunities of business and strategies can be made to grab these opportunities.

For example, on scanning the Indian Business Environment we find there is great scope for tourism industry in our country. So, businessmen are planning strategies to grab these opportunities. Various hotels of private, public sector, ITC group are making new strategies for tourists. There is a separate travel segment set up and separate leisure and fun segment is set up to get the benefit of upcoming Tourist Industry.

6. Improvement in Performance:

With continuous scan of Business environment companies can easily improve their performance. By making changes in the internal environment matching to external environment, organisations can prosper and improve their market share.

For example, Weston Company which could not cooperate with the changing environment started suffering loss and lost its name in T.V. market whereas BPL, Onida, etc. did scan the environment well and are still competing successfully with many multinational companies.

Lesson 1.3

Factors influencing Business Environment

Businesses are also influenced by the environment that they are in and all the situational factors that determine circumstances from day to day. It is because of this, that businesses need to keep a check and constantly analyze the environment within which they run their trade and within which the market lays. Business environment is the sum total of all external and internal factors that influence a business. You should keep in mind that external factors and internal factors can influence each other and work together to affect a business.

The different environmental factors that affect the business can be broadly categorized as

A. internal environmental factors

B. external environmental factors

A. Internal business environmental factors

Internal environment includes all those factors which influence business and which are present within the business itself. These factors are usually under the control of business. The study of internal factors is really important for the study of internal environment.

These factors are:

1. Objectives of Business
2. Policies of Business
3. Production capacity
4. Production Methods
5. Management Information System,
6. Participation in Management
7. Composition of Board of Directors
8. Managerial Attitude
9. Organisational Structure
10. Features of Human Resource

1. Objectives of Business,

Every business enterprise has certain objectives which regulate and generate its activities. Objectives are needed in every area where performance and results directly affect survival and prosperity of a business. An objective is something that the firm wants to achieve over a specific period of time. It is presumed that business has the only objective of earning profit. But today one cannot deny the fact that along with profit maximization the business also has certain objectives towards the society as well as the nation. The business unit can prosper only if it enjoys the support of the society. It also aims at contributing to the national goals.

2. Policies of Business,

Business policies are the guidelines developed by an organization to govern its actions. They define the limits within which decisions must be made. Business policy also deals with acquisition of resources with which organizational goals can be achieved. Business policy is the study of the roles and responsibilities of top level management, the significant issues affecting organizational success and the decisions affecting organization in long-run.

3. Production capacity

The production capacity is defined as volume of products that can be generated by a production plant or enterprise in given period by using current resources. Capacity decisions abound in the business world, and balancing various capacities reflects how a company approaches business. Production capacity deals with output and how a manufacturer balances raw materials, machinery, labor and storage to match demand for its products. Decisions about production capacity can be strategic and operational, long- and short term. Factors affecting production capacity inter relate to such a level that a change to one potentially affects all.

4. Production Methods,

The various methods of production are not associated with a particular volume of production. Similarly, several methods may be used at different stages of the overall production process. Job, Batch and Flow production are the three main ways a firm could choose to make its product(s). Each method varies greatly in how they actually handle the production process but the aim of each is the same: to transform inputs into outputs in the most efficient way.

5. Management Information System,

A Management Information System is an integrated user-machine system, for providing information, to support the operations, management, analysis & decision-making functions in an organization. The System utilizes computer hardware & software, manual procedures, models for analysis, planning, control & decision making and a database. MIS provides information to the users in the form of reports and output from simulations by mathematical models. The report and model output can be provided in a tabular or graphic form

6. ***Participation in Management,***

Participation provides an opportunity to every member of the organisation to contribute his brain and ingenuity as well as his physical efforts for the improvement of organisational effectiveness and at the same time enhancing his own economic welfare. It also develops in them a sense of organisational loyalty and involvement. It motivates the employees to contribute their maximum and provides an opportunity to workers to direct their initiative and creativity towards the objectives of the group. It encourages people to accept responsibility for an activity as they feel self involved in the group.

7. Composition of Board of Directors,

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company or organization. Other names include board of governors, board of managers, board of regents, board of trustees, and board of visitors. It is often simply referred to as "the board". The bylaws commonly also specify the number of members of the board, how they are to be chosen, and when they are to meet. However, these bylaws rarely address a board's powers when faced with a corporate turnaround or restructuring, where board members need to act as agents of change in addition to their traditional fiduciary responsibilities.

8. Managerial Attitude,

Presents and compares two contrasting managerial attitudes towards strategic decisions. The first attitude is called maximizing behaviour, and it is founded on a set of assumptions that are unattainable in real-world decision making. The use of this attitude invariably results in a failed strategic decision. The second managerial attitude is called satisfying behaviour, and its use is demonstrably conducive to strategic decision success.

9. *Organisational Structure,*

An organizational structure defines how activities such as task allocation, coordination and supervision are directed towards the achievement of organizational aims. It can also be considered as the viewing glass or perspective through which individuals see their organization and its environment. Organizations are a variant of clustered entities.

An organization can be structured in many different ways, depending on their objectives. Organizational structure allows the expressed allocation of responsibilities for different functions and processes to different entities such as the branch, department, workgroup and individual.

10. Features of Human Resource,

Human Resource management is a process and philosophy of acquisition, development, utilization, and maintenance of competent human force to achieve goals of an organization in an efficient and effective manner.

Human resource management is regarded as sub system of the organization. Human resource offers a distinct approach of managing human resources in today's competitive and changing environment. It is an emerging discipline. Organisations survive and thrive only because of the concept of Human Resource Management.

B. External business environmental factors

External environmental factors are classified as

1. Micro environmental factors and
2. Macro environmental factors

1. Micro Environmental Factors

The micro environment of the organisation consists of those elements which are controllable by the management. Normally the micro environment does not affect all the companies in an industry in the same way, because the size, capacity, capability and strategies are different. For example, the raw material suppliers are giving more concessions to large sized companies. However, they may not give the same concessions to small companies.

Like the same, the competitors do not mind about the rival company if it is compared to the small, but they will be very much conscious if the rival firm is large. Sometimes micro environment of the various firms in an industry is almost the same. In such a case, response of these firms to their micro environment may differ as each firm will attempt to achieve a higher success level. The general micro environment factors are discussed below.

Most important factors of micro environment of business are as follows:

1. competitors,
2. customers,
3. suppliers,
4. public,
5. marketing intermediaries,
6. workers and their union!

FIG. 3 : MICRO ENVIRONMENT OF BUSINESS

1. Competitors:

The competitive environment consists of certain basic things which every firm has to take note of. No company, howsoever large it may be, enjoys monopoly. In the original business world a company encounters various forms of competition. The most common competition which a company's product now faces is from differentiated products of other companies.

For example, in the Colour Television Market, Philips TV faces competition from other companies like Videocon, Onida, BPL and others. This type of competition is called brand competition. It is found in all durable product markets.

The consumer wants to purchase a two-wheeler and the next question in his mind is with gear or without gear, 100 cc or more than that, self starter or kick starter, etc. This type is otherwise known as ‘Product form competition’.

Philip Kotler is of the opinion that the best way for a company to grasp the full range of its competition is to take the viewpoint of a buyer. What does a buyer thinks about that which eventually leads to purchasing something? So, tracing of the consumer mind set will help to retain the market share for all the firms.

2*. Customers:*

According to Peter. F. Drucker, “There is only one valid definition of business purpose, that is to create a customer.” The business enterprises aim to earn profit through serving the customer demand. It now thinks more in terms of profitable sale rather than more sales volume for its sake. Today marketing of a firm begins and also ends with the customers.

Now a days, a business firm to be successful, must find customers for its products. This is the reason the customers thus constitute the most important element in the micro environment of business. Products sales depend mainly on the degree of consumer satisfaction. From the company’s point of view it is always better to have customer from various groups and sustains demand for the company’s product.

3. Suppliers:

Regarding the suppliers, the organisation can think of availing the required material or labour according to its manufacturing programme. It can adopt such a purchase policy which gives bargaining power to the organisation.

Suppliers are either individuals or business houses. They combined together; provide resources that are needed by the company. Now the company necessarily should go for developing specifications, searching for potential suppliers, identifying and analysing the suppliers and thereafter choose those suppliers who offer best mix of quality, delivery reliability, credit, warranties and obviously low cost.

4. Public:

Literally word ‘public’ refers to people in general. According to Philip Kotler, “A public is any group that has an actual or potential interest in or impact on a company’s ability to achieve its objectives.” The environmentalists, consumer protection groups, media persons and local people are some of the well-known examples of publics.

The company has a duty to satisfy the people at large along with competitors and the consumers create goodwill among public, help to get a favourable response for a company. In the modern business public have assumed important role and their presence in the micro environment of business.

5. Marketing Intermediaries:

Market intermediaries are either individuals or business houses who come to the aid of the company in promoting, selling and distributing the goods to the ultimate consumers. They are Middlemen (wholesalers, retailers and agents), distributing agencies, market service agencies and financial institutions. Most of the companies find that it is too difficult to reach the consumers. In such a cases the agents and distribution firms help to reach the product to the consumer.

6. Workers and Their Union:

As per the production function theory, the labour gets more importance. He is also one of the pillars of the company. The organised labours is highly secured their position compared to unorganised workers So, the workers now prefer to join labour unions which invariably resort to collective bargaining and thereby makes them less vulnerable to employer’s exploitation.

On the other hand, Trade Unions are a major component of a modern business. Trade Union of workers is an organisation formed by workers to protect their interests, improve their working conditions etc.

Trade Unions are now considered a sub-system, which seeks to serve the specific sub-group' s interest (i.e. workers') and also considers itself a part of the organisation. From the point of view of the company, industrial relation is more important to improve the company, otherwise conflict between labour and management leads to Sick Unit.

2. Macro environmental factors

`Macro environment refers to those factors which are external forces in the company's activities and do not concern the immediate environment. Macro environment are the forces which indirectly affect company's operation and working condition. These factors are uncontrollable and the company is powerless and incapable of exercising any control over them.

Macro environment can be classified into economic environment and non-economic environment. Since the business is basically an economic activity, economic environment of business both national and international gets importance.

Most important factors of macro environment of business are as follows:

(i) Economical Environment
(ii) Social Environment
(iii) Political Environment
(iv) Legal Environment
(v) Technological Environment
(vi) International Environment

(i) Economical Environment:

Economic Environment consists of Gross Domestic Product, Income level at national level and per capita level, Profit earning rate, productivity and employment rate, industrial monetary and fiscal policy of the government etc.

The economic environment factors have immediate and direct impact on the businessman so businessmen must scan the economic environment and take timely actions to deal with these environments. Economic environment may put constraints and may offer opportunities to the businessman. After the new economic policy of 1991, lots of opportunities are offered to businessmen. The common factors which have influenced the Indian economic environment are

(a) Banking sector reform has led to many attractive schemes of deposits and lending money. The Banks are offering loans at very nominal rate of interest and with minimum formalities to be completed.

(b) Recent changes in economic and fiscal policy of country have encouraged NRIs and foreign investors to invest in Indian companies.

(c) Lots of economic reforms are taking place in leasing and financing institutions. The private sector is allowed to enter in financial institutions; as a result customers are gaining. Some Aspects of Economic Environment:

1. Role of Private and Public sector

2. Rate of growth of GDP, GNP, and Per Capita Income

3. Rate of Saving and Investment

4. Balance of Trade

5. Balance of Payment

6. Transport and Communication System

7. Money Supply in the Economy

8. International Debt

(ii) Social Environment:

Social Environment consists of the customs and traditions of the society in which business is existing. It includes the standard of living, taste, preferences and education level of the people living in the society where business exists. The businessman cannot overlook the components of social environment as these components may not have immediate impact on the business but in the long run the social environment has great impact on the business.

For example, when the Pepsi Cola Company used the slogan of “Come Alive” in their advertisement then the people of a particular region misinterpreted the word “Come Alive” as they assumed it means Coming out of Graves. So, they condemned the use of the product and there was no demand of Pepsi Cola in that region. So, the company had to change its advertisement slogan as it cannot survive in market by ignoring the sentiments of the people.

In India also, there are many Social reforms taking place and the common factors of Indian Social Environment are:

(a) Demand for reservation in jobs for minority and women

(b) Demand for equal status of women by paying equal wages for male and female workers

(c) Demand for automatic machines and luxury items in middle class families

(d) The social movements to improve the education level of girl child.

(e) Health and Fitness trend has become popular.

Some Aspects of Social Environment:

1. Quality of life

2. Importance or place of women in workforce

3. Birth and Death rates

4. Attitude of customers towards innovation, life style etc.

5. Education and literacy rates

6. Consumption habits

7. Population

8. Tradition, customs and habits of people

(iii) Political Environment:

Political environment constitutes all the factors related to government affairs such as type of government in power, attitude of government towards different groups of societies, policy changes implemented by different governments etc. The political environment has immediate and great impact on the business transactions so businessman must scan this environment very carefully.

The businessman has to make changes in his organisation according to the changing factor of political environment. For example, in 1977 when Janata Government came in power they made the policy of sending back all the foreign companies. As a result the Coca Cola Company had to close its business and leave the country.

The common factors and forces which have influenced the Indian political environment are:

(a) The government in Hyderabad is taking keen interest in boosting I.T. industry, as a result the state is more commonly known as Cyberabad instead of Hyderabad.

(b) After the economic policy of liberalisation and globalisation, the foreign companies got easy entry in India. As a result the Coca Cola which was sent back in 1977 came back to India. Along with Coca Cola, Pepsi Cola and many other foreign companies are establishing their business in India.

Some Aspects of Political Environment:

1. Present political system

2. Constitution of the country

3. Profile of political leaders

4. Government intervention in business

5. Foreign policy of government

6. Values and ideology of political parties

(iv) Legal Environment:

Legal environment constitutes the laws and various legislations passed in the parliament. The businessman cannot overlook the legislations because he has to perform his business transactions within the framework of legal environment.

The common legislation passed which has affected the business transactions are Trade Mark Act, Essential Commodity Act, Weights and Measures Act, etc. Most of the time legal environments put constraints on the businessman but sometimes they provide opportunities also. The common instances of Indian legal environment which have influenced business transactions recently are:

1. Deregulation of capital market has made it easy for businessman to collect capital from primary market.

2. Removal of control from the foreign exchange and liberalisation in investment is encouraging foreign investors and NRIs to invest in Indian capital market.

3. Advertisement of alcoholic product is prohibited.

4. Compulsory to give statutory warning in Tobacco production.

5. Delicencing policy of industries.

Some Aspects of Legal Environment:

1. Various laws and legislative Acts.

2. Legal policies related to licensing.

3. Legal policies related to foreign trade.

4. Statutory warnings essential to be printed on label.

5. Foreign Exchange Management Act.

6. Laws to keep a check on Advertisements.

(v) Technological Environment:

Technological environment refers to changes taking place in the method of production, use of new equipment and machineries to improve, the quality of product etc. The businessman must closely monitor the technological changes taking place in the industry because he will have to implement these changes to remain in the competitive market. Technological changes always bring quality improvement and more benefits for customers. The recent technological changes of Indian market are:

1. Digital watches have killed the prospects and the business of traditional watches.

2. Color T.V. technology has closed the business of black and white T.V.

3. Artificial fabric has taken the market of traditional cotton and silk fabrics.

4. Photo copier and Xerox machines have led to the closure of carbon paper business.

5. Shift in demand from vacuum tubes to transistors.

6. Shift from steam locomotives its diesel and electric engine.

7. From typewriter to World Processors.

Some Aspects of Technological Environment**:**

1. Various Innovations and Inventions.

2. Scientific Improvements.

3. Developments in IT sector

4. Import and Export of Technology.

5. Technological Advances in Computers.

(vi) International Environment:

The environment consists of those factors which have an impact on foreign trade of a country. Those factors may be foreign policy, international treaties and foreign investment policy and various acts which are concerned with the dealings with other countries in trade matters. With the charges in government and their policies, there will be change in international environment.

With the introduction of economic reforms and the policy of liberalisation in our country, our exports have increased considerably and many foreign companies started to trade with our country. With the formation of World Trade Organisation (WTO), there is a tremendous change in the international trading environment.

Although Government of India's policy has been encouraging foreign investment in Indian companies, subject to certain conditions, and several factors like the domestic economic policy and the domestic economic situation have been deterrents to foreign investment to Indian companies. The foreign collaborations is enabling Indian companies to upgrade their production methods.

Government Control over Business in India

The government controls over business are as follows:

(i) Economic Planning:

Planning in India started in the year 1951. The economic planning aims to regulate the investment activity by private enterprises, and improve the government activities towards underdeveloped areas. A significant aspect of Indian Planning is to achieve social justice.

(ii) Industrial Policy:

Industrial policy of Government of India guides the state attitudes towards industrial development and it lays down priorities regarding the relative roles of public and private sectors, large, small and cottage industries. The salient feature of industrial policy is mainly to improve the Industries in India.

iii) Industrial Licensing:

Industrial licensing is a major device through which industrial policy of the government implemented. The licensing system designed to ensure proper utilization of the country's resources, balanced regional development and overall economic development.

(iv) Labour Laws:

Labour laws help to regulate the employer-employee relations, working and living conditions of workers, wages, bonus, labour welfare, social security etc. The labour laws include the Factories Act, the Minimum Wages Act, Workmen's Compensation Act, The Payment of Wages Act, the Payment of Bonus Act, Trade Unions Act, Industrial Disputes Act, Employees State Insurance Act, Payment of Gratuity Act etc.

(v) Regulation of Foreign Trade:

The regulation of business activities like import and exports, foreign exchange and etc., through Imports and Exports (Control) Act, COFEPOSA, and FEMA. The Imports and Experts (Control) Act, 1947 amended from time to time empowers the government to prohibit or control imports and exports in the public interest. The government itself directly participates in the import and exports business through its agency like the State Trading Corporation of India (STC), the Minerals and Metals Trading Corporation of India (MMTC).

These agencies have been set up by the government by doing import and export business in specified areas. The main objective of Foreign Exchange Management Act (FEMA) is the conservation of the foreign exchange resources of the country and the proper utilization thereof in the interest of the economic development of the country

Self Assessment Questions

1. Define business. What are the objectives of business ?
2. Explain the main characteristics of a business .

3. Define business environment. Explain the nature of business environment.
4. What are the significances of business environment?
5. Explain features and benefits of business environment
6. What are the internal factors affecting business environment?
7. What are the external factors affecting business environment?

Unit – II

SOCIAL ENVIRONMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Nature of Internal and external social environment
- Types of social organization
- Types of linguistic and religious groups
- Evils of linguistics systems in India and the remedial measures to eradicate them
- Characters of joint family systems in India
- Types of cultural heritage
- Benefits of cultural heritage
- Origin of caste system in India
- Various types of Indian communities
- Difference between Indian and foreign culture
- Impact of foreign culture in India
- Meaning of social responsibilities
- Factors influencing social responsibilities in business
- Corporate social responsibilities in India

Unit Structure

Lesson 2.1 – Social Environment

Lesson 2.2 – Cultural Environment

Lesson 2.3 – Social Responsibilities in Business

Lesson 2.1

Social Environment

Social Environment - Meaning

The social environment consists of the sum total of a society's beliefs, customs, practices and behaviors. It is, to a large extent, an artificial construct that can be contrasted with the natural environment in which we live.

Every society constructs its own social environment. Some of the customs, beliefs, practices and behaviors are similar across cultures, and some are not. For example, an American traveling to Britain will find many familiar practices but not so much if traveling to China.

This social environment created by a society-at-large in which a business functions can be referred to as its external social environment. If a business operates in a multicultural society, then the social external social environment is even more complicated because the environment will consist of diverse sub-populations with their own unique values, beliefs and customs.

A business also has its own social environment. We can refer to this as its internal social environment, which is simply the customs, beliefs, practices and behaviors within the confines of the business. A business has much more control over its internal social environment than it does with its external social environment.

Internal and External Social Environment

A business must be keenly aware of the society's social preferences regarding its needs and wants. These preferences and needs and wants will be influenced by

i) internal social environments

ii) external social environments

i) Internal Social Environment

A business also creates a social environment consisting of its own organizational values, norms, customs and practices. Many of these values, norms and beliefs will mirror the internal social environment, but some will be unique to the organization.

Businesses need to operate as a cohesive unit, so it is important that they build a strong and productive organizational culture. It is also important to ensure that the culture is stable and positive. Thus, a business should carefully monitor the relations between its members to detect any hostility or other dysfunction that needs to be corrected.

ii) External Social Environment

A business must utilize and adapt to its external social environment, or it will not survive. Let us look at some examples. A change in beliefs and values towards energy conservation and global climate change may create a change in consumer preference away from gas guzzling SUVs to hybrid sedans. Some cultures treat the meal as a long social event, and fast food just won't cut it. Social preferences relating to fashion are constantly changing. Skirt lengths go up and down depending upon the years, as do the preference for single-breasted and double-breasted suits.

If a business refuses to adapt to changing social preferences, its sales will drop, and it will fail. Of course, sometimes the change in social preferences may be so large that a business simply can't adapt. For example, a social movement led to the outlawing of alcohol in the early 20th century, which was known as Prohibition. During Prohibition, it was illegal to sell alcohol. Distilleries were put out of business until Prohibition was repealed.

While there are risks with social change, there are also opportunities. Businesses often try to influence social values through the use of marketing, advertising and targeted public relations strategies. Marketing campaigns are used in an attempt to create trends. The fashion industry is a prime example. Public relation campaigns are often used to build up or repair a business' image.

For example, BP launched a massive public relations campaign to improve its image after a massive oil leak in the Gulf of Mexico caused by offshore drilling. Fast food restaurants may include healthier choices on their menus and sponsor health-related activities.

Broader social values will also affect the success of a business. A society that values higher education will provide a better workforce that will lead to more productivity and innovation. Likewise, a society that supports investment in public infrastructure will have access to good transportation and communication systems. And if the social values of a community include a hard work ethic, a business will have access to productive workers and a population that has money to spend on goods and services.

Types of Social Organizations

Social organizations or institutions arise out of social needs and situations of members. These organizations are the means through which individuals adjust their behaviour to environmental conditions.

Lapiere says that "social organization consists of all the ways by which men live and work together, more especially of all the programmed, ordered and coordinated relations of the members of the society." Social organisations at different levels organize and give expression to collective behaviour. They coordinate and crystallize numerous interests of individuals and groups.

Social organisations are of two broad types, namely, those which grow out of kinship and those that result from the free and voluntary associations of members. A brief analysis of a few such organizations are given below:

1. ***Family:***

It is the earliest and the most universal of all social institutions. It is also the most natural, simplest and permanent form of social organization. In society, individuals are primarily organized into separate families and households.

Family is generally composed of husband, wife and their children. It may be defined as a group of persons, united either by the ties of marriage or blood relationship, having a common household, a common tradition or culture.

The form and features of family may be different from place to place and country to country but family as a social group exists everywhere. It may rightly be described as the keystone of the social arch. It performs a variety of functions like biological, emotional, economic, educational and cultural.

2. Clan:

The members of a clan are supposed to be the descendants of common ancestors. They usually bear common surname. They are usually found among primitive people and members act through the guidance of a chieftain.

They are associated through common social, religious and cultural ceremonies. Members practice exogamy; they do not marry a person belonging to the same clan. All members worship a totem or a symbolic object like cow, bull, bird etc.

3. Tribe:

A tribe is a wider social organization than clan and has been defined as "a social group of a simple kind, and members of which speak a common dialect, have a common government and act together for such common purpose as welfare." Tribe is usually formed after a stronger clan subordinates a weaker one.

Tribe has a government with a tribal chief as its head. It is organized for military purposes and has a common dialect and language. Though devoid of blood relationship, a tribe maintains solidarity among its members.

4. Community:

One way of organizing individuals on secular lines is through formation of communities and associations. A community is defined as "the total organisation of social life within a limited area." A community is a self-sufficient group based on common life. The area of a community may range from narrow to very broad (even global) limits.

5. ***Association:***

MacIver defines, "An association as a group organized for the pursuit of an interest or group of interests in common." Associations may be of various types including kinship, religious, cultural, recreational, philanthropic, vocational, political groups.

Linguistic systems in India

India has become a land of many tongues and has been called “as a tower of veritable languages” or a “Museum of languages”. In 1950, the States in India were reorganized on linguistic basis. As a result, the domiciles of a particular state speak a particular language. The Constitution of India has approved of 22 languages.

In India we find a number of languages. India has also been called a “Tower of Babel”. This multilingual nature of the country affects every aspect of her national life. But linguistic diversity was not a great problem in the past since Sanskrit in the beginning, later Persian and during last hundred years English served as link languages.

At present the language problem has become so acute that it has posed a major threat to national integration. Most often linguistic tensions are being manifested in the borders which are bilingual.

For example, in Belgaum there is a tug of war between Marathi and Kannada speaking people. Assam confronted with Bengali and Assamese. Although Hindi has been recognized as the national language, this has promoted bitter hostilities, particularly in the South. Language problem has never been as intensely felt as it is today. Even Bihar and Utter Pradesh are not free from the linguistic problems. Further, conflict tends to persist among the Urdu, Hindi and Oriya linguistic groups and Urdu and Hindi speaking people respectively.

Origin of Linguistic systems in india

The basis for the Origin of Linguistic systems in India are discussed below:

1. Love of Literature:

Love of literature creates and strengthens a sense of loyalty towards it among the linguistic groups. These linguistic loyalties hamper the evolution of a common language.

***2. Geographical Causes*:**

Geographical conditions also promote linguism. People living in a particular locality tend to speak the same language. This promotes local identity and distinctiveness among people. Living together geographically reinforces a linguistic group's love for its own language.

3. Historical Causes:

Linguistic system in India is a by-product of India's struggle for national freedom. Our leaders of freedom movement criticized the British system of dividing country by cutting across linguistic boundaries. Rather, they pleaded for the division of India into different provinces along linguistic lines. After independence, in 1956, the States were reorganized on the basis of homogeneity of languages. The reorganization of the States on linguistic lines has provided geographical foundations for sub-nationalism in India.

4. Political Causes:

Political parties create linguistic feeling among the people of a locality and exploit their sentiments at the time of election.

5. Psychological Causes:

Language has certain psychological and emotional characteristics which invoke the feeling of ethnocentrism to a homogeneous group. In India, the linguistic groups are tied together by ties of common interest. This creates the spirit of regionalism, sectarianism and separatist feeling in the mind of the inhabitant.

Evils of Linguistic systems in india

The evils of linguistic systems in india are as follows:

1. Increasing Regionalism and Parochialism:

The people of different linguistic groups who are concentrated in a state seem to think only in terms of interests of their own States. This undermines consideration of national issues and causes parochial feelings.

2. Formation of Regional Political Parties:

Linguistic system has resulted in regionalism which has ultimately led to the formation of regional political parties in some state. Some of these regional political parties have also formed government. Such political parties in power often complicate Centre-State relationship.

3. Persecution of the Linguistic Minorities:

The State Reorganization Commission had provided for safeguard of linguistic minorities in States. But in reality the linguistic minorities have been harassed in different States. As a result certain complications and disturbing trends have developed which seem to have threatened the unity of the country.

4. Demand for Separate States:

Linguistic conflicts take place due to selfish motive of politicians. These politicians instigate the linguistic minority to demand partition of the States along linguistic lines. The demand for a separate state creates problems for the concerned state as well as the centre.

5. Erosion of National Feeling:

The national feeling is eroded due to linguistic and regional loyalties. The erosion of national feeling threatens the sovereignty of the country.

6. Inter-State Border Dispute:

Language problems have created tensions in the boarder which are bilingual. For example, the Goans are divided on the basis of Konkani and Marathi languages.

Remedial Measures for eradication of the evils of Linguistic systems in India

Following measures may be taken for the eradication of tensions between different linguistic groups.

1. Development of a National Language:

Although Hindi has been recognized as the national language, it has caused bitter hostilities, particularly in the South. It will be unwise to impose Hindi on non-Hindi speaking people. Therefore, the propagation of Hindi as the national language requires lot most care and tact.

2. Development of Common Script:

At present there are a number of scripts in India. But if a common script is evolved, it would break through the script barrier which separates one language area from another. M. N. Srinivas's suggestion for the use of Roman Script may also be considered.

3. Ban on Political Parties and other Organisations:

The regional political or any other organization which try to exploit the sentiments of people along the linguistic lines should be banned. The Sarkaria Commission was appointed in 1983 to examine the language problem in India. The Commission made a couple of recommendations for the solution of the problem. It suggested that the styles, forms and expression of English along with other regional languages are to be retained in the process of development of official language. The three language formula such as regional language, Hindi and English should be properly implemented.

Indian Religion Groups

India is a land of diversities. This diversity is also visible in the spheres of religion. The major religions of India are Hinduism (majority religion), Islam (largest minority religion), Sikhism, Christianity, Buddhism, Jainism, Zoroastrianism, Judaism and the Baha'i Faith. India is a land where people of different religions and cultures live in harmony. This harmony is seen in the celebration of festivals. The message of love and brotherhood is expressed by all the religions and cultures of India.

Whether it's the gathering of the faithful, bowing in prayer in the courtyard of a mosque, or the gathering of lamps that light up houses at Diwali, the good cheer of Christmas or the brotherhood of Baisakhi, the religions of India are celebrations of shared emotion that bring people together. People from the different religions and cultures of India, unite in a common chord of brotherhood and amity in this fascinating and diverse land.

1. Buddhism

At present Buddhism is one of the major world religions. The philosophy of Buddhism is based on the teachings of Lord Buddha, Siddhartha Gautama (563 and 483 BC), a royal prince of Kapilvastu, India. After originating in India, Buddhism spread throughout the Central Asia, Sri Lanka, Tibet, Southeast Asia, as well as the East Asian countries of China, Mongolia, Korea, Japan and Vietnam.

2. Christians

Christianity is one of the prominent religions in India. At present there are about 25 million Christians in India. It is interesting to note that the Christian population in India is more than the entire population of Australia and New Zealand or total population of a number of countries in Europe.

3. Hinduism

Hinduism is the oldest religion in the world. Hinduism is world's third largest religion after Christianity and Islam. Hinduism is the dominant religion in India, where Hindus form about 84 per cent of the total population. Hinduism is also known as "Sanatan Dharma" or the everlasting religion.

4. Islam

One of the prominent religions of India, Islam forms about 12 per cent of India's population. Though India's contact with Islam had begun much earlier, the real push came in the 8th century when the province of Sindh was conquered. Though the Muslims form only 12 per cent of the total population of India but the influence of Islam on Indian society is much stronger.

5. Jainism

Jains form less than one percent of the Indian population. For centuries, Jains are famous as community of traders and merchants. The states of Gujarat and Rajasthan have the highest concentration of Jain population in India. The Jain religion is traced to Vardhamana Mahavira (The Great Hero 599-527 B.C.).

6. Sikhism

Sikhs form about 2 per cent of Indian population. In comparison to other religions, Sikhism is a younger religion. The word 'Sikh' means a disciple and thus Sikhism is essentially the path of discipleship. The true Sikh remains unattached to worldly things.

7. Zoroastrian

Though the total number of Zoroastrians in Indian population is very less yet they continue to be one of the important religious communities of India. According to the 2001 census, there were around 70,000 members of the Zoroastrian faith in India. Most of the Parsis (Zoroastrians) live in Maharashtra (mainly in Mumbai) and the rest in Gujarat.

8. Guru Nanak Dev

Sri Guru Nanak Dev Ji is credited with starting the Sikh religion. He was the first Guru of the Sikhs and is worshipped next to God. His sole aim in life was to unify the Hindus and Muslims and form a universal religion of brotherhood and compassion. He believed that true salvation could be achieved only by devotion of thought and excellence of conduct.

9. Lord Mahavira

Lord Mahavira is often credited with the advent of Jainism in India. However, Jainism existed even before Lord Mahavira was born. He is supposed to be the twenty-fourth (last) Tirthankara according to the Jain philosophy. A Tirthankara is an enlightened soul who is born as a human being and attains perfection through intense meditation.

10. Adi Shankaracharya

One of the greatest philosophers of India, Adi Shankaracharya founded the Advaita Vedanta, which is one of the sub-schools of Vedanta. Adi Shankaracharya whole-heartedly believed in the concept of the Vedas but at the same time advocated against the rituals and religious practices that were over exaggerated.

Social attitude

The emotional component is the feeling experienced on evaluation of a particular entity. The cognitive aspect implies thoughts and beliefs adopted towards the subject, while the behavioral component is the conduct that results from a social attitude. An individual with an explicit attitude is aware of it and how it dictates his behavior and beliefs. On the other hand, a person may not be conscious of his implicit attitude, although it still may influence his beliefs and behavior.

People pick social attitudes from personal experiences or observation. Likewise, social roles and norms can dictate formation of attitudes. Social roles determine the behavior an individual occupying a particular position or context in the society is expected to demonstrate, while social norms define the conduct that's acceptable to the society.

However, social attitude does not always lead to specific behavior. For example, someone may favor policies of a specific politician but fail to turn out to vote. Attitudes can be dropped the same way they're learned.

Joint Family System in India

A joint family or undivided family is an extended family arrangement prevalent throughout the Indian subcontinent, particularly in India, consisting of many generations living in the same home. All the daughters, or widowed relatives, all bound by the common relationship. The joint family status being the result of birth, possession of joint cord that knits the members of the family together is not property but the relationship. The family is headed by a patriarch, usually the oldest male called Kartha, who makes decisions on economic and social matters on behalf of the entire family. The patriarch's wife generally exerts control over the kitchen, child rearing and minor religious practices. All money goes to the common pool and all property is held jointly.

Characteristics of joint family system in India

On the basis of the conceptual framework, we can mention some characteristics of joint family system in India.

1. Common Residence:

One of the most important features of the joint family system is common residence. Members of the joint family normally reside together in the same house or at one particular place. Some scholars like Iravati Karve regard co- residentiality as an essential ingredient of jointness.

2. Common Kitchen:

Living together is not the only ingredient of joint family. A group of persons living at one place or under one roof may not form a joint family. Therefore, the essential feature of a joint family is the common kitchen. The members eat food prepared jointly at the common kitchen. The undivided kitchen has been traditionally associated with the joint family system.

3. Common property:

The members hold common property. As Milley writes, the joint family “is a cooperative institution similar to a joint stock company in which there is joint property.” The head of the family manages the family property like a trustee.

The total earnings of the members are pooled into family treasury and family expenses are met out of that. According to old Hindu law givers, the nature of joint family consisted in the ownership of ancestral property. Daya Bhag and Mitakshara rules enjoin that during the life time of the father, the property of the family cannot be divided between the members of the family.

4. Depth of Generations:

The joint family is large in size in comparison to nuclear family. It consists of members of three or more generations including grandparents, parents and children. Sometimes, other kith and kin such as uncles, aunts, cousins and great grandsons also live in the joint family.

5. Common Worship:

The Hindu joint family derives its strength from religion. Hence, it is associated with various religious rituals and practices. It is a feature of joint family system that there is a common mode of worship and common Gods and Goddesses. The reason for this might have been the practice of ancestor worship and the custom of Pinda Dana.

In ancient times, every family had its own deity or 'Kula Devata' who was worshipped throughout the ages. Thus, common worship of Gods and Goddesses has been associated with joint family system.

6. Co-operation and Sentiment:

Scholars like I.P. Desai and K.M. Kapadia point out that jointness should be looked in functional terms. A patrilineal joint family may consist of a number of households headed by males related through the father.

It may be located even at distant places and may not even have property in common. But what is common is that it identifies itself as members of a particular ' family', cooperates in rituals and ceremonies, renders financial and other kinds of help, and cherishes common family sentiment and abides by the norms of joint living.

7. Ritual Bonds:

The ritual bonds of the joint family are considered to be important component of jointness. A joint family, thus, is bound together by periodic propitiation of the dead ancestors. The members perform a 'Shradha' ceremony in which the senior male member of the joint family propitiates his dead father's or mother's spirit offering it through the 'Pinda' on behalf of all the members.

8. Authority of Karta:

The Hindu family is usually patriarchal. In the patriarchal joint family, the eldest male member exercises authority. The authority of the head of the family is considered to be supreme.

The Hindu family, in theory and practice, enjoins the figure of the head of the family who is responsible for the management of the house, management of finances, bread winner and wage earner. The head of the family or the Karta enjoys the highest position in the family.

Majumdar has written, the Karta of the joint or extended family has the right to make decisions for his family, he is the working head, he is the judge and the jury, he decides family quarrels, he is the political head as every family has a place and is represented by the head of the family in the social, ceremonial and in community activities. "The power is traditionally given to the eldest male of the family and the head allows little individual freedom to the family members.

As opposed to it, in the matriarchal joint family the eldest female member in theory exercises the supreme authority.

9. Mutual Obligations:

The joint family consists of a number of relations who have a common residence and a common kitchen. Because of living together and enjoying property in common, the members of the joint family are also bound together by the ties of mutuality of obligations. It means that since they live together, they share the sorrows and joys together. On all important occasions like birth, death and marriage, they commonly share the burden of sentiments and emotions.

10. Familistic Organisation:

Joint family is based on a family which means the subordination of individual interests to the interests of the family as a whole. This also means that goals or interests of the family must be the goals or interests of the individuals.

11. Filial Relationship:

In contrast to conjugal ties (i.e. between husband and wife), emphasis is laid on filial relationship (the father-son relationship) and fraternal relationship (the relationship between brothers) in the joint family system. In other words, the conjugal relationship is subordinated to filial and fraternal relationships.

12. Arranged Marriage:

In the joint family, the head considers it as his privilege to arrange the marriages of the members. The individual's right to select his / her life partner is not allowed. The younger members rarely challenge his decisions and arrangements.

13. Self-Sufficiency:

There was a time when the joint family was mostly self- sufficient. It used to meet the economic, recreational, educational and other needs of members. The rural agricultural joint families were mostly self-reliant.

14. Segregation of Sexes:

In the traditional joint family, social life of women was largely confined to family and relatives. The segregation of sexes was accomplished in a variety of ways. There was separation of perspective sphere of work for men and women.

Men were looking after the major occupational activities and women were looking after the household works. Basically, the spheres of operation were separated. This separation of the sexes in the family tends to characterize social life as well. The women were forming their own social groups.

15. Kin Relationship between the Members:

We can say that a joint family may consist of members related lineally or collaterally or both. There is more or less a unanimous agreement that a family is essentially defined as "joint" only if it includes two or more related married couples. Also it has been observed that these couples may be related (i) lineally (usually in a father -son relationship or occasionally in a father- daughter relationship) or (ii) collaterally (usually in a brother-brother relationship or / occasionally in a brother-sister relationship). Both these types refer to the compositional aspect of the patrilineal joint family.

South-west and North-East India, the family is usually composed of a woman, her mother and her married and unmarried daughters. The mother's brother is also an important member of the family; he is the manager of the matrilineal joint family affairs the husbands of the female members live with them. In Kerala, husbands used to be frequent visitors in their wife's household and lived with their mother's household.

Lesson 2.2

Cultural Environment

Cultural Heritage – Meaning

Cultural heritage comprises the sources and evidence of human history and culture regardless of origin, development and level of preservation (tangible/material heritage), and the cultural assets associated with this (intangible/non-material heritage). Because of their cultural, scientific and general human values, it is in the state's interest to protect and preserve cultural heritage.

The basic cultural function of cultural heritage is its direct incorporation into space and active life within it, chiefly in the area of education, the transfer of knowledge and experience from past periods of history, and the strengthening of national originality and cultural authenticity.

Types of Cultural Heritage

1. ***Tangible (material) heritage***

   Tangible (material) heritage is made up of individual buildings, groups of buildings, areas, objects and collections of objects.

2. ***Built heritage***

   It comprises buildings (including their associated facilities), decorative elements, equipment and attached land, other built elements, settlements and parts thereof, and spatial arrangements (even if they are formed from natural elements). We can classify built heritage as follows:

   i. **buildings (units):** all buildings or built components that have an expressly historical, archaeological, artistic, scientific, social or technical importance;
   ii. **groups of buildings**: uniform groups of urban or rural buildings that that have an expressly historical, archaeological, artistic, scientific, social or technical

importance and are sufficiently interlinked that they comprise spatially definable units;

iii. **areas:** joint creations of man and nature, i.e. areas that are partly built and sufficiently recognisable and uniform that they are spatially definable, and have a special historical, archaeological, artistic, scientific, social or technical importance.

3. Archaeological heritage

It comprises all relics, objects and human traces from past periods of history on the surface, in the earth and in water whose preservation and study contributes to the uncovering of the historical development of mankind and his links to the natural environment and for which archaeological research is the main source of information.

4. Cultural heritage landscapes

They are special distinct areas of land as recognised by people and whose characteristics and spatial layout are the result of the operation and mutual influence of natural and human factors. The terms 'integral heritage' and 'area of national identity' are two terms with a wider meaning.

5. Integral heritage

It is formed by units of the human environment or nature in which elements of natural and cultural heritage are intertwined and whose value is increased by the fact that both forms of heritage are genetically, functionally or substantively linked and dependent on each other.

Benefits of cultural heritage

Not everyone feels a connection with their cultural heritage, but many people do. What is it about cultural heritage that draws these people to it? Some may think traditions are archaic and no longer relevant, and that they are unnecessary during these modern times. Perhaps for some, they aren't; but for others, exploring cultural heritage offers a robust variety of benefits.

i. *Connection to social values, beliefs, religions and customs*

Culture can give people a connection to certain social values, beliefs, religions and customs. It allows them to identify with others of similar mindsets and backgrounds.

ii. *Sense of unity and belonging within a group*

Cultural heritage can provide an automatic sense of unity and belonging within a group and allows us to better understand previous generations and the history of where we come from.

iii. *Preserving cultural heritage as communal support*

Another benefit that comes from preserving cultural heritage as a whole is the communal support. Those that identify strongly with a certain heritage are often more likely to help out others in that same community.

The Caste System in India

The origins of the caste system in India and Nepal are shrouded, but it seems to have originated more than two thousand years ago. Under this system, which is associated with Hinduism, people were categorized by their occupations.

Although the early Vedic sources name four primary castes, in fact there were thousands of castes, sub-castes and communities within Indian society. These *jati* were the basis of both social status and occupation.

Castes or sub-castes besides the four mentioned in the Bhagavad Gita include such groups as the Bhumihar or landowners, Kayastha or scribes, and the Rajput, who are a northern sector of the Kshatriya or warrior caste.

Some castes arose from very specific occupations, such as the Garudi - snake charmers- or the Sonjhari, who collected gold from river beds.

Some people were born outside of (and below) the caste system. They were called "untouchables."

Origins of the Caste System:

Early written evidence about the caste system appears in the Vedas, Sanskrit-language texts from as early as 1500 BC, which form the basis of Hindu scripture. The *Rigveda*, from c. 1700-1100 BCE, rarely mentions caste distinctions, and indicates that social mobility was common.

The *Bhagavad Gita*, however, from c. 200 BCE-200 CE, emphasizes the importance of caste. In addition, the "Laws of Manu" or *Manusmriti* from the same era defines the rights and duties of the four different castes or *varnas*. Thus, it seems that the Hindu caste system began to solidify sometime between 1000 and 200 BC.

The Caste System during Classical Indian History:

The caste system was not absolute during much of Indian history. For example, the renowned Gupta Dynasty, which ruled from 320 to 550 CE, were from the Vaishya caste rather than the Kshatriya. Many later rulers also were from different castes, such as the Madurai Nayaks (r. 1559-1739) who were Balijas (traders).

From the 12th century onwards, much of India was ruled by Muslims. These rulers reduced the power of the Hindu priestly caste, the Brahmins. The traditional Hindu rulers and warriors, or Kshatriyas, nearly ceased to exist in north and central India. The Vaishya and Shudra castes also virtually melded together.

Although the Muslim rulers' faith had a strong impact on the Hindu upper castes in the centers of power, anti-Muslim feeling in rural areas actually strengthened the caste system. Hindu villagers reconfirmed their identity through caste affiliation.

Nonetheless, during the six centuries of Islamic domination (c. 1150-1750), the caste system evolved considerably. For example, Brahmins began to rely on farming for their income, since the Muslim kings did not give rich gifts to Hindu temples. This practice was considered justified so long as Shudras did the actual physical labor.

The British Raj and Caste:

When the British Raj began to take power in India in 1757, they exploited the caste system as a means of social control. The British allied themselves with the Brahmin caste, restoring some of its privileges that had been repealed by the Muslim rulers. However, many Indian customs concerning the lower castes seemed discriminatory to the British, and were outlawed.

During the 1930s and 40s, the British government made laws to protect the "Scheduled castes" - untouchables and low-caste people. Within Indian society in the 19th and early 20th centuries there was a move towards the abolition of untouchability, as well. In 1928, the first temple welcomed untouchables or *Dalits* ("the crushed ones") to worship with its upper-caste members. Mohandas Gandhi advocated emancipation for the Dalits, too, coining the term *harijan* or "Children of God" to describe them.

Caste Relations in Independent India:

The Republic of India became independent on August 15, 1947. India's new government instituted laws to protect the "Scheduled castes and tribes" - including both the untouchables and groups who live traditional life-styles. These laws include quota systems to ensure access to education and to government posts. Over the past sixty years, therefore, in some ways a person's caste has become more of a political category than a social or religious one.

Caste among Non-Hindus:

Curiously, non-Hindu populations in India sometimes organized themselves into castes as well. After the introduction of Islam on the subcontinent, for example, Muslims were divided into classes such as the Sayed, Sheikh, Mughal, Pathan, and Qureshi. These castes are drawn from several sources - the Mughal and Pathan are ethnic groups, roughly speaking, while the Qureshi name comes from the Prophet Muhammad's clan in Mecca. Small numbers of Indians were Christian from c. 50 onward, but Christianity expanded after the Portuguese arrived in the 16th century. However many Christian Indians still observed caste distinctions.

Indian Communities

Indian communities refer to that structured and integrated group of people, belonging to a certain religion and believing in one single united cause, who establish amongst themselves a clustered bunch to discuss various issues on a general panel.

The term, rather the coinage Indian communities perhaps cannot be credited to any single individual. In fact, ancienthistory in India does lend considerable and credible information regarding primeval communities, or organisations that had cropped up since the times of pre-Christian era.

Indeed, since the eras of Indus Valley Civilization and Harappa, the concept of organising communities had been well assimilated within both uneducated and educated classes. Indus Valley is known to contain both uneducated and educated society, with Indian history also informing that it was this very civilisation itself that perhaps had first traced lines of illustrious lineage and something now referred to as sophistication. Religious, economic, administrational, even, societal classed communities had existed during ancient Indian evolvement.

Indian Communities under Hinduism

Caste system and class consciousness was one such idealistic concept that had driven these ancient Indian communities to behave the way they did. The gigantic awareness of belonging to a higher caste or higher religious order paved way for first ever establishment of Hindu religious community, divided into Brahmins, Kshatriyas, Vaishyas and Shudras.

These four cardinal Hindu caste systems were further sub-divided into their own specific community, a concept that is very much retained in present-day Indian society. It is also known that an omnipresent and unseen demarcation line had existed amongst these ancient Indian communities, with none daring to cross that thin red line.

Hinduism had hugely dominated in ancient Indian religious systems, with the Mauryans, Guptas, Palas, Cholas, Kushanas, Vijayanagaras,Satavahanas, Pratiharas, Chalukyas, even Marathas (in much later times) assorting to significant establishment of communities, information from which are still being deduced by historians and researchers.

Indian Communities under Islam

Islamic invasion and subsequent extensive Muslim rule in India, wholly changed and metamorphosed the concept of communities in India. The Khiljis, Tughlaqs, Lodis and finally the Mughals had entirely altered the graph of Islamic communities in India, with an overwhelming mass of the erstwhile populace joining in the various causes to form organisational communities. Discussions and forums within these groups ranged from an assorted bunch of views, like religion, governance, conditions of society, economy, monetary involvements, literature and foreign trading. It is also an acknowledged fact that legendary luminaries had indeed been shot to recognition and admiration from the masses, never for once denoting the class consciousness, a breakaway and distinct facet different from erstwhile Hindu communities. Emperors, army generals and high profile men had contributed whole-heartedly and honestly to each meticulous cause to make these Indian communities as well grounded as mountainous rocks.

Indian Communities under Christianity

With passage of time and advancement in Indian ruling and sovereign administration, arrived the concept of Christian communities in India, ushered in by the Dutch, Portuguese, French and British, uniquely accompanied by the former Jewish and Armenian settlers in the country. Till this period of time Christianity and Christians were not a thing much heard of in India, with Hindus and Muslims dominating the entire topography.

However, with the very overpowering European encroachments, Indian population took on a dramatic turn, with communities within India looking towards rather modernistic domains in daily life, leaving aside religious dogmatism. The historic and long-drawn British Empire and its western outlook stood in vast difference with eastern phenomena, paving way for establishing innovative communities based upon creed and caste that were divided upon religious basics. For instance, Hindu communities went regional into Punjab, Madras, Andhra Pradesh or Kashmir.

Contemporary Indian communities

Contemporary and present times stay witness to and believe in much more an amalgamation of various communities in India put together, with globalisation aiding in several occasions. The concept of Indian communities has become much more panoptic and international in conscience, almost lapping up everything coming to its way.

Matrimonial alliance amongst the aboriginal Indian communities is another striking factor that is assisting in betterment of Indian citizens. Yet, some specific and historic communities that have gained prominence over these years comprise: Armenian Community, Jewish Community, Khatri Community, Maratha Community, Jat Sikh Community etc..

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Difference between Indian culture and western culture

This topic is always debatable and frankly there is never a winner as to which culture is better. Both are different types of culture and customs that are followed in different parts of the world. Indian Culture refers to the customs, traditions, religions and set of rules that are followed in India, while the Western Culture most commonly refers to culture that is followed in America and Europe.

Both the cultures differ from each other in the traditional mindset, however, in today's world both the cultures are coming to a mix. The Indian Culture has been dealing with westernization for a few decades now and the Western Culture has started developing a taste for the exotic Indian food and yoga.

Each culture has a set of negative and positive points. They are similar to the two sides of the same coin. No one culture ever surpasses the other culture, as it all depends on perception; to each person either culture could be better than the other one. Many people these days opt to take positive points from both the cultures and live as it suits them.

	Indian Culture	**Western Culture**
Definition	Indian culture is the traditional mindset of people that reside in India. It is the customs, traditions, ceremonies, festivals, religions of India	Western culture started from the Ancient Greece and Rome, which then spread all over the world under Roman rule. It was then encouraged by the European civilization and now refers to modern way of thinking
Origin	Indian culture is one of the oldest cultures in the world. The traditions are several millennia old	Though according to historical records ,western culture began with Ancient Greece and Ancient Rome, it is considered as a modern culture to many people

Religions	Hinduism, Buddhism, Jainism and Sikhism	Christianity, Judaism
Cuisine	Indian food is heavily spiced and is rich in flavor. Major emphasis is put on having lunch	Basis of food is meat; it is an essential part of every meal. More emphasis is placed on having dinner
Family	Traditional people usually prefer joint-families, while modern people are now living in nuclear-like families	Most people believe in nuclear families
Festivals	Holi, Diwali, Navratri, etc. There a whole lot of festivals that are based on different events in the history; modern festivals are being accepted such as Christmas	Christmas, Labor Day, Easter, Halloween etc. Also due to it being a melting pot a whole of other festivals are also celebrated
Marriages	Arranged Marriages are more common, compared to love marriages	Love marriages are more common
Society	Society plays an active part in a person's life. Every decision that a person takes , reflects what the society thinks about it	Society does not take an active part. People take decisions depending on what they want, not what the society thinks
Gender Equality	Women are still considered unequal to men though acceptance of westernization is changing this idea	Women are equal to men in society
Castes	Still have various castes, where one caste is lesser than the other caste	No such thing as castes, all people are equal
Clothing	Clothing should not be revealing or tight	A person can wear clothing according to what they desire
	Religious, classical, folk, popular,	Is a melting pot and mix of all kinds

Music	bollywood and pop music	of music from all over the world; includes rap, hip hop, pop, metal, rock, soft rock, etc
Hierarchy	The social hierarchy cannot be challenged. (ex: Boss has final decision)	Hierarchy can be challenged at any point by anyone

Impact of foreign culture on India

Civilizations do meet and even merge but never has such an impact been witnessed as the impact of the west on India. A Birdseye view of the Indian scenario would depict a miniature or a distorted West in India.

i. Notice only western modes

The impact has been so great and so deep that, wherever we go, and, as far as the eye can see, we notice only western modes and we are for a moment set to wonder if we are in India or in some western country.

ii. Culture of the west has penetrated so deep

Impact of cultures is felt elsewhere also and this is bound to be, when two people or two societies or two countries meet but, neither leaves its own system wholesale as in India. This is a unique feature in India only, where the culture of the west has penetrated so deep and far and wide that, the original Indian culture has got lost somewhere.

iii. Completely influenced by the west

To find western impact on India we do not have to go far to seek. Each and every home, each and every sphere of life has been completely influenced by the west that it is difficult to recognize what is Indian in India. Our food, and food habits, our dresses, our dances, our songs, our music, our life style are the entire western pattern.

vi. ***English language most prominent***

One often wonders whether where we live is India, or a colony of the west? The influence is also changing our education system. In schools, the language most prominent is English and not Hindi. The medium of instruction is also English, so far so good. However, the sad part of this system is that, the schools that lay more stress on Hindi, or use the Hindi Medium of instruction, are known to be second rate schools. Thus, we have not only adopted the British ways but we also appreciate them only. The height of it all is seen when see that, a person who can communicate in English is known to be smarter than a person who cannot. This volume of change is not understandable.

vii. ***Follow the western styles***

It implies that, not only have we taken to western styles, we also admire only them who follow the western styles, in comparison to those who follow the Indian styles.

viii. ***Loss of the identity***

This much influence is not only unwarranted but also shameful. It has often been seen that countries do adopt methods of other countries but in doing so, they maintain their own identity. The loss of the identity is only found in India.

ix. ***Indigenous is difficult to introduce***

To a great extent the influence of the British can be well understood as, we have remained slaves to them for two centuries. This much may be excused, but to revolt if anything Indian or anything indigenous is being introduced cannot be forgiven at all.

x. ***Remain culturally and mentally bonded to the west***

This only points to the ugly fact that, we have got independence from the British only physically and politically but, mentally and culturally the onslaught on India has been complete. We, even to-day, remain culturally and mentally bonded to the west. Whenever anything Indian is talked about there is an attitude of derision for it, even in the highest echelons of society.

This indicates a full and complete degeneration of Indian culture and its total merger with the culture of the west.

xi. ***To learn a thing just because it is of the west***

It is good to learn whatever is good anywhere, but, to learn a thing just because it is of the west only depicts a crumbled and shattered state of the Indian mind. We must learn to sort out and learn what is good elsewhere and maintain what is good in us.

Lesion 2.3

Social Responsibility of Business

Social Responsibility- Meaning

Social responsibility is an ethical framework which suggests that an entity, be it an organization or individual, has an obligation to act for the benefit of society at large. Social responsibility is a duty every individual has to perform so as to maintain a balance between the economy and the ecosystems. A trade-off may exist between economic development, in the material sense, and the welfare of the society and environment, though this has been challenged by many reports over the past decade.

Social responsibility means sustaining the equilibrium between the two. It pertains not only to business organizations but also to everyone whose any action impacts the environment. This responsibility can be passive, by avoiding engaging in socially harmful acts, or active, by performing activities that directly advance social goals.

According to some experts, most rules and regulations are formed due to public outcry, which threatens profit maximization and therefore the well-being of the shareholder and that if there is not outcry there often will be limited regulation.

Some critics argue that corporate social responsibility (CSR) distracts from the fundamental economic role of businesses; others argue that it is nothing more than superficial window-dressing, or "green washing"; others argue that it is an attempt to pre-empt the role of governments as a watchdog over powerful corporations though there is no systematic evidence to support these criticisms.

A significant number of studies have shown no negative influence on shareholder results from CSR but rather a slightly negative correlation with improved shareholder returns. Some studies have shown strongly positive correlations between a CSR-type commitment to sustainability and company performance in the long-term.

Factors influencing social responsibilities on business

The following arguments will support the involvement of business in social activities:

1. Public Requirements:

Business can exist only with public support and only if business fulfills needs of society. One of the main arguments for social responsibility is that public expectations from business have changed. Therefore if business wishes to remain in existence for a long term it must respond to society's needs and give society what society wants.

The business must come up to expectations of public for its survival since the demand for products or services arises from customers who are a part of society. Since business is a part and parcel of society, it must think of its responsibilities.

2. Favourable For Business:

Performance of social obligation by business will not only be in the interest of society but in its own interest also. The firm which is more responsive to improvement of community quality of life will as a result has better community in which it conducts its business.

People with healthy environment, good health and education will make them good customers and employees. Recruitment of labour will be of higher quality. Turnover and absenteeism will be reduced. The society may reject an enterprise which does not care for social welfare. Crime rate will also decrease as a result of social improvements.

3. Moral Justification:

Nowadays modern industrial society faces many serious social problems as a result of emergence of large companies. Therefore, these large corporations have a moral responsibility to solve these problems. Also business which is using so many resources of our economy has responsibility to devote some of these resources in overall development of society.

4. Socio-Cultural Norms:

In a country like India where social and cultural values have long and rich heritage, a business promoting social equalities, healthy employer-employee relations and consumer service will enjoy better social position. A business working against traditional values will face criticism from society.

5. Business Can Shoulder Responsibility:

Many people who feel frustrated with failure of other institutions in handling social problems are turning to the business for their solution to social problems. In such a situation, it becomes the duty of business to come up to expectation of public and fulfill its responsibilities towards society.

6. Responsibility Must Correspond with Power:

Business enjoys social power to a great extent. So they do affect economy, minorities and other social problems. Business should perform equal amount of social responsibility to match their social power. If they don't then it will reflect their irresponsible behaviour, which will ultimately affect the natural growth.

7. Public Image:

Only that firm can enjoy better reputation in public which supports social goals. Each firm seeks an enhanced public image so that it may gain more customers, better employees, more responsive money markets etc. It is possible only if business performs its responsibilities towards society whole-heartedly which will result in raising the value of shares and debentures held by the owners.

8. Government Regulations:

If business does not respond positively to the needs of society, then it may be compelled to do so through government laws and regulations. Before government stretches its long arms, the business should discharge its obligations to society. It has to regulate the business in public interest.

9. Indebted to Society:

Business units benefit from society. In return it also has certain debts that it owes to society. Business uses vast pool of resources in terms of men, talents, expertise and money. Business is in a position to work for social goals with the help of these resources. Also corporations unlike citizens are created by society so they have certain civic duties and responsibilities.

Corporate Social Responsibility (CSR)

Corporate social responsibility or CSR has been defined by Lord Holme and Richard Watts in the World Business Council for Sustainable Development's publication "Making Good Business Sense" as the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large."

CSR is one of the newest management strategies where companies try to create a positive impact on society while doing business. Evidence suggests that CSR taken on voluntarily by companies will be much more effective than CSR mandated by governments. There is no clear-cut definition of what CSR comprises. Every company has different CSR objectives though the main motive is the same. All companies have a two-point agenda—to improve qualitatively (the management of people and processes) and quantitatively (the impact on society). The second is as important as the first and stake holders of every company are increasingly taking an interest in "the outer circle"-the activities of the company and how these are impacting the environment and society.

Corporate social responsibility (CSR) promotes a vision of business accountability to a wide range of stakeholders, besides shareholders and investors. Key areas of concern are environmental protection and the wellbeing of employees, the community and civil society in general, both now and in the future.

The concept of CSR is underpinned by the idea that corporations can no longer act as isolated economic entities operating in detachment from broader society. Traditional views about competitiveness, survival and profitability are being swept away.

Features of Corporate Social Responsibility

Some of the drivers pushing business towards CSR include:

1. The shrinking role of government

In the past, governments have relied on legislation and regulation to deliver social and environmental objectives in the business sector. Shrinking government resources, coupled with a distrust of regulations, has led to the exploration of voluntary and non-regulatory initiatives instead.

2. Demands for greater disclosure

There is a growing demand for corporate disclosure from stakeholders, including customers, suppliers, employees, communities, investors, and activist organizations.

3. Increased customer interest

There is evidence that the ethical conduct of companies exerts a growing influence on the purchasing decisions of customers. In a recent survey by Environics International, more than one in five consumers reported having either rewarded or punished companies based on their perceived social performance.

4. Growing investor pressure

Investors are changing the way they assess companies' performance, and are making decisions based on criteria that include ethical concerns. The Social Investment Forum reports that in the US in 1999, there was more than $2 trillion worth of assets invested in portfolios that used screens linked to the environment and social responsibility.

5. Competitive labour markets

Employees are increasingly looking beyond paychecks and benefits, and seeking out employers whose philosophies and operating practices match their own principles. In order to hire and retain skilled employees, companies are being forced to improve working conditions.

6. Supplier relations

As stakeholders are becoming increasingly interested in business affairs, many companies are taking steps to ensure that their partners conduct themselves in a socially responsible manner. Some are introducing codes of conduct for their suppliers, to ensure that other companies' policies or practices do not tarnish their reputation.

Benefits of Corporate Social Responsibility

Some of the positive outcomes that can arise when businesses adopt a policy of social responsibility include:

1. Company benefits:

- Improved financial performance;
- Lower operating costs;
- Enhanced brand image and reputation;
- Increased sales and customer loyalty;
- Greater productivity and quality;
- More ability to attract and retain employees;
- Reduced regulatory oversight;
- Access to capital;
- Workforce diversity;
- Product safety and decreased liability.

2. Benefits to the community and the general public:

- Charitable contributions;
- Employee volunteer programmes;
- Corporate involvement in community education, employment and homelessness programmes;
- Product safety and quality.

3. Environmental benefits:

- Greater material recyclability;
- Better product durability and functionality;
- Greater use of renewable resources;

- Integration of environmental management tools into business plans, including life-cycle assessment and costing, environmental management standards, and eco-labelling.

The concept of corporate social responsibility is now firmly rooted on the global business agenda. But in order to move from theory to concrete action, many obstacles need to be overcome. A key challenge facing business is the need for more reliable indicators of progress in the field of CSR, along with the dissemination of CSR strategies. Transparency and dialogue can help to make a business appear more trustworthy, and push up the standards of other organizations at the same time.

Corporate Social Responsibility (CSR) in Indian context

India`s new Companies Act 2013 (Companies Act) has introduced several new provisions which change the face of Indian corporate business" Companies Act 2013 (Companies Act) has introduced several new provisions which change the face of Indian corporate business. One of such new provisions is Corporate Social Responsibility (CSR). The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc from the society. By performing the task of CSR activities, the companies are giving something back to the society.

***Applicability*:**

Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company i.e. (a) net worth of the company to be Rs 500 crore or more; (b) turnover of the company to be Rs 1000 crore or more; (c) net profit of the company to be Rs 5 crore or more. Further as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies, but also applicable to branch and project offices of a foreign company in India.

***Activities under CSR*:**

The activities that can be done by the company to achieve its CSR obligations include

- eradicating extreme hunger and poverty,
- promotion of education,
- promoting gender equality and empowering women,

- reducing child mortality and improving maternal health,
- combating human immunodeficiency virus, acquired, immune deficiency syndrome, malaria and other diseases,
- ensuring environmental sustainability,
- employment enhancing vocational skills,
- social business projects,
- contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and
- funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women and such other matters as may be prescribed.

Self Assessment Questions

1. Explain the meaning of social environment
2. What are the types of social organizations?
3. What are the internal and external factors affecting social environment?
4. Explain the linguistics systems prevailing in India and its origin.
5. What are the evils of linguistics Systems in India and what the remedial measures to eradicate them
6. What are the major religious groups in India?
7. How do the social attitudes affect social behavior?
8. What are the Characteristics features of joint family system in India?
9. What is meant by Cultural Heritage? And what are the types of Cultural Heritage?
10. Explain the origins and evolutions of the Caste System in India.
11. What are the various types of Indian communities?
12. What are the differences between Indian and foreign culture?
13. What are the impacts of foreign culture in India?
14. What are the factors influencing social responsibilities in business?
15. Explain the features of Corporate Social Responsibility (CSR)
16. What are the benefits of Corporate Social Responsibility?
17. Explain the Corporate Social Responsibility (CSR) in Indian context.

Unit – III

POLITICAL ENVIRONMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning and definition of Political Environment
- Types of political systems
- Political ideologies and classifications
- Impact of Political environment on Business
- Classifications of Directive Principles under Indian constitution
- Centre and State relations under Indian constitution

Unit Structure

Lesson 3.1 – Political Environment – Meaning and Concepts

Lesson 3.2 – Political Environment and Constitution of India

Lesson 3.1

Political Environment – Meaning and Concepts

Political Environmental- Definition

Government actions affects the operations of a company or business. These actions may be on local, regional, national or international level. Business owners and managers pay close attention to the political environment to gauge how government actions will affect their company.

The political environment is one of the less predictable elements in an organisation's business environment. The fact that democratic governments have to seek re-election every few years has contributed towards a cyclical political environment. Inter-linkages in politics occur in many ways, for example:

- Political decisions inevitably affect the economic environment.
- Political decisions also influence the social and cultural environment of a country.
- Politicians can influence the pace at which new technologies appear and are adopted.

The political environment in its widest sense includes the effects of pressure groups who seek to change government policies.

Political Climate

Political climate can be manipulated by social activism and mass public opinion. The way people feel about and perceive the social and political environment creates the dynamic of a political climate. The organic nature of political climate means that at any time public sentiment can impose a change in what's valued by society.

Variables that can work independently or in concert include the actions of political decision-makers, societal events and social change movements. Interpretation of political climate is subjective but as a whole, can create a mechanism for governmental action and new social constructs.

Interpretation for political climate

1. ***Public Opinion***

   Public opinion helps to define a political climate, especially in a democratic society. Politicians often base decision-making and legislative strategy on the feelings and thoughts of their constituents. They will even use surveys to gather information about what will influence election results. The media is a common vehicle for public opinion. For example, a demonstration about a political issue may be televised and consequently impact public perception. In turn, a groundswell of support may spark the development of new laws or action by a governmental official.

2. ***Organizational Infrastructure***

   Political climate is often shaped by the organizational operating structure. Decision-making by leaders about specific issues sets the tone for what is valued. Popular political leaders wield more power and usually have more support to get things done. Similarly, the financial health of government influences the political climate. For example, in a time of serious budgetary constraints, approval to spend money on new initiatives is likely to be more challenging. Understanding the way an organization operates sheds insight on leaders who may be allies on a particular issue or obstacles to making organizational change.

3. Significant Events

Societal events tell the story of a political climate. The way people behave indicates their feelings, mood or comfort-level in an organization or community. For example, if a same-sex couples feels comfortable being open about their relationship, the political climate might be considered liberal or open. The media helps to shape the climate, simply by sharing stories about social change or community issues. The news about public reaction to a political issue makes a statement about societal environment and can influence the feelings and thoughts of those who are uninvolved.

4. Social Change Movement

Social change initiatives may serve as a barometer of political climate or even shape it. Public sentiment about an issue can be a deciding factor in the importance of the issue. For example, a topic that goes viral on the Internet or results in a massive demonstration may result in attention from local, state or even national politicians. A group invested in a particular issue needs public support to make broad-based change. The change itself may swing political climate by instilling new public expectations or garnering mass support.

Political Systems

When we speak of political systems, it's difficult to determine what the most common types are. After all, many political systems are similar, or have similar roots. Many countries actually have republics of some kind — variants of democracy. As you study political science, it can be helpful to understand some of the most common types of political systems from around the world.

Understanding different political systems is important. Each political system has its advantages and disadvantages. It is worth considering the merits of other political systems, and perhaps incorporating some of the ideas into your own system. Some of the five more common political systems around the world include:

1. Democracy

2. Republic
3. Monarchy
4. Communism
5. Dictatorship

Here are some overviews of these five fairly recognizable political systems:

1. Democracy

We often hear the United States referred to as a democracy. Indeed, many refer to India or U.S. as a representative democracy. A democracy in a more traditional sense is a political system that allows for each individual to participate. There are two rather popular types of democracy:

i. Direct Democracy:

Many scholars point to Athens as an example of direct democracy. Technically, every citizen has an equal say in the workings of government. (The qualifications for being considered a citizen are completely different.) Citizens could show up at a meeting, and then directly participate in the governing process, and the process of making laws.

ii. Representative Democracy:

In a representative democracy set-up, citizens elect representatives who actually make the law. India operates similarly to this principle. Citizens elect legislators who, in turn, make laws. In India, the prime minister is elected from among the elected representatives

iii. Deliberative Democracy

Other types of democracy include versions known as deliberative democracy, in which citizens approach decision making by considering different viewpoints and options, as well as democratic socialism, in which citizens help make decisions or vote for policies that are socialistic in nature. There are other types of democracy as well. The defining characteristic is some level of citizen participation in the political system.

2. Republic

In theory, a republic is a political system in which the government remains mostly subject to those governed. Some scholars define any political system in which the citizens legitimize the government. As such, some (including Montesquieu) consider the U.S. a republic. In some cases, a representative democracy (or any form of democracy) might be considered a republic. Some of the types of republics that you might see include:

- Crowned (a constitutional monarchy might be considered a crowned republic)
- Single Party
- Capitalist
- Federal (the United States is often referred to as a federal republic)
- Parliamentary

The main characteristic of a republic is that the government is subject to the people, and leaders can be recalled. Some even make the argument that an oligarchy, which is rule by a few citizens, or a group of citizens, is a form of republic, since the government is subject to some of the wishes of some of the governed.

3. Monarchy

When most of us think of a monarchy, we think of the political systems of medieval European countries. In a monarchy, a ruler is not usually chosen by the voice of the people or their representatives. Often a monarch is the head of state until he or she abdicates or until death. In many cases a monarch is the final word in government. There may be functionaries to make decisions and run the political system, but the monarch has discretion with the laws, and how they are enforced.

However, as with other political systems, there are different types of monarchies. The type that many of us think of as common is the absolute monarchy, in which the monarch truly has the ultimate say in matters of government. However, most monarchies in political systems today do not follow this method. Many of them, especially in the developed world, have limits. Constitutional monarchies fall into this category (and are sometimes considered republics as well). In this type of monarchy, the ruler is the head of state, but a constitution limits the power, and others make laws. The U.K., Denmark, Kuwait, Spain, Sweden, and many more are examples of constitutional monarchies.

Other types of monarchies include duchies, grand duchies, elective monarchy (where the monarch is actually elected), and non-sovereign monarchy.

4. Communism

In most cases, a communist state is based on the ideology of communism as taught by Marx and/or Lenin. However, some argue that these political systems are not true to the ideals espoused by these revolutionary thinkers. Communist states are often dominated by a single party, or a group of people. A planned economy is often part of the governing class, and in many cases resources are taken and then redistributed to others, at the top of the system. Sometimes communists call themselves "workers' states" or "socialist," but there are very real differences in their operation. In a lot of cases, citizens are required to do certain jobs, or have some of their life decisions — especially concerning where they can live and what jobs they can do. Communism is often considered an authoritarian political system.

5. Dictatorship

Another authoritarian form of government is the dictatorship. Normally, a dictator is the main individual ruling the country. While there are lackeys and others who work for the dictator, he or she makes most of the decisions, and usually has enforcers. In some cases, the political system is run by a small group of people. Dictators are not restricted by constitutions or parliaments. The governed are usually not consented in any way. Elections held are usually affairs in which the dictator is the only candidate.

One of the more common types of dictatorship is the military dictatorship, in which a military organization governs, running the political system. Sometimes, the military just exerts a great deal of pressure on the government, running the country de facto. In many cases a very few are benefited from the decisions made in a dictatorship.

While authoritarian political systems have the advantage of quick decisions being made, many citizens prefer other forms of government — those that allow them greater participation in the political process.

Political Ideologies

Over the millennia, political philosophers have expounded on a variety of political ideologies, or ways governments and societies can be organized. Today, scholars generally talk about five major political ideologies:

1. Anarchism
2. Absolutism
3. Liberalism
4. Conservatism
5. Socialism

These political ideologies are, for the most part, mutually exclusive. So, a liberal government does not usually practice socialism, nor does an absolute ruler follow liberalism. The five major political ideologies have played a key role in history by shaping governments and political movements.

1. Anarchism

The belief that the best government is absolutely no government is known as *anarchism.* This ideology argues that everything about governments is repressive and therefore must be abolished entirely. A related ideology known as *nihilism* emphasizes that everything—both government and society—must be periodically destroyed in order to start anew. Nihilists often categorically reject traditional concepts of morality in favor of violence and terror. Anarchism and nihilism were once associated with socialism because many anarchists and nihilists supported the socialists' call for revolution and the complete overhaul of government and society in the early to mid-twentieth century.

Example: Although neither violent nor strictly anarchist, members of the American Libertarian Party believe that government should be so small that it hardly ever interferes in citizens' lives, thereby best preserving individual liberty.

2. Absolutism

Traditionally, much of Western civilization's history was dominated by *absolutism*, the belief that a single ruler should have control over every aspect of the government and of the people's lives. Absolute rulers had a variety of titles, including *chieftain, king, shah, pharaoh, emperor, sultan,* and *prince.* In some cultures, the absolute ruler was seen as a god in human form. Other peoples believed that their ruler had the *divine right of kings*, meaning that God had chosen the ruler to govern the rest. As a result, many cultures with absolute rulers practiced some form of *caesaropapism*, the belief that the ruler is head of both the governmental authority and the religious authority.

Example: In the Byzantine Empire, the double-headed eagle symbolized caesaropapism. The two heads stood for church and state. This symbol clearly and graphically portrayed the unity of religious and secular power in one person.

Absolutism emphasizes:

- *A strong sense of order*: Everything should be carefully structured, including society. Disorder and chaos are generally considered to be dangerous.
- *A clear-cut law of nature (or law of God):* This law must be obeyed. According to this law, some people are inherently better than others. A natural *hierarchy* (a power structure in which some people have authority over others) exists. Therefore, the superior should rule the inferior. This general view is called *elitism*,or *elite theory.*
- *The wisdom of traditional values and institutions*: New ideas are considered dangerous to the order of things.

3. Liberalism

In the early modern age of the Western world (beginning roughly in the early 1500s), a number of changes occurred that led to new ideologies: The European discovery of the

Americas, the rise of Protestantism, the beginnings of the free-market economy, and the early stages of the scientific revolution fundamentally altered Europe. People began developing

Perhaps the most important of the new ideas is *liberalism* (also known as *classical liberalism*). This type of liberalism, which began in England in the 1600s, differs from American liberalism. Classical liberalism developed when such thinkers as John Locke (in his *Second Treatise of Government* in 1690) rethought the relationship between the individual and society, as well theorized about the rights and responsibilities of the individual. These ideas formed the foundation for many political systems still operating today.

Liberalism emphasizes:

- *Individualism*: The individual takes priority over society.
- *Freedom:* Individuals have the right to make choices for themselves. This freedom is not absolute, and some behaviors, such as murder, are prohibited. Freedom of religion is particularly an important freedom to come out of liberalism because so many governments at the time were very closely tied to a particular religious creed.
- *Equality:* No person is morally or politically superior to others. Hierarchies are rejected.
- *Rationalism*: Humans are capable of thinking logically and rationally. Logic and reason help us solve problems.
- *Progress*: Traditions should not be kept unless they have value. New ideas are helpful because they can lead to progress in the sciences, the economy, and society.
- *The free market*: Liberalism and capitalism go hand in hand. Liberals like the free market because it more easily creates wealth, as opposed to traditional economies, which often have extensive regulations and limits on which occupations people can hold.

These basic characteristics of liberalism have led liberals to argue in favor of a limited government, which draws its power from the people. In practice, this has meant favoring a democratic government.

4. ***Conservatism***

Conservatism (also known as *classical conservatism*) began as a reaction against the liberal ideas taking hold of Europe during the French Revolution in the late eighteenth century. This type of conservatism differs from American conservatism. Edmund Burke, a British Member of Parliament, observed the early stages of the French Revolution with great distress and predicted the violence and terror that would ensue. His book, *Reflections on the Revolution in France* (1790), is one of the founding texts of classical conservatism.

Burke and other conservatives attacked liberalism for many reasons. They argued that liberalism destroyed tradition. In its rush to overturn the old and bring in the new, liberalism and capitalism ruthlessly attacked traditional institutions and beliefs.

Conservatism emphasizes:

- *Stability***:** Stability is a precious thing, and change must be made gradually in order to preserve it. Undermining stability is very dangerous because societies can easily fall into chaos and violence. Classical liberals frequently called for revolution, which opens the door to great turbulence, according to the classical conservative view.
- *Concreteness***:** Liberalism is too abstract. It focuses on freedom and equality, not on the concrete way people live every day.
- *Human fallibility***:** Liberalism overestimates human beings. Humans are frequently ignorant, prejudiced, and irrational. By ignoring these defects, liberalism becomes unrealistic.
- *Unique circumstances***:** There is no universal answer to the problems of society; the circumstances are unique in each country.

Impact of Political environment on Business

There are many external environmental factors that can affect your business. It is common for managers to assess each of these factors closely. The aim is always to take better decisions for the firm's progress. Some common factors are political, economic, social and technological (known as PEST analysis). Companies also study environmental, legal, ethical and demographical factors.

The political factors affecting business are often given a lot of importance. Several aspects of government policy can affect business. All firms must follow the law. Managers must find how upcoming legislations can affect their activities.

There are *4 main effects* of these political factors on business organizations. They are:

a) Impact on economy
b) Changes in regulation
c) Political stability
d) Mitigation of risk

A) Impact on Economy

The political situation of a country affects its economic setting. The economic environment affects the business performance.

For example, there are major differences in Democratic and Republican policies in the US. This influences factors like taxes and government spending, which ultimately affect the economy. A greater level of government spending often stimulates the economy.

B) Changes in Regulation

Governments could alter their rules and regulations. This could in turn have an effect on a business. After the accounting scandals of the early 21st century, the US *Securities and Exchange Commission* became more attentive on corporate compliance. The government introduced the Sarbanes-Oxley compliance regulations of 2002. This was a reaction to the social environment. The social environment urged a change to make public companies more liable.

C) Political Stability

Lack of political stability in a country effects business operations. This is especially true for the companies which operate internationally.

For example, an aggressive takeover could overthrow a government. This could lead to riots, looting and general disorder in the environment. These disrupt business operations. Sri Lanka was in a similar state during a civil war. Egypt and Syria faced disturbances too.

D) Mitigation of Risk

Buying political risk insurance is a way to manage political risk. Companies that have international operations use such insurance to reduce their risk exposure. There are some indices that give an idea of the risk exposure in certain countries. The index of economic freedom is a good example. It ranks countries based on how politics impact business decisions there.

Lesson 3.2

Political Environment and Constitution of India

Directive principles under Constitution of India

The Directive Principles of State Policy contained in Part IV, Articles 36-51 of the Indian constitution constitute the most interesting and enchanting part of the constitution.

The Directive Principles may be said to contain the philosophy of the constitution. The idea of directives being included in the constitution was borrowed from the constitution of Ireland. As the very term "Directives" indicate, the Directive Principles are broad directives given to the state in accordance with which the legislative and executive powers of the state are to be exercised.

As Nehru observed, the governments will ignore the directives "Only at their own peril." As India seeks to secure an egalitarian society, the founding fathers were not satisfied with only political justice. They sought to combine political justice with economic and social justice.

Part IV of the constitution does not form an operative part of the constitution. The directives are non-justiciable in character. The courts cannot compel the governments to enforce the directives. The non- justifiability of part IV has exposed the directives to trenchant criticism. Jennings calls them "pious aspirations," and "Fabian socialism without socialism." Where characterizes them as "paragraphs of generalities."

The Directive Principles may be classified into 3 broad categories—

1. Socialistic
2. Gandhian
3. Liberal-intellectual.
4.

(1) Socialistic Directives : Principal among this category of directives are

(a) Securing welfare of the people under Art. 38

(b) Securing proper distribution of material resources of the community as to best sub serve the common-good, equal pay for equal work, protection of childhood and youth against exploitation. etc. under Art.39

(c) Curing right to work, education etc. under Art. 41,

(d) Securing just and humane conditions of work and maternity relief under Art. 42 etc.

(2) Gandhian Directives

Such directives are spread over several Articles. Principal among such directives are

(a) to organize village panchayats (Art. 40),

(b) to secure living wage, decent standard of life, and to promote cottage industries (Art.43),

(c) to provide free and compulsory education to all children up to 14 years of age (Art. 45),

(d) to promote economic and educational interests of the weaker sections of the people, particularly, the scheduled castes and scheduled tribes,

(e) to enforce prohibition of intoxicating drinks and cow-slaughter and to organize agriculture and animal husbandry on scientific lines (Arts. 46-48).

(3) Liberal intellectual Directives

Principal among such directives are

(a) to secure uniform civil code throughout the country (Art.44),

(b) to separate the judiciary from the executive (Art.50),

(c) to protect monuments of historic and national importance

(d) to promote international peace and security.

On the whole, Part IV contains a formidable list of directives given to the executives and the legislatures to follow in issuing orders or making laws.

Classification of Directive Principles

1. Socialist Principles

Article 38 – the state shall endeavour to formulate such social system which will secure social, economic and political justice to all in all the spheres of life.

Article 39(a) - the state shall try to formulate its policy in such a manner so as to secure adequate means of livelihood for all its citizens.

Article 39(b) - the ownership of material resources would be controlled in such a manner so as to subserve the common good.

Article 39(c) - the economy of the state will be administered in such a manner so that wealth may not yet be concentrated in a few hands and the means of production may not be used against the public interest.

Article 41 - the State will work within the limits of its economic viability and progress, provide to the citizens the right to work, the right to education and general assistance in the event of unemployment, old age, disease and other disabilities.

Article 42 - the state will make provisions for the creation of just and humane conditions of work. It will also ensure maternity relief.

Article 43 - the state will ensure adequate wages, good life and rest to the labourers. The state will also endeavour to make available to the labourers various socio-cultural facilities.

2. Liberal Principles

Article 44 - The State shall endeavour to formulate and implement a Uniform Civil Code for all the people living throughout the territory of India.

Article 45 - the State shall endeavour to provide early childhood care and education for all the children until they complete the age of six years.

Article 47 - the State shall strive to raise the level of nutrition and the standard of living. Thus, it will endeavour to improve upon the health of the people.

Article 48 - the State shall strive to organise agriculture and husbandry on modern and scientific lines. It will also try to maintain and improve upon the breed of the animals.

Article 50 - the state will try to separate the judiciary from the executive in the case of public service.

3. Gandhian Principles

Article 4 - the State will strive to organise Panchayats in villages and will endow them with such powers which enable them to act as units of self government.

Article 43 - the state shall strive to develop the cottage industry in the rural areas both, on individual or cooperative basis.

Article 47 - the state will strive to ban the consumption of wine, other intoxicating drinks and all such commodities which are considered injurious to health.

Article 48 suggests that the State will ban slaughtering of cows, calves and other milch cattle.

4. International principles

Article 51(a)- The State will strive to promote international peace and security.

Article 51(b)- The State will strive to maintain just and honourable relations among various states in the world.

Article 51(c)- The State will endeavour to promote respect for International treaties, agreements, and law.

Article 51(f)- The State will strive to settle international disputes by arbitration.

5. Directives that is non-judicial

1. Article 350 A enjoins every state and every local authority within the state to provide adequate facilities for instruction in the mother tongue at the belonging to linguistic minority groups.

2. Article 351 enjoins the union to promote the spread of Hindi and to develop it so that it may serve as a medium of expression of all the elements of the composite culture of India.

3. Article 335 enjoins that the claims of the members of the Scheduled Castes and Scheduled Tribes shall be taken into consideration, consistently with the maintenance of efficiency of administration, in the making of appointments to services and posts in connection with the affairs of the union or a state. Though the Directives contained in Article 335, 305A and 351 are not included in Part IV, courts have given similar attention to them on the application of the principle that all part of the Constitution should be read together.

Centre and State powers under Constitution

India has a *federal structure* i.e. there is division of powers between the Centre and the State. These division of powers can be classified into following types :

1. Legislative Powers (enumerated in Articles 245 to 255 in Part XI of the constitution)
2. Administrative Powers (enumerated in Articles 256 to 263 in Part XI of the constitution)
3. Financial Powers (enumerated in Articles 268 to 293 in Part XII of the constitution)

Judicial powers have not been divided among the Centre and the state. The judicial powers are exercised by an integrated system of judicial courts only with Supreme Court at its apex followed by High Court & then the Subordinate courts.

Difference between the legislative powers of Centre and State

Centre	**State**
Centre can make laws for whole or for a particular area of India.	State can make laws only for the area which comes under it as territorial area.
Centre can also make laws for Union Territory subject to some conditions.*	State can't make laws for Union Territory even when it is located in that particular state.
Centre has the power to make laws that are "extra-territorial" in nature i.e. such laws are applicable outside India.	State can't make such laws.

*****Note :
i) If President has the supreme power in the case of Union Territory. If the President thinks that a particular law is not fit for any union territory he can even repeal or amend that act.
ii) Governor of the state has the power to limit or modify the provisions of any law made by Parliament on the grounds of protecting the interests of Scheduled Area.
iii) The Governor of Assam may direct that an act of Parliament does not apply to a tribal area (Autonomous District) in the state or apply with specified modifications and exceptions. The President enjoys the same power with respect to tribal areas (autonomous districts) in Meghalaya, Tripura & Mizoram.

Way of distribution of legislative subject

Subjects in India have been divided into three types according to constitution:

1. Union List
2. State List
3. Concurrent List

List	**Description**
Union List	Only Parliament can make laws in the case of a subject listed in the Union list. It has 100 subjects for now.

State List	Only state can make laws in the case of a subject listed in the State List. It has 61 subjects for now.
Concurrent List	Parliament and state (both) are allowed to make laws on the subjects listed in this list. If both have made laws on the same subject then the central law overrides the state law. It has 52 subjects for now. 42nd Amendment Act, 1976 transferred 5 Subjects from state list to concurrent list. (those five subjects were – education, forests, weights and measures, protection of wild animals and birds and administration of justice; constitution and organisation of all courts except the Supreme Court and the high courts.

- Residuary subjects : Only Parliament has the power to make laws on the subjects that are not enumerated in any of the list mentioned. These subjects are called residuary subjects & the power the parliament has in case of them is called residuary powers.
- This classification of subjects into three lists has been taken by India from the Government of India Act 1935.
- Order of the list in which they have received power: Union list > Concurrent List > State List.

Other ways in which centre controls state's legislative powers

Way	**Description**
By Governor	Governor can reserve some bills passed by the state legislature for the President's consideration. The President has absolute veto over them.
By President	State has to take prior permission from President in case of law made on a certain subjects in state list. (like the bill to restrict trade and commerce)
By President	President can direct the states to reserve money bills and other financial bills passed by the state legislature for his consideration during financial emergency.

Difference between the Executive powers of centre and state

Centre	State
Executive power of the centre extends to whole India	Executive powers of the state is limited to the territorial extent of the state
Executive power over laws made on subjects mentioned in the concurrent list doesn't lie with the centre.	Executive power over laws made on subjects mentioned in the concurrent list lies with the state except when a constitutional provision or a parliamentary law specifically confers it on the centre.

Restrictions on the use of executive power of the state

Executive power of the state should be used in such a way so
i) as to ensure compliance with the laws made by the Parliament and any existing law which apply in the state.
ii) as not to impede or prejudice the exercise of executive power of the Centre in the state.

Tension Areas in Centre-State Relations:

a. Encroachment by the Centre on the State List
b. Appointment of enquiry commission against the chief ministers
c. Management of All-India Services (IAS, IFS and IPS)
d. Discrimination in financial allocations to the states
e. Deployment of central forces in the states to maintain law and order
f. Discriminatory and partisan role of governors
g. Mode of appointment and dismissal of governor
h. Imposition of presidents rule for partisan interests
i. Reservation of state bills for the consideration of the President
j. Role of Planning Commission in approving state projects
k. Use of electronic media for political purposes
l. Sharing of finances (between centre and state)

Self Assessment Questions

1. Define political environment.
2. How do you interpret political climate?
3. Explain various types of political systems.
4. What are the major classifications of political ideologies?
5. What are the impacts of political environment on business?
6. What are the classifications of Directive Principles under Indian Constitution?
7. Explain the Centre and State relations under Indian Constitution

Unit – IV

ECONOMIC ENVIRONEMNT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning of economic environment and its definition
- Elements of economic environment
- Impact of economic environment on business
- Types of economic systems
- Types of various macroeconomic parameters
- The objectives and achievements of Five Year Plans in India

Unit Structure

Lesson 4.1 – Meaning and Concepts of Economic Environment

Lesson 4.2 – Economic Environment on Business

Lesson 4.3 – Macroeconomic Parameters

Lesson 4.4 - Five Year Plan in India

Lesson 4.1

Meaning and Concepts of Economic Environment

Economic Environment - Meaning and Concept

A qualitative evaluation of several key economic factors are undertaken in order to predict the success of a business venture or to evaluate the amount of risk involved in economic activities in general. The economic environment may include factors such as unemployment percentages, consumer confidence measurements, and the values of market indexes.

So far as the economic environment is concerned, it is affected by the total or overall economic system of the economy, i.e., whether capitalist or social system. Country’s system of economic planning and control, such as Government’s fiscal or monetary systems, commercial and industrial policies of the Government, commercial and industrial laws, of the country are all important elements of the economic environment. Every such element affects the functioning of the business.

The economic environment consists of external factors in a business' market and the broader economy that can influence a business. You can divide the economic environment into the microeconomic environment, which affects business decision making - such as individual actions of firms and consumers - and the macroeconomic environment, which affects an entire economy and all of its participants. Many economic factors act as external constraints on your business, which means that you have little, if any, control over them. Let's take a look at both of these broad factors in more detail.

Macroeconomic influences are broad economic factors that either directly or indirectly affect the entire economy and all of its participants, including your business. These factors include such things as:

- Interest rates
- Taxes
- Inflation
- Currency exchange rates
- Consumer discretionary income
- Savings rates
- Consumer confidence levels
- Unemployment rate
- Recession
- Depression

Microeconomic factors influence how your business will make decisions. Unlike macroeconomic factors, these factors are far less broad in scope and do not necessarily affect the entire economy as a whole. Microeconomic factors influencing a business include:

- Market size
- Demand
- Supply
- Competitors
- Suppliers
- Distribution chain, such as retailer stores

Elements of economic environment

Economic environment refers all economic surroundings that influence organization activities. It consists of economic parameters. It is concerned with the nature and direction of economy in which the organizations operate. Important elements of economic development are :

1. ***Economic systems :***

   Economic system determines the scope of private sector ownership of the factors of production and market forces. The models of economic systems are:

   A) Free market economic :

   This system is based on private ownership of the factors of production. Profit serves as the driver of economic engine. The competitive market mechanism guides business decisions. There is freedom of choice. Individual initiative is encouraged.

   B) Centrally planned economy :

   This system is based on policy ownership of the factors of production. The economy is centrally planned, controlled and regulated by the government. There is no consumer sovereignty. Policy enterprises play a dominant role.

   C) Mixed economy :

   This system is a mix of free market and centrally planned economics. Both public and private sectors coexist. The public sector has ownership and control of basic industries including utilities. The sector owns agriculture and other industries but is regulated by the state.

2. Economic policies:

Policies are guidelines for decision making and action. Economic policies of the government significantly influence and guide organizations. Key economic policies influencing organization are :

A) Monetary policy-

It is concerned with money supply, inflation rates, interest rates and credit availability. It influences the level of spending through interest rates. Cheap money reduces cost, dear money increase cost. Foreign exchange rates affect imports and exports.

B) Fiscal policy :

It is concerned with the use of taxation and government expenditure to regulate economic activity, tax on income, expenditure and capital influence business decisions.

C) Industrial policy :

It is concerned with industrial licensing location, incentives, facilities, foreign investment, technology transfer and nationalization.

3. Economic conditions :

They indicate the health of the economy in which the organization operate. The factors affecting economic conditions are :

- ***State of economic development***: An economy can be least developed developing and developed. Organizational activities are influenced by the stage of economic development.
- ***Income:*** *The* level of employment affect expenditure, saving and investment. They together influence the economic conditions of organization.
- ***Employment***: The level of employment affects organization. It determines availability of labour.
- ***Business cycle***: The stages of business cycle can prosperity, rescission and recovery. They affect the health of the organization.
- *Influence*: It is rise in price level. It influences costs, price and profit of organization.

Lesson 4.2

Economic Environment on Business

Impact of Economic Environment on Business

The economic environment can have a major impact on businesses by affecting patterns of demand and supply. Companies need to keep a track of relevant economic indicators and monitor them over time.

1. ***Income :***

One of the most important factors in the economic environment is the income of customers. This indicates their ability to spend on the products sold by the marketer. The marketer not only needs to estimate the income of customers, but he also has to decipher the products on which the customer would be willing to spend his money.

The proportion of money spent by a customer on various products varies across cultures. Some products, for instance, dishwashers, which are considered to be necessities in western markets, do not even fall into the consideration set of consumers in the Indian market. Therefore, despite having a higher income, customers will not spend on products that are not considered to be desirable.

2. Inflation:

Inflation is an important economic indicator of an economy. Inflation refers to an increase in prices without a corresponding increase in wages, resulting in lower purchasing power of consumers. An economy should try to achieve low rate of inflation. The best way to achieve a low rate of inflation is to ensure that products and services are produced efficiently.

When costs of production go up, companies should try to withhold increasing prices as long as possible, since customers do not start valuing the product more because it is more costly. In the long run, companies will have to look for better methods of production and cheaper inputs so that the cost of production can be brought down. If inflation exists because the supplies are less than the demand, the money supply can be restricted in the short run, but in the long run, companies will have to expand capacities and increase their supplies.

3. Recession:

Recession is a period of economic activity when income, production and employment tend to fall and demand for products and services are reduced. Specific activities cause recession. The slowdown in the high-tech sector, rising fuel prices, excessive consumer credit and terror attacks resulted in recession in America in 2001.

Companies selling to consumers have special responsibility during recession. Once consumers start buying, businesses will start buying automatically. Therefore companies selling to consumers should generate confidence among them by offering them high quality products and services at reasonable prices and also extend credit to them. Companies should be prepared to do whatever it takes to make the consumers buy from them.

4. Interest Rate:

If interest rate in an economy is high, businesses will borrow capital at a higher rate and they will set up new businesses only when they are convinced that they can earn at a rate higher than the interest rate they are paying on the capital.

If the interest rates are high, new businesses will not come. Even among existing businesses, operating costs would go up as their working capital requirements will attract higher interest rates. Therefore, companies will be able to produce products and services at higher costs and will sell them at higher prices.

Lower interest rate is one sure way to spur consumer purchases. Also, consumers are not too keen to save because their money will not grow rapidly due to lower interest rate. They would be keener to spend their money. And when they invest, they are more likely to do so in equity markets because they are more likely to get higher returns there. Therefore business will get impetus because finance in the form of equity capital will be available to them.

5. Exchange rate:

Exchange rate becomes a very important driver of performance when a company exports its products, and when it imports materials and components for making its products. It is more profitable to export when the currency of the exporting country is weaker than the currency of the importing country. But this advantage is nullified if materials and components are imported from a country whose currency is stronger. A company will run its most profitable operations when it exports its product to a country whose currency is stronger, and imports material and components from a country whose currency is weaker.

Exchange rate has become more important, as supply chains of most companies are becoming global in scope, i.e., companies are locating their manufacturing and distribution centers throughout the world, depending upon the advantages of each location.

Economic Systems

There are four primary types of economic systems in the world:

1. Traditional economic systems
2. Command economic systems
3. Market economic systems
4. Mixed economic systems.

Each system in turn and give ample attention to the attributes listed above. It's important to understand how different parts of the world function economically, as the economy is one of the strongest forces when it comes to balancing political power, instigating war and delivering a high (or low) quality of life to the people it serves.

1. ***Traditional Economic System***

A traditional economic system is the best place to start because it is, quite literally, the most traditional and ancient type of economy in the world. There are certain elements of a traditional economy that those in more advanced economies, such as Mixed, would like to see return to prominence.

There is also the fact that each member of a traditional economy has a more specific and pronounced role, and these societies are often very close-knit and socially satisfied. The main disadvantage is that traditional economies do not enjoy the things other economies take for granted i.e. western medicine, centralized utilities, technology, etc.

2. Command Economic System

In terms of economic advancement, the command economic system is the next step from a traditional economy. This by no means indicates that it is fairer or an exact improvement. There are many things fundamentally wrong with a command economy.

You can see how this kind of economy would, over time, create unrest among the general population. But there are actually several potential advantages, as long as the government uses intelligent regulations. First of all, a command economy is capable of creating a healthy supply of its own resources and it generally rewards its own people with affordable prices (but because it is ultimately regulated by the government, it is ultimately priced by the government). Still, there is often no shortage of jobs as the government functions similarly to a market economy in that it wants to grow and grow upon its populace.

3. Market Economic System

A market economy is very similar to a free market. The government does not control vital resources, valuable goods or any other major segment of the economy. In this way, organizations run by the people determine how the economy runs, how supply is generated, what demands are necessary, etc.

***a) Capitalism And Socialism*:**

No truly free market economy exists in the world. For example, while America is a capitalist nation, government still regulates (or attempts to regulate) fair trade, government programs, moral business, monopolies, etc. etc. The advantage to capitalism is you can have an explosive economy that is very well controlled and relatively safe. This would be contrasted to socialism, in which the government (like a command economy) controls and owns the most profitable and vital industries but allows the rest of the market to operate freely; that is, price is allowed to fluctuate freely based on supply and demand. If you want to know how the global economy works and the role you play in it, check out this sweet class on Economics Without Boundaries.

b) Market Economy And Politics:

Arguably the biggest advantage to a market economy (at least, outside of economic benefits) is the separation of the market and the government. This prevents the government from becoming too powerful, too controlling and too similar to the governments of the world that oppress their people while living lavishly on controlled resources.There is something wary about a system which to be successful must foster constant growth, but as a result progress and innovation have occurred at such incredible rates as to affect the way the world economy functions.

4. Mixed Economic System

A mixed economic system (also known as a Dual Economy) is just like it sounds (a combination of economic systems), but it primarily refers to a mixture of a market and command economy (for obvious reasons, a traditional economy does not typically mix well). As you can imagine, many variations exist, with some mixed economies being primarily free markets and others being strongly controlled by the government. Learn more about an essential part of our economy with this free post on understanding the stock market.

In the most common types of mixed economies, the market is more or less free of government ownership except for a few key areas. These areas are usually *not* the resources that a command economy controls. Instead, there are the government programs such as education, transportation, etc. While a mixed economy can lead to incredible results, it can also suffer from similar downfalls found in other economies.

Lesson 4.3

Macroeconomic Parameters

The performance of an economy is usually assessed in terms of the achievement of economic objectives. Long term objectives are for sustainable growth and development, and short term objectives are for stabilisation of the economy in response to sudden and unpredictable events.

To know how well an economy is performing against these objectives, economists employ a wide range of economic *indicators*. Economic indicators measure macro-economic variables that directly or indirectly enable economists to judge whether economic performance has improved or deteriorated. Tracking these indicators is especially valuable to policy makers, both in terms of assessing whether to intervene and whether the intervention has worked or not.

Macroeconomic parameters are statistics that indicate the current status of the economy of a state depending on a particular area of the economy (industry, labor market, trade, etc.). They are published regularly at a certain time by governmental agencies and the private sector. When properly used, these indicators can be an invaluable resource for any Forex trader.

In truth, these statistics help Forex traders monitor the economy's pulse; thus it is not surprising that these are religiously followed by almost everyone in the financial markets. After publication of these indicators we can observe volatility of the market. The degree of volatility is determined depending on the importance of an indicator. That is why it is important to understand which indicator is important and what it represents. The important macroeconomic parameters are as follows:

1. Interest Rates Announcement
2. Gross Domestic Product (GDP)
3. Gross national product (GNP)
4. National Income
5. Per capita income
6. Inflation
7. Balance of Payments
8. Fiscal Deficit
9. Wholesale Price Index
10. Consumer Price Index

The macroeconomic parameters are discussed below:

1. Interest Rates Announcement

Interest rates play the most important role in moving the prices of currencies in the foreign exchange market. As the institutions that set interest rates, central banks are therefore the most influential actors. Interest rates dictate flows of investment. Since currencies are the representations of a country's economy, differences in interest rates affect the relative worth of currencies in relation to one another. When central banks change interest rates they cause the forex market to experience movement and volatility. In the realm of Forex trading, accurate speculation of central banks' actions can enhance the trader's chances for a successful trade.

2. Gross Domestic Product (GDP)

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as "the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year."

The GDP is the broadest measure of a country's economy, and it represents the total market value of all goods and services produced in a country during a given year. Since the GDP figure itself is often considered a lagging indicator, most traders focus on the two reports that are issued in the months before the final GDP as "an aggregate measure of production equal to the sum of the gross values added of all resident, institutional units engaged in production (plus any taxes, and minus any subsidies, on products not included in the value of their outputs)

GDP estimates are commonly used to measure the economic performance of a whole country or region, but can also measure the relative contribution of an industry sector. This is possible because GDP is a measure of 'value added' rather than sales; it adds each firm's value added (the value of its output minus the value of goods that are used up in producing it). For example, a firm buys steel and adds value to it by producing a car; double counting would occur if GDP added together the value of the steel and the value of the car. Because it is based on value added, GDP also increases when an enterprise reduces its use of materials or other resources ('intermediate consumption') to produce the same output.

GDP at factor cost is the sum of net value added by all producers within the country. Since the net value added gets distributed as income to the owners of factors of production, GDP is the sum of domestic factor incomes and fixed capital consumption (or depreciation). Thus GDP at Factor Cost = Net value added + Depreciation.

The more familiar use of GDP estimates is to calculate the growth of the economy from year to year (and recently from quarter to quarter). The pattern of GDP growth is held to indicate the success or failure of economic policy and to determine whether an economy is 'in recession'.

3. Gross national product (GNP)

Gross National Product (GNP) is the total market value of the final goods and services produced by a nation's economy during a specific period of time (usually a year), computed before allowance is made for the depreciation or consumption of capital used in the process of production. It is distinguished from net national product, which is computed after such an allowance is made. The GNP is nearly identical to gross domestic product (GDP) except that the latter does not include the income accruing to a nation's residents from investments abroad (minus the income earned in the domestic economy accruing to non nationals from abroad). Gross national product is a convenient indicator of the level of a nation's economic activity

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Basically, GNP measures the value of goods and services that the country's citizens produced regardless of their location. GNP is one measure of the economic condition of a country, under the assumption that a higher GNP leads to a higher quality of living, all other things being equal.

Equivalent estimates of GNP (or GDP) produced in a given year may theoretically be arrived at through at least three different accounting approaches,

a. Using the *expenditure approach*, you can estimate total GNP as the sum of estimates of the amounts of money that are spent on final goods and services by households (*Consumption*), by business firms (*Investment*), by government (*Government Purchases*), and by the world outside the country (*Net Exports*).

b. Using the *incomes approach,* you can estimate total GNP by summing up estimates of the different kinds of earnings people receive from producing these same final goods and services:

I. Total wages and salaries
II. Profits of incorporated and unincorporated businesses
III. Rental incomes
IV. Interest incomes

(Plus certain adjustments to account for wear and tear on productive assets like plant and machinery -- *depreciation* -- and what are called *indirect business taxes*).

c. Using the *product* or *output* approach, you can estimate GNP by summing up the output of all the various organizations producing goods and services in the country, subtracting out the costs of their raw materials to avoid double counting and making suitable adjustments for depreciation and for the value of imports and exports. (In theory, all three approaches should give you the same grand totals -- but of course in actual practice there will be discrepancies, and sometimes sizable discrepancies, between the three estimates.)

4. National Income

According to Marshall National Income means : "The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend." In this definition, the word 'net' refers to deductions from the gross national income in respect of depreciation and wearing out of machines. And to this, must be added income from abroad.

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced annually in a country.

In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

5. Per capita income

Per capita income, also known as income per person, is the mean income of the people in an economic unit such as a country or city. It is calculated by taking a measure of all sources of income in the aggregate (such as GDP or Gross national income) and dividing it by the total population.

Per capita income is often used as a way of communicating average income, though it can also be used as a measure of the wealth of the population of a nation, particularly in comparison to other nations. Per capita income is often used to measure a country's standard of living. It is usually expressed in terms of a commonly used international currency such as the Euro or United States Dollar, and is useful because it is widely known, easily calculated from readily-available GDP and population estimates, and produces a useful statistic for comparison of wealth between sovereign territories. This helps the country to know their development status.

Critics claim that per capita income has several weaknesses as an accurate measurement of prosperity:

- Comparisons of per capita income over time need to take into account changes in prices. Without using measures of income adjusted for inflation, they will tend to overstate the effects of economic growth.

- International comparisons can be distorted by the differences in the costs of living with each country that are not reflected in exchange rates.
- As it is a mean value, it does not reflect income distribution. If the distribution of income within a country is skewed, a small wealthy class can increase per capita income far above that of the majority of the population. In this respect Median income is a more useful measure of prosperity than per capita income, because it is less influenced by the outliers.

- Economic activity that does not result in monetary income, such as services provided within the family, or for barter, is usually not counted. The importance of these services varies widely among different economies.
- Per capita income does not take into account how income is deployed; whether it is invested in factors likely to improve the development of a country or nation such as medical facilities, educational facilities, transport infrastructure etc.

6. Inflation

To put it simply, inflation is the long term rise in the prices of goods and services caused by the devaluation of currency. Inflationary problems arise when we experience *unexpected* inflation which is not adequately matched by a rise in people's incomes.

If incomes do not increase along with the prices of goods, everyone's purchasing power has been effectively reduced, which can in turn lead to a slowing or stagnant economy. Moreover, excessive inflation can also wreak havoc on retirement savings as it reduces the purchasing power of the money that savers and investors have squirreled away.

So what exactly causes inflation in an economy? There is not a single, agreed-upon answer, but there are a variety of theories, all of which play some role in inflation:

a. The Money Supply

Inflation is primarily caused by an increase in the money supply that outpaces economic growth. Ever since industrialized nations moved away from the gold standard during the past century, the value of money is determined by the amount of currency that is in circulation and the public's perception of the value of that money

b. The National Debt

We all know that high national debt in the U.S. is a bad thing, but did you know that it can actually drive inflation to higher levels over time? The reason for this is that as a country's debt increases, the government has two options: they can either raise taxes or print more money to pay off the debt.

c. Demand-Pull Effect

The demand-pull effect states that as wages increase within an economic system (often the case in a growing economy with low unemployment), people will have more money to spend on consumer goods. This increase in liquidity and demand for consumer goods results in an increase in demand for products. As a result of the increased demand, companies will raise prices to the level the consumer will bear in order to balance supply and demand.

d. ***Cost-Push Effect***

Another factor in driving up prices of consumer goods and services is explained by an economic theory known as the cost-push effect. Essentially, this theory states that when companies are faced with increased input costs like raw goods and materials or wages, they will preserve their profitability by passing this increased cost of production onto the consumer in the form of higher prices.

e. ***Exchange Rates***

Inflation can be made worse by our increasing exposure to foreign marketplaces. On a day-to-day basis, we as consumers may not care what the exchange rates between our foreign trade partners are, but in an increasingly global economy, exchange rates are one of the most important factors in determining our rate of inflation.

7. Balance of Payments

The Balance of Payments represents the ratio between the amount of payments received from abroad and the amount of payments going abroad. In other words, it shows the total foreign trade operations, trade balance, and balance between export and import, transfer payments. If coming payment exceeds payments to other countries and international organizations the balance of payments is positive. The surplus is a favorable factor for growth of the national currency.

The balance of payments (BOP) records all financial transactions made between consumers, businesses and the government in one country with others. The BOP figures tell us about how much is being spent by consumers and firms on imported goods and services, and how successful firms have been in exporting to other countries.. Inflows of foreign currency are counted as a positive entry (e.g. exports sold overseas). Outflows of foreign currency are counted as a negative entry (e.g. imported goods and services)

The balance of payments is made up of these key parts

a. Current Account Balance of Payments

Measures transactions for goods and services.(used to be called visible and invisibles) The current account comprises the trade balance (which is trade in goods) and also includes the balance for trade in services. When people refer to a balance of payments deficit they invariably mean a current account deficit

b. Financial Account (Capital) Balance of Payments

The financial account measures inflows of capital both short term and long term. this includes a) foreign direct investment b) Purchase of securities by investors. In a floating exchange rate a current account deficit must be matched by a surplus on the financial account.. This occurs when the current account deficit cannot be maintained. It means there will be a fall in foreign exchange reserves and the country can no longer attract sufficient capital flows to finance the current account deficit.

The solution to a balance of payments crisis is usually to devalue the currency and slow down consumer spending on imports, usually by causing a recession. If a country is running a current account surplus, this means there is a net inflow of foreign currency into their economic system. From a balance of payments point of view, a surplus on the current account would allow a deficit to be run on the capital account. For example, surplus foreign currency can be used to fund investment in assets located overseas. The balance of payments must balance.

Countries with current account deficits can run into difficulties. If the deficit is large and the economy is not able to attract enough inflows of foreign investment, then their currency reserves will dwindle and there may come a point when the country needs to seek emergency borrowing from institutions such as the International Monetary Fund. Trade deficits and the resulting borrowing lead to a rise in external debt

8. Fiscal Deficit

Fiscal deficit presents a more comprehensive view of budgetary imbalances. It is widely used as a budgetary tool for explaining and understanding the budgetary developments in India. Fiscal deficit refers to the excess of total expenditure over total receipts (excluding borrowings) during the given fiscal year. The extent of fiscal deficit is an indication of how far the government is spending beyond its means.

Fiscal Deficit = Total Expenditure – Total Receipts excluding borrowings.

The implications of fiscal deficit are as follows:

a. ***Debt Trap:***
   Fiscal deficit indicates the total borrowing requirements of the government. Borrowings not only involve repayment of principal amount, but also require payment of interest. Interest payments increase the revenue expenditure, which leads to revenue deficit. It creates a vicious circle of fiscal deficit and revenue deficit, wherein government takes more loans to repay the earlier loans. As a result, country is caught in a debt trap.

b. ***Inflation:***
   Government mainly borrows from Reserve Bank of India (RBI) to meet its fiscal deficit. RBI prints new currency to meet the deficit requirements. It increases the money supply in the economy and creates inflationary pressure.

c. ***Foreign Dependence:***
   Government also borrows from rest of the world, which raises its dependence on other countries.

d. ***Hampers the future growth:***
   Borrowings increase the financial burden for future generations. It adversely affects the future growth and development prospects of the country.

9. Wholesale Price Index (WPI)

WPI represents the price of goods at a wholesale stage i.e. goods that are sold in bulk and traded between organizations instead of consumers. Wholesale Price Index (WPI) represents the price of goods at a wholesale stage i.e. goods that are sold in bulk and traded between organizations instead of consumers. WPI is used as a measure of inflation in some economies.

WPI is used as an important measure of inflation in India. Fiscal and monetary policy changes are greatly influenced by changes in WPI.

WPI is an easy and convenient method to calculate inflation. Inflation rate is the difference between WPI calculated at the beginning and the end of a year. The percentage increase in WPI over a year gives the rate of inflation for that year.

WPI index reflects average price changes of goods that are bought and sold in the wholesale market. WPI in India is published by the Office of Economic Adviser, Ministry of Commerce and Industry. Further, the data for WPI is monitored and updated on a monthly basis taking into account all the 679 items that form the index.

The various commodities taken into consideration for computing the WPI can be categorized into primary article, fuel and power, and manufactured goods. Primary articles included for the computation of WPI include food articles, nonfood articles and minerals. In the fuel, power, light and lubricants, electricity, coal mining and mineral oil are included. The manufactured goods category encompasses food products; beverages, tobacco and tobacco products, wood and wood products, textiles, paper and paper products, basic metals and alloys, rubber and rubber products and many others.

10. Consumer Price Index

The Consumer Price Index (CPI) is a "measure of the average change over time in the prices paid by consumers for a market basket of consumer goods and services." In other words, it indicates the cost of living for a typical consumer, but it's not a straight measurement of living costs.

The Consumer Price Index (CPI) is probably the most crucial indicator of inflation. It represents changes in the level of retail prices for the basic consumer basket. Inflation is tied directly to the purchasing power of a currency within its borders and affects its standing on the international markets. If the economy develops in normal conditions, the increase in CPI can lead to an increase in basic interest rates. This, in turn, leads to an increase in the attractiveness of a currency.

A comprehensive measure used for estimation of price changes in a basket of goods and services representative of consumption expenditure is called consumer price index. The calculation involved in the estimation of CPI is quite rigorous. Various categories and sub-categories have been made for classifying consumption items and on the basis of consumer categories like urban or rural.

Based on these indices and sub indices obtained, the final overall index of price is calculated mostly by national statistical agencies. It is one of the most important statistics for an economy and is generally based on the weighted average of the prices of commodities. It gives an idea of the cost of living. Inflation is measured using CPI. The percentage change in this index over a period of time gives the amount of inflation over that specific period, i.e. the increase in prices of a representative basket of goods consumed.

What CPI can specifically identify is periods of inflation or deflation for consumers in their day-to-day living expenses. when goods and services costs more, the CPI will rise over a short period of time, say six to eight months. If the CPI declines, that means there's deflation, or a steady decrease in the prices of goods and services.

The CPI is compiled and released every month by the Bureau of Labor Statistics (BLS), which is a sub-agency of the Department of Labor.

Lesson 4.4

Five Year Plan in India

Introduction

For the smooth functioning of any economy, planning plays an important role. The Planning Commission has been entrusted with the responsibility of the creation, development and execution of India's five year plans. India's five year plans are also supervised by the Planning commission (from 2014, it is supervised by NITI Aayog) The planned economic development in India began in 1951 with the inception of First Five Year Plan.

Theoretical efforts had begun much earlier , even prior to the independence. Setting up of National Planning Committee by Indian National Congress in 1938 , The Bombay Plan & Gandhian Plan in 1944, Peoples Plan in 1945 (by post war reconstruction Committee of Indian Trade Union), Sarvodaya Plan in 1950 by Jaiprakash Narayan were all various steps taken in this direction.

After independence, India launched its First Five Year Plan in 1951, under socialist influence of first Prime Minister Jawaharlal Nehru. The process began with setting up of Planning Commission in March 1950 in pursuance of declared objectives of the Government to promote a rapid rise in the standard of living of the people by efficient exploitation of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community.

Planning Commission of India Vs NITI Aayog

Planning Commission of India (till December 2013)

Planning Commission was an institution in the Government of India, which formulated India's Five-Year Plans, among other functions. It was established in accordance with Article 39 of the Constitution of India, which is a part of directive principles of state policy.

The Planning Commission was charged with the responsibility of making assessment of all resources of the country, augmenting deficient resources, formulating plans for the most effective and balanced utilisation of resources and determining priorities.

The composition of the Commission has undergone considerable changes since its initiation. With the Prime Minister as the ex officio Chairman, the committee has a nominated Deputy Chairman, who is given the rank of a full Cabinet Minister. A Vice Chairman is also appointed. Cabinet Ministers with certain important portfolios act as ex officio members of the Commission, while the full-time members are experts of various fields like economics, industry, science and general administration.

The Commission works through its various divisions, of which there are two kinds (1) General Planning Divisions and (2) Programme Administration Divisions. The majority of the experts in the Commission are economists, making the Commission the biggest employer of the Indian Economic Service.

The functioning of the Planning Commission of India was replaced by National Institution for Transforming India Aayog (NITI Aayog) from 1 st January, 2014

NITI Aayog ***(National Institution for Transforming India Aayog)- since 2014***

NITI Aayog (National Institution for Transforming India Aayog) is a policy think-tank of Government of India that replaces Planning Commission and aims to involve the states in economic policy-making in India as otherwise called " Policy Commission " Union Government of India had announced formation of NITI Aayog on 1 January 2015.

It will be providing strategic and technical advice to the central and the state governments i.e. by adopting bottom-up approach rather than traditional top-down approach as in planning commission.

The new body will comprise the office of Direct Benefit Transfer (DBT), Unique Identification Authority of India (UIDAI), the inter-state councils and Programme Evaluation. Each of the four departments will be headed by a secretary-level officer.

NITI will include leaders of India's 29 states and seven union territories. But its full-time staff - a Deputy Chairman, Chief Executive Officer and experts - will answer directly to the Prime Minister, who will be Chairman.. While the Planning Commission had no representation for State and Union territories, the NITI Aayog has representations from all states and union territories

The first meeting of NITI Aayog was held on 8 February 2015. The website of the Aayog has a unique feature of NITI Blogs, which incorporates articles, field reports, work in progress, and opinions by NITI officials.

There are a couple of things to be considered here. NITI Aayog would therefore mean:

1. A group of people with authority entrusted by the government to formulate/regulate policies concerning transforming India.
2. It is a commission to help government in social and economic issues.
3. Also it's an Institute of think tank with experts in it.

The 65-year-old Planning Commission had become a redundant organisation. It was relevant in a command economy structure, but not any longer. India is a diversified country and its states are in various phases of economic development along with their own strengths and weaknesses. In this context, a 'one size fits all' approach to economic planning is obsolete. It cannot make India competitive in today's global economy.

First Five Year Plan (1951 To 1956):

The 1st five year plan was presented by Jawaharlal Nehru, who was the Prime Minister during that period. It was formulated for the execution of various plans between 1951 to 1956. The Planning Commission was responsible for working out the plan.

The first five year plan had been made by the planning commission whose objective was to improve the standard of living of the people by effective use of the country's resources. In India, the first five year plan's total outlay was estimated to be worth Rs. 2,069 crore.

The target growth rate was 2.1% annual gross domestic product (GDP) growth; the achieved growth rate was 3.6% the net domestic product went up by 15%. The monsoon was good and there were relatively high crop yields, boosting exchange reserves and the per capita income, which increased by 8%. National Income increased more than the per capita income due to rapid population growth. Many irrigation projects were initiated during this period, including the Bhakra Dam and Hirakud Dam. The World Health Organization (WHO), with the Indian government, addressed children's health and reduced infant mortality, indirectly contributing to population growth.

At the end of the plan period in 1956, five Indian Institutes of Technology (IITs) were started as major technical institutions. The University Grants Commission (UGC) was set up to take care of funding and take measures to strengthen the higher education in the country. Contracts were signed to start five steel plants, which came into existence in the middle of the Second Five-Year Plan. The plan was quasi successful for the government.

Second Five Year Plan (1956-1961)

The total amount allocated under the Second Five-Year Plan in India was Rs. 4,800 crore. This amount was allocated among various sectors: power and irrigation, social services, communications and transport, and miscellaneous. The target growth rate was 4.5% and the actual growth rate was 4.27%. Industrial policy was formulated in 1956

The Second Plan was particularly in the development of the public sector. The plan followed the Mahalanobis model, an economic development model developed by the Indian statistician Prasanta Chandra Mahalanobis in 1953.

The plan attempted to determine the optimal allocation of investment between productive sectors in order to maximise long-run economic growth. It used the prevalent state of art techniques of operations research and optimization as well as the novel applications of statistical models developed at the Indian Statistical Institute. The plan assumed a closed economy in which the main trading activity would be centered on importing capital goods.

Hydroelectric power projects and five steel plants at Bhilai, Durgapur, and Rourkela were established. Coal production was increased. More railway lines were added in the north east. The Tata Institute of Fundamental Research was established as a research institute. In 1957 a talent search and scholarship program was begun to find talented young students to train for work in nuclear power.

Third Five Year Plan India (1961–1966)

The Third Five Year Plan envisages a total outlay of Rs. 11,600 crore, The Third Five-year Plan stressed agriculture and improvement in the production of wheat, but the brief Sino-Indian War of 1962 exposed weaknesses in the economy and shifted the focus towards the defense industry and the Indian Army. In 1965–1966, India fought a War with Pakistan. There was also a severe drought in 1965. The target growth rate was 5.6%, but the actual growth rate was 2.4%.

The war led to inflation and the priority was shifted to price stabilisation. The construction of dams continued. Many cement and fertilizer plants were also built. Punjab began producing an abundance of wheat. Many primary schools were started in rural areas. In an effort to bring democracy to the grass-root level, Panchayat elections were started and the states were given more development responsibilities.

State electricity boards and state secondary education boards were formed. States were made responsible for secondary and higher education. State road transportation corporations were formed and local road building became a state responsibility.

Plan Holidays (1966-69)

Due to miserable failure of the Third Plan the government was forced to declare "plan holidays" (from 1966–67, 1967–68, and 1968–69). Three annual plans were drawn during this intervening period. During 1966-67 there was again the problem of drought. Equal priority was given to agriculture, its allied activities, and industrial sector. The main reasons for plan holidays were the war, lack of resources, and increase in inflation.

Fourth Five Year Plan (1969 To 1974)

The Fourth Plan provided for a total outlay of Rs. 15,779 crores. The Fourth Five Year Plan of India also served as a stepping stone for the economic growth. The following section will highlight the main events that had taken place under the 4th five year plan. The target growth rate was 5.6%, but the actual growth rate was 3.3%.

India had to reform and restructure its expenditure agenda, following the attack on India in the year 1962 and for the second time in the year 1965. Due to recession, famine and drought, India did not pay much heed to long term goals. Food grains production increased to bring about self sufficiency in production.

The need for foreign reserves was felt. This facilitated growth in exports. Import substitution drew considerable attention. The Indira Gandhi government nationalised 14 major Indian banks and the Green Revolution in India advanced agriculture. In addition, the situation in East Pakistan (now Bangladesh) was becoming dire as the Indo-Pakistan War of 1971 and Bangladesh Liberation War took funds earmarked for industrial development.

Fifth Five Year Plan (1974–1979)

The Fifth Five Year Plan India was chalked out for the period spanning 1974 to1979 with the objectives of increasing the employment level, reducing poverty, and attaining self-reliance. The total outlay for fifth Five Year Plan was Rs. 39,426. The target growth rate was 4.4% and the actual growth rate was 3.8%.

At the onset of the Fifth Five Year Plan India in the 1970s, the international economy was in a turmoil, which had a great impact on the economy of both, developed and developing countries of the world. The main changes were perceived in sectors such as food, oil, and fertilizers where prices sky-rocketed.

As a result of this, attaining self-reliance in food and energy became a top priority. During this period, the Indian economy was affected by several inflationary pressures. Food grain production was above 118 million tons due to the improvement of infrastructural facilities like the functioning of the power plants and the rise in the supply of coal, steel, and fertilizers. Regarding the oil, credibility of Bombay High had shot up the commercial production of oil in India. In 1974-75, Indian exports crossed 18%, and the large earnings from these exports have further increased the Indian foreign exchange reserves.

The Fifth Five-Year Plan laid stress on employment, poverty alleviation (Garibi Hatao), and justice. The plan also focused on self-reliance in agricultural production and defence. In 1978 the newly elected Morarji Desai government rejected the plan. The Electricity Supply Act was amended in 1975, which enabled the central government to enter into power generation and transmission. The Indian national highway system was introduced and many roads were widened to accommodate the increasing traffic. Tourism also expanded.

Rolling Plan (1978–1980)

The Janata Party government rejected the Fifth Five-Year Plan and introduced a new Sixth Five-Year Plan (1978-1980). This plan was again rejected by the Indian National Congress government in 1980 and a new Sixth Plan was made. The Rolling Plan consists of three kind of plans that were proposed. The First Plan is for the present year which comprises the annual budget and Second is a plan for a fixed number of years, which may be 3, 4 or 5 years. Plan number two is kept changing as per the requirements of the Indian economy. The Third Plan is a perspective plan which is for long terms i.e. for 10, 15 or 20 years. Hence there is no fixation of dates in for the commencement and termination of the plan in the rolling plans.

The main advantage of the rolling plans is that they are flexible and are able to overcome the rigidity of fixed five year plans by mending targets, The object of the exercise, projections and allocations as per the changing conditions in the country's economy. The main disadvantage of this plan is that if the targets are revised each year, it becomes very difficult to achieve them which are laid down in the five-year period and it turned out to be a complex plan. Frequent revisions make them resulted in instability of the economy which are essential for its balanced development and progress.

Sixth Five Year Plan(1980-1985)

The Sixth Five Year Plan India was undertaken for the period between 1980 to1985, with the main aim of attaining objectives like speedy industrialization, rise in the employment level, poverty reduction, and acquisition of technological self-reliance. The Sixth Five-Year Plan was a great success to the Indian economy. The target growth rate was 5.2% and the actual growth rate was 5.4%. The plan outlay of 6th Five Year Plan was Rs. 1,09,292 Crores

At the onset of the Sixth Five Year Plan India, Rajiv Gandhi, the then prime minister prioritized speedy industrial development, with special emphasis on the information technology sector. From the Fifth Five Year Plan, the nation had been able to achieve self sufficiency in food. Moreover, the industrial sector was also diversified and science and technology also made a significant advance.

One of the major hindrances in the way of further development in this period was the boom in the Indian population. However, several successful programs on improvement of public health and epidemic control were also undertaken to reduce infant mortality and increase life expectancy. Significant investments were made by the government in the Indian healthcare sector. Family planning was also expanded in order to prevent overpopulation

The Sixth Five-Year Plan marked the beginning of economic liberalisation. Price controls were eliminated and ration shops were closed. This led to an increase in food prices and an increase in the cost of living. This was the end of Nehruvian socialism. On one hand it had improved the tourism industry in India and on the other hand it aimed at development in the Information Technology sector.

The transport and communication system also improved under this Plan. The National Highways were all built during this time. During this time the Indian currency was devalued and this led to a dramatic increase in the number of foreign travelers in India thus helping India to become a tourist destination.

Economic Liberalization was introduced for the first time in India during this period. Ration shops were closed because government has not produced articles at a subsidized rate. Price control measures were no more useful. As a consequence the prices of various goods increased leading to growth in the standard of living of the residents of India.

Seventh Five Year Plan (1985–1990)

The Seventh Five Year Plan India was for the duration between 1985 and 1990 under the approval of the National Development Council in India. The total outlay for the seventh Five Year Plan was Rs. 2,18,730

Based on a 15-year period of striving towards steady growth, the Seventh Plan was focused on achieving the prerequisites of self-sustaining growth by the year 2000. The plan expected the labour force to grow by 39 million people and employment was expected to grow at the rate of 4% per year. The target growth rate was 5.0% and the actual growth rate was 6.01%.

The main objectives of the 7th five year plans were to establish growth in the areas of increasing economic productivity, production of food grains, and generating employment opportunities. As an outcome of the sixth five year plan, there had been steady growth in agriculture, control on rate of Inflation, and favorable balance of payments which had provided a strong base for the seventh five Year plan to build on the need for further economic growth.

The 7th Plan had strived towards socialism and energy production at large. Under the Seventh Five-Year Plan, India strove to bring about a self-sustained economy in the country with valuable contributions from voluntary agencies and the general populace.

Eighth Five Year Plan India (1992–1997)

Eighth Five Year Plan India runs through the period from 1992 to1997 with the main aim of attaining objectives like modernization of the industrial sector, rise in the employment level, poverty reduction, and self-reliance on domestic resources.

Just before the formulation of the Eighth Five Year Plan India, there was great political instability in India which hindered the implementation of any five years plan for the following two years after the Seventh Five Year Plan. This period is characterized by extreme FOREX reserve crisis and introduction of liberalization and privatization in Indian economy. To invite FDI in Indian industrial sector and to follow free market reforms were the only possible ways to revive the country from foreign debt.

The total outlay for the eighth Five Year Plan was Rs. 4,34,100. Energy was given priority with 26.6% of the outlay. An average annual growth rate of 6.78% against the target 5.6%[6] was achieved. To achieve the target of an average of 5.6% per annum, investment of 23.2% of the gross domestic product was required. The incremental capital ratio is 4.1. The saving for investment was to come from domestic sources and foreign sources, with the rate of domestic saving at 21.6% of gross domestic production and of foreign saving at 1.6% of gross domestic production.

Under pressure, the country took the risk of reforming the socialist economy. India's free market reforms that brought the nearly bankrupt nation back from the edge. It was the beginning of privatisation and liberalization in India. Modernization of industries was a major highlight of the Eighth Plan. Under this plan, the gradual opening of the Indian economy was undertaken to correct the burgeoning deficit and foreign debt.

Meanwhile India became a member of the World Trade Organization on 1 January 1995. This plan can be termed as, the Narasimha Rao and Manmohan Singh model of economic development. The major objectives included, controlling population growth, poverty reduction, employment generation, strengthening the infrastructure, institutional building, tourism management, human resource development, involvement of Panchayati Rajs, Nagar Palikas, NGOs, decentralisation and people's participation.

Ninth Five Year Plan (1997-2002)

Ninth Five Year Plan India runs through the period from 1997 to 2002 with the main aim of attaining objectives like speedy industrialization, human development, full-scale employment, poverty reduction, and self-reliance on domestic resources. The main feature of the Ninth Five Year Plan India is that at its onset our nation crossed the fifty years of independence and this called for a whole new set of development measures. The Ninth Five-Year Plan also aimed at correcting the historical inequalities which were still prevalent in the society.

The Ninth Five-Year Plan had a total public sector plan outlay of Rs 8,59,200 crores. The Ninth Five-Year Plan achieved a GDP growth rate of 5.4% against a target of 6.5%. The agriculture industry grew at a rate of 2.1% against the target of 4.2%. The industrial growth in the country was 4.5% which was higher than that of the target of 3%. The service industry had a growth rate of 7.8%.. An average annual growth rate of 6.7% was reached as against the targeted growth of 7.1%

The Ninth Five-Year Plan came after 50 years of Indian Independence. Atal Bihari Vajpayee was the Prime Minister of India during the Ninth Five-Year Plan. The Ninth Five-Year

Plan tried primarily to use the latent and unexplored economic potential of the country to promote economic and social growth. . New implementation measures in the form of Special Action Plans (SAPs) were evolved during the Ninth Five-Year Plan to fulfill targets within the stipulated time with adequate resources. The SAPs covered the areas of social infrastructure, agriculture, information technology and Water policy.

As a result in the Ninth Five Year Plan India, the emphasis was on human development, increase in the growth rate and adoption of a full scale employment scheme for all. For such development one needs to promote the social sectors of the nation and to give utmost importance to the eradication of poverty.

The Ninth Five-Year Plan looks through the past weaknesses in order to frame the new measures for the overall socio-economic development of the country. However, for a well-planned economy of any country, there should be a combined participation of the governmental agencies along with the general population of that nation. A combined effort of public, private, and all levels of government ensured the growth of India's economy.

Tenth Five-Year Plan (2002–2007)

The 10th Five year Plan of India in a nutshell is to Increase the mobility of all the available financial resources of India, and optimizing them as well, to setting up of a state-of-the-art infrastructure for all the existing industries in India, to encourage the initiative of capacity building within the Indian industrial sector, to create a friendly, amiable and pleasant investment environment in India, to encourage sufficient transparency in the corporate sectors of India and to introduction of reforms in the industrial sectors, which are more investor-friendly in nature.

The primary aim of the 10th Five Year Plan is to renovate the nation extensively, making it competent enough with some of the fastest growing economies across the globe. The Tenth Five-Year Plan had a total public sector plan outlay of Rs 15,25,639 crores. The main objectives of the Tenth Five-Year Plan were:

I. Attain 8% GDP growth per year.
II. Reduction of poverty rate by 5% by 2007.

III. Providing gainful and high-quality employment at least to the addition to the labour force.

IV. Reduction in gender gaps in literacy and wage rates by at least 50% by 2007.

V. 20-point program was introduced.

VI. Target growth: 8.1% - growth achieved: 7.7%

The agriculture, livestock and forestry sector grew on average by 2.2%, marginally lower than the planned growth rate of 2.5%. In contrast, the 25% annual average growth in the electricity sector over the plan period far surpassed the envisaged growth rates by 8.5 percentage points.

This significant difference is largely explained by the enhanced tariff revisions for electricity exports and given that revenue generation from the Tala Hydroelectric power project was expected to impact the economy a little later in the first year of the Tenth Plan rather than at the close of the Ninth Plan, as it did. The trade and other services sector grew at an average of 11.5% and exceeded planned projections by four percentage points.

Similarly, the public administration and social services sector grew a percentage and half points faster than was envisaged in the Ninth Plan projections. The construction sector also experienced strong growth rates at 11.8%, though this was well below the planned sectoral growth rate by close to five percentage points. Likewise, the transport and communications sector grew strongly but growth was close to three percentage points short of the planned target. Growth in the manufacturing sector remained broadly in line with Ninth Plan expectations at around 5%

Eleventh five year plan(2007-2012):

Eleventh Plan was aimed “Towards Faster & More Inclusive Growth “after UPA rode back to power on the plank of helping Aam Aadmi (common man). Total plan outlay for 11^{th} Five Year Plan was Rs. 25,62,707 crore. Eleventh Plan (2007 - 2012) fixed a target for growth at 9 % but the actual Growth was 8%. The objectives envisaged in 11 th Five Year Plan are given bleow :

- Rapid and inclusive growth.(Poverty reduction)

- Emphasis on social sector and delivery of service therein.
- Empowerment through education and skill development.
- Reduction of gender inequality.
- Environmental sustainability.
- To increase the growth rate in agriculture, industry and services to 4%,10% and 9% respectively.
- Reduce Total Fertility Rate to 2.1
- Provide clean drinking water for all by 2009.
- increase agriculture growth to 4%.

The broad vision for 11th Plan included several inter related components like rapid growth reducing poverty & creating employment opportunities , access to essential services in health & education, specially for the poor, extension if employment opportunities using National Rural Employment Guarantee Programme , environmental sustainability , reduction of gender inequality etc.

The Eleventh Plan started well with the first year achieving a growth rate of 9.3 per cent, however the growth decelerated to 6.7 per cent rate in 2008-09 following the global financial crisis. The economy recovered substantially to register growth rates of 8.6 per cent and 9.3 per cent in 2009-10 and 2010-11 respectively. However, the second bout of global slowdown in 2011 due to the sovereign debt crisis in Europe coupled with domestic factors such as tight monetary policy and supply side bottlenecks, resulted in deceleration of growth to 6.2 per cent in 2011-12. Consequently, the average annual growth rate of Gross Domestic Product (GDP) achieved during the Eleventh Plan was 8 per cent, which was lower than the target but better than the Tenth Plan achievement.

Since the period saw two global crises - one in 2008 and another in 2011 – the 8 per cent growth may be termed as satisfactory. However, the domestic savings and investment averaged 33.5 per cent and 36.1 per cent of GDP at market prices respectively in the Eleventh Plan which is below the target but not very far.

Based on the latest estimates of poverty released by the Planning Commission, poverty in the country has declined by 1.5 percentage points per year between 2004-05 and 2009-10. The decline in percentage of population below poverty line is almost same. On the fiscal front, the expansionary measures taken by the government to counter the effect of global slowdown led to increase in key indicators through 2009-10 with some moderation thereafter.

The issue of Price Stability remained resonating for more than half of the Plan period. Inability to pass on burden on costlier imported oil prices might have constrained the supply of investible funds in the government's hand causing the 11th Plan to perform at the levels below its target.

Twelfth Five-Year Plan (2012–2017)

The total plan outlay of the Twelfth Five-Year Plan was estimated at Rs. Rs 35, 68,626 crore. The Twelfth Five-Year Plan of the Government of India has decided for the growth rate at 8 %. The government intends to reduce poverty by 10% during the 12th Five-Year Plan

The Twelfth Plan commenced at a time when the global economy was going through a second financial crisis, precipitated by the sovereign debt problems of the Euro zone which erupted in the last year of the Eleventh Plan. The crisis affected all countries including India. Our growth slowed down to 6.2 percent in 2011-12 and the deceleration continued into the first year of the Twelfth Plan, when the economy is estimated to have grown by only 5 percent .

The Twelfth Plan therefore emphasizes that our first priority must be to bring the economy back to rapid growth while ensuring that the growth is both inclusive and sustainable. The broad vision and aspirations which the Twelfth Plan seeks to fulfill are reflected in the subtitle: 'Faster, Sustainable, and More Inclusive Growth'.

Inclusiveness is to be achieved through poverty reduction, promoting group equality and regional balance, reducing inequality, empowering people etc whereas sustainability includes ensuring environmental sustainability, development of human capital through improved health, education, skill development, nutrition, information technology etc and development of institutional capabilities , infrastructure like power telecommunication, roads, transport etc ,

Major investment projects in energy and transport have slowed down because of a variety of implementation problems. Some changes in tax treatment in the 2012–13 have caused uncertainty among investors. These developments have produced a reduction in the rate of investment, and a slowing down of economic growth.

Immediate priority is to revive the investor sentiment along with next short term action of removing the impediments to implementation of projects in infrastructure, especially in the area of energy which would require addressing the issue of fuel supply to power stations, and clarity in terms of New Exploration Licensing Policy (NELP)

The Twelfth Plan lays out an ambitious set of Government programmes, which will help to achieve the objective of rapid and inclusive growth. In view of the scarcity of resources, it is essential to take bold steps to improve the efficiency of public expenditure through plan programmes.

Need for fiscal correction viz tax reforms like GST , reduction of subsidies as per cent of GDP while still allowing for targeted subsidies that advance the cause of inclusiveness etc . and managing the current account deficit would be another chief concerns.

Achieving sustained growth would require long term increase in investment and savings rate . This will require action to revive private investment, including private corporate investment, and also action to stimulate public investment, especially in key areas of infrastructure especially, energy, transport, water supply and water resource management. Reversal of the combined deterioration in government and corporate savings has to be a key element in the strategy.

Self Assessment Questions

1. What is meant by economic environment?
2. What are the elements of economic environment?
3. What are the impacts of economic environment on business?
4. Explain the different types of economic systems.
5. What are the various types of macroeconomic parameters?
6. What are the differences between Gross Domestic Product and Gross National Product?
7. What is per capita income? Critically examine the weaknesses of per capita income in accurate measurement of prosperity?
8. What is inflation? Explain the theories that play vital role on inflation.
9. What is balance of payment? What are the key parts of balance of payment?
10. What is meant by Wholesale Price Index and Consumer Price Index?
11. What is the role of Planning Commission and NITI Aayog in formation of Five Year Plans?
12. What are the objectives of 12^{th} Five year Plan?

Unit – V

FINANCIAL ENVIRONMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning and definition
- Components of Financial Environment
- Financial Systems
- Various types of Financial Services
- Pattern of Financial institutions in India
- Reserve Bank of India (RBI) and its functions
- Role, structure, types and functions of Commercial banks in India
- NABARD's role in agricultural banking
- Cooperative banks in India and their structures
- Role of Stock Exchanges in Capital Market of India
- Types of stock exchanges in India
- **Role of Securities and Exchange Board of India (SEBI)**
- Role and function of development banks in India
- Role and function of Industrial Development Banks of India (IDBI)
- Role of Export-Import Bank of India (EXIM Bank)
- Functions of National Housing Bank (NHB)
- Various categories of Non-Banking Financial Companies (NBFC)

Unit Structure

Lesson 5.1

Financial Environment, Systems & Services

Financial Environment- Meaning

A financial environment is a part of an economy with the major players being firms, investors, and markets. Essentially, this sector can represent a large part of a well-developed economy as individuals, who retain private property have the ability to grow their capital. Firms are business entities that offer goods or services to consumers. Investors are individuals or businesses that place capital into businesses for financial returns.

Markets represent the financial environment that makes this all possible. Historically, firms were very small or even nonexistent in economies or financial markets. Though a few firms have always been in existence, the ability for a large number of firms was not possible until markets became more mature. Mature markets allow for more access to resources necessary to produce goods and services. As firms begin to grow, expand, and multiply, higher capital needs to persist in order for firms to succeed.

Capital sources include money from outside parties, such as investors. Many times investors are individuals who have more capital than is necessary to provide a sufficient living standard. Any excess capital can actually make individuals more money if they invest the funds into a firm that offers a financial return. This symbiotic relationship in the financial environment allows both parties to increase their capital. Many different factors play a role for individuals making investments. A few of these may include risk, current market conditions, and competition, among others.

Financial environment of a company refers to all the financial institutions and financial market around the company that affects the working of the company as a whole. The financial environment has a number of factors. It includes the financial institutions, government, individuals and firms around the business. Firms use their financial markets to keep their savings as property. It is extremely important for the monetary markets.

Components of Financial Environment

The financial environment is composed of three key components:

(1) Financial managers,

(2) Financial markets, and

(3) Investors (including creditors).

1. **Financial Managers**

Financial Managers are responsible for deciding how to invest a company's funds to expand its business and how to obtain funds (financing). The actions taken by financial managers to make financial decisions for their respective firms are referred to as financial management (or managerial finance) Financial Managers are expected to make financial decisions that will maximize the firm's value and therefore maximize the value of the firm's stock price. They are usually compensated in a manner that encourages them to achieve this objective

2. **Financial Markets**

Financial markets facilitate the flow of funds from the suppliers of funds to firms or governments who need funds. Financial institution serves as intermediaries by channeling the savings of individuals to firms that need funds

Financial markets represent forums that facilitate the flow of funds among investors, firms, and government units and agencies. Each financial market is served by financial institutions that act as intermediaries. The equity market facilitates the sale of equity by firms to investors or between investors. Some financial institutions serve as intermediaries by executing transactions between willing buyers and sellers of stock at agreed-upon prices.

The debt market enables firms to obtain debt financing from institutional and individual investors or to transfer ownership of debt securities between investors. Some financial institutions serve as intermediaries by facilitating the exchange of funds in return for debt securities at an agreed-upon price.

Thus it is quite common for one financial institution to act as the institutional investor while another financial institution serves as the intermediary by executing the transaction that transfers funds to a firm that needs financing.

3. **Investors**

Investors are individuals or financial institutions that provide funds to firms, government agencies, or individuals who need funds. In this book, our focus regarding investors is on their provision of funds to firms. Individual investors commonly provide funds to firms by purchasing their securities (stocks and debt securities). The financial institutions that provide funds are referred to as institutional investors. Some of these institutions focus on providing loans, whereas others commonly purchase securities that are issued by firms

Financial System

The processes and procedures used by an organization's management to exercise financial control and accountability is called financial system. These measures include recording, verification, and timely reporting of transactions that affect revenues, expenditures, assets, and liabilities.

In finance, the financial system is the system that allows the transfer of money between savers (and investors) and borrowers. A financial system can operate on a global, regional or firm specific level. Gurusamy, writing in Financial Services and Systems has described it as comprising "a set of complex and closely interconnected financial institutions, markets, instruments, services, practices, and transactions."

According to Franklin Allen and Douglas Gale, "Financial systems are crucial to the allocation of resources in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow inter temporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks. These functions are common to the financial systems of most developed economies. Yet the form of these financial systems varies widely."

Financial systems depend on the countries viewpoint on freedom of trade. Some countries i.e. The Soviet Union had socialist financial systems because they value centralized organized state funded trading rather than freedom of trade by everyone.

Financial Services

Financial services are the economic services provided by the finance industry, which encompasses a broad range of businesses that manage money, including credit unions, banks, credit card companies, insurance companies, accountancy companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

1. Commercial banking services

A "commercial bank" is what is commonly referred to as simply a "bank". The term "commercial" is used to distinguish it from an "investment bank"

The primary operations of commercial banks include:

a. Keeping money safe while also allowing withdrawals when needed
b. Issuance of cheque books so that bills can be paid and other kinds of payments can be delivered by post
c. Provide personal loans, commercial loans, and mortgage loans (typically loans to purchase a home, property or business)
d. Issuance of credit cards and processing of credit card transactions and billing
e. Issuance of debit cards for use as a substitute for cheques
f. Allow financial transactions at branches or by using Automatic Teller Machines (ATMs)
g. Provide wire transfers of funds and Electronic fund transfers between banks
h. Facilitation of standing orders and direct debits, so payments for bills can be made automatically
i. Provide overdraft agreements for the temporary advancement of the bank's own money to meet monthly spending commitments of a customer in their current account.
j. Provide internet banking system to facilitate the customers to view and operate their respective accounts through internet.
k. Provide charge card advances of the bank's own money for customers wishing to settle credit advances monthly.

l. Provide a check guaranteed by the bank itself and prepaid by the customer, such as a cashier's check or certified check.
m. Notary service for financial and other documents
n. Accepting the deposits from customer and provide the credit facilities to them.
o. Sell investment products like mutual funds etc.

2. ***Investment banking services***

a. **Capital markets services** - underwriting debt and equity, assist company deals (advisory services, underwriting, mergers and acquisitions and advisory fees), and restructure debt into structured finance products.
b. **Private banking** - Private Banks provide banking services exclusively to high-net-worth individuals. Many financial services firms require a person or family to have a certain minimum net worth to qualify for private banking services. Private Banks often provide more personal services, such as wealth management and tax planning, than normal retail banks.
c. **Brokerage services** - facilitating the buying and selling of financial securities between a buyer and a seller. Brokerages services are offered online to self trading investors throughout the world who have the option of trading with 'tied' online trading platforms offered by a banking institution or with online trading platforms sometimes offered in a group by so-called online trading portals.

3. ***Foreign exchange services***

Foreign exchange services are provided by many banks and specialist foreign exchange brokers around the world. Foreign exchange services include:

a. **Currency exchange** - where clients can purchase and sell foreign currency banknotes.
b. **Wire transfer** - where clients can send funds to international banks abroad.
c. **Remittance** - where clients that are migrant workers send money back to their home country.

4. *Investment services*

a. **Asset management -** the term usually given to describe companies which run collective investment funds. Also refers to services provided by others, generally registered with the Securities and Exchange Commission as Registered Investment Advisors. Investment banking financial services focus on creating capital through client investments.

b. **Hedge fund management -** Hedge funds often employ the services of "prime brokerage" divisions at major investment banks to execute their trades.

c. **Custody services** - the safe-keeping and processing of the world's securities trades and servicing the associated portfolios.

5. ***Insurance*** *services*

a. **Insurance brokerage-** Insurance brokers shop for insurance (generally corporate property and casualty insurance) on behalf of customers. Recently a number of websites have been created to give consumers basic price comparisons for services such as insurance, causing controversy within the industry.

b. **Insurance underwriting** - Personal lines insurance underwriters actually underwrite insurance for individuals, a service still offered primarily through agents, insurance brokers, and stock brokers. Underwriters may also offer similar commercial lines of coverage for businesses. Activities include insurance and annuities, life insurance, retirement insurance, health insurance, and property & casualty insurance.

c. **F&I - Finance & Insurance**, a service still offered primarily at asset dealerships. The F&I manager encompasses the financing and insuring of the asset which is sold by the dealer. F&I is often called "the second gross" in dealerships who have adopted the model

d. **Reinsurance** - Reinsurance is insurance sold to insurers themselves, to protect them from catastrophic losses.

6. *Other financial services*

a. **Bank cards** - include both credit cards and debit cards.

b. **Credit card machine services and networks** - Companies which provide credit card machine and payment networks call themselves "merchant card providers".

c. **Intermediation or advisory services** - These services involve stock brokers (private client services) and discount brokers. Stock brokers assist investors in buying or selling shares. Primarily internet-based companies are often referred to as discount brokerages, although many now have branch offices to assist clients. These brokerages primarily target individual investors. Full service and private client firms primarily assist and execute trades for clients with large amounts of capital to invest, such as large companies, wealthy individuals, and investment management funds.

d. **Private equity** - Private equity funds are typically closed-end funds, which usually take controlling equity stakes in businesses that are either private, or taken private once acquired. Private equity funds often use leveraged buyouts (LBOs) to acquire the firms in which they invest. The most successful private equity funds can generate returns significantly higher than provided by the equity markets

e. **Venture capital** is a type of private equity capital typically provided by professional, outside investors to new, high-growth-potential companies in the interest of taking the company to an IPO or trade sale of the business.

f. **Angel investment** - An angel investor or angel (known as a business angel or informal investor in Europe), is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. A small but increasing number of angel investors organize themselves into angel groups or angel networks to share resources and pool their investment capital.

g. **Conglomerates** - A financial services company, such as a universal bank, that is active in more than one sector of the financial services market e.g. life insurance, general insurance, health insurance, asset management, retail banking, wholesale banking, investment banking, etc. A key rationale for the existence of such businesses is the existence of diversification benefits that are present when different types of businesses are aggregated i.e. bad things don't always happen at the same time. As a consequence, economic capital for a conglomerate is usually substantially less than economic capital is for the sum of its parts.

h. **Financial market utilities** - Organisations that are part of the infrastructure of financial services, such as stock exchanges, clearing houses, derivative and commodityexchanges and payment systems such as real-time gross settlement systems or interbank networks.

i. **Debt resolution** is a consumer service that assists individuals that have too much debt to pay off as requested, but do not want to file bankruptcy and wish to pay off their debts owed. This debt can be accrued in various ways including but not limited to personal loans, credit cards or in some cases merchant accounts.

Lesson 5.2

Financial institutions in India

The Financial Institutions in India mainly comprises of the Central Bank which is better known as the Reserve Bank of India, the commercial banks, the credit rating agencies, the securities and exchange board of India, insurance companies and the specialized financial institutions in India.

1. Reserve Bank of India

The Reserve Bank of India was established in the year 1935 with a view to organize the financial frame work and facilitate fiscal stability in India. The bank acts as the regulatory authority with regard to the functioning of the various commercial bank and the other financial institutions in India. The bank formulates different rates and policies for the overall improvement of the banking sector. It issues currency notes and offers aids to the central and institutions governments.

2. Commercial Banks in India:

The commercial banks in India are categorized into foreign banks, private banks and the public sector banks. The commercial banks indulge in varied activities such as acceptance of deposits, acting as trustees, offering loans for the different purposes and are even allowed to collect taxes on behalf of the institutions and central government.

3. Credit Rating Agencies in India:

The credit rating agencies in India were mainly formed to assess the condition of the financial sector and to find out avenues for more improvement. The credit rating agencies offer various services as:

a. Operation Up gradation
b. Training to Employees
c. Scrutinize New Projects and find out the weak sections in it
d. Rate different sectors

e. The two most important credit rating agencies in India are:
f. CRISIL (Credit Rating Information Services of India Limited)
g. ICRA Limited (Investment Credit Rating Agencies Limited)

4. Securities and Exchange Board of India

The Securities and Exchange board of India, also referred to as SEBI was founded in the year 1992 in order to protect the interests of the investors and to facilitate the functioning of the market intermediaries. They supervise market conditions, register institutions and indulge in risk management.

5. Insurance Companies in India:

The insurance companies offer protection against losses. They deal in life insurance, marine insurance, and vehicle insurance and so on. The insurance companies collect the little saving of the investors and then reinvest those savings in the market. The insurance companies are collaborating with different foreign insurance companies after the liberalization process. This step has been incorporated to expand the Indian insurance market and make it competitive.

6. Specialized Financial Institutions in India

The specialized financial institutions in India are government undertakings that were set up to provide assistance to the different sectors and thereby cause overall development of the Indian economy. The significant institutions falling under this category includes:

a. Board for Industrial & Financial Reconstruction
b. Export-Import Bank of India
c. Small Industries Development Bank of India
d. National Housing Bank

Reserve Bank of India

The central bank of our nation is the Reserve Bank of India (RBI). It was established in April 1935 with a share capital to Rs. 5 crores on the basis of the recommendations of the Hilton Young Commission. The share capital was divided into shares of Rs. 100 each fully paid, which was entirely owned by private shareholders in the beginning. The government held shares of nominal value of Rs. 2, 20,000.

Reserve Bank of India was nationalised in the year 1949. The general superintendence and direction of the Bank is entrusted to Central Board of Directors of 20 members, the Governor and four Deputy Governors, one Government official from the Ministry of Finance, ten nominated Directors by the Government to give representation to important elements in the economic life of the country, and four nominated Directors by the Central Government to represent the four local Boards with headquarters at Mumbai, Kolkata, Chennai and New Delhi.

Local Boards consist of five members each and the Central Government is appointing them for a term of four years to represent territorial and economic interests and the interests of co-operative and indigenous banks.

The Reserve Bank of India Act, 1934 was commenced on April 1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank.

The Bank was constituted for the need of following:

i. To regulate the issue of bank notes

ii. To maintain reserves with a view to securing monetary stability, and

iii. To operate the credit and currency system of the country to its advantage

Objectives of RBI

The Preamble to the Reserve Bank of India Act, 1934 spells out the objectives of the Reserve Bank as: "to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

Prior to the establishment of the Reserve Bank, the Indian financial system was totally inadequate on account of the inherent weakness of the dual control of currency by the Central Government and of credit by the Imperial Bank of India.

The Hilton-Young Commission, therefore, recommended that the dichotomy of functions and division of responsibility for control of currency and credit and the divergent policies in this respect must be ended by setting-up of a central bank — called the Reserve Bank of India — which would regulate the financial policy and develop banking facilities throughout the country. This is the primary object of the Reserve Bank of India.

Another object of the Reserve Bank has been to remain free from political influence and be in successful operation for maintaining financial stability and credit. The fundamental object of the Reserve Bank of India is to discharge purely central banking functions in the Indian money market, i.e., to act as the note- issuing authority, bankers' bank and banker to government, and to promote the growth of the economy within the framework of the general economic policy of the government, consistent with the need of maintenance of price stability.

A significant object of the Reserve Bank of India has also been to assist the planned process of development of Indian economy. Besides the traditional central banking functions, with the launching of the five-year plans in the country, the Reserve Bank of India has been moving ahead in performing a host of developmental and promotional functions, which are normally beyond the purview of a traditional central bank.

As has been stated by the First Five Year Plan document, "central banking in a planned economy can hardly be confined to the regulation of the overall supply of credit or to a somewhat negative regulation of the flow of bank credit. It would have to take on a direct and active role, firstly, in creating or helping to create the machinery needed for financing developmental activities all over the country and secondly, ensuring that the finance available flows in the directions intended."

The Reserve Bank of India, as such, aims at the promotion of monetisation and monetary integration of the economy, filling in the "credit gaps" and gaps in the financial infrastructure, catering to the financial needs of the economy with appropriate sartorial allocation, as well as supporting the planners in the efficient and productive deployment of investible funds with a view to attain the macro-economic goals of maximisation of growth with stability and social justice.

Reserve Bank of India and its Departments

To carry out the work efficiently and economically, the Reserve Bank of India is classified into

1. **Central office** divided in to many departments functioning at Head Office

2. **The local officers** are situated at seven major cities, each office comprising of the banking and issue departments. Wherever the RBI does not have a branch, the State Bank of India and its subsidiaries have been authorised to act on behalf of the RBI.

The departments function at Central Office situated at Head Office are as follows

1. Banking Department:

The Banking Department is responsible for rendering the bank's services as a banker to the Government and to the banks. It consists of four sub-divisions:

i. Public Accounts Department;

ii. Public Debt Department;

iii. Deposit Accounts Department; and

iv. Securities Department.

There are 14 branches of the Banking Department, each headed by a Joint/Deputy Manager.

2. Issue Department:

The Issue Department is concerned with the proper and efficient management of the note issue. For the conduct of monetary transactions, the country has been divided into 14 circles of issue, each having an Office of Issue — the branch of the Issue Department. Each branch of the Issue Department consists of:

(i) **the General Department,** which deals with resource operations, i.e., arrangement of supply of notes and coins from the presses and Government Mints.

(ii) **the Cash Department,** which is controlled by the currency officer. The Cash Department deals with the cash transactions.

3. Department of Currency Management

This department is concerned with the forecasting of the long-term requirements of the currency, indenting and allocation of currency notes to various branches of the Issue Department taking into account the demand pattern, storage facilities, etc. It is headed by the Chief Officer.

4. Department of Expenditure and Budgetary Control:

This department is concerned with the preparation of the bank's budget and monitoring of the expenditure of the different units. It is headed by the Financial Controller.

5. Department of Government and Bank Accounts:

This department is concerned with the maintenance and supervision of the bank's accounts in the Issue and the Banking Departments and the compilation of weekly statements of affairs and the Annual Profits & Loss Account and Balance Sheet. It is headed by the Chief Accountant

6. Exchange Control Department:

The Exchange Control department is responsible for controlling foreign exchange transactions and maintaining exchange rate stability.

7. Department of Banking Operations and Development:

This Department was entrusted with the responsibility of the supervision, control and development of the commercial bank system in the country. Till July 1982, it was also concerned with the Lead Bank Scheme and bank credit to the priority sectors.

8. Industrial Credit Department:

The Industrial Finance Department is basically concerned with the administration of the Credit Guarantee Scheme for small scale industries or as agent of the Government of India, with the operational and organisational aspects of the State Financial Corporation's (SFC's) work connected with the Industrial Development Bank of India (IDBI), data collection about financing of small-scale industries and other relevant problems. It also deals with the operation and administration of the Credit Authorisation Scheme.

9. Agricultural Credit Department:

This department is mainly responsible for building up of a sound cooperative credit structure in rural financing, supplementing the financial resources of state co-operative banks, providing financial assistance to State Governments to strengthen the co-operative structure, advising Central and State Governments on agricultural and rural credit, formulating policies for taking over of Primary Agriculture Cooperatives (PACs) for financing by commercial banks, coordinating the long-term credit activities of State Land Development Banks, etc.

The department also keeps liaison with the Agricultural Refinance and Development Corporation, the Agricultural Finance Corporation, State Cooperative Banks (SCBs) and Land Development Banks (LDBs).

With the establishment of the NABARD (National Bank for Agriculture and Rural Development) , all functions of the Agricultural Credit Department have been transferred to this new institution, except for the supervision and control over the operations of the primary urban co-operative banks. The responsibility of supervision and control of PCBs are now shifted to the Department of Banking Operations and Development.

10. Rural Planning and Credit Department:

This department was established in 1982. It is basically concerned with issues like District Credit Plans, Lead Bank Scheme, provision of expert guidance/assistance and processing and sanction of general lines of credit for short-term advances to the NABARD, special studies for promoting IRDP (Integrated Rural Development Program), and for framing the Reserve Bank's policy on rural development.

11. Department of Non-Banking Companies:

This department administers and controls as well as regulates deposits of non-banking financial companies.

12. Credit Planning Cell:

The Credit Planning and Banking Development Cell have been constituted for the formulation and monitoring of credit policies as well as the developmental aspects of commercial banking. It chalks out macro-level monetary budgets of the country.

13. Department of Economic Analysis and Policy:

This department conducts economic research and reviews financial and banking conditions in the country. The Economic Department comprises five units: (i) the Internal Finance Unit; (ii) International Finance Unit; (iii) Prices, Production and General Unit; (iv) Analysis of National Economic Parameters Unit; and (v) General Unit.

The Economic Department prepares the Bank's Annual Report, the Report on Trend and Progress of Banking in India, the Report on Currency and Finance, and the Reserve Bank of India Bulletins. It also undertakes ad hoc studies on emerging aspects of banking and other important issues.

14. Department of Statistical Analysis and Computer Services:

Its main function involves the generation, collection, processing and compilation of statistical data relating to the banking and financial sectors from the operational as well as research point of view.

15. Legal Department:

It tenders legal advice on various matters referred to it by the Bank.

16. Inspection Department:

It carries out internal inspections of the offices and departments of the bank.

17. Department of Administration and Personnel:

It looks after the general administration and personnel policy, such as recruitment, training, placements, promotions, transfers, discipline, appeals, service conditions, wage structure, etc.

18. Premises Department:

It is mainly concerned with the construction of buildings for the Bank's offices, training institutions and staff quarters.

19. Management Services Department:

It is basically concerned with organisational analysis, systems research and development, work procedure studies and codification, manpower planning, costing studies, etc.

20. Reserve Bank of India Service Board:

Its functions involve conducting of examinations/interviews for the selection and promotion of staff in the Reserve Bank.

21. Central Records and Documentation Centre:

It is meant for the preservation of non-current records of the Bank. It provides arrangement for the scientific preservation of records, retrieval service to the enquirer departments, tools of reference such as catalogues, indices, etc.

22. Secretary's Department:

It attends to the secretarial work connected with the meetings of the Central Board and its committee and of the Administrators of the RBI Employee's Provident Fund and RBI Employees' Co-operative Guarantee Fund.

23. Training Establishments:

The Reserve Bank has set-up three prominent training institutions for imparting training in different areas of banking. These are:

(i) the Banker's Training College, Bombay

(ii) the College of Agricultural Banking, Pune

(iii) the Reserve Bank Staff College, Madras

There are also Zonal Training Centres situated in Bombay, Calcutta, Madras and New Delhi for conducting induction, functional and short-term preparatory courses for the clerical staff.

Major Functions of the Reserve Bank of India

Major functions of the RBI are as follows:

1. Issue of Bank Notes:

The Reserve Bank of India has the sole right to issue currency notes except one rupee notes which are issued by the Ministry of Finance. Currency notes issued by the Reserve Bank are declared unlimited legal tender throughout the country.

This concentration of notes issue function with the Reserve Bank has a number of advantages: (i) it brings uniformity in notes issue; (ii) it makes possible effective state supervision; (iii) it is easier to control and regulate credit in accordance with the requirements in the economy; and (iv) it keeps faith of the public in the paper currency.

2. Banker to Government:

As banker to the government the Reserve Bank manages the banking needs of the government. It has to maintain and operate the government's deposit accounts. It collects receipts of funds and makes payments on behalf of the government. It represents the Government of India as the member of the IMF and the World Bank.

3. Custodian of Cash Reserves of Commercial Banks:

The commercial banks hold deposits in the Reserve Bank and the latter has the custody of the cash reserves of the commercial banks.

4. Custodian of Country's Foreign Currency Reserves:

The Reserve Bank has the custody of the country's reserves of international currency, and this enables the Reserve Bank to deal with crisis connected with adverse balance of payments position.

5. Lender of Last Resort:

The commercial banks approach the Reserve Bank in times of emergency to tide over financial difficulties, and the Reserve bank comes to their rescue though it might charge a higher rate of interest.

6. Central Clearance and Accounts Settlement:

Since commercial banks have their surplus cash reserves deposited in the Reserve Bank, it is easier to deal with each other and settle the claim of each on the other through book keeping entries in the books of the Reserve Bank. The clearing of accounts has now become an essential function of the Reserve Bank.

7. Controller of Credit:

Since credit money forms the most important part of supply of money, and since the supply of money has important implications for economic stability, the importance of control of credit becomes obvious. Credit is controlled by the Reserve Bank in accordance with the economic priorities of the government.

Commercial Banks in India:

History of Banking Sector in India

Bank is a financial institution that performs several functions like accepting deposits, lending loans, agriculture and rural development etc. Bank plays an important role in the economic development of the country.

It is necessary to encourage people to deposit their surplus funds with the banks. These funds are used for providing loans to the industries thereby making productive investments. A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities. They are the active players in financial market. The essential role of a bank is to connect those who have capital with those who seek capital. After the post economic liberalization and globalization, there has been a significant impact on the banking industry.

Banking in India originated in the 18th century. The oldest bank in existence in India is the State Bank of India, a government-owned bank in 1806. SBI is the largest commercial bank in the country.

After the independence, Reserve Bank of India was nationalized and given wide powers. Currently, India has 96 Scheduled Commercial Banks, 27 public sector banks, 31 private banks and 38 foreign banks.

Today, banks have diversified their activities and are getting into new products and services that include opportunities in credit cards, consumer finance, wealth management, life and general insurance, investment banking, mutual funds, pension fund regulation, stock broking services, etc.

Further, most of the leading Indian banks are going global, setting up offices in foreign countries, by themselves or through their subsidiaries.

Role of Commercial Banks in India

Banks help in accelerating the economic growth of a country in the following ways:

1. Accelerating the Rate of Capital Formation:

Commercial banks encourage the habit of thrift and mobilise the savings of people. These savings are effectively allocated among the ultimate users of funds, i.e., investors for productive investment. So, savings of people result in capital formation which forms the basis of economic development.

2. Provision of Finance and Credit:

Commercial banks are a very important source of finance and credit for trade and industry. The activities of commercial banks are not only confined to domestic trade and commerce, but extend to foreign trade also.

3. Developing Entrepreneurship:

Banks promote entrepreneurship by underwriting the shares of new and existing companies and granting assistance in promoting new ventures or financing promotional activities. Banks finance sick (loss-making) industries for making them viable units.

4. Promoting Balanced Regional Development:

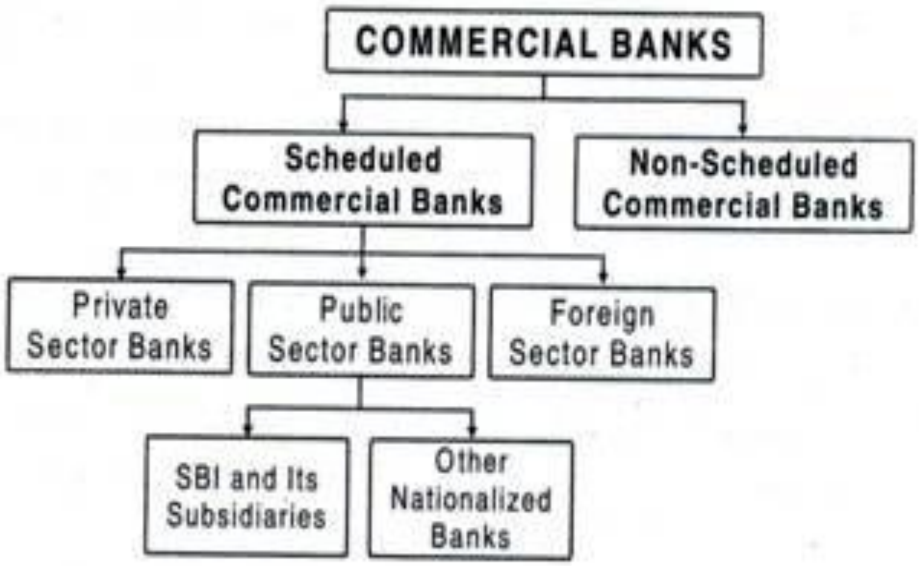
Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.

5. Help to Consumers:

Commercial banks advance credit for purchase of durable consumer items like Vehicles, T.V., refrigerator etc., which are out of reach for some consumers due to their limited paying capacity. In this way, banks help in creating demand for such consumer goods.

Structure of Commercial Banks in India

The commercial banks can be broadly classified under two heads:



1. Scheduled Banks:

Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934. In India, scheduled commercial banks are of three types:

(i) Public Sector Banks:

These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks. Public sector banks are of two types: (a) SBI and its subsidiaries; (b) Other nationalized banks.

(ii) Private Sector Banks:

These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank are some examples of private sector banks.

(iii) Foreign Banks:

These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

2. Non-Scheduled Banks:

Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934

Types of Commercial Banks of India

A bank is an institution where debts (usually referred to as bank deposits) are commonly accepted in final settlement of other peoples' debts. Yet another definition defines banking as "the accepting for the purpose of lending, investment of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheques, drafts or otherwise."

The modern bank thus, carries out several functions. It provides safe custody for those savers who want to put their savings with it and earns an income also, offers facilities to the busy businessmen or professional like cheque facilities, thus making the flow of payments and receipts easier while at the same time acting as the custodian of their funds. It also provides finance for the needy ones by allowing overdraft and loan facilities by creating credit.

Banks can be classified into different groups either on the basis of their structure or on the basis of their function.

A. Division according to Structure

1. Branch banking
2. Unit Banking.
3. Group Banking
4. Chain Banking

B. Division according to Structure

1. Deposit Banking,
2. Investment Banking and
3. Mixed Banking.

1. Branch Banking:

This refers to a system under which two or more banks are opened under a single ownership. Examples are State Bank of India, Punjab National Bank, Indian Bank etc. which have several branches spread all-over India.

2. Unit Banking:

This refers to that system of banking in which banking operations are carried on through a single organisation, without any branches. This system used to be popular in America.

3. Group Banking:

This is a system under which two or more banks, separately incorporated, are connected by being controlled by a single holding company as trust.

4. Chain Banking:

This is similar to Group Banking. Here two or more banks are controlled by a single group through the ownership of shares or otherwise.

5. Deposit Banking:

In this category, the banks act as custodian or trustees of the depositors.

6. Investment Banking:

This refers to banks whose main function is to provide finance for investment to industrial concerns. They provide this by purchasing shares and debentures of newly floated companies.

7. Mixed Banking:

Most banks in India play both roles viz. Deposit Banking and Investment Banking. Such type of banking is called mixed banking.

Functions of Commercial Banks

The major functions of Commercial Banks are as follows:

1. Acceptance of Deposits:

The main function of commercial banks is to accept deposits from the public. Banks maintain demand deposits accounts for their customers and converts deposit money into cash and vice versa, at the direction of the latter. Demand deposits are technically accepted in current accounts, which are withdrawn any time by the depositor by means of cheques.

Deposits are made in fixed deposit accounts which are withdrawn only after a specific period. Thus, fixed deposits are time liabilities of the banks. Deposits are also received in saving bank accounts subject to certain restrictions on the amount receivable and withdrawing. This is how banks pool the scattered savings of the community and serve as the reserves of its savings.

2. Giving Loans and Advances:

Another function of commercial banks is to extend loans and advances out of the money which comes to them by way of deposits to businessmen and entrepreneurs against approved securities such as gold or silver bullion, government securities, easily saleable stocks and shares and marketable goods. **Bank advances to customers may be made in the following ways:** (i) Overdrafts, (ii) discounting bills, (iii) money-at-call and short notice, (iv) loans and advances (v) various forms of direct loans to traders and producers.

3. Using Cheque System:

Banks also render important services by providing an expensive medium of exchange, such as cheques. In modern business transactions, the use of cheques to settle debts is found to be much more convenient than the use of cash. In fact, the cheque is also known as the most developed credit instrument.

4. Other Functions:

Commercial banks also perform a multitude of other non-banking functions which may be classified as (a) agency services and (b) general utility services.

(a) Agency services:

The bankers perform certain functions for and on behalf of their customers, such as:

(i) To act as executor, trustee and attorney for the customer's will.

(ii) To collect or make payments for bills, cheques, promissory notes, interest, dividends, rents, subscriptions, insurance premium, etc. For these services, some charges are usually levied by the banks.

(iii) To remit funds on behalf of the clients by drafts or mail or telegraphic transfers.

(iv) To arrange income-tax experts to prepare income tax returns for their customers, and help them to get refund of income tax in appropriate cases.

(v) To work as correspondents, agents or representatives of their clients.

(b) General Utility Services:

The modem Commercial banks usually perform certain general utility services for society, such as:

(i) Bank drafts and traveler's cheques are issued in order to provide facilities for transfer of funds from one part of the country to another.

(ii) Letter of credit may be given by the banks to their customers to enable then to go abroad.

(iii) Dealing with foreign exchange or finance foreign trade by accepting or collecting foreign bills of exchange.

(iv) Shares floated by Government, Public bodies and corporations may be underwritten by banks.

(v) Banks arrange the safe deposit vaults, to the customers, for their valuables.

(vi) Banks also compile statistics and business information relating to trade, commerce and industry. Some banks may publish valuable journals or bulletins containing research on financial economic and commercial matters.

Agricultural Banking

The Indian farmer is proverbially poor. He has no money for the purchase of good seeds, fertilizers and modern implements like tractors. Neither has he any money for the construction of tube wells and store houses. Banks are helping him a lot by advancing loans to him on easy terms. In this way he is saved from the clutches of the indigenous money Landers and agriculture receives a big boost. In this way banks help in modernizing Indian agriculture.

Agriculture being the backbone of the Indian economy, commercial banks as well as cooperative banks are contributing significantly in accelerating the pace of rural development by providing finance to farmers by way of following agriculture products. Agricultural banks have covered a whole gamut of agricultural activities. Some of them are:

1. Crop production, Plantation crops and Forestry
2. Mulberry cultivation and rearing of silk worms
3. Allied activities like dairy , fisheries, poultry, sheep-goat and piggery
4. Land development and reclamation
5. Loans against book debts of artisan.
6. Purchase of agricultural implements
7. Purchase of heavy agricultural machinery like tractors, power-tillers, etc
8. Farm produce marketing loan / Financing against warehouse receipt against pledge of receipt of warehouse/ cold storages to the farmers.
9. Development of irrigation facilities, covering sinking of wells/bore wells, lifting of water by installation of pump sets etc.

10. Extending working capital needs to dealers of dealers/ distributors/traders of agricultural inputs like seeds, fertilisers etc.

11. Construction farm building/structures like cattle shed, tractor shed, thrashing yards, fencing etc

12. Construction/Expansion/modernisation/Renovation of Rural Godown/Cold storage.

13. Development of horticulture

In short the banking industry is bound to play, in times to come, a role of increasing importance in boosting Indian agriculture. The present difficulties of the Indian farmer, let us hope, would soon be over-come and the increased agricultural productions would make food scarcity a matter of the past.

National Bank for Agriculture and Rural Development (NABARD)

NABARD is set up as an apex Development Bank with a mandate for facilitating credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts. It also has the mandate to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure.

NABARD was established in terms of the Preamble to the Act, "for providing credit for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting Integrated Rural Development Program (IRDP) and securing prosperity of rural areas and for matters connected therewith in incidental thereto".

The main objectives of the NABARD as stated in the statement of objectives while placing the bill before the Lok Sabha were categorized as under :

1. The National Bank will be an apex organisation in respect of all matters relating to policy, planning operational aspects in the field of credit for promotion of Agriculture, Small Scale Industries, Cottage and Village Industries, Handicrafts and other rural crafts and other allied economic activities in rural areas.

2. The Bank will serve as a refinancing institution for institutional credit such as long-term, short-term for the promotion of activities in the rural areas.

3. The Bank will also provide direct lending to any institution as may be approved by the Central Government.

Role of NABARD

NABARD is an apex institution accredited with all matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas.

1. It is an apex refinancing agency for the institutions providing investment and production credit for promoting the various developmental activities in rural areas.
2. It takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel, etc.
3. It co-ordinates the rural financing activities of all the institutions engaged in developmental work at the field level and maintains liaison with Government of India, State Governments, Reserve Bank of India and other national level institutions concerned with policy formulation.
4. It prepares, on annual basis, rural credit plans for all districts in the country; these plans form the base for annual credit plans of all rural financial institutions.
5. It undertakes monitoring and evaluation of projects refinanced by it.
6. It promotes research in the fields of rural banking, agriculture and rural development.

Major Activities of NABARD

1. Preparing of Potential Linked Credit Plans for identification of exploitable potentials under agriculture and other activities available for development through bank credit.
2. Refinancing banks for extending loans for investment and production purpose in rural areas.

3. Providing loans to State Government/Non Government Organizations (NGOs)/Panchayati Raj Institutions (PRIs) for developing rural infrastructure. Supporting credit innovations of Non Government Organizations (NGOs) and other non-formal agencies.
4. Extending formal banking services to the unreached rural poor by evolving a supplementary credit delivery strategy in a cost effective manner by promoting Self Help Groups (SHGs)
5. Promoting participatory watershed development for enhancing productivity and profitability of rain fed agriculture in a sustainable manner.
6. On-site inspection of cooperative banks and Regional Rural Banks (RRBs) and off-site surveillance over health of cooperatives and RRBs.

Co-operative Banks

Co-operative banks are small-sized units organized in the co-operative sector which operate both in urban and non-urban centers. These banks are traditionally centered on communities, localities and work place groups and they essentially lend to small borrowers and businesses.

While the co-operative banks in rural areas mainly finance agricultural based activities including farming, cattle, milk, hatchery, personal finance, etc. along with some small scale industries and self-employment driven activities, the co-operative banks in urban areas mainly finance various categories of people for self-employment, industries, small scale units and home finance.

Co operative Banks in India are registered under the Co-operative Societies Act. The cooperative bank is also regulated by the RBI. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

These banks provide most services such as savings and current accounts, safe deposit lockers, loan or mortgages to private and business customers. Co-operative banks function on the basis of 'no-profit no-loss'. Co-operative banks, as a principle, do not pursue the goal of profit maximisation. Therefore, these banks do not focus on offering more than the basic banking services. So, co-operative banks finance small borrowers in industrial and trade sectors, besides professional and salary classes. This exponential growth of co-operative banks in India is attributed mainly to their much better local reach, personal interaction with customers, and their ability to catch the nerve of the local clientele.

The co-operative banking structure in India is divided into following main 5 categories:

- Primary Agricultural Credit Societies
- District Central Co-op Banks
- State Co-operative Banks
- Land Development Banks
- Primary Urban Co-op Banks

Primary Co-operative Credit Society

The primary co-operative credit society is an association of borrowers and non-borrowers residing in a particular locality. The funds of the society are derived from the share capital and deposits of members and loans from central co-operative banks. The borrowing powers of the members as well as of the society are fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, pesticides, etc.

Central Co-operative Banks

These are the federations of primary credit societies in a district and are of two types-those having a membership of primary societies only and those having a membership of societies as well as individuals. The funds of the bank consist of share capital, deposits, loans and overdrafts from state co-operative banks and joint stocks. These banks provide finance to member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint stock bank.

State Co-operative Banks

The state co-operative bank is a federation of central co-operative bank and acts as a watchdog of the co-operative banking structure in the state. Its funds are obtained from share capital, deposits, loans and overdrafts from the Reserve Bank of India. The state co-operative banks lend money to central co-operative banks and primary societies and not directly to the farmers.

Land Development Banks

The Land development banks are organized in 3 tiers namely; state, central, and primary level and they meet the long term credit requirements of the farmers for developmental purposes. The state land development banks oversee, the primary land development banks situated in the districts and tehsil areas in the state. They are governed both by the state government and Reserve Bank of India. Recently, the supervision of land development banks has been assumed by National Bank for Agriculture and Rural development (NABARD). The sources of funds for these banks are the debentures subscribed by both central and state government. These banks do not accept deposits from the general public. This type of bank is providing long term credit for the following purposes: 1) land development and reclamation 2) purchase of heavy agricultural machinery like tractors, power-tillers, etc 3) development of irrigation facilities, covering sinking of wells/bore wells 4) construction farm building/structures like cattle shed, tractor shed, thrashing yards, fencing etc

Urban Co-operative Banks

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary co-operative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centered on communities, localities, work place groups. They essentially lend to small borrowers and businesses. Today, their scope of operations has widened considerably.

Lesson 5.3

Capital Market

Capital markets are financial markets for the buying and selling of long term debt or equity-backed securities. These markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. Capital markets are defined as markets in which money is provided for periods longer than a year.

A key division within the capital markets is between the primary markets and secondary markets. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments tend to issue only bonds, whereas companies often issue either equity or bonds.

The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary markets, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere.

The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.

Role of Stock Exchanges in Capital Market of India

Stock Exchanges play a crucial role in the consolidation of a national economy in general and in the development of industrial sector in particular. It is the most dynamic and organised component of capital market. Especially, in developing countries like India, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilisation of savings and ensuring investment safety.

Lets study the role of stock exchanges in capital market of India :-

1. Effective Mobilisation of savings

Stock exchanges provide organised market for individuals as well as institutional investors. They regulate the trading transactions with proper rules and regulations in order to ensure investor's protection. This helps to consolidate the confidence of investors and small savers. Thus, stock exchanges attract small savings especially of large number of investors in the capital market.

2. Promoting Capital formation

The funds mobilised through capital market are provided to the industries engaged in the production of various goods and services useful for the society. This leads to capital formation and development of national assets. The savings mobilised are channelised into appropriate avenues of investment.

3. Wider Avenues of investment

Stock exchanges provide a wider avenue for the investment to the people and organisations with investible surplus. Companies from diverse industries like Information Technology, Steel, Chemicals, Fuels and Petroleum, Cement, Fertilizers, etc. offer various kinds of equity and debt securities to the investors. Online trading facility has brought the stock exchange at the doorsteps of investors through computer network. Diverse type of securities is made available in the stock exchanges to suit the varying objectives and notions of different classes of investor. Necessary information from stock exchanges available from different sources guides the investors in the effective management of their investment portfolios.

4. Liquidity of investment

Stock exchanges provide liquidity of investment to the investors. Investors can sell out any of their investments in securities at any time during trading days and trading hours on stock exchanges. Thus, stock exchanges provide liquidity of investment. The on-line trading and online settlement of Demat securities facilitates the investors to sell out their investments and realise the proceeds within a day or two. Even investors can switch over their investment from one security to another according to the changing scenario of capital market.

5. Investment priorities

Stock exchanges facilitate the investors to decide his investment priorities by providing him the basket of different kinds of securities of different industries and companies. He can sell stock of one company and buy a stock of another company through stock exchange whenever he wants. He can manage his investment portfolio to maximise his wealth.

6. Investment safety

Stock exchanges through their by-laws, Securities and Exchange Board of India (SEBI) guidelines, transparent procedures try to provide safety to the investment in industrial securities. Government has established the National Stock Exchange (NSE) and Over the Counter Exchange of India (OTCEI) for investors' safety. Exchange authorities try to curb speculative practices and minimise the risk for common investor to preserve his confidence.

7. Wide Marketability to Securities

Online price quoting system and online buying and selling facility have changed the nature and working of stock exchanges. Formerly, the dealings on stock exchanges were restricted to its head quarters. The investors across the country were absolutely in dark about the price fluctuations on stock exchanges due to the lack of information. But today due to Internet, on line quoting facility is available at the computers of investors. As a result, they can keep track of price fluctuations taking place on stock exchange every second during the working hours. Certain T.V. Channels like CNBC are fully devoted to stock market information and corporate news. Even other channels display the on line quoting of stocks. Thus, modern stock exchanges backed up by internet and information technology provide wide marketability to securities of the industries. Demat facility has revolutionised the procedure of transfer of securities and facilitated marketing.

8. Financial resources for public and private sectors

Stock Exchanges make available the financial resources available to the industries in public and private sector through various kinds of securities. Due to the assurance of liquidity, marketing support, investment safety assured through stock exchanges, the public issues of securities by these industries receive strong public response (resulting in oversubscription of issue).

9. Funds for Development Purpose

Stock exchanges enable the government to mobilise the funds for public utilities and public undertakings which take up the developmental activities like power projects, shipping, railways, telecommunication, dams & roads constructions, etc. Stock exchanges provide liquidity, marketability, price continuity and constant evaluation of government securities.

10. Indicator of Industrial Development

Stock exchanges are the symbolic indicators of industrial development of a nation. Productivity, efficiency, economic-status, prospects of each industry and every unit in an industry is reflected through the price fluctuation of industrial securities on stock exchanges. Stock exchange Sensex and price fluctuations of securities of various companies tell the entire story of changes in industrial sector.

11. Barometer of National Economy

Stock exchange is taken as a Barometer of the economy of a country. Each economy is economically symbolized (indicators) by its most significant stock exchange. New York Stock Exchange, London Stock Exchange, Tokyo Stock Exchange and Bombay Stock Exchange are considered as barometers of U.S.A, United Kingdom, Japan and India respectively. At both national and international level these stock exchanges represent the progress and conditions of their economies.

Various Stock Exchanges In India

1. Bombay Stock Exchange (BSE)

BSE is the leading and the oldest stock exchange in India as well as in Asia. It was established in 1887 with the formation of "The Native Share and Stock Brokers' Association". BSE is a very active stock exchange with highest number of listed securities in India. Nearly 70% to 80% of all transactions in the India are done alone in BSE.

BSE is now a national stock exchange as the BSE has started allowing its members to set-up computer terminals outside the city of Mumbai (former Bombay). It is the only stock exchange in India which is given permanent recognition by the government. At present, (Since 1980) BSE is located in the "**Phiroze Jeejeebhoy Towers**" (28 storey building) located at Dalal Street, Fort, Mumbai. Pin code - 400021.

In 2005, BSE was given the status of a fully fledged public limited company along with a new name as "Bombay Stock Exchange Limited". The BSE has computerized its trading system by introducing BOLT (Bombay on Line Trading) since March 1995. BSE is operating BOLT at 275 cities with 5 lakh (0.5 million) traders a day.

2. National Stock Exchange (NSE)

Formation of National Stock Exchange of India Limited (NSE) in 1992 is one important development in the Indian capital market. The need was felt by the industry and investing community since 1991. The NSE is slowly becoming the leading stock exchange in terms of technology, systems and practices in due course of time. NSE is the largest and most modern stock exchange in India. In addition, it is the third largest exchange in the world next to two exchanges operating in the USA.

The NSE boasts of screen based trading system. In the NSE, the available system provides complete market transparency of trading operations to both trading members and the participates and finds a suitable match. The NSE does not have trading floors as in conventional stock exchanges. The trading is entirely screen based with automated order machine. The screen provides entire market information at the press of a button. At the same time, the system provides for concealment of the identify of market operations. The screen gives all information which is dynamically updated. As the market participants sit in their own offices, they have all the advantages of back office support, and facility to get in touch with their constituents.

1. Wholesale debt market segment,
2. Capital market segment, and
3. Futures & options trading.

3. Over The Counter Exchange of India (OTCEI)

The OTCEI was incorporated in October, 1990 as a Company under the Companies Act 1956. It became fully operational in 1992 with opening of a counter at Mumbai. It is recognised by the Government of India as a recognised stock exchange under the Securities Control and Regulation Act 1956. It was promoted jointly by the financial institutions like UTI, ICICI, IDBI, LIC, GIC, SBI, IFCI, etc.

The Participants of OTCEI are :-

i. Members and dealers appointed by OTCEI,
ii. Companies whose securities are listed,
iii. Investors who trade in the OTCEI,
iv. Registrar who keeps custody of scrip certificates,
v. Settlement Bank which clears the payment between counters, and
vi. SEBI and Government who supervise and regulate the working.

The Features of OTCEI are :-

2. OTCEI is a floorless exchange where all the activities are fully computerised.
3. Its promoters have been designated as sponsor members and they alone are entitled to sponsor a company for listing there.
4. Trading on the OTCEI takes place through a network of computers or OTC dealers located at different places within the same city and even across the cities. These computers allow dealers to quote, query & transact through a central OTC computer using the telecommunication links.
5. A Company which is listed on any other recognised stock exchange in India is not permitted simultaneously for listing on OTCEI.
6. OTCEI deals in equity shares, preference shares, bonds, debentures and warrants.

Securities and Exchange Board of India (SEBI)

Securities and Exchange Board of India (**SEBI**) is an apex body for overall development and regulation of the securities market. It was set up on April 12,**1988**. To start with, SEBI was set up as a non-statutory body. Later on it became a statutory body under the Securities Exchange Board of India Act, 1992. The Act entrusted SEBI with comprehensive powers over practically all the aspects of capital market operations.

Role or Functions of SEBI

The role or functions of SEBI are discussed below:

1. To protect the interests of investors through proper education and guidance as regards their investment in securities, SEBI has made rules and regulation to be followed by the financial intermediaries such as brokers, etc. SEBI looks after the complaints received from investors for fair settlement. It also issues booklets for the guidance and protection of small investors.

2. To regulate and control the business on stock exchanges and other security markets, SEBI keeps supervision on brokers. Registration of brokers and sub-brokers is made compulsory and they are expected to follow certain rules and regulations. Effective control is also maintained by SEBI on the working of stock exchanges.
3. To make registration and to regulate the functioning of intermediaries such as stock brokers, sub-brokers, share transfer agents, merchant bankers and other intermediaries operating on the securities market, it provides suitable training to intermediaries. This function is useful for healthy atmosphere on the stock exchange and for the protection of small investors.
4. To register and regulate the working of mutual funds including UTI (Unit Trust of India), SEBI has made rules and regulations to be followed by mutual funds. The purpose is to maintain effective supervision on their operations & avoid their unfair and anti-investor activities.
5. To promote self-regulatory organization of intermediaries, SEBI is given wide statutory powers. However, self-regulation is better than external regulation. Here, the function of SEBI is to encourage intermediaries to form their professional associations and control undesirable activities of their members. SEBI can also use its powers when required for protection of small investors.
6. To regulate mergers, takeovers and acquisitions of companies in order to protect the interest of investors, SEBI has issued suitable guidelines so that such mergers and takeovers will not be at the cost of small investors.
7. To prohibit fraudulent and unfair practices of intermediaries operating on securities markets, SEBI is not for interfering in the normal working of these intermediaries. Its function is to regulate and control their objectionable practices which may harm the investors and healthy growth of capital market.
8. To issue guidelines to companies regarding capital issues, separate guidelines are prepared for first public issue of new companies, for public issue by existing listed companies and for first public issue by existing private companies. SEBI is expected to conduct research and publish information useful to all market players (i.e. all buyers and sellers).

9. SEBI conducts inspection, inquiries & audits of stock exchanges, intermediaries and self-regulating organizations and to take suitable remedial measures wherever necessary. This function is undertaken for orderly working of stock exchanges & intermediaries.

10. SEBI restricts insider trading activity through suitable measures. This function is useful for avoiding undesirable activities of brokers and securities scams.

Lesson 5.4.

Development Banks

Meaning of Development Banks

Development banks are specialized financial institutions. They provide medium and long-term finance to the industrial and agricultural sector. They provide finance to both private and public sector. Development banks are multipurpose financial institutions. They do term lending, investment in securities and other activities. They even promote saving and investment habit in the public.

Development bank is essentially a multi-purpose financial institution with a broad development outlook. A development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities which means economic development in general, and industrial development, in particular. In short, a development bank is a development- oriented bank.

Features of a Development Bank:

Following are the main characteristic features of a development bank:

1. It is a specialised financial institution.

2. It provides medium and long term finance to business units.

3. Unlike commercial banks, it does not accept deposits from the public.

4. It is not just a term-lending institution. It is a multi-purpose financial institution.

5. It is essentially a development-oriented bank. Its primary object is to promote economic development by promoting investment and entrepreneurial activity in a developing economy. It encourages new and small entrepreneurs and seeks balanced regional growth.

6. It provides financial assistance not only to the private sector but also to the public sector undertakings.

7. It aims at promoting the saving and investment habit in the community.

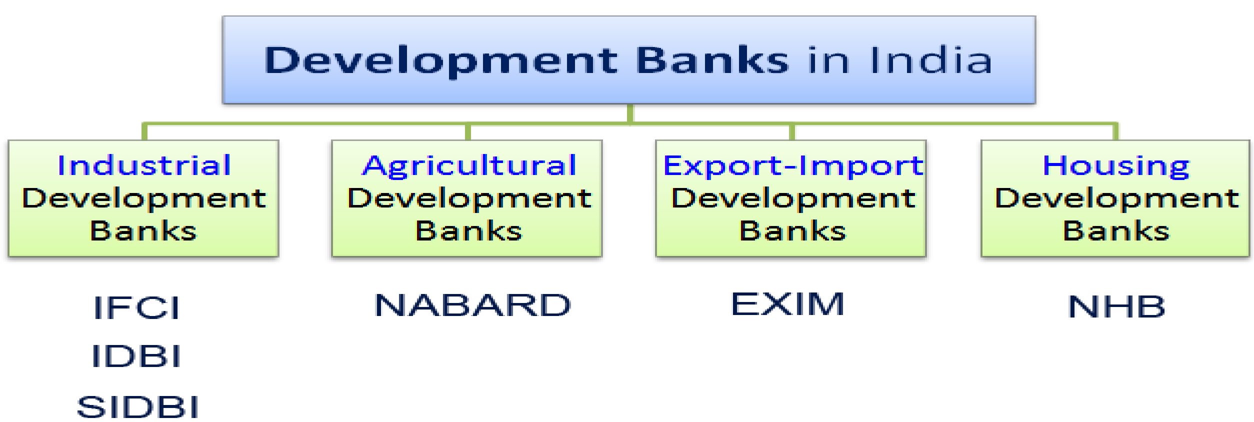
8. It does not compete with the normal channels of finance, i.e., finance already made available by the banks and other conventional financial institutions. Its major role is of a gap-filler, i. e., to fill up the deficiencies of the existing financial facilities.

9. Its motive is to serve public interest rather than to make profits. It works in the general interest of the nation.

Development Banking in India

Development banking was started after the World War II. It provided finance to reconstruct the buildings and industries which were destroyed in the war. In India, development banking was started immediately after independence. In the field of industrial finance, the concept of development bank is of recent origin. In a country like India, the emergence of development banking is a post-independence phenomenon. In India, the first development bank called the Industrial Finance Corporation of India (IFCI) was established in 1948.

The arrangement of development banks in India is depicted below.



Development banks in India are classified into following four groups:

1. **Industrial Development Banks** : It includes, for example, Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI).
2. **Agricultural Development Banks**: It includes, for example, National Bank for Agriculture & Rural Development (NABARD).
3. **Export-Import Development Banks**: It includes, for example, Export-Import Bank of India (EXIM Bank).
4. **Housing Development Banks**: It includes, for example, National Housing Bank (NHB).

Functions of Development Banks in India

The nine important functions of development banks in India are as follows:

1. To promote and develop small-scale industries (SSI) in India.
2. To finance the development of the housing sector in India.
3. To facilitate the development of large-scale industries (LSI) in India.
4. To help the development of agricultural sector and rural India.
5. To enhance the foreign trade of India.
6. To help to review (cure) sick industrial units.
7. To encourage the development of Indian entrepreneurs.
8. To promote economic activities in backward regions of the country.
9. To contribute in the growth of capital markets.

Now let's discuss each important function of development banks one by one.

1. Small Scale Industries (SSI)

Development banks play an important role in the promotion and development of the small-scale sector. Government of India (GOI) started Small industries Development Bank of India (SIDBI) to provide medium and long-term loans to Small Scale Industries (SSI) units. SIDBI provides direct project finance, and equipment finance to SSI units. It also refinances banks and financial institutions that provide seed capital, equipment finance, etc., to SSI units.

2. Development of Housing Sector

Development banks provide finance for the development of the housing sector. GOI started the National Housing Bank (NHB) in 1988. NHB promotes the housing sector in the following ways:

1. It promotes and develops housing and financial institutions.
2. It refinances banks and financial institutions that provide credit to the housing sector.

3. Large Scale Industries (LSI)

Development banks promote and develop large-scale industries (LSI). Development financial institutions like IDBI, IFCI, etc., provide medium and long-term finance to the corporate sector. They provide merchant banking services, such as preparing project reports, doing feasibility studies, advising on location of a project, and so on.

4. Agriculture and Rural Development

Development banks like National Bank for Agriculture & Rural Development (NABARD) helps in the development of agriculture. NABARD started in 1982 to provide refinance to banks, which provide credit to the agriculture sector and also for rural development activities. It coordinates the working of all financial institutions that provide credit to agriculture and rural development. It also provides training to agricultural banks and helps to conduct agricultural research.

5. Enhance Foreign Trade

Development banks help to promote foreign trade. Government of India started Export-Import Bank of India (EXIM Bank) in 1982 to provide medium and long-term loans to exporters and importers from India. It provides Overseas Buyers Credit to buy Indian capital goods. It also encourages abroad banks to provide finance to the buyers in their country to buy capital goods from India.

6. Review of Sick Units

Development banks help to revive (cure) sick-units. Government of India (GOI) started Industrial investment Bank of India (IIBI) to help sick units.

IIBI is the main credit and reconstruction institution for revival of sick units. It facilitates modernization, restructuring and diversification of sick-units by providing credit and other services.

7. Entrepreneurship Development

Many development banks facilitate entrepreneurship development. NABARD, State Industrial Development Banks and State Finance Corporations provide training to entrepreneurs in developing leadership and business management skills. They conduct seminars and workshops for the benefit of entrepreneurs.

8. Regional Development

Development banks facilitate rural and regional development. They provide finance for starting companies in backward areas. They also help the companies in project management in such less-developed areas.

9. Contribution to Capital Markets

Development banks contribute to the growth of capital markets. They invest in equity shares and debentures of various companies listed in India. They also invest in mutual funds and facilitate the growth of capital markets in India.

Industrial Development Bank of India (IDBI)

Industrial Development Bank of India (IDBI) established under Industrial Development Bank of India Act, 1964, is the principal financial institution for providing credit and other facilities for developing industries and assisting development institutions.

Till 1976, IDBI was a subsidiary bank of RBI. In 1976 it was separated from RBI and the ownership was transferred to Government of India. IDBI is the tenth largest bank in the world in terms of development. The National Stock Exchange (NSE), the National Securities Depository Services Ltd. (NSDL) and Stock Holding Corporation of India (SHCIL) are some of the Institutions which have been built by IDBI.

Organisation and Management:

IDBI consist of a Board of Directors, consisting of a chairman and Managing Director appointed by the Government of India, a Deputy Governor of the RBI nominated by that bank and 20 other Directors are nominated by the Central Government.

The Board had constituted an Executive Committee consisting of 10 Directors, including the Chairman and Managing Director. The Executive Committee is empowered to sanction financial assistance.

The Head office of IDBI is located in Mumbai. The bank has five regional offices, one each in Kolkata, Guwahati, New Delhi, Chennai and Mumbai. Besides the bank has 21 branch offices.

Functions of IDBI:

The main functions of IDBI are discussed below:

(i) To provide financial assistance to industrial enterprises.

(ii) To promote institutions engaged in industrial development.

(iii) To provide technical and administrative assistance for promotion management or expansion of industry.

(iv) To undertake market and investment research and surveys in connection with development of industry.

IDBI Assistance:

The IDBI provides financial assistance either directly or through some specified financial institutions:

(i) Direct Assistance:

The IDBI grants loans and advances to industrial concerns. There is no restriction on the upper or lower limits for assistance to any concern itself. The bank guarantees loans raised by industrial concerns in the open market from the State Co-operative Banks, the Scheduled Banks, the Industrial Finance Corporation of India (IFCI) and other 'notified' financial institutions.

(ii) Indirect Assistance:

The IDBI can refinance term loans to industrial concerns repayable within 3 to 25 years given by the IFCI, the State Financial Corporation and some other financial institutions and to SIDCs (State Industrial Development Corporations), Commercial banks and Cooperative banks which extend term loans not exceeding 10 years to industrial concerns. IDBI subscribes to the shares and bonds of the financial institutions and thereby provide supplementary resources.

Developmental Activities of IDBI:

(1) Promotional Activities:

In fulfillment of its developmental role, the bank continues to perform a wide range of promotional activities relating to developmental programmes for new entrepreneurs, consultancy services for small and medium enterprises and programmes designed for accredited voluntary agencies for the economic upliftment of the underprivileged.

These include entrepreneurship development, self-employment and wage employment in the industrial sector for the weaker sections of society through voluntary agencies, support to Science and Technology Entrepreneurs' Parks, Energy Conservation, Common Quality Testing Centers for small industries.

(2) Technical Consultancy Organisations:

With a view to making available at a reasonable cost, consultancy and advisory services to entrepreneurs, particularly to new and small entrepreneurs, IDBI, in collaboration with other All-India Financial Institutions, has set up a network of Technical Consultancy Organisations (TCOs) covering the entire country. TCOs offer diversified services to small and medium enterprises in the selection, formulation and appraisal of projects, their implementation and review.

(3) Entrepreneurship Development Institute:

Realising that entrepreneurship development is the key to industrial development; IDBI played a prime role in setting up of the Entrepreneurship Development Institute of India for fostering entrepreneurship in the country. It has also established similar institutes in Bihar, Orissa, Madhya Pradesh and Uttar Pradesh. IDBI also extends financial support to various organisations in conducting studies or surveys of relevance to industrial development.

Export-Import Bank of India (EXIM Bank)

Export-Import Bank of India (EXIM Bank) is a specialized financial institution, wholly owned by Government of India, set up in 1982, for financing, facilitating and promoting foreign trade of India. Since its inception, EXIM Bank of India has been both a catalyst and a key player in the promotion of cross border trade and investment.

EXIM Bank is managed by a Board of Directors, which has representatives from the Government, Reserve Bank of India, Export Credit Guarantee Corporation of India, a financial institution, public sector banks, and the business community.

Commencing operations as a purveyor of export credit, like other Export Credit Agencies in the world, EXIM Bank of India has, over the period, evolved into an institution that plays a major role in partnering Indian industries, particularly the Small and Medium Enterprises, in their globalisation efforts, through a wide range of products and services offered at all stages of the business cycle, starting from import of technology and export product development to export production, export marketing, pre-shipment and post-shipment and overseas investment.

EXIM Bank extends Lines of Credit (LOCs) to overseas financial institutions, regional development banks, sovereign governments and other entities overseas, to enable buyers in those countries to import developmental and infrastructure projects, equipments, goods and services from India, on deferred credit terms.

EXIM Bank has laid strong emphasis on enhancing project exports, the funding options for which have been enhanced with introduction of the Buyer's Credit-National Export Insurance Account (BC-NEIA) program. The Bank facilitates two-way technology transfer by financing import of technology into India, and investment abroad by Indian companies for setting up joint ventures, subsidiaries or undertaking overseas acquisitions.

To promote hi-tech exports from India, the Bank has a lending programme to finance research and development (R&D) activities of export-oriented companies. The Bank, with its diverse programmes, caters to different segments of exporters and the export cycle. The Bank provides assistance in helping Indian firms in their globalization efforts by locating overseas distributor(s)/ buyer(s)/ partner(s) for their products and services. EXIM Bank also lays special emphasis on enhancing export capabilities and international competitiveness of Indian companies through its various Advisory Services.

Role and function of development banks in India

Small Industries Development Bank of India (SIDBI), set up on April 2, 1990 under an Act of Indian Parliament, is the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for Co-ordination of the functions of the institutions engaged in similar activities.

The Charter establishing it, the Small Industries Development Bank of India Act, 1989 envisaged SIDBI to be "the principal financial institution for the promotion, financing and development of industry in the small scale sector and to co-ordinate the functions of the institutions engaged in the promotion and financing or developing industry in the small scale sector and for matters connected therewith or incidental thereto.

It was incorporated initially as a wholly owned subsidiary of Industrial Development Bank of India. Currently the ownership is held by 33 Government of India owned / controlled institutions. Beginning as a refinancing agency to banks and state level financial institutions for their credit to small industries, it has expanded its activities, including direct credit to the SME through 100 branches in all major industrial clusters in India.

Besides, it has been playing the development role in several ways such as support to micro-finance institutions for capacity building and on lending. Recently it has opened seven branches christened as Micro Finance branches, aimed especially at dispensing loans up to Rs.5 lakh.

SIDBI has also floated several other entities for related activities. Credit Guarantee Fund Trust for Micro and Small Enterprises provides guarantees to banks for collateral-free loans extended to SME. SIDBI Venture Capital Ltd. is a venture capital company focused at SME. The SME Rating Agency of India Ltd. (SMERA) provides composite ratings to SME. Another entity founded by SIDBI is ISARC (India SME Asset Reconstruction Company) in 2009, as specialized entities for NPA (Non Performing Assets) resolution for SME

In its endeavour towards holistic development of the MSME sector, SIDBI adopts a 'Credit Plus' approach wherein, besides credit, the Bank also provides grant support for the Promotion and Development (P&D) of the sector to make it strong, vibrant and competitive. The P&D activities of the bank include Micro Enterprise Promotion, Entrepreneurship Development, Cluster Development, Capacity Building of the MSME Sector, promoting Responsible Finance among Micro Finance Institutions, Sustainable Finance to MSMEs including Energy Efficiency, Environment Protection, etc.

The business domain of SIDBI consists of Micro, Small and Medium Enterprises (MSMEs), which contribute significantly to the national economy in terms of production, employment and exports. MSME sector is an important pillar of Indian economy as it contributes greatly to the growth of Indian economy

National Housing Bank (NHB)

National Housing Bank (NHB), a wholly owned subsidiary of Reserve Bank of India (RBI), was set up on July 9, 1988 under the National Housing Bank Act, 1987. NHB is an apex financial institution for housing. NHB has been established with an objective to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support incidental to such institutions and for matters connected therewith. NHB registers, regulates and supervises Housing Finance Company (HFCs), keeps surveillance through On-site & Off-site Mechanisms and co-ordinates with other Regulators.

Objectives

NHB has been established to achieve, inter alia, the following objectives –

a. To promote a sound, healthy, viable and cost effective housing finance system to cater to all segments of the population and to integrate the housing finance system with the overall financial system.

b. To promote a network of dedicated housing finance institutions to adequately serve various regions and different income groups.

c. To augment resources for the sector and channelise them for housing.

d. To make housing credit more affordable.

e. To regulate the activities of housing finance companies based on regulatory and supervisory authority derived under the Act.

f. To encourage augmentation of supply of buildable land and also building materials for housing and to upgrade the housing stock in the country.

g. To encourage public agencies to emerge as facilitators and suppliers of serviced land, for housing.

Function of NHB

The three main function of NHB in the housing finance business in the country are as follows

1. Promotion and Development Function

There was a need to set up local and regional level financial institutions for supply of housing credit. NHB is of the opinion that intervention through institutional credit can be made more effective by adoption of different approaches to cater to the needs of different income groups. There has been a sustained effort at creating and supporting new set of specialised institutions to serve as dedicated centres for housing credit.

2. Regulatory Function

The second most important function of NHB is the regulatory role assigned to it. NHB has come up with guidelines for recognising HFCs for its financial assistance, guidelines for financial assistance. Besides it has also issued guidelines for prudential norms for income recognition, asset classification etc.

3. Financial Function

The third important role of NHB is to provide financial assistance to the various banks and housing finance institutions. It supports housing finance sector by extending refinance to different lenders in respect of eligible housing loans extended by them to individual beneficiaries and for project loans extended by them to various implementing agencies.

It also supports by lending directly in respect of projects undertaken by public housing agencies for housing construction and development of housing related infrastructure. It helps by guaranteeing the repayment of principal and payment of interest on bonds issued by housing finance companies. NHB plays as refinancing operations, project finance, guarantee and securitisation.

Lesson 5.5

Non-Banking Financial Companies (NBFCS)

The Reserve Bank of India is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934. The regulatory and supervisory objectives are:

a) To ensure healthy growth of the financial companies;

b) To ensure that these companies function as a part of the financial system within the policy framework, in such a manner that their existence and functioning do not lead to systemic aberrations; and that

c) To the quality of surveillance and supervision exercised by the Bank over the NBFCs is sustained by keeping pace with the developments that take place in this sector of the financial system.

It has been felt necessary to explain the rationale underlying the regulatory changes and provide clarification on certain operational matters for the benefit of the NBFCs, members of public, rating agencies, Chartered Accountants etc. To meet this need, the clarifications in the form of questions and answers, is being brought out by the Reserve Bank of India (Department of Non-Banking Supervision) with the hope that it will provide better understanding of the regulatory framework.

A Non-Banking Financial Company (NBFC) is engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without obtaining a certificate of registration from the Bank and without having a Net Owned Funds of Rs. 25 lakhs (Rs two crore since April 1999).

Certain Categories of NBFCs

However, in terms of the powers given to the Bank. to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz.

1. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI,
2. Insurance Company holding a valid Certificate of Registration issued by IRDA,
3. Nidhi companies as notified under Section 620A of the Companies Act, 1956,
4. Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982,
5. Housing Finance Companies regulated by National Housing Bank,
6. Stock Exchange or a Mutual Benefit company.

Different Types/Categories of NBFCs

NBFCs are categorized

a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs,

b) non deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and

c) by the kind of activity they conduct.

Within this broad categorization the different types of NBFCs are as follows:

i. ***Asset Finance Company(AFC)*** *:*

An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.

ii. ***Investment Company (IC)*** *:*

IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,

iii. ***Loan Company (LC):***

LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

iv. ***Infrastructure Finance Company (IFC):***

IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of Rs. 300 crore, c) has a minimum credit rating of ‘A ‘or equivalent d) a CRAR of 15%.

v. ***Systemically Important Core Investment Company (CIC-ND-SI):***

CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities. IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

v. ***Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI):***

NBFC-MFI is a non-deposit taking NBFC having not less than 85%of its assets in the nature of qualifying assets

vi. ***Non-Banking Financial Company – Factors (NBFC-Factors):***

NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 75 percent of its total assets and its income derived from factoring business should not be less than 75 percent of its gross income.

Self Assessment Questions

1. What is meant by financial environment? What are the components of financial environment?
2. Explain the financial systems.
3. What are the various financial serves provided by financial industries?
4. What are the main financial institutions in India? Explain.
5. Explain the objectives, role and functions of RBI.
6. Explain the role, structure, types and functions of Commercial Banks in India
7. Explain the role and functions of NABARD in agricultural banking.
8. Explain the role of Cooperative Banks in India and their structures.
9. What is capital market? What is the role of Stock Exchanges in Capital Market of India?
10. Explain the different types of stock exchanges in India.
11. Explain the role of Securities and Exchange Board of India **(**SEBI**)**
12. What are the features and functions of development banks in India?
13. Explain the role and functions of Industrial Development Banks of India (IDBI).
14. Explain the role and functions of Export-Import Bank of India (EXIM Bank)
15. Explain the functions of National Housing Bank (NHB)
16. What are the various categories of Non-Banking Financial Companies (NBFCS)

Unit – VI

TECHNOLOGICAL ENVIRONEMNT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning of Technological Environment
- Factors affecting technology in business environment
- Importance of technology in business environment
- Choice of technology in modern business
- Selecting appropriate technology in business

Lesson 6.1 – Technology in business environment

Lesson 6.2 – Choice of technology in business environment

Lesson 6.1

TECHNOLOGY IN BUSINESS ENVIRONMENT

Technological Environment - Meaning

Technological Environment means the development in the field of technology which affects business by new inventions of productions and other improvements in techniques to perform the business work.

We see that in 21st century, technology is changing very fast. Now, all work is done online and business shops are using machinery at high level. Following technological environment factors affect business are :

* New inventions to produce the products.
* New inventions relating to marketing like BPO for selling online in international market.

The technology has a major impact on the business. It affects the business prospects, cuts down the profits and forces the management to change the course of the business operations. Any change in technology changes the work cultures, the methods and the systems. It affects the speed of the operations and gives a boost to the productivity. Examples of technological changes are seen in aviation, electronics, energy, communication, consumer goods industry, optics, medicines and manufacturing.

Factors affecting technology in businesses environment

Technological factors affecting businesses all over the world demands a changing behaviour with regard to traditional marketing. The rapid development of technology requires quick reaction by businesses in order to survive in an emerging competitive environment and keep up with new trends and innovative services which other competitors might be offering.

The technological factors affecting business environment are as follows

1. ***Organisational change***

   It is usually quite difficult especially when a high number of people are involved as routines will be modified. It is recommended to inform employees in advance and keep them up to date by encouraging feedback while making such change.

2. ***Business processes***

   Integrating modern technology solicits identifying the business requirements and evaluating the business processes according to its objectives and goals. These changes should benefit the company and the consumers.

3. ***SCA (Sustainable Competitive Advantage)***

   Technology is looked at from a positive perspective instead of a 'necessary evil'. Traditional models are changing and advantages can be achieved by investing in modern technology but just purchasing technology for the sake of having it is not enough. Implementing a strategic plan is the key to succeed.

4. Costs involved

A necessary expense in today's emerging environment is unavoidable. However, it is understandable that some organisations are hesitant to invest due to systems being outdated quite often, but the one who views this investment as an opportunity to gain competitive advantage and have a well-developed strategy attached, could benefit immensely.

5. Efficiency

Productivity, reducing manual labour costs, cost-effective overall factor as it can simplify, speed up and enhance accuracy (or e.g. departments can interact or check a particular issue or status of an order/delivery/service from different locations in the Value Chain).

6. ***Information Security/Contingency Planning***

Technology provides a lot of advantages but we should also take into consideration the responsibilities that come with it. Businesses should take into account the rise in data breaching and various cyber-crime elements and must invest in effective ways of preventing or combating these factors. Imagine if an important process becomes unavailable suddenly or a system is hacked, businesses must have these contingency plans in order to protect their valuable assets.

The following points are considered as immense value to the business for the rapid development of technology

- Understanding Web Terminology
- Technology legislation
- Internet/broadband – consumer & business markets
- Technology infrastructure in a country (Web/Broadband/Mobile)
- Technologies offer consumers and businesses more innovative products and services such as Internet banking, new generation mobile telephones…
- Secured Systems are encryptions, digital certificates, SSL (secure sockets layer protocol mechanisms)

- Distribution of products and services are changed by new technologies e.g. books via the Internet, flight tickets, auctions etc.
- Technology offesr companies a new way to communicate with consumers e.g. Social media, Customer Relationship Management (e CRM), etc?
- Machinery
- Equipment

Importance of technology in business

Technology has important on business operations. No matter the size of your enterprise, technology has both tangible and intangible benefits that will help you make money and produce the results. Technological infrastructure affects the culture, efficiency and relationships of a business. It also affects the security of confidential information and trade advantages.

1. Communication with Customers

First and foremost, technology affects a firm's ability to communicate with customers. In today's busy business environment, it is necessary for employees to interact with clients quickly and clearly. Websites allow customers to find answers to their questions after hours. Fast shipment options allow businesses to move products over a large geographic area. When customers use technology to interact with a business, it creates better communication and builds stronger public image.

2. Efficiency of Operations

Technology also helps a business understand its cash flow needs and preserve precious resources such as time and physical space. Warehouse inventory technologies let business owners understand how best to manage the storage costs of holding a product. With proper technology in place, executives can save time and money by holding meetings over the Internet instead of at corporate headquarters.

3. Business Culture and Class Relations

Technology creates a team dynamic within a business because employees at different locations have better interactions. If factory managers can communicate with shipment coordinators at a different location, tensions and distrust are less likely to evolve. Cliques and social tensions can become a nightmare for a business; technology often helps workers put their different backgrounds aside.

4. ***Security***

Most businesses of the modern era are subject to security threats and vandalism. Technology can be used to protect financial data, confidential executive decisions and other proprietary information that leads to competitive advantages. Simply put, technology helps businesses keep their ideas away from their competition. By having computers with passwords, a business can ensure none of its forthcoming projects will be copied by the competition.

5. ***Research Capacity***

A business that has the technological capacity to research new opportunities will stay a step ahead of its competition. For a business to survive, it must grow and acquire new opportunities. The Internet allows a business to virtually travel into new markets without the cost of an executive jet or the risks of creating a factory abroad.

Lesson 6.2

Choice of technology in business environment

Few successful companies do not use technology to improve productivity, communicate more efficiently and track customers and goods. In fact, most successful organizations rely on technology for almost every aspect of their business. Although there are many types of technology available, going digital have to intimidate business owners. It can all be broken down into understandable chunks of functionality.

1. ***Computers***

For most companies, the most useful piece of equipment is computer. Desktop computers loaded with office and productivity software packages allow workers to write letters, analyze financial information, send and receive emails, and design sales presentations. The computer itself could be a desktop model with a separate monitor and keyboard, or a mobile laptop. There are two main types of computers: Personal computers (PCs) is operated using Microsoft Windows operating systems most commonly. Macintosh Computers are using Apple operating system which are popular among creative professionals.

2. Software

Software is loaded onto a computer to provide specific types of functionality. Productivity tools, such as Microsoft Word, a word processing package, and Microsoft Excel, a financial spreadsheet system, can perform many of the most common tasks a small business requires. Microsoft PowerPoint or Apple Keynote allows users to prepare professional-looking sales presentations quickly and easily. Millions of other titles are available, each developed to perform specific tasks.

3. Networking

Computers are often linked to form a network. This can allow people within an organization to share documents or information, provide a central repository to store documents, or for people to communicate using email within an office. They also allow several computers to share a printer or storage device. A network can be limited to computers within a shared office, or span across multiple offices and locations.

4. Telephone Systems

Although you might not consider an office telephone to be a piece of technology, business phone systems are quite complex. The most common type of phone system consists of a hardware unit that uses software to split the phone line among individual handsets. These systems often include an auto attendant that helps callers find the employee they are seeking and most also include a voice mail system for messages. Voice Over Internet Protocol (VOIP) phones are becoming more popular. VOIP phones do not require a telephone line, but instead route all traffic over the Internet to a special handset.

5. Accounting System

Although technically software, accounting systems deserve their own mention because of their mission-critical role in any business. Accounting systems keep track of every dollar a company spends along with every dollar of revenue. One popular choice for smaller companies is Quick books by Intuit, which is simple to set up and maintain. Larger companies may want to consider SAP , which allow for more customization and more integration with other systems. In India “ Tally” accounting software is very popular.

6. Inventory Control System

If your business sells goods, you may want to explore an inventory control system. These systems keep track of every item in your inventory, ensuring you do not run out of stock, nor you order too much. When new inventory arrives, the system is updated to reflect the additions and when it is sold, it is deducted from the totals.

7. Customer Relationship Management Systems

A Customer Relationship Management (CRM) System tracks a customer throughout his experience with your company. From the moment you obtain information about the customer, the CRM system will track their interactions with you. If a customer calls to order a product or service, or calls for help or a technical question, the CRM system will tell the service representative when the items were shipped, what is back-ordered and any other conversations the customer may have had with your company. CRM systems help build relationships with a customer by assembling all the information your company collects from the customer in one place for use, review and proactive response.

Selecting appropriate technology in business - Problems and Solutions

Technology issues can trip up any entrepreneur, from creating an affordable website to figuring out collaboration tools to setting up cloud storage. And most entrepreneurs get frustrated with the learning curve and expense required to master a new device, application or service. But, done right, technology can empower your business to climb to amazing heights.

1. ***Building a website***

Designing, building and maintaining a website is naturally intimidating to anyone unfamiliar with the process. And, once launched, a website or blog generates ongoing work such as responding to customer inquiries, performing search engine optimization, posting content and staying current with changes in internet technology. It's enough to make any business owner run for cover.

There are a number of companies offering free or low-cost website building platforms. These companies usually offer easy-to-use customizable website designs, and can help you with a domain name, hosting and email set up.

*2. **Data loss***

According to research conducted by Price Waterhouse Coopers, 70% of small businesses that experience a data loss will go out of business within a year. That may reflect the vulnerability of smaller businesses in this area: we simply don't have the big-business budgets to spend on data storage, backup and protection. And, a disproportionate amount of our data may reside on one or two devices – leaving us vulnerable to catastrophe if a key machine is lost, stolen or destroyed.

Thankfully, there are a number of data solutions available. You can physically back up your data to an external device, you can copy your data onto disc, or you can subscribe to a cloud storage facility such as Box.com. For extra security, do all three. Whatever solution you prefer, make sure your data backup source is offsite, secure and accessible anytime.

*3. **Managing information***

Who knew a small business could generate so much data? Business owners are bombarded with different types of data including website analytics, sales numbers, financial reports and prospect research – all of it important and constantly changing.

Before anyone can make sense of this information, the challenge is organizing it. And that's where dashboards come in very handy. A dashboard is management tool that allows a business leader to monitor key performance indicators (KPIs). It curates information to provide at-a-glance reviews – imagine being able to track the dollar value of sales secured by your remote sales team as deals close. You can also use a dashboard to spot problems within your business early enough to take action.

For example, Microsoft Dynamics is customer relationship management (CRM) software that lets you monitor team activities across sales, marketing, customer care and social media for up-to-date information.

4. ***Social media***

The challenge here is time: Business owners want to be active in social media platforms (and know their marketing success depends on it) but understandably struggle to find the time to send tweets, post blogs, or build connections.

Lean on technology and apps to make social media participation fast and easy. Hoot suite gives you one platform to manage and measure your social media activities across networks such as Facebook, Twitter, YouTube and LinkedIn. And every social media network is mobile enabled, so you can dash off some words of wisdom from your phone whenever and wherever you choose.

5. ***Cost to upgrade technology***

The good news about technology is also the bad news: it changes quickly. It can get expensive to pay for the latest smart phones, tablets, wireless routers and other productivity devices – especially if you're buying for a team. There's also the cost to subscribe to current Software-as-a-Service (SaaS) applications essential to power everyday business functions such as accounting, invoicing, customer relationship management, data storage and more.

Upgrading technology is an important strategy for two reasons: it will help your business to remain competitive, and it will enable you and your employees to work more efficiently. Upgrading your tools only when you notice an impact on productivity may be too late – work with your accountant or financial advisor to establish a realistic annual budget to keep your technology fresh. Thankfully, technology costs are trending downward as more vendors compete for your business.

6. Emerging Technology in Business

Information technology has transformed the social and business environment. Technology often deals with methods or tools used to gather, manipulate, store and communicate information. Many businesses have implemented technology designed for personal use to reduce business costs and improve the efficiency and effectiveness of production methods. Companies also use technology to open several domestic or international business locations. Emerging technology includes new or advanced hardware or software.

Self Assessment Questions

1. What is meant by technology environment?
2. What are the factors affecting technological business environment?
3. Explain the importance of technology in business environment
4. What are the varieties of technologies available for business use?
5. What are the problems faced by business organizations in selecting appropriate technology? Give your suggestions to select suitable technologies in business.

Unit – VII

LEGAL ENVIRONMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning of legal environment
- Factors affecting legal environment in business
- Legal environment of international business
- Business regulations in India
- Meaning and principles of corporate governess
- Importance of corporate governess
- Benefits of corporate governess

Lesson 7.1 – Legal environment in business

Lesson 7.2 – Business regulations in Inida

Lesson 7.3. – Corporate Governess

Lesson 7.1

LEGAL ENVIRONMENT IN BUSINESS

Legal Environment -Meaning

The environmental approach views law as an arm of societal control that must continuously reflect the current society's moral constructed through the enforcement of rules, regulations, and laws. This approach is much broader in scope, since the law is an institution that reflects the societal need for social order

The legal environment of business refers to the code of conduct that defines the legal boundaries for business activity. To understand these boundaries, it is essential to first have a basic understanding of the law and how it affects businesses and business practices. The nature of business spans over a number of legal realms, all of which are continuously influenced by the needs and demands of the business community, consumers, and the government.

Factors Affecting Legal Environment in Business

While an in-depth understanding of the various areas of law is a vast undertaking requiring years of intensive study, the primary objective is to cover a variety of legal topics that are most commonly encountered in the business environment. However, developing legal insight by understanding the fundamentals of legal theory and how they may impact business is only a first step in learning how legal decisions should be made in a business context.

The second step involves learning to apply legal theories in practice and recognizing that having legal awareness may present opportunities for proactive business planning and empowering business owners and managers to limit liability, gain a competitive edge, and add value to the business. The legal frameworks that affects business environments are discussed below :

1. ***Organizational Law***

   If your business is organized as a legal entity, it will be subject to the state law which governs the operation and conduct of that type of entity. Legal business entities include corporations, partnerships, limited partnerships, limited liability partnerships and limited liability companies.

2. ***Securities Law***

   Businesses that seek to obtain financing through investors may be subject to securities law. For example, if you decide to offer promissory notes - a special type of loan - to investors, the offering will often be considered the offering of a security and will subject you and your business to state and federal securities laws and regulations.

3. ***Employment Law***

   Businesses that employ people are subject to a myriad of state and federal laws related to employment, including anti-discrimination laws, occupational health and safety laws that are meant to protect the health and well-being of employees, workers compensation laws that compensate workers injured on the job, wage and hour laws, and other labor laws regarding unions.

4. ***Contract Law***

If you intend to enter into any agreement with another person or entity, you will be subject to contract law. There is also a special area of law that deals directly with government contracts, often referred to as government procurement law.

5. ***Commercial Law***

Commercial laws relate to the sales of goods. This field also addresses special types of commercial instruments, like promissory notes and other forms of commercial paper, such as a check, and laws relating to certain banking transactions. The primary law governing commercial law is adopted by each state.

Legal Environment of International Business

Public international law is the system of rules and principles governing the conduct of, and relationships between, states and international organizations as well some of their persons.

Private international law governs relationships between persons and organizations engaged in international transactions and addresses which laws will apply when the parties are in a legal dispute. Foreign law is a law enacted by a foreign country.

Conceptual Framework

If your company engages in any transactions overseas, it will have to familiarize itself with the general concepts of public and private international law as well as foreign law, because all can affect the manner in which you can engage in business abroad. We'll look at the most essential aspects of the international legal system that are relevant to businesses. Key concepts and terms needed for understanding will be explained along the way.

Public International Law:

Public international law comes from three primary sources.

1. Treaties, conventions, protocols, charters of international organizations such as the United Nations (UN), and executive agreements govern relationships between countries and international organizations. A treaty is an agreement between one or more countries that addresses specific aspects of international relations between the parties to the treaty. A convention is also an agreement between countries, and is often negotiated through international organizations such as the UN, the International Monetary Fund (IMF), or World Bank on a regional or global basis such as the entire continent of Europe. Protocols are agreements that address matters that are less important than treaty. Finally, executive agreements are simply agreements between the executives of two or more governments.
2. Customary international law is basically the customs that have developed between states in addressing international relationships that have become general practice and accepted as law.
3. Certain principles common to major legal systems such as due process, rules of evidence, and trial by legal tribunal (such as a court of law) also comprise a source of international law.

Lesson 7.2

BUSINESS REGULATION IN INDIA

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 of India. The following is the list of main laws which affect business:

1. **Economic Regulations:**

   Economic laws of the country may be mapped broadly into:

   i) Corporate Laws: Primarily the Companies Act, 2013 ("Companies Act") and the regulations laid down by the Securities and Exchanges Board of India ("SEBI");

   ii) Operational and contract laws as Industries (Development and Regulation) Act, 1951; Indian Contract Act, 1872, Sale of Goods Act, 1930, Specific Relief Act, 1963, Competition Act, 2002.

   iii) Exchange Control Laws: Primarily the Foreign Exchange Management Act, 1999 ("FEMA") and numerous circulars, notifications and press notes issued under the same;

   iv) Sector Specific Laws: Specific Laws relating to Financial Services (banking, non-banking financial services), Infrastructure (highways, airports) and other sectors:

   v) Intellectual property laws; and,

   vi)Tax framework;

2. **Environment Legislation**

   Environment enactments pertaining to environment protection are as follows: ƒ

   i) The Environment (Protection) Act, 1986: This Act authorizes the central government to protect and improve environmental quality, control and reduce pollution from all sources, and prohibit or restrict the setting and /or operation of any industrial facility on environmental grounds. ƒ

   ii) The National Environmental Tribunal Act, 1995: This Act has been created to award compensation for damages to persons, property, and the environment arising from any activity involving hazardous substances. ƒ The National

iii) Environment Appellate Authority Act, 1997: This Act has been created to hear appeals with respect to restrictions of areas in which classes of industries etc. are carried out or prescribed subject to certain safeguards under the EPA. ƒ

iv) The Biological Diversity Act, 2002: This is an Act to provide for the conservation of biological diversity, sustainable use of its components, and fair and equitable sharing of the benefits arising out of the use of biological resources and knowledge associated with it.

3. **Consumer Legislation**

The central consumer legislation is the Consumer Protection Act, 1986 (hereinafter "CPA"). The CPA is a comprehensive piece of consumer legislation enacted for the better protection of the interests of consumers by providing for the establishment of consumer councils and other forums for the settlement of consumer disputes. Though there are various scattered pieces of legislation relating to inter alia, standardization, grading, packaging and branding, prevention of food adulteration, weights and measures and hoarding and profiteering which do not specifically mention the concept of consumer interest however contain provisions nevertheless to defend consumers.

4. Intellectual Property Laws

Intellectual property rights as a collective term includes the following independent IP rights which can be collectively used for protecting different aspects of an inventive work for multiple protection:- Patents, Copyrights, Trademarks, Registered (industrial) design, Protection of IC layout design, Geographical indications, and Protection of undisclosed information. The importance of intellectual property in India is well established at all levels such as statutory, administrative and judicial. India ratified the agreement establishing the World Trade Organization (hereinafter "WTO"). This agreement, inter alia, contains an agreement on Trade Related Aspects of Intellectual Property Rights (hereinafter "TRIPS"). India has laid down minimum norms and standards with respect to Patents; Trademarks; Copyright; Geographical indications; and Designs. The obligations under the TRIPS agreement relate to the provision of minimum standards of protection within the legal systems and practices

Lesson 7.3

Corporate Governance

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the Board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

Corporate Governance is the interaction between various participants (shareholders, board of directors, and company's management) in shaping corporation's performance and the way it is proceeding towards. The relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two. The owners must see that individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked.

Corporate Governance deals with the manner the providers of finance guarantee themselves of getting a fair return on their investment. Corporate Governance clearly distinguishes between the owners and the managers. The managers are the deciding authority. In modern corporations, the functions/ tasks of owners and managers should be clearly defined, rather, harmonizing.

Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today's market- oriented economy, the need for corporate governance arises. Also, efficiency as well as globalization is significant factors urging corporate governance. Corporate Governance is essential to develop added value to the stakeholders.

Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights. Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment.

Principles of Corporate Governance

1. **Shareholder recognition** is key to maintaining a company's stock price. More often than not, however, small shareholders with little impact on the stock price are brushed aside to make way for the interests of majority shareholders and the executive board. Good corporate governance seeks to make sure that all shareholders get a voice at general meetings and are allowed to participate.

   Stakeholder interests should also be recognized by corporate governance. In particular, taking the time to address non-shareholder stakeholders can help your company establish a positive relationship with the community and the press.
2. **Board responsibilities must be clearly outlined** to majority shareholders. All board members must be on the same page and share a similar vision for the future of the company.
3. **Ethical behavior** violations in favor of higher profits can cause massive civil and legal problems down the road. Underpaying and abusing outsourced employees or skirting around lax environmental regulations can come back and bite the company hard if ignored. A code of conduct regarding ethical decisions should be established for all members of the board.
4. Business **transparency** is the key to promoting shareholder trust. Financial records, earnings reports and forward guidance should all be clearly stated without exaggeration or "creative" accounting. Falsified financial records can cause your company to become a Ponzi scheme, and will be dealt with accordingly.

The Importance of Corporate Governance

Through seeing how corporate governance works, you can tell why it is important. It helps streamline the process and gives people accountability. The point of corporate governance is to help the decision making process. As mentioned above in the principles of corporate governance, one of the main goals is to clearly explain to the board, the stakeholders, and the shareholders what their duties and responsibilities are within the company.

With knowing those roles and responsibilities, the people within the corporation can understand what they are held accountable for. For example, the board has the responsibility of properly evaluating the management in the company. If the company has poor management, then it is the fault of the board for not properly evaluating the manager. In this regard, the blame cannot be placed on other members of the corporation. This prevents situations in which there is no way to know who is accountable for what action.

Accountability is what helps people within the company make decisions, whether it is finding out what person should be terminated from their position due to the mistakes that they've made or who should be acknowledged for their good work due to doing something exceptional in their field. With good corporate governance, it's pretty simple to know what the key members of the business are supposed to do.

1. *Lowering Risk*

Another important aspect of corporate governance is mitigating or reducing the amount of risk that is involved. Through corporate governance, scandals, fraud, and criminal liability of the company can be prevented or avoided altogether.

Since the people involved in the organization know what they are accountable for, the actions of one person doesn't mean the downfall of the entire corporation. Properly identifying what the roles in the corporation are allows decisions to be made that won't have a negative effect on the overall corporation, and it means that the offender can be much more quickly identified and punished instead.

Corporate governance is also great because it is a form of self-policing. Before outside forces are able to do anything to a corporation, it's possible for the corporation to handle matters itself. With corporate governance, everyone is held to a specific standard and communication is made easier due to their being an established hierarchy and role that everyone involved in the corporation plays. This level of handling business on its own instead of being forced into making decisions outside of the company helps keep the corporation sustaining itself.

2. *Public Acceptance*

In terms of business, a company with corporate governance is widely accepted by the public. This is mostly due to the idea of disclosure and transparency that comes with corporate governance. With full disclosure and the ability for people who work in the business to get information, as well as the general public, there is a higher level of trust. There's also the fact that due to the way that corporate governance is setup, there is a lower chance of fraud and company-wide criminal activity, which helps gain the trust of the public as well.

3. *Public Image*

Today many corporations hold a high level of corporate governance. This is because a corporation has a public image to maintain. With corporate governance, the corporation takes more responsibility for its actions, and also allows it to keep tabs on what is going on as well as helps those in charge remain more aware of the public image of the corporation.

With the way that businesses are run today, it can be difficult for a corporation to become successful just by having a high level of profit. Due to the fact that a corporation is also evaluated based on its image, corporate governance is established to help ensure that image remains clean. Making sure there is a high level of awareness, ethical behavior, and understanding of what the public wants is all encompassed in corporate governance.

4. *Having a Successful Business*

Corporate governance is an aspect of business that becomes incredibly important in recent years, but it is not the only part of business a person has to understand. If you've been holding on to a business idea, then you will need to learn quite a bit.

Benefits of Corporate Governance

1. Good corporate governance ensures corporate success and economic growth.
2. Strong corporate governance maintains investors' confidence, as a result of which, company can raise capital efficiently and effectively.
3. It lowers the capital cost.
4. There is a positive impact on the share price.
5. It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
6. Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
7. It helps in brand formation and development.
8. It ensures organization in managed in a manner that fits the best interests of all.

Self Assessment Questions

1. What is the meaning of legal environment?
2. What are the factors affecting legal environment in business?
3. Explain the legal environment of international business.
4. Explain the various regulations affecting business and its working in India.
5. What is corporate governess? And what are the principles of corporate governess?
6. Explain the importance of corporate governess and their benefits.

Unit – VIII

GLOBAL ENVIRONMENT

Learning Objectives

After going through this unit, you should be able to understand the following concepts

- Meaning of global business environment
- Factors affecting global business environment
- Importance of international business for economy
- Salient features of Foreign Trade in India
- Foreign trade policy of India / EXIM Policy
- Features of GAAT
- Structure and functions of WTO
- Need for foreign capital
- Forms of foreign capital
- Objectives and functions of World Bank
- Objectives and functions of IMF
- Impact of foreign investment in economy growth
- Objectives of foreign collaboration
- Types of foreign collaboration
- Characteristics of multinational corporations (MNCs)
- Significance of multinational corporations(MNCs)
- Importance of MNCs
- Advantages and Disadvantages of Multinational Corporations for the home country and the host country

Lesson 8.1 - Global Business Environment

Lesson 8.2 - Foreign Trade

Lesson 8.3- Foreign Capital and Foreign Collaboration

Lesson 8.4 - Multi National Corporations

Lesson 8.1
Global Business Environment

Global Business Environment - Meaning

Businesses are affected by an external environment as much as they are affected by the competitors. The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's likely that you'll meet and work with individuals from various countries and cultures as customers, suppliers, colleagues, employees, or employers. The bottom line is that the globalization of world commerce has an impact on all of us. Therefore, it makes sense to learn more about how globalization works.

Global factors influencing business

Global factors influencing business are legal, political, social, technological and economic. Understanding of these global factors is important while developing a business strategy.

a. Social factors

These factors are related to changes in social structures. These factors provide insights into behaviour, tastes, and lifestyles patterns of a population. Buying patterns are greatly influenced by the changes in the structure of the population, and in consumer lifestyles. Age, gender, etc. All determine the buying patterns and understanding of such changes is critical for developing strategies which are in line with the market situations. In a global environment it is important that business strategies are designed keeping in mind the social and cultural differences that vary from country to country. Consumer religion, language, lifestyle patterns are all important information for successful business management.

b. Legal factors

These factors that influence business strategies are related to changes in government laws and regulations. For a successful business operation it is important that the businesses consider the legal issues involved in a particular situation and should have the capability to anticipate ways in which changes in laws will affect the way they must behave. Laws keep changing over a period of time. From the point of view of business it is important that they are aware of these changes in the areas of consumer protection legislation, environmental legislation, health & safety and employment law, etc.

c. Economic factors

These factors involve changes in the global economy. A rise in living standards would ultimately imply an increase in demand for products thereby, providing greater opportunities for businesses to make profits. An economy witnesses fluctuations in economic activities. This would imply that in case of a rise in economic activity the demand of the product will increase and hence the price will increase. In case of reduction in demand the prices will go down. Business strategies should be developed keeping in mind these fluctuations. Other economic changes that affect business include changes in the interest rate, wage rates, and the rate of inflation. In case of low interest rates and increase in demand , businesses will be encouraged to expand and take risks. Therefore, business strategies should have room for such fluctuations.

d. Political factors

This refers to the changes in government and government policies. Political factors greatly influence the operation of business. This has gained significant importance of late. For example: companies operating in the European Union have to adopt directives and regulations created by the EU. The political arena has a huge influence upon the regulation of businesses, and the spending power of consumers. Business must consider the stability of the political environment, government's policy on the economy etc

e. Technological factors

These factors greatly influence business strategies as they provide opportunities for businesses to adopt new innovations, and inventions. This helps the business to reduce costs and develop new products. With the advent of modern communication technologies, the technological factors have gained great impetus in the business arena. . Huge volumes of information can be securely shared by means of databases thereby enabling vast cost reductions, and improvements in service. Organisations need to consider the latest relevant technological advancements for their business and to stay competitive. Technology helps business to gain competitive advantage, and is a major driver of globalization. While designing the business strategies firms must consider if use of technology will allow the firm to manufacture products and services at a lower cost. Firms can select new modes of distributions with the help of technology. It has become easier for companies to communicate with their customer in any part of the world.

Importance of International Business for Economy

The points below highlight the importance of international business:-

1. **Earn foreign exchange** :

International business exports its goods and services all over the world. This helps to earn valuable foreign exchange. This foreign exchange is used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of its country.

2. **Optimum utilisation of resources** :

International business makes optimum utilisation of resources. This is because it produces goods on a very large scale for the international market. International business utilises resources from all over the world. It uses the finance and technology of rich countries and the raw materials and labour of the poor countries.

3. **Achieve its objectives** :

International business achieves its objectives easily and quickly. The main objective of an international business is to earn high profits. This objective is achieved easily. This is because it uses the best technology. It has the best employees and managers. It produces high-quality goods. It sells these goods all over the world. All this results lead to high profits for the international business.

4. **To spread business risks** :

International business spreads its business risk. This is because it does business all over the world. So, a loss in one country can be balanced by a profit in another country. The surplus goods in one country can be exported to another country. The surplus resources can also be transferred to other countries. All this helps to minimise the business risks.

5. **Improve organisation's efficiency** :

International business has very high organisation efficiency. This is because without efficiency, they will not be able to face the competition in the international market. So, they use all the modern management techniques to improve their efficiency. They hire the most qualified and experienced employees and managers. These people are trained regularly. They are highly motivated with very high salaries and other benefits such as international transfers, promotions, etc. All this results in high organisational efficiency, i.e. low costs and high returns.

6. **Get benefits from Government** :

International business brings a lot of foreign exchange for the country. Therefore, it gets many benefits, facilities and concessions from the government. It gets many financial and tax benefits from the government.

7. **Expand and diversify** :

International business can expand and diversify its activities. This is because it earns very high profits. It also gets financial help from the government.

8. **Increase competitive capacity** :

International business produces high-quality goods at low cost. It spends a lot of money on advertising all over the world. It uses superior technology, management techniques, marketing techniques, etc. All this makes it more competitive. So, it can fight competition from foreign companies.

Lesson 8.2

Foreign Trade of India

Salient features of foreign trade

Foreign Trade Policy frames rules and regulations for exports and imports of a country. It provides policy and strategy of the government to be followed for promoting exports and regulating imports. This policy is periodically reviewed to incorporate necessary changes as per changing domestic and international environment. In this policy, approach of government towards various types of exports and imports is conveyed to different exporters and importers.

Export refers to selling goods and services to other countries, while import means buying goods and services from other countries. Now in the era of globalization, no economy in the world can remain cut-off from rest of the world. Export and import play a significant role in the economic development of all the developed and developing economies. With the growth of international organisations like WTO, UNCTAD, ASEAN, etc., world trade is growing at a very fast rate. Some of the salient features of foreign trade of India are:

1. Negative or Unfavourable Trade
2. Diversity in Exports
3. Worldwide Trade
4. Change in Imports
5. Maritime Trade
6. Trade through a few Selected Ports Only
7. Insignificant Place of India in the World Overseas Trade
8. State Trading

1. Negative or Unfavourable Trade:

India had to import various items like heavy machinery, agricultural implements, mineral oil and metals on a large scale after Independence for economic growth. But our exports could not keep pace with our imports which left us with negative or unfavourable trade.

2. Diversity in Exports:

Previously, India used to export its traditional commodities only which included tea, jute, cotton textile, leather, etc. But great diversity has been observed in India's export commodities during the last few years. India now exports over 7,500 commodities. Since 1991, India has emerged as a major exporter of computer software and that too to some of the advanced countries like the USA and Japan.

3. Worldwide Trade:

India had trade links with Britain and a few selected countries only before Independence. But now India has trade links with almost all the regions of the world. India exports its goods to as many as 190 countries and imports from 140 countries.

4. Change in Imports:

Earlier we used to import food-grains and manufactured goods only. But now oil is the largest single commodity imported by India. Both the imports as well as exports of pearls and precious stones have increased considerably during the last few years. Our other important commodities of import are iron and steel, fertilizers, edible oils and paper.

5. Maritime Trade:

About 95 per cent of our foreign trade is done through sea routes. Trade through land routes is possible with neighbouring countries only. But unfortunately, all our neighbouring countries including China, Nepal, and Myanmar are cut off from India by lofty mountain ranges which make trade by land routes rather difficult. We can have easy access through land routes with Pakistan only but the trade suffered heavily due to political differences between the two countries.

6. Trade through a few Selected Ports Only:

We have only 12 major ports along the coast of India which handle about 90 per cent overseas trade of India. Very small amount of foreign trade is handled by the remaining medium and small ports.

7. Insignificant Place of India in the World Overseas Trade:

Although India has about 16 per cent of the world's population, her share in the world overseas trade is less than one per cent. This shows the insignificant place of India in the world's overseas trade. This is, however, partly due to very large internal trade, vast dimensions of the country provide a solid base for inter-state trade within the country. Europe is divided into a large number of smaller countries and the international trade is quite high (trade counted twice, first time as exports and second times as imports).

8. State Trading:

Most of India's overseas trade is done in public sector by state agencies and very little trade is done by individuals.

Foreign Trade Policy (or) EXIM Policy

EXIM Policy or Foreign Trade Policy is a set of guidelines and instructions established by the Director General of Foreign Trade (DGFT) in matters related to the import and export of goods in India. The Foreign Trade Policy of India is guided by the Export Import in known as in short EXIM Policy of the Indian Government and is regulated by the Foreign Trade Development and Regulation Act, 1992. The Directorate General of Foreign Trade is the main governing body in matters related to EXIM Policy. The main objective of the Foreign Trade (Development and Regulation) Act is to provide the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India. Foreign Trade Act has replaced the earlier law known as the imports and Exports (Control) Act 1947.

History of EXIM Policy of India

In the year 1962, the Government of India appointed a special EXIM Policy Committee to review the government's previous export import policies. The committee was later on approved by the Government of India, Mr. V. P. Singh, the then Commerce Minister and announced the EXIM Policy on the 12th of April, 1985. Initially the EXIM Policy was introduced for the period of three years with main objective to boost the export business in India

Objectives Of The EXIM Policy : -

The main objective of the Government's EXIM Policy is to promote exports to the maximum extent. Exports should be promoted in such a manner that the economy of the country is not affected by unregulated exportable items specially needed within the country. Export control is, therefore, exercised in respect of a limited number of items whose supply position demands that their exports should be regulated in the larger interests of the country. In other words, the main objectives of the EXIM Policy are :

a) To accelerate the economy from low level of economic activities to high level of economic activities by making it a globally oriented vibrant economy and to derive maximum benefits from expanding global market opportunities.
b) To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and capital goods required for augmenting production.
c) To enhance the techno local strength and efficiency of Indian agriculture, industry and services, thereby, improving their competitiveness.
d) To generate new employment.
e) Opportunities and encourage the attainment of internationally accepted standards of quality.
f) To provide quality consumer products at reasonable prices.

EXIM Policy Documents

A) EXIM Policy 1992 -1997

In order to liberalize imports and boost exports, the Government of India for the first time introduced the Indian EXIM Policy on April I, 1992. In order to bring stability and continuity, the Export Import Policy was made for the duration of 5 years. However, the Central Government reserves the right in public interest to make any amendments to the Trade Policy in exercise of the powers conferred by Section 5 of the Act. Such amendment shall be made by means a notification published in the Gazette of India. Export Import Policy is believed to be an important step towards the economic reforms of India.

B) EXIM Policy 1997 -2002

With time the EXIM Policy 1992-1997 became old, and a New Export Import Policy was need for the smooth functioning of the Indian export import trade. Hence, the Government of India introduced a new EXIM Policy for the year 1997-2002. This policy has further simplified the procedures and educed the interface between exporters and the Director General of Foreign Trade (DGFT) by reducing the number of documents required for export by half. Import has been further liberalized and better efforts have been made to promote Indian exports in international trade.

C) EXIM Policy 2002 – 2007

The EXIM Policy 2002 - 2007 deals with both the export and import of merchandise and services. It is worth mentioning here that the EXIM Policy: 1997 - 2002 had accorded a status of exporter to the business firm exporting services with effect from1.4.1999. Such business firms are known as Service Providers. The main objectives of the Export Import Policy 2002-2007 are as follows:

1. To encourage economic growth of India by providing supply of essential raw materials, intermediates, components, consumables and capital goods required for augmenting production and providing services.
2. To improve the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitive strength while generating new employment opportunities and encourage the attainment of internationally accepted standards of quality; and
3. To provide consumers with good quality products and services at internationally competitive prices while at the same time creating a level playing field for the domestic producers.

D) Foreign Trade Policy 2004-09:

Following are the highlights of the Foreign Trade Policy 2004-09:

- A massive push to exports to garner 1.5 per cent of the world share by exporting $150 billion worth of merchandise annually by 2009.
- FDI permitted up to 100 per cent to establish and develop free trade and warehousing zone, each to have a Rs 100 crore outlay.
- Vishesh Krishi Upaj Scheme to boost exports of fruits, vegetables, flowers and minor forest produce.
- Duty-free import of capital goods under EPCG scheme for agriculture sector. Such goods permitted to be installed anywhere in an agri-export zone.
- Import of seeds, bulbs and tubers liberalised.
- New Handicraft Special Economic Zone.
- Handicraft Export Promotion Council authorised to import.
- Duty-free import of consumables for metals other than gold and platinum upto two per cent of the FoB export value.
- Import of gold of 18 carat and above allowed under replenishment scheme.
- Duty-free import of specified items for leather sector raised to five per cent of the FoB value for exports.
- 'Served from India' scheme to accelerate growth in the export of services.

- Exporters, who achieve quantum growth, entitled for duty-free credit based on incremental exports higher than general actual target fixed under "Target Plus" scheme.
- Services' exports expected to touch $150 billion by the end of this decade.
- EOUs exempted from service tax.
- EOUs permitted to retain 100 per cent export earnings.
- DEPB scheme retained till replaced by a new one.
- New scheme to categorise star export houses.
- An exclusive service export promotion council.
- Pragati Maidan to be state-of-the-art complex.
- Restrictions on importing secondhand capital goods lifted.
- Board of Trade to be revamped.
- Biotechnology parks to be set up.
- New mechanism for grievance redressal.
- Special focus initiatives in five areas.
- Validity of licences of various schemes increased to uniform 24 months.

E) Foreign Trade Policy 2009-14

Objectives of Foreign Trade Policy 2009-14

- Achieving an annual export growth of 15% with an annual export target of US$ 200 billion by March 2011.
- The country should be able to come back on the high export growth path of around 25% per annum by 2014.
- Double India’s exports of goods and services by 2014

In order to meet these objectives, the Government would follow a mix of policy measures including:

- Fiscal incentives
- Institutional changes
- Procedural rationalization

- Enhanced market access across the world
- Diversification of export markets.

F) Foreign Trade Policy (2015-2020)

To boost India's exports, PM Narendra Modi's pet projects, 'Make in India' and 'Digital India' will be integrated with the new Foreign Trade Policy. The government is pitching India as a friendly destination for manufacturing and exporting goods, and the new policy is being seen as an important step towards realising that goal.

Here are some key features of the new Foreign Trade Policy:

- India to be made a significant participant in world trade by 2020.
- Merchandize exports from India (MEIS) to promote specific services for specific Markets Foreign Trade Policy.
- FTP would reduce export obligations by 25% and give boost to domestic manufacturing.
- FTP benefits from both MEIS & SEIS will be extended to units located in SEZs.
- FTP 2015-20 introduces two new schemes, namely "Merchandise Exports from India Scheme (MEIS)" and "Services Exports from India Scheme (SEIS)". The 'Services Exports from India Scheme' (SEIS) is for increasing exports of notified services. These schemes (MEIS and SEIS) replace multiple schemes earlier in place, each with different conditions for eligibility and usage. Incentives (MEIS & SEIS) to be available for SEZs also. E-Commerce of handicrafts, handlooms, books etc., eligible for benefits of MEIS.
- Agricultural and village industry products to be supported across the globe at rates of 3% and 5% under MEIS. Higher level of support to be provided to processed and packaged agricultural and food items under MEIS.
- Industrial products to be supported in major markets at rates ranging from 2% to 3%.
- Served from India Scheme (SFIS) will be replaced with Service Export from India Scheme (SEIS).

- Branding campaigns planned to promote exports in sectors where India has traditional Strength.
- SEIS shall apply to 'Service Providers located in India' instead of 'Indian Service Providers'.
- Business services, hotel and restaurants to get rewards scrip under SEIS at 3% and other specified services at 5%.
- Duty credit scrip to be freely transferable and usable for payment of customs duty, excise duty and service tax.
- Debits against scrip would be eligible for CENVAT credit or drawback also.
- Nomenclature of Export House, Star Export House, Trading House, Premier Trading House certificate changed to 1,2,3,4,5 Star Export House.
- The criteria for export performance for recognition of status holder have been changed from Rupees to US dollar earnings.
- Manufacturers who are also status holders will be enabled to self-certify their manufactured goods as originating from India.
- Reduced Export Obligation (EO) (75%) for domestic procurement under EPCG scheme.
- Online procedure to upload digitally signed document by Chartered Accountant/Company Secretary/Cost Accountant to be developed.
- Inter-ministerial consultations to be held online for issue of various licences.
- No need to repeatedly submit physical copies of documents available on Exporter Importer Profile.
- Validity period of SCOMET export authorisation extended from present 12 months to 24 months.
- Export obligation period for export items related to defence, military store, aerospace and nuclear energy to be 24 months instead of 18 months.
- Calicut Airport, Kerala and Arakonam ICDS, Tamil Nadu notified as registered ports for import and export.
- Vishakhapatnam and Bhimavarm added as Towns of Export Excellence.
- Certificate from independent chartered engineer for redemption of EPCG authorisation no longer required.

General Agreement on Tariffs and Trade (GATT)

General Agreement on Tariffs and Trade (GATT), set of multilateral trade agreements aimed at the abolition of quotas and the reduction of tariff duties among the contracting nations. When GATT was concluded by 23 countries at Geneva, in 1947 (to take effect on Jan. 1, 1948), it was considered an interim arrangement pending the formation of a United Nations agency to supersede it.

When such an agency failed to emerge, GATT was amplified and further enlarged at several succeeding negotiations. It subsequently proved to be the most effective instrument of world trade liberalization, playing a major role in the massive expansion of world trade in the second half of the 20th century.

By the time GATT was replaced by the World Trade Organization (WTO) in 1995, 125 nations were signatories to its agreements, which had become a code of conduct governing 90 percent of world trade.

GATT's most important principle was that of trade without discrimination, in which each member nation opened its markets equally to every other. As embodied in unconditional most-favoured nation clauses, this meant that once a country and its largest trading partners had agreed to reduce a tariff, that tariff cut was automatically extended to every other GATT member.

GATT included a long schedule of specific tariff concessions for each contracting nation, representing tariff rates that each country had agreed to extend to others. Another fundamental principle was that of protection through tariffs rather than through import quotas or other quantitative trade restrictions; GATT systematically sought to eliminate the latter.

Other general rules included uniform customs regulations and the obligation of each contracting nation to negotiate for tariff cuts upon the request of another. An escape clause allowed contracting countries to alter agreements if their domestic producers suffered excessive losses as a result of trade concessions.

GATT's normal business involved negotiations on specific trade problems affecting particular commodities or trading nations, but major multilateral trade conferences were held periodically to work out tariff reductions and other issues.

a. held at Geneva in 1947 (concurrent with the signing of the general agreement);
b. at Annecy,France, in 1949; at Torquay,
c. England in 1951

d. at Geneva in 1956 and again in 1960–62.
e. Kennedy Round (1964–67),
f. the Tokyo Round (1973–79) held at Geneva.
g. the Uruguay Round (1986–94) held at Geneva

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These agreements succeeded in reducing average tariffs on the world's industrial goods from 40 percent of their market value in 1947 to less than 5 percent in 1993. The Uruguay Round negotiated the most ambitious set of trade-liberalization agreements in GATT's history. The worldwide trade treaty adopted at the round's end slashed tariffs on industrial goods by an average of 40 percent, reduced agricultural subsidies, and included groundbreaking new agreements on trade in services.

The treaty also created a new and stronger global organization, the WTO, to monitor and regulate international trade. GATT went out of existence with the formal conclusion of the Uruguay Round on April 15, 1994. Its principles and the many trade agreements reached under its auspices were adopted by the WTO.

World Trade Organization (WTO)

The Uruguay round of GATT (1986-93) gave birth to World Trade Organization. The members of GATT singed on an agreement of Uruguay round in April 1994 in Morocco for establishing a new organization named WTO. It was officially constituted on January 1, 1995 which took the place of GATT as an effective formal, organization. GATT was an informal organization which regulated world trade since 1948.

Contrary to the temporary nature of GATT, WTO is a permanent organization which has been established on the basis of an international treaty approved by participating countries. It achieved the international status like IMF and IBRD, but it is not an agency of the United Nations Organization (UNO).

Structure:

The WTO has nearly 153 members accounting for over 97% of world trade. Around 30 others are negotiating membership. Decisions are made by the entire membership. This is typically by consensus. A majority vote is also possible but it has never been used in the WTO and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have been ratified in all members' parliaments.

The WTO's top level decision-making body is the Ministerial Conferences which meets at least once in every two years. Below this is the General Council (normally ambassadors and heads of delegation in Geneva, but sometimes officials sent from members' capitals) which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Disputes Settlement Body.

At the next level, the Goods Council, Services Council and Intellectual Property (TRIPs) Council report to the General Council. Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas such as, the environment, development, membership applications and regional trade agreements.

Secretariat:

The WTO secretariat, based in Geneva, has around 600 staff and is headed by a Director-General. Its annual budget is roughly 160 million Swiss Francs. It does not have branch offices outside Geneva. Since decisions are taken by the members themselves, the secretariat does not have the decision making the role that other international bureaucracies are given.

The secretariat's main duties to supply technical support for the various councils and committees and the ministerial conferences, to provide technical assistance for developing countries, to analyze world trade and to explain WTO affairs to the public and media. The secretariat also provides some forms of legal assistance in the dispute settlement process and advises governments wishing to become members of the WTO.

Objectives:

The important objectives of WTO are:

1. To improve the standard of living of people in the member countries.

2. To ensure full employment and broad increase in effective demand.

3. To enlarge production and trade of goods.

4. To increase the trade of services.

5. To ensure optimum utilization of world resources.

6. To protect the environment.

7. To accept the concept of sustainable development.

Functions:

The main functions of WTO are discussed below:

1. To implement rules and provisions related to trade policy review mechanism.

2. To provide a platform to member countries to decide future strategies related to trade and tariff.

3. To provide facilities for implementation, administration and operation of multilateral and bilateral agreements of the world trade.

4. To administer the rules and processes related to dispute settlement.

5. To ensure the optimum use of world resources.

6. To assist international organizations such as, IMF and IBRD for establishing coherence in Universal Economic Policy determination.

WTO Ministerial Conference:

Conference	Year	Place
I	9-13 Dec., 1996	Singapore
II	18-20 May 1998	Geneva (Switzerland)
III	30 Nov.-3 Dec., 1999	Seattle (USA)
IV	9-14 Nov., 2001	Doha (Qatar)
V	10-14 Sep., 2003	Cancun (Mexico)
VI	13-18 Dec.. 2005	Hong Kong
VII	30 Nov-2Dec., 2009	Geneva (Switzerland)

WTO Agreements:

The WTO's rule and the agreements are the result of negotiations between the members. The current sets were the outcome to the 1986-93 Uruguay Round negotiations which included a major revision of the original General Agreement on Tariffs and Trade (GATT).

GATT is now the WTO's principal rule-book for trade in goods. The Uruguay Round also created new rules for dealing with trade in services, relevant aspects of intellectual property, dispute settlement and trade policy reviews.

The complete set runs to some 30,000 pages consisting of about 30 agreements and separate commitments (called schedules) made by individual members in specific areas such as, lower customs duty rates and services market-opening.

Through these agreements, WTO members operate a non-discriminatory trading system that spells out their rights and their obligations. Each country receives guarantees that its exports will be treated fairly and consistently in other countries' markets. Each country promises to do the same for imports into its own market. The system also gives developing countries some flexibility in implementing their commitments.

(a) Goods:

It all began with trade in goods. From 1947 to 1994, GATT was the forum for negotiating lower customs duty rates and other trade barriers; the text of the General Agreement spelt out important, rules, particularly non-discriminations since 1995, the updated GATT has become the WTO's umbrella agreement for trade in goods. It has annexes dealing with specific sectors such as, agriculture and textiles and with specific issues such as, state trading, product standards, subsidies and action taken against dumping.

(b) Services:

Banks, insurance firms, telecommunication companies, tour operators, hotel chains and transport companies looking to do business abroad can now enjoy the same principles of free and fair that originally only applied to trade in goods. These principles appear in the new General Agreement on Trade in Services (GATS). WTO members have also made individual commitments under GATS stating which of their services sectors, they are willing to open for foreign competition and how open those markets are.

(c) Intellectual Property:

The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity. The rules state how copyrights, patents, trademarks, geographical names used to identify products, industrial designs, integrated circuit layout designs and undisclosed information such as trade secrets "intellectual property" should be protected when trade is involved.

(d) Dispute Settlement:

The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore, for ensuring that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements are being infringed. Judgments by specially appointed independent experts are based on interpretations of the agreements and individual countries' commitments. The system encourages countries to settle their differences through consultation. Failing that, they can follow a carefully mapped out, stage-by-stage procedure that includes the possibility of the ruling by a panel of experts and the chance to appeal the ruling on legal grounds. Confidence in the system is borne out by the number of cases brought to the WTO, around 300 cases in eight years compared to the 300 disputes dealt with during the entire life of GATT (1947-94).

(e) Policy Review:

The Trade Policy Review Mechanism's purpose is to improve transparency, to create a greater understanding of the policies that countries are adopting and to assess their impact. Many members also see the reviews as constructive feedback on their policies. All WTO members must undergo periodic scrutiny, each review containing reports by the country concerned and the WTO Secretariat.

Lesson 8.3

Foreign Capital and Foreign Collaboration

Foreign Capital in India

Everywhere in the world, including the developed countries, governments are vying with each other to attract foreign capital. The belief that foreign capital plays a constructive role in a country's economic development, it has become even stronger since mid-1980.

The experience of South East Asian Countries (1986-1995) has especially confirmed this belief and has led to a progressive reduction in regulations and restraints that could have inhibited the inflow of foreign capital.

Need for Foreign Capital:

The need for foreign capital arises because of the following reasons. In most developing countries like India, domestic capital is inadequate for the purpose of economic growth. Foreign capital is typically seen as a way of filling in gaps between the domestically available supplies of savings, foreign exchange, government revenue and the planned investment necessary to achieve developmental targets. To give an example of this 'savings-investment' gap, let us suppose that planned rate of growth output per annum is 7 percent and the capital-output ratio is 3 percent, then the rate of saving required is 21 percent.

If the saving that can be domestically mobilized is 16 percent, there is a shortfall or a savings gap of 5 percent. Thus the foremost contribution of foreign capital to national development is its role in filling the resource gap between targeted investment and locally mobilized savings. Foreign capital is needed to fill the gap between the targeted foreign exchange requirements and those derived from net export earnings plus net public foreign aid. This is generally called the foreign exchange or trade gap.

An inflow of private foreign capital helps in removing deficit in the balance of payments over time if the foreign-owned enterprise can generate a net positive flow of export earnings. The third gap that the foreign capital and specifically, foreign investment helps to fill is that between governmental tax revenue and the locally raised taxes. By taxing the profits of the foreign enterprises the governments of developing countries are able to mobilize funds for projects (like energy, infrastructure) that are badly needed for economic development.

Foreign investment meets the gap in management, entrepreneurship, technology and skill. The package of these much-needed resources is transferred to the local country through training programmes and the process of learning by doing. Further foreign companies bring with them sophisticated technological knowledge about production processes while transferring modern machinery equipment to the capital-poor developing countries.

In fact, in this era of globalization, there is a great belief that foreign capital transforms the productive structures of the developing economics leading to high rates of growth. Besides the above, foreign capital, by creating new productive assets, contributes to the generation of employment a prime need of a country like India.

Forms of Foreign Capital:

Foreign Capital can be obtained in the form of foreign investment or non-concessional assistance or concessional assistance.

1. Foreign Investment includes Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). FPI includes the amounts raised by Indian corporate through Euro Equities, Global Depository Receipts (GDR's), and American Depository Receipts (ADR's).

2. Non-Concessional Assistance mainly includes External Commercial Borrowings (ECB's), loans from governments of other countries/multilateral agencies on market terms and deposits obtained from Non-Resident Indians (NRIs).

3. Concessional Assistance includes grants and loans obtained at low rates of interest with long maturity periods. Such assistance is generally provided on a bilateral basis or through multilateral agencies like the World Bank, International Monetary Fund (IMF), and International

Development Association (IDA) etc. Loans have to be repaid generally in terms of foreign currency but in certain cases the donor may allow the recipient country to repay in terms of its own currency. Grants do not carry any obligation of repayment and are mostly made available to meet some temporary crisis. Foreign Aid can also be received in terms of direct supplies of agricultural commodities or industrial raw materials to overcome temporary shortages in the economy. Foreign Aid may also be given in the form of technical assistance.

Forms of Foreign Capital Flowing into India

1. ***Foreign Direct Investment in India:***

There are many Forms of Foreign Capital Flowing into India such as banking and NRI deposits. The various Forms of Foreign Capital Flowing into India has helped to bring in huge amounts of FDI into the country, which in its turn has given a major boost to the Indian economy. The government of India made several changes in the economic policy of the country in the early 1990s. This led to the deregulation and liberalization of the Indian economy and also increased the flow of foreign direct investment into the country.

2. ***NRI deposits***

The Forms of Foreign Capital Flowing into India include, NRI deposits, which are made in profitable foreign currency accounts. For the lakhs of Indians working abroad and their families back home in India, these are indeed good times. The sharp depreciation in the local currency means the money they send home fetches more rupees on conversion. In fact, a World Bank report says that India's migrant workers are expected to rush back more dollars home this year to take advantage of the weak rupee.

3. Portfolio flow of capital

Further the various Forms of Foreign Capital Flowing into India are portfolio flow of capital that are made by institutional foreign investors that make investments in India's debt and stock markets. Private capital flows have become an increasingly significant source of investment in developing countries, indicating the high degree to which developing countries have become integrated into the global economy and thus how exposed they are to any financial shock.

Foreign Portfolio Investment (FPI) differs from Foreign Direct Investment (FDI), in which a domestic company runs a foreign firm. While FDI allows a company to maintain better control over the firm held abroad, it might make it more difficult to later sell the firm at a premium price. This is due to information asymmetry: the company that owns the firm has intimate knowledge of what might be wrong with the firm, while potential investors (especially foreign investors) do not. The share of FDI in foreign equity flows is greater than FPI in developing countries compared to developed countries, but net FDI inflows tend to be more volatile in developing countries because it is more difficult to sell a directly-owned firm than a passively owned security.

4. Investments in the commercial banks by foreign investors

The Forms of Foreign Capital Flowing into India also include, investments that are being made by the foreign investors in the commercial banks of India. FDI in private banking sector of India is allowed up to 74% where FDI up to 49% is allowed through automatic route and FDI beyond 49% but up to 74% is allowed through government approval route.

World Bank/ The International Bank for Reconstruction and Development (IBRD)

The International Bank for Reconstruction and Development (IBRD), commonly referred to as the World Bank, is an international financial institution whose purposes include assisting the development of its member nation’s territories, promoting and supplementing private foreign investment and promoting long-range balance growth in international trade.

The World Bank was established in December 1945 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire. It opened for business in June 1946 and helped in the reconstruction of nations devastated by World War II. Since 1960s the World Bank has shifted its focus from the advanced industrialized nations to developing third-world countries.

Organization and Structure:

The organization of the bank consists of the Board of Governors, the Board of Executive Directors and the Advisory Committee, the Loan Committee and the president and other staff members. All the powers of the bank are vested in the Board of Governors which is the supreme policy making body of the bank.

The board consists of one Governor and one Alternative Governor appointed for five years by each member country. Each Governor has the voting power which is related to the financial contribution of the Government which he represents.

The Board of Executive Directors consists of 21 members, 6 of them are appointed by the six largest shareholders, namely the USA, the UK, West Germany, France, Japan and India. The rest of the 15 members are elected by the remaining countries.

Each Executive Director holds voting power in proportion to the shares held by his Government. The board of Executive Directors meets regularly once a month to carry on the routine working of the bank.

The president of the bank is pointed by the Board of Executive Directors. He is the Chief Executive of the Bank and he is responsible for the conduct of the day-to-day business of the bank. The Advisory committees appointed by the Board of Directors.

It consists of 7 members who are expects in different branches of banking. There is also another body known as the Loan Committee. This committee is consulted by the bank before any loan is extended to a member country.

Capital Resources of World Bank:

The initial authorized capital of the World Bank was $ 10,000 million, which was divided in 1 lakh shares of $ 1 lakh each. The authorized capital of the Bank has been increased from time to time with the approval of member countries. On June 30, 1996, the authorized capital of the Bank was $ 188 billion out of which $ 180.6 billion (96% of total authorized capital) was issued to member countries in the form of shares. Member countries repay the share amount to the World Bank in the following ways:

1. 2% of allotted share are repaid in gold, US dollar or Special Drawing Rights (SDR).

2. Every member country is free to repay 18% of its capital share in its own currency.

3. The remaining 80% share deposited by the member country only on demand by the World Bank.

Objectives:

The following objectives are assigned by the World Bank:

1. To provide long-run capital to member countries for economic reconstruction and development.

2. To induce long-run capital investment for assuring Balance of Payments (BoP) equilibrium and balanced development of international trade.

3. To provide guarantee for loans granted to small and large units and other projects of member countries.

4. To ensure the implementation of development projects so as to bring about a smooth transference from a war-time to peace economy.

5. To promote capital investment in member countries by the following ways;

(a) To provide guarantee on private loans or capital investment.

(b) If private capital is not available even after providing guarantee, then IBRD provides loans for productive activities on considerate conditions.

Functions:

World Bank is playing main role of providing loans for development works to member countries, especially to underdeveloped countries. The World Bank provides long-term loans for various development projects of 5 to 20 years duration. The main functions can be explained with the help of the following points:

1. World Bank provides various technical services to the member countries. For this purpose, the Bank has established "The Economic Development Institute" and a Staff College in Washington.

2. Bank can grant loans to a member country up to 20% of its share in the paid-up capital.

3. The quantities of loans, interest rate and terms and conditions are determined by the Bank itself.

4. Generally, Bank grants loans for a particular project duly submitted to the Bank by the member country.

5. The debtor nation has to repay either in reserve currencies or in the currency in which the loan was sanctioned.

6. Bank also provides loan to private investors belonging to member countries on its own guarantee, but for this loan private investors have to seek prior permission from those counties where this amount will be collected.

International Monetary Fund (IMF)

A landmark in the history of world economic cooperation is the creation of the International Monetary Fund, briefly called IMF. The IMF was organised in 1946 and commenced operations in March, 1947.

The fundamental object of the IMF was the avoidance of competitive devaluation and exchange control that had characterised the era of 1930s. It was set up to administer a "code of fair practice", in the field of foreign exchange and to make short-term loans to member nations experiencing temporary deficits in their balance of payments, to enable them to meet these payments without resorting to devaluation or exchange control, while at the same time following' international policies to maintain domestic income and employment at high levels. Thus, basically there are three general objectives of the IMF:

(i) The elimination or reduction of existing exchange controls,

(ii) The establishment and maintenance of currency convertibility with stable exchange rates, and

(iii) The widest extension of multi-lateral trade and payments.

In essence the Fund is an attempt to achieve the external or international advantages of gold standard system without subjecting nations to its internal disadvantages, and at the same time maintaining the internal advantages of paper standard while bypassing its external disadvantages.

Functions of IMF

The following are the major functions of the IMF:

1. It functions as a short-term credit institution.

2. It provides machinery for the orderly adjustments of exchange rates.

3. It is a reservoir of the currencies of all the member countries from which a borrower nation can borrow the currency of other nations.

4. It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.

5. It also provides machinery for altering sometimes the par value of the currency of a member country. In this way, it tries to provide for an orderly adjustment of exchange rates, which will improve the long-term balance of payments position of member countries.

6. It also provides machinery for international consultations.

In fine, the Fund contributes to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all member nations. The Fund is an autonomous organisation affiliated to the UNO. IMF's constitution represents a departure in the formation of an international organisation. It is financed by the participating countries, with each country's contribution fixed in terms of quotas according to the relative importance of its prevailing national income and international trade.

Thus, the quota assigned to a country is determined by its contribution to the capital of the Fund. The quotas of all the countries taken together constitute the total financial resources of the Fund. Moreover, the contributed quota of a country determines its borrowing rights and voting strength.

India being one of the largest quota-holders (600 million dollars) has the honour of having a permanent seat on the Board of Executive Directors. Each member nation of the IMF is required to subscribe its quota partly in gold and partly in its own currency.

Specifically, a member nation must contribute gold equal to 25 per cent of its quota or 10 per cent of its gold stock and U.S. dollar holdings, whichever is less. The portion of subscription paid in a nation's own currency is generally paid in the form of deposit balance in favour of the IMF held in the nation's central bank. Thus, the Fund gets a pool of foreign currencies to lend, together with gold enables it to acquire additional amounts of currencies whenever its initial supply of some currencies becomes depleted.

The lending operations of the Fund technically take the form of sale of currency. Any member nation running short of foreign currency may buy the required currency from the Fund, paying for it in its own currency.

Since each member contributes gold to the extent of 25 per cent of its quota, the Fund freely permits a member to draw up to the amount of its gold contribution. Additional drawings are permitted only after certain careful and strict scrutinizes. Since the purpose of the Fund is to make temporary and long-term loans, it expects repayment of loans within 3 to 5 years.

The Fund has also laid down provisions relating to exchange stability. At the same time, the Fund started functioning; members were required to declare the par values of their currencies in terms of gold as a common denominator or in terms of U.S. dollar.

Thus, under IMF arrangements, gold retains its role in determining the relative values of currencies of different nations. And once the par values of different currencies are fixed, it is quite easy to determine the exchange rate between any two member nations.

However, if at any time a member country feels there is a fundamental disequilibrium in its balance of payments position, it may propose a change in the par value of its currency, i.e., its devaluation.

But devaluation is allowed or even advised by the IMF for the purpose of correcting a fundamental disequilibrium and not for undue competition or for other advantages. Thus, the decision to devalue should not be taken unilaterally by the member concerned, but only after consultation with the Fund.

The Fund has also laid down that member countries should not adopt a system of multiple exchange rates. That is to say, there should not be two or more rates between the currency of one member country and that of any other member country. This was necessary to prevent countries deviating from the principle of fixed exchange rates. Secondly, it was laid down that a member country should not purchase or sell gold internationally at prices other than those indicated by the par values.

In essence, these provisions were laid down in order to secure the chief advantage of the gold standard system, viz., exchange stability. At the same time, the exchange rates are not rigidly fixed as in the case of gold standard and exchange depreciation or devaluation is permissible only for correcting a fundamental disequilibrium in the balance of payments of a country. Similarly, the Fund may ask a member enjoying a persistent surplus position to revalue its currency and set things right.

With a view to eliminate or minimise exchange control tactics, the Fund laid down that there should be no restrictions in ordinary trade and other current transactions. Although the

Fund laid down that exchange controls and other restrictions should not be used for normal current transactions, it allows their use at all times to control international capital movements, especially capital flights.

Moreover, exchange controls are expressly permitted in the case of currencies which may be declared “scarce” by the Fund. It is also permitted during the “transition period.” Thus, the elements of exchange control have been incorporated in the provision of the Fund.

In short, the IMF may be described as a bank of central banks of different countries, because it collects the resource of the various central banks in the same way in which a country’s central bank collects cash reserves of all the commercial banks, assists them in times of emergency.

However, while a central bank can control the credit policy of its member banks, the Fund cannot control the domestic economic and monetary policies of member nations. It only seeks to maintain a multiple payments system through an orderly adjustment of the exchange rates.

Foreign Investment

Foreign investment is when a company or individual from one nation invests in assets or ownership stakes of a company based in another nation. As increased globalization in business has occurred, it's become very common for big companies to branch out and invest money in companies located in other countries. These companies may be opening up new manufacturing plants and attracted to cheaper labor, production and fewer taxes in another country.

They may make a foreign investment in another firm outside their country because the firm being purchased has specific technology, products, or access to additional customers that the purchasing firm wants. Overall, foreign investment in a country is a good sign that often leads to growth of jobs and income. As more foreign investment comes into a country it can lead to even greater investments because others see the country as economically stable.

Foreign investment can be split into direct and indirect investments. Direct investments are when companies make physical investments and purchases in buildings, factories, machines and other equipment outside their home country. Indirect investments are when companies or financial institutions purchase positions or stakes in companies on a foreign stock exchange.

This type of investment isn't as favorable as direct investment because the home country can sell their investment very easily or the next day if they choose. Direct investments are usually a longer term investment in the economy of a foreign country. It is not nearly as easy to sell factories, machines and buildings as it is to sell shares of stock.

Examples

- Ford and General Motors Factories - These two auto giants have foreign investments in dozens of countries all over the world. They have opened up factories and invested in machinery to produce vehicles in countries such as Brazil, Mexico, Vietnam, South Korea, and India. By investing in these other countries, they are able to increase their production, often save on labor costs, and can directly enter a market where they are looking to sell more vehicles.

Foreign Collaboration

In general, the definition of foreign collaboration can be stated as follows.
"Foreign collaboration is an alliance incorporated to carry on the agreed task collectively with the participation (role) of resident and non-resident entities."

Alliance is a union or association formed for mutual benefit of parties. Foreign collaboration is such an alliance of domestic (native) and abroad (non-native) entities like individuals, firms, companies, organizations, governments, etc., that come together with an intention to finalize a contract on some tasks or jobs or projects.

Following important points convey the meaning of foreign collaboration:

1. Foreign collaboration is a mutual co-operation between one or more resident and non-resident entities. In other words, for example, an alliance (a union or an

association) between an abroad based company and a domestic company forms a foreign collaboration.

2. It is a strategic alliance between one or more resident and non-resident entities.
3. Only two or more resident (native) entities cannot make a foreign collaboration possible. For its formation and as per above definitions, it is mandatory that one or more non-resident (foreign) entities must always collaborate with one or more resident (domestic) entities.
4. Before starting a foreign collaboration, both entities, for example, a resident and non-resident company must always seek approval (permission) from the governmental authority of the domestic country.
5. During an ongoing process of seeking permission, the collaborating entities prepare a preliminary agreement.
6. According to this preliminary agreement, for example, the non-resident company agrees to provide finance, technology, machinery, know-how, management consultancy, technical experts, and so on. On the other hand, resident company promises to supply cheap labour, low-cost and quality raw-materials, ample land for setting factories, etc.
7. After obtaining the necessary permission, individual representative of a resident and non-resident entity sign this preliminary agreement. Signature acts as a written acceptance to each other's expectations, terms and conditions. After signatures are exchanged, a contract is executed, and foreign collaboration gets established. Contract is a legally enforceable agreement. All contracts are agreements, but all agreements need not necessarily be a contract.
8. After establishing foreign collaboration, resident and non-resident entity start business together in the domestic country.
9. Collaborating entities share their profits as per the profit-sharing ratio mentioned in their executed contract.
10. The tenure (term) of the foreign collaboration is specified in the written contract.

Objectives of Foreign Collaboration

The main intention or prime goal or objective of foreign collaboration is to

1. Improve the financial growth of the collaborating entities.
2. Occupy a major market share for the collaborating entities.
3. Reduce the higher operating cost of a non-resident entity.
4. Make an optimum and effective use of resources available in the resident entity's country.
5. Generate employment in the resident entity's country.

Types of Collaboration Available for Indian Companies

As no country is self sufficient in itself all countries are dependent on each other to meet out the requirements. Interdependence among countries is a common phenomenon these days. Foreign collaboration is very useful in meeting out the deficiencies of the resources and in getting advanced technology with competitive price. Foreign collaboration in Indian market is increasing at a great speed due to the effects liberalization; privatisation and globalisation. Indian companies are interested in foreign counterpart because of gaining technical and market skills from the foreign market.

The following are the types of collaboration:

1. Technical collaboration:

Technical collaboration is a contract whereby the developed country agrees to provide technical know-how, sophisticated machinery and any kind of technical assistance to the developing country. Technical collaboration enables to undertake research and development activities and innovation.

2. Marketing collaboration:

Marketing collaboration is the agreement where the foreign collaborator agrees to market the products of the domestic company in the international market. Marketing collaboration creates value for customers and builds strong customer relationship. Marketing collaboration promotes export.

3. Financial collaboration:

When the foreign contribution is in the form capital participation, that contract is known as foreign collaboration. When the foreign company agrees to provide capital or financial assistance to the domestic company, it is known" as financial collaboration.

4. Consultancy collaboration:

A Consultant is a professional who provides advice in a particular area of expertise such as management, accountancy, human resource, marketing, finance etc. Consultancy collaboration is the agreement between the foreign and the domestic company where the company agrees to provide managerial skills and expertise to the domestic company. This type of collaboration bridges the information gap.

5. Joint Venture:

Joint venture is a legal entity formed between two or more parties to undertake an economic activity together. In joint venture companies agree to share capital, technology, human resources, risks and rewards in a formation of a new entity under shared control. A joint venture takes place when two parties come together to undertake one project. It is a temporary partnership between the two organisations for achieving common goals. Once the goal is achieved, joint venture comes to an end.

6. Amalgamation:

Amalgamation means bringing of two or more business into single entity. In other words, amalgamation means blending together two or more undertakings into one undertaking. In this type of growth strategy two or more companies come together to form a new company. In amalgamation companies lose their individual identity. For example: one company called ABC. Another company called BCD. Now, ABC is running loss and BCD also running loss, so these two companies agreed to Amalgamate and a new company ABCD is formed.

7. Merger:

Merger is a combination of two companies into one company where one company loses its identity. It is an arrangement whereby the assets of two companies become vested under the control of one company. Merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. The process of mergers and acquisitions has gained substantial importance in today's corporate world. For example: Tata Steel acquired Corus Group.

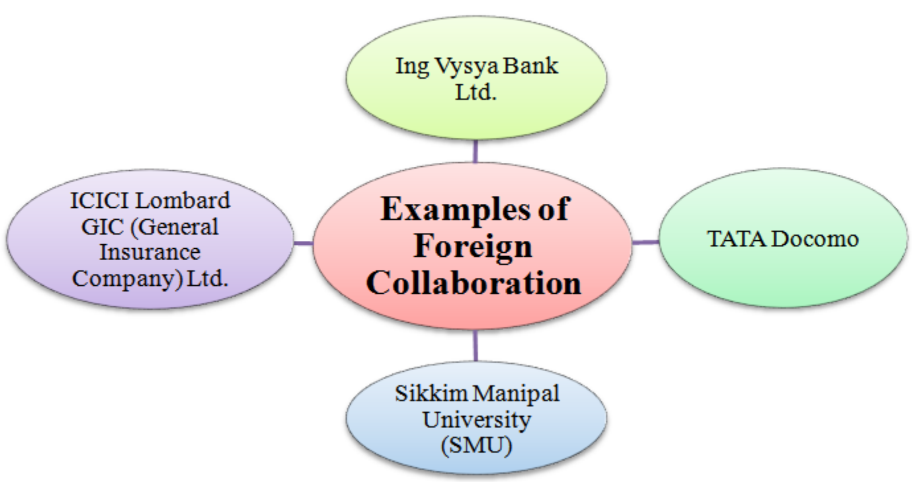
8. Take Over/Acquisition:

Acquisition is a growth strategy in which a strong company acquires all the assets and liabilities of another company. When one company takes over another company and clearly established itself as the new owner, the purchase is called an acquisition.

Takeover is a form of acquisition. There are two types of acquisitions; Friendly acquisitions and Hostile acquisitions. In a friendly acquisition the target company is formally informed about the acquisition and there is an agreement on corporate management and finance control. In a hostile acquisition, the owner loses their ownership and control of the company against their wishes.

Examples of Foreign Collaboration

Some prominent examples of foreign collaboration are depicted below.



The examples of foreign collaboration between an Indian and abroad entity:

1. ICICI Lombard GIC (General Insurance Company) Limited is a financial foreign collaboration between ICICI Bank Ltd., India and Fairfax Financial Holdings Ltd., Canada.
2. ING Vysya Bank Ltd. is a financial foreign collaboration formed between ING Group from Netherlands and Vysya Bank from India.
3. Tata DOCOMO is a technical foreign collaboration between Tata Teleservices from India and NTT Docomo, Inc. from Japan.
4. Sikkim Manipal University (SMU) from India runs some academic programs through an educational foreign collaboration with abroad universities like Liverpool School of Tropical Medicine from UK, Loma Linda and Louisiana State Universities from USA, Kuopio University from Finland, and University of Adelaide from Australia.

Lesson 8.4

Multinational Corporations (MNCs)

Multinational corporations (MNCs in short) are also known as Transnational Corporations (TNCs), Super National Enterprises, Global companies, and so on. According to Prof. John H. Dunning, “A multinational enterprise is one which undertakes foreign direct investment, i.e., which owns or controls income gathering assets in more than one country; and in so doing produces goods or services outside its country of origin, i.e., engages in international production.”

A multinational corporation has also been defined as “an enterprise: which owns and/or controls producing facilities in more than one country such as factories, mines, oil refineries, distribution channels, offices, etc.”‘

According to another definition, “Any business corporation in which ownership, management, production and marketing extend over several national jurisdictions is called a multinational corporation.” Today, in international economic affairs they constitute the most important institutions. There are four participants in the drama of multinationals. First, the MNCs themselves; secondly, the host countries ; thirdly, the home countries ; and fourthly, the international community.

Characteristics of multinational corporations (MNCs):

The multinational corporations have certain characteristics which may be discussed below :

(1) Giant Size

The most important feature of these MNCs is their gigantic size. Their assets and sales run into billions of dollars and they also make supernormal profits. According to one definition an MNC is one with a sales turnover of f 100 million. The MNCs are also super powerful organisations. In 1971 out of the top ninety producers of wealth, as many as 29 were MNCs, and the rest, nations. Besides the operations, most of these multinationals are spread in a vast number of countries.

(2) International Operation

A Fundamental feature of a multinational corporation is that in such a corporation, control resides in the hands of a single institution. But its interests and operations sprawl across national boundaries. The Pepsi Cola Company of the U.S operates in 114 countries. An MNC operates through a parent corporation in the home country. It may assume the form or a subsidiary in the host country. If it is a branch, it acts for the parent corporation without any local capital or management assistance. If it is a subsidiary, the majority control is still exercised by the foreign parent company, although it is incorporated in the host country. The foreign control may range anywhere between the minimum of 51 per cent to the full, 100 per cent. An MNC thus combines ownership with control. The branches and subsidiaries of MNCs operate under the unified control of the parent company.

(3) Oligopolistic Structure

Through the process of merger and takeover, etc., in course of time an MNC comes to assume awesome power. This coupled with its giant size makes it oligopolistic in character. So it enjoys a huge amount of profit. This oligopolistic structure has been the cause of a number of evils of the multinational corporations.

(4) Spontaneous Evolution

One thing to be observed in the case of the MNCs is that they have usually grown in a spontaneous and unconscious manner. Very often they developed through "Creeping incrementalism." Many firms become multinationals by accident. Sometimes a firm established a subsidiary abroad due to wage differentials and better opportunity prevailing in the host country.

(5) Collective Transfer of Resources

An MNC facilitates multilateral transfer of resources Usually this transfer takes place in the form of a "package" which includes technical know-how, equipment's and machinery, materials, finished products, managerial services, and soon, "MNCs are composed of a complex of widely varied modern technology ranging from production and marketing to management and financing. B.N. Ganguly has remarked in the case of an MNC “resources are transferred, but not traded in, according to the traditional norms and practices of international trade.”

(6) American dominance

Another important feature of the world of multinationals is the American dominance. The U.S. has assumed more of the role of a foreign investor than the traditional exporter of home products.

Significance of multinational corporations (MNCs):

The multinational corporations today have a revolutionary effect on the international economic system. It is so because the growth of international transactions of the multinationals has affected the more traditional forms of capital flows and international trade for many economies. Today they constitute a powerful force in the world economy.

In the field of international trade and international finance, the multinational firms have come to exercise enormous power. In early seventies the MNCs accounted for about one-eighth of all international trade- From the nature of their growth it may be presumed that in the early eighties their share will rise to one-fourth.

Among the developing countries only India had an annual income twice that of General Motors, which is the biggest multinational corporation. Otherwise the annual income of the other less developed countries is much less than that of the giant MNCs. By their sheer size the MNCs can disrupt the economies of the less developed countries, and may even threaten their political sovereignty.

We may comprehend the relative economic power of the MNCs vis-a-vis the nation-states by ranking them together according to gross annual sales and gross national product respectively. As Lester R. Brown has shown, out of 100 entries in the merged list 56 were nation-states and as many as 44 were MNCs.

Importance of MNCs

The establishment of multinational companies has been good boon all over the world..Some of its importance are as follow:

1.Transfer of Capital and Technology

The multinational companies transfer investment, advance technology to developing countries through establishing branches and subsidiaries. Therefore developing countries like Nepal get benefited of receiving advanced technology and capital investment through such companies.

2. Mass production

With help of advanced technology, the can produce quality goods and products at cheaper price. Due to Job innovation and specialization help to produce more consumption increase as production in more unit reduce cost.

3. Increase in Employment Opportunity

A multinational company requires a large number of skilled as well as unskilled employees to operate its activities. Thus it provides employment opportunity to the people of host country as a result economic standard of society is improved.

4. Increase in Government Revenue

A multinational company is a large scale business. It pays a large amount of duties, income tax, VAT,etc to government. Therefore Government revenue is increased due to operation of such companies.

5. Research and Development

In complete world, it is need of Research and Development. To meet international standard of its products and services ,a multinational company conducts several research and development activities. Constantly such programs are beneficial to society. It helps to develop better equipments, quality products and advanced technology in production.

6. Good International Relation

A multinational company recognizes the country in the international market. It creates harmonious relation between parent company and subsidiary countries. It recognizes exporting country to all over the world.

Advantages and Disadvantages of Multinational Corporations

Multinational Corporations no doubt, carry out business with the ultimate object of profit making like any other domestic company. According to ILO report "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others they are monsters which our present institutions, national or international, cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept. MNC's directly and indirectly help both the home country and the host country.

Advantages of MNC's for the host country

MNC's help the host country in the following ways

1. The investment level, employment level, and income level of the host country increases due to the operation of MNC's.

2. The industries of host country get latest technology from foreign countries through MNC's.

3. The host country's business also gets management expertise from MNC's.

4. The domestic traders and market intermediaries of the host country gets increased business from the operation of MNC's.

5. MNC's break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.

6. Domestic industries can make use of R and D outcomes of MNC's.

7. The host country can reduce imports and increase exports due to goods produced by MNC's in the host country. This helps to improve balance of payment.

8. Level of industrial and economic development increases due to the growth of MNC's in the host country.

Advantages of MNC's for the home country

MNC's home country has the following advantages.

1. MNC's create opportunities for marketing the products produced in the home country throughout the world.

2. They create employment opportunities to the people of home country both at home and abroad.

3. It gives a boost to the industrial activities of home country.

4. MNC's help to maintain favourable balance of payment of the home country in the long run.

5. Home country can also get the benefit of foreign culture brought by MNC's.

Disadvantages of MNC's for the host country

1. MNC's may transfer technology which has become outdated in the home country.

2. As MNC's do not operate within the national autonomy, they may pose a threat to the economic and political sovereignty of host countries.

3. MNC's may kill the domestic industry by monpolising the host country's market.

4. In order to make profit, MNC's may use natural resources of the home country indiscriminately and cause depletion of the resources.

5. A large sums of money flows to foreign countries in terms of payments towards profits, dividends and royalty.

Disadvantages of MNC's for the home country

1. MNC's transfer the capital from the home country to various host countries causing unfavourable balance of payment.

2. MNC's may not create employment opportunities to the people of home country if it adopts geocentric approach.

3. As investments in foreign countries is more profitable, MNC's may neglect the home countries industrial and economic development.

Self Assessment Questions

1. What is meant by global business environment?
2. What are the factors affecting global business environment?
3. Explain the importance of international business for economy.
4. What are the salient features of Foreign Trade in India?
5. Explain the Foreign Trade Policy of India / EXIM Policy
6. What are the features of GAAT?
7. Explain the objectives, structure and functions of WTO.
8. Explain the needs for foreign capital
9. What are the forms of foreign capital in india?
10. What are the objectives and functions of World Bank?
11. What are the objectives and functions of IMF?
12. Explain the impact of foreign investment in economy growth
13. What is foreign collaboration? And what are the objectives of foreign collaboration?
14. Explain the types of foreign collaboration available for Indian companies?
15. What are the characteristics of multinational corporations (MNCs)
16. Explain the significance of multinational corporations(MNCs)
17. What are importance of MNCs?
18. Explain the advantages and disadvantages of Multinational Corporations for the home country and the host country.