BBA-04

VARDHAMAN MAHAVEER OPEN UNIVERSITY, KOTA

BUSINESS ENVIRONMENT

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Vardhaman Mahaveer Open University, Kota

Business Environment

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CONTENTS

Business Environment

Unit - 1 Overview of Indian Business Environment

Structure of Unit

1.0 Objectives

After completing this unit, you would be able to:

- Understand the relationship between organizations and environment;
- Classify the business environment as internal and external;
- Point out various internal environment components affecting business decisions;
- Know about various external environment factors of businesses;
- Learn and appreciate the significance of business and its environment to society;
- Understand difference between old and emerging economics.

1.1 Introduction

Organizations in today's fast changing environment face intense competition, economic fluctuations, changing profile of developing and developed economies, technological breakthroughs and developments, changing social values, demographic profiles, legal system, regulatory mechanisms, government policies, cultural profiles, etc.

These factors are subject to changes on continuous basis. Managerial personnel have to adjust and adopt these environmental factors for the purpose of formulation and/or revision of their business policies. The success or failure of a business concern depends, to a greater extent, upon the accuracy with which the environmental scanning is made and according to the changes in environment the business policies are formulated/modified, are implemented. The real challenge for the organizations in current context is o achieve results by being sensitive to the social environment on one hand and having ethical approach on the other hand. The long term sustainable growth necessarily requires ethical and value based approach to achieve organizational objectives on continuous basis.

1.2 What is Business Environment?

The word 'Business Environment' is a combination of two words- Businesses, Environment. Let's understand both in detail:

1.2.1 What is Business?

The role of business is crucial it includes all such activities which are organized and operated to provide goods and services to the society, creation of employment opportunities, offer of better quality of life, contribution to the economic growth of a country. Society cannot live without business and business needs society as much.

According to Musselman and Hughes, Business represents the "organized efforts of enterprises to supply consumers with goods and services."

According to L.R. Dicksee, "A business is a form of activities pursued primarily with the object of earning profit for the benefit of those on whose behalf the business activities are conducted".

According to Arthur M. Weimer, Business is that "complex field of commerce and industry in which goods and services are created and distributed in the hope profit within a framework of laws and regulations."

To sum up, business may be understood as the organized efforts of enterprises to supply consumers with goods and services and to make profit in the process, but only profit is not the sole objective of the business. Business may have other objectives like promotion and welfare of the workers and the society in general.

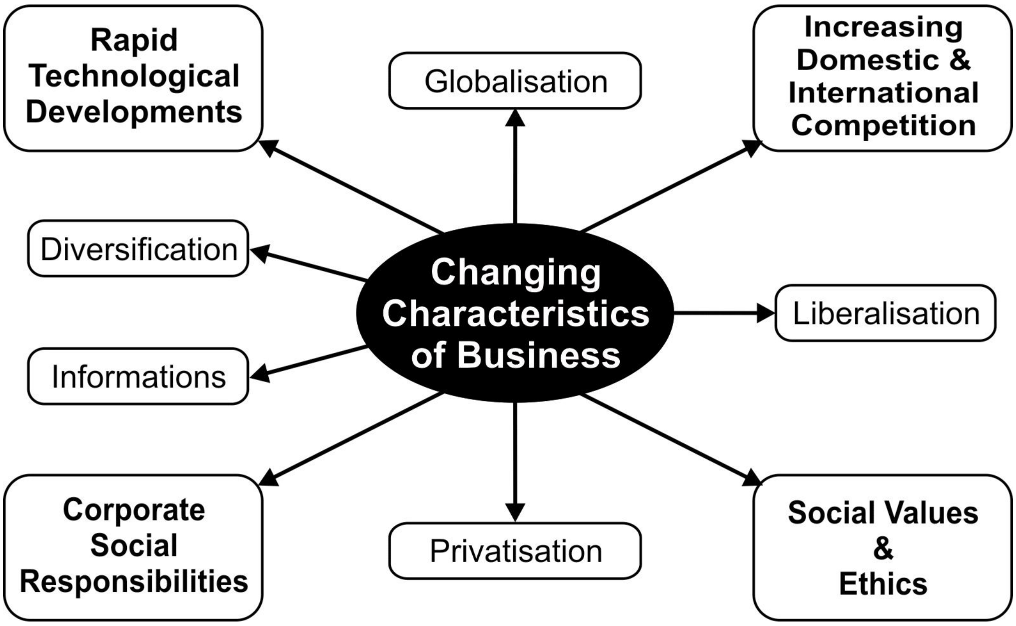

Fig. 1.1 Changing Characteristics of Business

Activity A :

1. According to you what is Business? How does business of today differ from that of four to five decades ago?

1.2.2 What is Environment?

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

According to William F. Glueck and Lawrence R. Jauch, "the environment includes factors outside the firm which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of these factors are socio-economic, technological, supplier, competitors and government."

Thus, an environment refers to the sum total of all factors – economic, political, business, social, legal and technological – which extends to and is beyond the control of the individual or an organization. In preset time, environmental factors are numerous and complex. Some of these factors are static while others are dynamic.

The environment imposes several constraints on the enterprises and has considerable impact and influence on the scope and direction of its activities. In the business terms environment may be local, national and international. In the same way, environment may be market environment and non-market environment.

1.2.3 Business Environment

Business environment refers to the totality of all such factors which influence the working and decision-marking of a business organization. Every business organization has to operate under a given environment, which is called business environment.

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

According to Arthur M. Weimer, "Business environment is the climate or set of conditions – economic, social, political or institutional in which business operations are conducted."

According to Richman and Copen, "There are lots of pressures and controls which are mostly out-side the control of individual firm and its managers."

According to William, Glueck and Jouch, "In environment there are external factors which constantly spin out opportunities and threats to the business firm."

Business environment encompasses all conditions, circumstances, and influences surrounding and affecting the development of an organization or an enterprise. Business environment comprises the monetary policy, fiscal policy, price behaviour, industrial policy, licensing policy, import-export policy, policy of financial institutions, state of technology, tastes and preferences of the consumers, customs, traditions etc.

Business environment is a relative concept, which changes over time and place. In actual practice, business environment may remain static during a short period, however, it does change in the long period. Business environment existing today in India may be different from what existed in the past, and the future business environment would be different from that of yesterday's and today's environment. The successful manager is one who changes the course of business according to the changes in the business environment.

Activity B:

1. Analyze the definition of business environment given by Reinecke & Schoell and correlate this with an imaginary case.

1.3 Classification of Business Environment

Business environment is the sum total of the environment factors which provides an atmosphere for business. It has a direct relation with every business organization which operates in it. Obviously the effectiveness of interaction of the enterprises with the environment primarily determines the success of failure of the business. Business environment can be classified into two groups:

(A) INTERNAL ENVIRONMENT

(B) EXTERNAL ENVIRONMENT

1.3.1 INTERNAL ENVIRONMENT

The internal environment consists of the factors in the company's immediate environment that affects the performance of the company. The internal environment factors are more intimately linked with the company than the external factors. Thus it is very important to understand internal environment because the day to day activities of business are regulated by internal environment. The following are the important components of internal environment of business:

- The approach and vision of founders about the choice of business, value system of business, the mission and objectives of the organization, business policies and practices etc. are the important factors contributing to success of an business entity.
- The organizational structure, the composition of the Board of Directors, extent of professionalism of management etc. are important factors influencing business decisions.
- The business domains of the company, priorities, direction of development, business philosophy, business policy etc. are guided by the mission and objectives of the company.
- Factors like the amount of support the top management enjoys from lower levels and workers, shareholders and Board of Directors have important influence on the decisions and their implementation.
- Physical assets and facilities like the production capacity, technology and efficiency of the productive apparatus, logistics etc. are among the factors which influence the competitiveness of a firm.
- Research & development and technological capabilities determine the ability to innovate and compete.
- The image of the company matters while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products etc. Brand equity is also relevant in several of these cases.
- Financial Factors like financial policies, financial position, and capital structure are also important internal environment affecting business performance, strategies and decisions.
- Change in size of organization is an important factor which affects the prospect of the individual organization.
- The characteristics of the personnel like skill, quality, morale, commitment, attitudes etc. could contribute to the strength or weakness of an organization.

1.3.2 EXTERNAL ENVIRONMENT

All organizations, irrespective of their goals, operate amidst changing external environment that affects and influences their managerial decisions. Management particularly at the senior and top levels must consider external factors for effective decision-making. The external environment is the actual environment of a business where the institution regulates its work. The external environment consists of two types of environment, viz., micro environment and macro environment. Let's explain these in detail:

(I) Micro Environment

According to Kotler, "The micro environment consists of the factors, which put effect on the company's immediate environment"

It is quite obvious that the micro environmental factors are more intimately linked with the company. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. These micro environment forces include the suppliers, marketing intermediaries, competitions, costumers etc. Let's understand in detail:

(a) Customers: The ultimate test of success of an organization lies in winning the goodwill of existing and prospective customers. A company can not exist if it does not have adequate customers to support its infrastructure, capital, manpower, etc. Customers add value to the existence of an organization. As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success. The choice of the customer segment should be made by considering a number of factors including the relative profitability, dependability, and stability of demand, growth prospects and the extent of competition.

(b) Threat of Substitutes: Developments and innovations in the industry result in substitute products/ services. Companies should not only understand and analyze the threat to their business from existing substitutes but also from potential substitutes. Therefore, companies are required to continuously work out the implications to their operations arising from existing and potential substitutes and create strategies to counter their effects on their business.

(c) Suppliers: Organizations acquire resources and add value to them by converting them into goods and services in order to achieve their objectives. An important force in the micro environment of a company is the suppliers, i.e. those who provide various resources to organizations such as people, raw material information, finances, machines, and equipment. Suppliers, depending upon market conditions, may be in a position to dictate their terms with regard to prices and quality of resources.

Therefore, it is a vital strategic decision on the part of organizations to choose right and dependable suppliers. Organization in today's environment ought to focus their efforts to develop harmonious and trustworthy relationship with their suppliers. And due to the sensitivity of the supply, many companies give high importance to vendor development. Vertical integration, where feasible, helps in solving the supply problem.

(d) Competitors: Each organization operates in the context of its immediate competitive environment consisting of the competitors operating in the same product or service industry. This mainly consists of specific organizations with which company directly or indirectly interacts and gets affected so far as its decisions are concerned.

(e) Marketing Intermediaries: The immediate environment of a company may consist of a number of marketing intermediaries. According to Kotler marketing intermediaries are "firms that aid the company in promoting, selling and distributing its goods to final buyers." The marketing intermediaries include middlemen such as agents and merchants, physical distribution firms such as warehouses and transportations firm, marketing service agencies such as advertising agencies, marketing research firms, media firms and consulting firms and financial intermediaries.

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of this link, or a wrong choice of the link, may cost the company very heavily.

All the above factors need to be appropriately diagnosed by the managers to achieve their corporate goals and objectives by responding effectively to various environmental forces.

(II) Macro Environment

Macro environment forces shape opportunities and pose threats to the company. The macro forces are, generally, more uncontrollable than the micro forces. Macro-environment that affects working of all or most organizations includes economic systems, economic conditions, political system, demographics, cultural background, technology, and legal framework

According to Kotler, "The macro environment consists of the larger societal forces that affect all the actors in the company's micro environment – namely, the demographic, economic, natural, technological, political and cultural forces." The micro environment is also known as task environment and operating environment. All the macro-environment factors- described below need to be continuously monitored and their implications on the operations of the organization need to be precisely identified. It is the systematic approach to environmental scanning that enables managers to identify important events and trends outside their organizations.

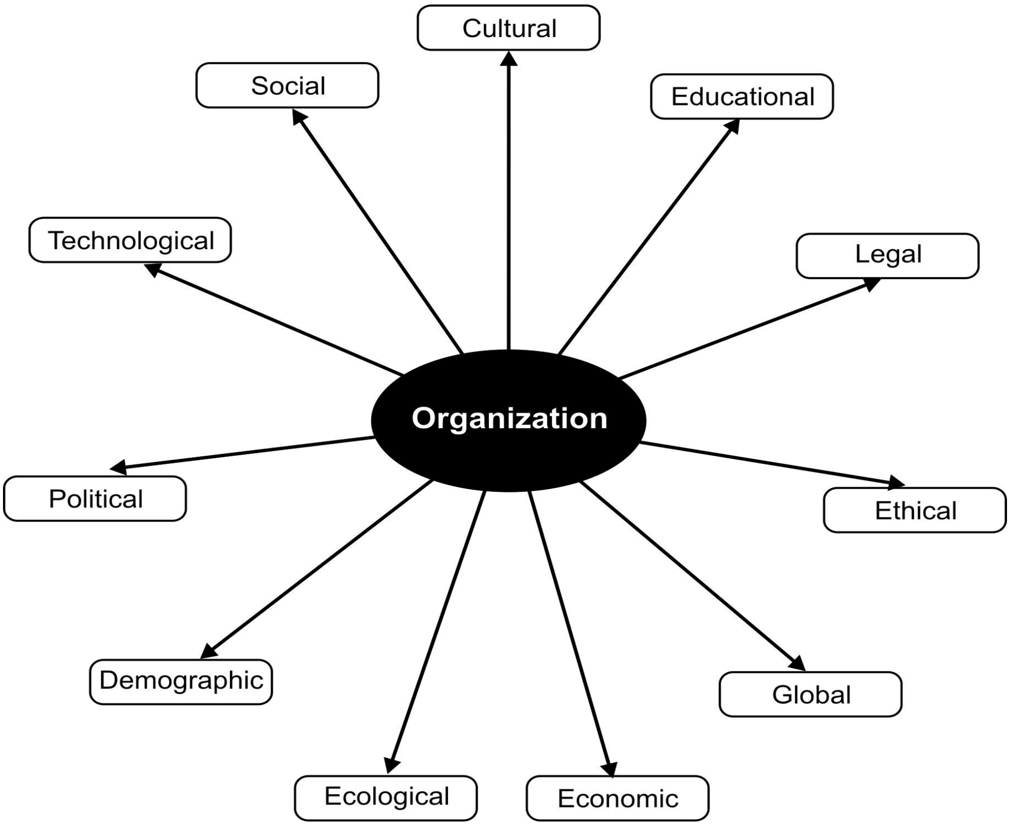

Figure: 1.2 Macro Environment Affecting Businesses

The detail description of important macro environment forces is give below:

(a) Demographic Environment

Demographic characteristics of the population reflect the details on parameters such as age profiles, gender profile, income levels of target group, occupation pattern, size of families, growth rate, economic stratification of the population, educational levels, life expectancy, language, caste, religion etc. are all factors which are relevant to business and affect the demand for goods and services.

The understanding of these parameters helps in defining the characteristics of people comprising groups to comprehend the affect on these dynamics having direct implication on the organizational plans to achieve its objectives. Population growth directly affects availability and composition of work force. Age profile of the population affects the dynamics as regards average age in the organization and its implications on absorption of new technology, ideas, and knowledge.

A diverse and young workforce provides a number of advantages in terms of flexibility, adaptation to change, etc. in an organization. Organizations are required to make strategic plan in the backdrop of demographic data to recruit, retain, train, develop, motivate, and productively utilize people of varied demographic backgrounds, so as to achieve their goals. Organizations are required to analyze workforce demographic and their implication on availability and formulation of their human resource plans.

(b) Economic Environment

Economic environment is the most important factor affecting business. Business firm is an economic unit; therefore, economic factors have a considerable influence on the business decisions. A business policy maker or a strategic planner has to probe into the economic environment in connection with scanning the environment. There are many economic variables and force which influences the business.

Economic environment comprises the comprise the economic system, level of banking institutions, fiscal and monetary policy, industrial production, agriculture, planning, basic economic philosophy, national income, per capital income, money supply, savings, stages in the economic development, trade cycles, price mechanism, money and capital market, resource availability and resource allocation, size of market, infrastructural facilities, level of economic development, etc.

Economic environment is the business environment in which the economic parameters act together to make or break a conducive climate for the growth of business. In accordance with the change in the economic environment, policy makers in business have to change their approach. Very often cultural factors are linked with social and economic factors.

(c) Political and Legal Environment

The working of organizations in any society gets affected by political and legal framework and the system within they have to operate. The policy thrust given to different industries keeps changing with the change in political regime. Political environment refers to the influence exerted by the three political institutions, viz., legislature, executive and judiciary in shaping, directing, developing and controlling business activities. The legislature decides on a particular course of action; the executive, also called government, implements whatever was decided by parliament and the judiciary plays the watchdog role in order to ensure that both the legislature and the executive function is in public interest and within the boundaries of the constitution.

The components of political environment are political approach of Government, political satiability, national protection and defence policy, foreign policy, Govt. control, bureaucracy, government laws and policies etc. A stable and dynamic political environment is indispensable for business growth

Legal environment actually provided the ground on which the business activities can be effectively carried out. It has a social objective also. Every manager or policy maker has to enforce every legal provision when he formulates the policy or strategy. Every aspect of business is regulated by Law in India. Hence legal environment plays a very vital role in business environment. Constitutional provisions, commercial laws, economic laws (MRTP Act, FEMA, SEBI), industry and labour laws, pollution control laws, tax laws and policies, laws related to social control, nationalization, socialization, privatization, industrial licensing, company formation, factory administration, industrial disputes, payment of wages, trade unionism, foreign exchange regulations etc. are examples of legal environment in India.

As the violation of Law can invite prosecution against the concerned persons or institutions, legal environment can be legally enforceable. Managers need to ensure compliance with the statutory provisions pertaining to companies in the country of their operations. In case of any conflict or dispute, they should also know how to take recourse to legal measures to safeguard their interests. Above all, the political set-up governs governmental priorities that have a direct bearing on the operation of the companies.

(d) Social-cultural Environment

Social Environment:

Every business organization is a part of its society. It operates within the society, and exists primarily to satisfy its needs. Hence the business organization has an inseparable position in the very social system. While the social factors influence the policy and strategy of business, business organization strives to satisfy the needs and wants of society. Every business has a social responsibility.

The components of social environment are population expansion and its characteristics (sex ratio (Male, Female), caste, religion, education, income, age structure), Family structure – may be nuclear or joint and role of family, level of public responsibilities, mutual cooperation, mentality of public towards work and wealth, attitude towards management, social integration and disintegration, ethical issues, distribution of income and wealth, equality of opportunity, social welfare, class structure, social attitude of the masses towards the authorities and managers of business, etc.

While social institution are closely linked with business organizations, business itself is a social institution as Keith Davis and Robert Blomstorm have observed that business is a “social institution performing a social mission and having a broad influence on the way people live and work together.”

Social environment plays a key role in determining the nature of product, quality of the product, marketing strategy of the firm, etc. Business must be responsive to the changing needs of the society. Besides maximizing profits, a firm has also to take care of the interest and welfare of the society.

Cultural Environment:

Culture factors of the business environment should also be taken into consideration during the course of scanning the environment and policy formulation. Culture relates to the shared characteristics – language, religion, heritage and values that differentiate the members of one group of people from those of another or from one nation of people from that of another, values relate to basic beliefs of individuals and considerable importance and meaning is attached to them. Managers need to be conscious and careful about culture and values of their stakeholders, so as to develop and make their strategies and action compatible to them. Values of individuals greatly affect operations of the organization, particularly to develop interpersonal relationships with the stakeholders. The approach to identify the problem, possible alternative solutions to the problem, clarity about ethical and non-ethical behaviour, and approaches to lead and control employees largely depend upon careful analysis about cultural practices and values of people. Thus a careful diagnosis of culture and value system helps a great deal in understanding the expectations of customers, employees, and other stakeholders. This helps to develop appropriate response systems to manage effectively.

The socio-culture fabric is an important environmental factor that should be analyzed while formulating business strategies. The cost of ignoring these factors could be very high. For a business to be successful, its strategy should be the one that is appropriate in the socio-culture environment. The marketing mix will have to be so designed as best to suit the environmental characteristics of the market.

(e) Physical or Natural Environment

Physical environment also influences business organizations. An organization has to take into account the influence of physical factor on the organization such as availability of land, mineral wealth, water resources, quantity and quality of existing forest wealth, possibility of artificial rain, the exploitation of sea products like fish, the health hazards arising out of pollution, social costs of rapid urbanization and industrialization, etc.

Geographical and ecological factors, such as natural resources endowments, weather and climatic conditions, topographical factors, location aspects in the global context, port facilities, etc., are all relevant to business.

Let’s understand these factors in detail:

(i) Natural Resources: The natural resources include land, mineral wealth, water, electricity, raw material etc. Each country has limited natural resources. Thus business has to utilize them optimally.

(ii) Geographic factors: Geographic factors are equally important when we consider the business environment. Geographic location, seasonal variations, climatic condition (temperature, rain, moisture) etc. considerably affect the taste and preferences of the people, the customers and prospects as well as the labour force. Business policy maker, particularly the managers in a global business environment must assign proper recognition to such geographic factors.

Difference in geographic condition between markets may sometimes call for changes in the marketing mix. Geographical factors also influence the location of certain industries. For example, industries with high material index tend to be located near the raw material sources. Climate and weather conditions affect the location of certain industries like the cotton textile industry.

(iii) Infrastructure: The development of business requires the infrastructure facilities of road, transport, power, finance, communication, godown, training, research, technology and other services.

(iv) Energy: Energy is the basis of business. The main physical energy of businesses are water, coal, petroleum, atomic power, solar energy, gas, electricity etc.

(v) Public Utilities: It includes the service like transport, communication, electricity supply, water, television, radio etc.

(vi) Topography: It includes the aspects of topology and location of business. Mountains, plains, plateaus, oceans, rivers, harbours etc. Topographical factors may affect the demand pattern. Fox example, in hilly areas with a difficult terrain, jeeps may be in greater demand than cars.

(vii) Ecological Environment: Ecological Environment is combination of all the physical and biological conditions. Ecological factors have received considerable importance, of late. Business strategy is sensitive to ecological environment too, since ecology forms a part of the business environment. The depletion of natural resources, environmental pollution and the disturbance of the ecological balance has caused great concern. Government policies aimed at the preservation of environmental purity and ecological balance, conservation of non-replenishable resources, etc., have resulted in additional responsibilities and problems for business, and some of these have the effect of increasing the cost of production and marketing.

The physical environment of business influences the structure and growth of business. The physical factors influence production, demand, distribution of goods, material mix, marketing mix, ecological balance, cost structure, price, supply etc. Deficient natural resources are major problem of business. The problem of centralization, environment pollution, regional balance, equal distribution of wealth, civilian pressure, property preservation of business are linked to physical environment. To what extent business depends on nature and what is the relationship between the two constitute an interesting study.

(f) Technological Environment

Organizations cannot grow without incorporating existing and emerging technologies in their strategic and operational plans. Technology environment exercises considerable influence on business. Technology is understood as the systematic application of scientific or other organized knowledge to practical tasks. It is through business that technology reaches people. Technology changes fast and to keep pace with, businessmen should be ever alert to adopt changed technology to their business.

The technology development of a country influence strategies of production, newer goods, marker, raw material source, tools and equipments, services etc. Technological development has revolutionized industrial development. Introduction of new technologies in an area leads to new products and services, advancement in production techniques resulting in cost advantages, and better way to manage by way of improved communication systems and decision making processes.

The following points are important in the field of technical development that influences business and trade-

- Increased efficiency to cover time and distance for distribution of goods.
- Increase in efficiency of power production, collection and distribution.
- Computer-aided designs and computer controlled machines have enabled improvement in efficiency of operation, precision in quality of production, wide ranging flexibility in coming out

with alternate designs to meet customer requirements as compared to traditional manufacturing machines.

- Newer form of raw material and change in characteristics of goods.
- Management information systems backed up by computer have started facilitating quick decision making processes by providing information when it is needed.
- Mechanization of production process
- Internet shopping and selling have resulted in overcoming physical barriers to tap markets.
- Increase in knowledge of treatment to different disease etc.

Technology has been playing a vital role in manufacturing systems and distribution networks. Thus, the operation of profit and non-profit organizations is fast changing due to changes in technology. Managers need to be alert to technological changes and their implication to their organizations, is as to effectively tackle and manage their operation.

(g) Global Environment

Environmental factors which is fast emerging as the force to reckon with is the global or international environment. Business responses and managerial practices must be fine-tuned to the global environment. Every country is influenced by international events. Thus, activities of every organization are affected by international factors like the rate of inflation in different nations with which it trades. In the same way, different trade barriers created by many countries affect the domestic organization and their export efforts.

It is particularly important for industries directly depending on imports or exports, and import-competing industries. For example, a recession in foreign markets or the adoption of protectionist policies by foreign nations may create difficulties for industries depending on exports. On the other hand, a boom in the export market or a relaxation of the protectionist policies may help the export-oriented industries. The liberalization of imports may help some industries which use imported items, but may adversely affect import-competing industries. It has been observed that major international developments have their spread effects on domestic business. The great depression in the United State sent its shock-waves to a number of other countries. Oil price-hikes have seriously affected a number of economies. Such hikes have increased the cost of production and the prices of certain items. The oil crisis led to reorientation of the government of India’s energy policy. Such developments affect the demand, consumption and investment pattern.

(h) Ethical Environment

Businesses have to follow ethical values of the society. Ethics refers to the code of conduct that guides an individual in dealing with others. Ethical rules differ from legal rules as much as the former are not enforced by public authority whereas the latter is enforced by the public authorities. Legal rules become unnecessary when ethical rules are observed by businessmen. Society expects businessmen to act ethically. Business ethics are the key of success of a businessman in long run. Enacting legislations and enforcing them rigidly is one way of disciplining businessmen. But legal rules are counter productive as happened in our country. The best way is to encourage businessmen to frame their own codes of conduct and adhere to them.

(i) Educational Environment

The business structure and environment is also affected by the prevailing education system, level of education, technological education etc. Educational facilities and training, higher education, research and development, management courses, administrative and legal education etc. help in the development and progress of business and industries to avail the services of efficient, trained and skilled labour. But mere facilities of education and training are not enough for development of managerial class, efficient workers and technocrats. It is also essential that the people develop a positive approach and attitude towards education and training.

Activity C :

1. Try to establish a relationship among above described macro environmental factors? Which factor do you think is most important and why?

Thus we can understand that business decisions are influenced by two sets of factors, viz., internal factors (the internal environment) and external factors (external environment). The internal factors are generally regarded as controllable factors because the company, generally, has control over these factors. The external factors, on the other hand, are, by and large, beyond the control of a company and these are, therefore, generally regarded as uncontrollable factors.

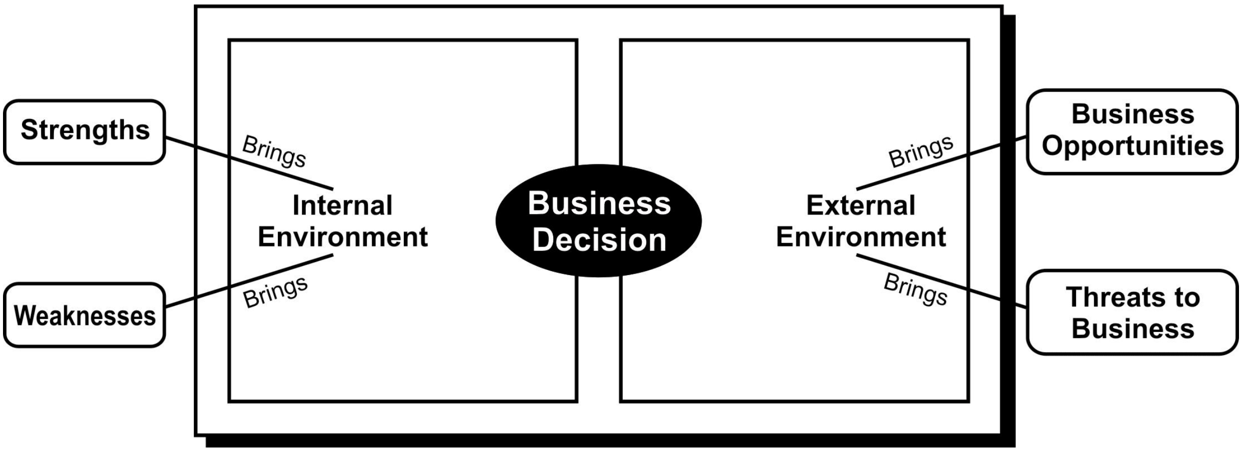

Fig. 1.3 Factors Influencing Business Environment

The external environment has, broadly, two components, viz., business opportunities and threats to business. Similarly, the organizational environment has tow components: strengths and weaknesses of the organization. Thus, strategy formulation is properly pitting the organizational factors (the internal environment) against the opportunities and threats in the external environment. A SWOT analysis (analysis of the strengths and weaknesses of the organization through analyzing internal environment and opportunities and threats in the environment through analyzing external environment), therefore is one of the first steps in the strategic management process.

Activity D :

1. "Environmental scanning should provide inputs for strategic decision making". Elaborate

1.4 Emerging Indian Business Environment

Economics deals with optimum resource allocation so as to fulfill, to the maximum possible extent, human wants and needs. Its main focus is on understanding how people and nations produce, distribute, and consume goods and services. The vital issues concerning economic development are inflation, interest rates, taxes-individual and corporate, financial assistance to business entities, employment of and wages paid to labour, cost of production, production processes, prices of goods and services, competitive forces, information technological developments and their implication on the cost of production and organized labour and their collective bargaining position. These issues directly affect business decisions.

India has a developing economy with a high order of potential material resources, large population and low level of per capita national income. Though a substantial magnitude of liberalization has been envisaged, the economic activities are still considerably controlled by Government.

The clear policy thrust along with the massive investment that was made in telecom sector by the Indian government has changes the whole complexion of communication industry in India. It was mainly an outcome of the initiative taken by the government in response to political will during nineties. Different industrial associations attempt to influence government decisions by providing facts and figures backed up by research outcomes and their likely adverse effects on the industry. Some of these prominent associations are Federation of Indian Chambers of Commerce and Industry (FICCI), Confederation of Indian Industry (CII), Bharat Chamber of Commerce and Industry (BCCI), Sports Industries Federation (SIF), Builders Association of India (BAI), Organization of Pharmaceutical Producers of India (OPPI), Chemical & Alkali Merchants' Association (CAMA), The Textile Association of India (TAI), National Association of Software and Services Companies (NASSCOM), etc. Each of these associations works for the common cause of its members who belong to the industry.

In the face of the impending globalization of business, arrays of international managers are bound to emerge in the indigenous business environment. It would, therefore, become necessary for the Indian managers to break their shell of traditionality and join the array of international managers so as to enable themselves to view the business environment alike in order to effectively incorporate the strategic management process for the global market. The traditional social system may gradually undergo a social change in accordance with the emerging globalization for which the managers must act as catalysts. The greater the professionalism of management, the greater would be the need and scope for faster social change which may necessitate the global manager of tomorrow to change the course of strategic planning for future. Such a social change is bound to result in economic changes too. After all economic variables are important element of business environment.

Table 1.1 Paradigm Shift in Economies

Old Economies	Emerging Economies
Emphasis on physical assets land, machines, and equipment	Emphasis on human assets knowledge and information
Physical barriers for growth	Physical barriers-far less important
Local and national market	Global markets
Competitive forces - tolerable	Competitive force-intense
Customer behaviour - loyalty	Global behaviour-highly fluid
Regulated economic regime	Deregulated regime
Dominance of agriculture and manufacturing	Dominance of service sector

Form the above profile of changes; it is evident that the whole complexion of business and non-business entities has been undergoing a revolutionary change. It is this change that has vital implications to the future growth of these entities under the changed context in which information, knowledge, and global operations has been playing a dominant role.

The visible changes in the social transformation such as proportionately far higher increase in the younger population, which is becoming financially independent at much younger age; accelerated increase in nuclear families; and increased media exposure, have contributed a great deal in increased consumption level of goods and services. It is estimated that around 720 million people constituting 60 per cent of total population will be in the age group of 15 to 54 years by 2010. The fast growing services sector coupled with accelerated industrial growth is growth is going to open up much needed opportunities for employment. Taking care of the nature of business environment enables the corporate policy maker to:

- Perform the critical function of matching the needs of the society and the capacity of the goods and services to satisfy the needs of the people;

- Adapt the organization itself the dynamic conditions of the society;
- Match the organizational polices and resources with the social needs; and
- Contribute to the social responsibility of business.

Activity E :

1. What are the business environmental changes taking place in your town/city. Make a report.

1.5 Summary

Organizations in today's fast changing environment face various internal and external environmental challenges; these environmental factors are subject to changes on continuous basis. Managerial personnel have to adjust and adopt these for the purpose of formulation and/or revision of their business policies. Business environment comprises the monetary policy, fiscal policy, price behaviour, industrial policy, licensing policy, import-export policy, policy of financial institutions, state of technology, tastes and preferences of the consumers, customs, traditions etc.

Business environment can be classified into two groups- Internal Environment, External Environment. The internal environment consists of the factors in the company's immediate environment that affects the performance of the company. The external environment consists of two types of environment, viz., micro environment and macro environment. Micro environment forces include the suppliers, marketing intermediaries, competitions, costumers etc. The macro environment consists of the larger societal forces that affect all the actors in the company's micro environment – namely, the demographic, economic, political and legal environment, social-cultural environment, physical or natural environment, technological environment, global environment, ethical environment, educational environment forces.

The internal factors are generally regarded as controllable factors because the company, generally, has control over these factors. The external factors, on the other hand, are, by and large, beyond the control of a company and these are, therefore, generally regarded as uncontrollable factors. Thus, strategy formulation is properly pitting the organizational factors (the internal environment) against the opportunities and threats in the external environment. Whole complexion of business and non-business entities has been undergoing a revolutionary change. It is this change that has vital implications to the future growth of these entities under the changed context in which information, knowledge, and global operations has been playing a dominant role. The success or failure of a business concern depends, to a greater extent, upon the accuracy with which the environmental scanning is made and according to the changes in environment the business policies are formulated/modified, are implemented.

1.6 Self Assessment Questions

1. What do you mean by "Business Environment". Explain in detail.
2. What are the different aspects of the external environment of business? How do these influence business?
3. State the constitution of business environment. Explain how these put influences on business decisions.
4. Write short note on following:
   (i) Economic environment of Business
   (ii) Physical and natural environment
5. Bring out the sources for environmental scanning.

6. “Firms which systematically analyze and diagnose the environment are more effective than those which don’t” Elaborate

7. Examine Indian business environment and put your views on paradigm shift taking place in our economy.

1.7 Reference Books

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Unit - 2 Demographic Environment

Structure of Unit

2.0 Objectives

After completing this unit, you will be able to:

- Discuss the importance of demographic environment
- Understand the effect of demography on Indian business
- Discuss the recent trend in social sector and economy
- Analyse the effect of population, food and environment
- Analyse the Government policies to measure the demographic environment

2.1 Introduction

The most important environment factor that needs proper and continuous monitoring is the demographical environment. Demography means the study of population and its characteristics. Management and Marketing Mangers are interested in the population and their habits, market growth rate is also depend on the growth of population. It is known to everybody that global business leader are very much interested in India, the reason is the base of largest population of India. Hence the Indian market is emerging market in the eyes of world business leader. The economic growth rate proves this.

Demographic environment reflects the population growth rate in cities, town, urban areas, villages, age distribution of population, educational level and household patterns, regional characteristics and migration of population.

For the detailed study the unit is divided into three parts:

A. Demography

B. Social Sector and Economy

C. Population, Food and Environment

2.2 Demography

2.2.1 Introduction

Demography is the statistical and mathematical study of the size, composition, and spatial distribution of human populations and how these features change over time. Data is obtained from a census of the population and from registries-records of events like birth, deaths, migrations, marriages, divorces, diseases, and employment. To do this, there needs to be an understanding of how they are calculated and the questions they answers which is included in these four concepts: population change, standardization of population numbers, the demographic book keeping equation, and population composition.

2.2.2 India's Population: The Past

Having grown very slowly in earlier times, India's population reached about 211 million by the first decennial census in 1871. The next five decades saw an alternating pattern of growth - relatively fast during one decade, slow or negative during the next - largely due to the occurrence of huge famines in the 1870s and 1890s, and the influenza epidemic of 1918. But despite these disasters the population reached approximately 251 million by 1921. And in each subsequent decade the scale of the population addition rose - from about 28 million during 1921-31 to 180 million during 1991-2001, a figure roughly equal to the total population of Indonesia in 1991.

In the past India's population was dominated by high mortality, from infectious and parasitic diseases, epidemics and famines. However, mortality improvement from around 1921 - which accelerated sharply after 1947 - led to an increasing concern with the high birth rate. As a result, in 1952 India became the first nation to adopt an official family planning programme. For much of the twentieth century the country pioneered new approaches to the mass provision of birth control. Nevertheless, although the birth rate has been falling since the 1960s, it was only during 1991-2001 that it fell significantly faster than the death rate - so bringing about a clear reduction in the rate of demographic growth. Overall the period 1947-2001 saw a trebling of the population.

Several of the basic features that characterize India's population have very deep roots. The Genetic plain has been the demographic 'centre of gravity' of the Indian subcontinent for over two thousand years - and it will remain so for the foreseeable future. Similarly, the origins of the familiar north/south demographic divide probably date back equally far. Historical perspective also sheds light on the phenomenon of son preference, and helps to explain why the demographic transition is significantly more advanced in the country's south. Finally, India's middling rate of fertility decline since the 1960s accounts for its present still fairly young age structure - a feature which will ensure very considerable future population growth.

2.2.3 Health and Mortality

During the period 1947-70, mortality fell considerably, due to reductions in several major communicable diseases and the absence of major famines. However, many infant and childhood diseases remained very prevalent, tuberculosis contributed to high levels of adult morbidity (and significant mortality), and malaria began to re-emerge after an initial period when it seemed to have been brought under control.

Mortality continued to improve fairly steadily during the last three decades of the twentieth century. Both the crude death rate and the infant mortality rate almost halved, the former falling from 16 to less than 9 per thousand, and the latter from 134 to about 70. Life expectation rose from 50 to 62 years.

This period saw considerable progress against communicable diseases such as gastro-enteritis, dysentery, tetanus, polio and leprosy. But regional differentials in mortality remained, mortality and health conditions generally being more favourable in the south than the north. Contamination of water supplies, inadequate management of liquid and solid wastes, and the high levels of crowding typical of urban slums contributed to the maintenance of infections in the general population, though urban mortality remained lower than rural.

The resurgence of malaria, the spread of drug-resistant forms of tuberculosis, and the menacing rise of HIV/AIDS from the mid-1980s (a development which has probably contributed to the resurgence of tuberculosis) all serve to illustrate just how important infectious diseases remain in the country's mortality and health profile. Indeed, although there has been a marked shift towards greater prominence of non-communicable diseases (e.g. cancers and circulatory ailments) in the country's overall pattern of cause of death, at the start of the twenty-first century India suffers from a 'double burden' of communicable and non-communicable diseases. Widespread nutritional and reproductive health problems, reflecting conditions of great poverty, coexist with lifestyle-induced illnesses linked to the adoption of new patterns of behaviour. These include reduced levels of physical activity and more obesity among the better-off in urban areas, and greater consumption of tobacco. Respiratory ailments remain prominent and stubbornly high, in part because of increased levels of atmospheric pollution.

2.2.4 Fertility

Given the scale and diversity of India's population, a decline from around 6 children per woman in 1970, to almost half that level in a span of 30 years is a significant achievement. Fertility has declined throughout the country, though at varying pace in rural and urban areas and in different states, with Kerala and Tamil Nadu already reaching the replacement level. Changes in fertility behaviour have diffused through space and time conditioned by socio-cultural and historical considerations rather than neat administrative boundaries. Fertility has fallen at all ages; at younger ages due to a rise in the age at marriage and at older ages due to control of fertility within marriage through the adoption of family planning (mainly sterilization). This has resulted in a very short time span of childbearing, especially in states with low fertility.

Fertility in India has fallen under a wide range of socio-economic and cultural conditions. The rising levels of education, influence of the media, economic changes, continuing urbanization, declines in infant and child mortality have all contributed to fertility decline. The diffusion of new ideas and enhanced aspirations for children has led even uneducated parents to limit their family size. However, fertility variation between regions is likely to persist for some time although a trend towards broad convergence in levels of fertility between the states is under way.

2.2.5 India's Population: The Future

The population reached 1027 million in 2001. The prospects for its further growth are explored using state-level projections. It is likely to be in the vicinity of 1.4 billion by 2026, and could well approach 1.6 billion by 2051, as depicted in Figure 1.1. These projections employ what some would regard as fairly 'optimistic' assumptions about the pace of future demographic progress - namely that for the country as a whole the total fertility rate will fall to around 2.1 births per woman by 2016-21, when life expectation will be approximately 67 years for males and 70 for females.

Alternative population projections, however, which also incorporate fairly plausible assumptions about future fertility, suggest that the population could reach 1.7 billion by 2051 and still be increasing. Yet other projections, which incorporate extremely optimistic assumptions about future fertility, indicate a population of at least 1.5 billion before it starts to decline. It appears that the only way 1.5 billion will not be reached is through an event such as an unexpectedly severe HIV/AIDS epidemic - or perhaps a full-scale nuclear war.

A population of about 1.4 billion in 2026 represents an addition of some 400 million over twenty-five years. Around half of this is likely to occur in the northern states of Bihar, Madhya Pradesh (MP), Rajasthan and Uttar Pradesh (UP). These states' populations will increase by 45-55 per cent during 2001-26. UP alone – including Uttaranchal - will reach some 270 million by 2026. And because they still have relatively high levels of fertility, it is the future fertility declines of these four states that will be particularly crucial in determining how much India's population will grow in the decades beyond 2026. Most other states in the country, however, already have moderate or low fertility, and their populations thus seem set to increase by only around 20-30 percent in the period to 2026 and grow only modestly thereafter.

Fertility decline will ensure that the proportion of the population below fifteen years of age will fall considerably during 2001-26. Indeed, most population growth during this period will happen at ages above fifteen years. Consequently the median age of the population will rise appreciably - from perhaps 22 years in 2001 to around 31 by 2026. The proportion of India's population aged 60 years and over is projected to rise from about 7 to 11 per cent during 2001-26. But because of the substantial fall in the proportion of the population at younger ages the overall dependency ratio of the population will decline significantly – that is, the ratio of those aged under 15 and over 59, to those aged 15-59. Not surprisingly, during 2001-26 the decline in dependency will be most pronounced in the states with relatively low levels of fertility.

2.2.6 Migration and Urbanisation

India's level of urbanisation is projected to rise from about 28 per cent in 2001 to 36 per cent by 2026 - when the total urban population could number roughly half a billion. Indeed, because there is considerable scope for reclassifying rural areas as 'urban' these figures could turn out to be underestimates. Whereas in 2001 there were thirty-five 'million plus' cities, it seems likely that there will be nearly seventy by 2026. And because the urban population is becoming increasingly concentrated, these seventy cities could contain around half of all the country's urban inhabitants. The largest urban agglomerations - Delhi and Greater Mumbai - will probably each contain thirty million people. Everywhere urban populations will grow much faster than their rural counterparts. Indeed, more than half of all India's population growth in the period to 2026 is likely to end up living in the urban sector. However, more demographically and socio-economically advanced states like Maharashtra and Tamil Nadu will experience relatively modest rises in the sizes of their rural populations, while less advanced states like UP and Bihar will experience considerable increases in the sizes of both their urban and their rural populations.

The volumes of people involved in different types of migration may increase in the coming decades, but many migration rates seem set to decline. Thus short term 'circulatory' migration rates will probably fall as such movements are increasingly replaced by the rise of commuting. Interstate migration rates may also fall - partly because the growing number of 'million plus' cities will mean that people can move to such places without having to leave their home state. Continued urbanisation will ensure that migration flows become more and more urban-oriented. UP and Bihar will remain the most important exporters of people, but it seems unlikely that major north-to-south migration flows within the country will develop soon. That said, short distance migration - which is dominated by women, and primarily for reasons of marriage - will continue to be the most frequent type of human movement.

Finally, international migration will continue to be negligible compared to the size of India's population. But the number of people leaving for North America, Europe and Australia seems certain to continue to rise in the period to 2026, as does the number of migrants entering India from Nepal and Bangladesh. International migration will probably have increasing social, economic, and political implications for India in the next few decades – not to speak of the wider world.

Activity A:

1. Compare the figures before 1950 v/s after 1950 to till 2008 on population, agriculture, fertility and health and mortality. Find out the differences in percentage term.

2.3 Social Sector and Economy

2.3.1 Education and Literacy

The recent progress in Indian education makes a welcome contrast with the past. The legacy of illiteracy and educational neglect inherited at the time of Independence led the new Indian state to resolve that it would provide free and compulsory education to all children up to age 14 by 1960. Since that time, the target date for achieving it has repeatedly been extended, and at the start of the new millennium the country is far from attaining its elusive goal. However, some encouraging signs from the 1990s could bode well for the future. Between the censuses of 1991 and 2001, the overall literacy rate of the population over age seven rose by 13 percentage points, to 65 per cent - the highest decadal rise ever. Age-specific literacy rates measured in 1993 and 1999 also show a 10 percentage point increase in literacy among 6-19 year olds, quite substantial for a six-year period. Even in the four large and educationally backward northern states of Bihar, MP, Rajasthan and UP, there was marked acceleration in the 10-14 year old literacy rate, which increased by 18 percentage points. Current school attendance also grew rapidly. For example, among rural 6-10 year old girls, it increased by fully 20 percentage points during the same six years.

The factors that are likely to have contributed to this accelerated progress are grouped into two broad categories: acceleration in the demand for schooling and improvements in the quantity and quality of the supply of schooling. The increase in demand over the 1990s is linked to the combined effects of falling poverty, fertility decline and brighter economic prospects due to greater openness to international trade and investment. These trends promise stronger demand in the economy for schooled persons and thus higher economic returns to education. Improvement in the supply of education is linked to better management via decentralisation measures, the initiation in the 1990s of centrally and externally financed education projects, the use of para-teachers to expand access, and the rapid spread of private schooling. Different parts of the country, however, have experienced very different patterns of educational provision, with varying degrees of reliance on the public and private sectors.

Population growth has made the task of educating India's children more difficult. Some states have in fact already experienced declines in their school-age numbers, while others will have growing school-age populations up to 2026. Projections are shown for the educational distribution of the population in 2026 in two illustrative cases, Bihar and Tamil Nadu. The treatment of education ends with a discussion of the problems of the near future such as low and static or falling per capita real public expenditures on education across many states; the low quality of education in terms of poor school facilities, high pupil-teacher ratios and dull curricula; the spread of private primary schooling; and hierarchies of access, that is, a tendency for poorer children, lower castes, and girls to have access only to lower quality schooling.

2.3.2 Employment

Despite rapid economic growth, the 1990s have in many ways been a disappointing decade for employment: there was a slowdown in the rate of employment generation and a corresponding increase in unemployment. The declining capacity of agriculture to absorb labour, together with absolute job losses in the public sector, has been the main culprits. Employment growth in other sectors like trade, financial services and some manufacturing activities has been unable to compensate. Persistently high unemployment among those with high job aspirations remains, although with some improvement. State-level dispersion in unemployment rates appears to have increased. There is also evidence that employment quality has deteriorated with an 'informalization' and 'casualization' of the workforce. However, research shows increasing labour productivity in the unorganized sector during the 1990s, together with an increasing growth rate of incomes. There is also evidence of an increase in the real wage earnings of casual workers.

The book's population projections indicate that the working age population will be approximately 1.5 times as large in 2026 as it was in 2001. This future growth is incorporated in employment projections. To estimate future labour force size, the growing population is combined with estimates of changes in the labour force participation rate, with particular attention to what may happen to women's participation. If women's participation increases, there will be an average annual addition of approximately 8 million people to the labour force between 2001 and 2026. And if recent trends in economic growth and the employment intensity of output continue until 2026, there will be a significant increase in unemployment. Even an annual economic growth rate of 8 per cent up to 2026 will not avoid future increases in unemployment.

These are of course only mechanical projections, not a forecast of worsening employment prospects. But they do suggest that if such prospects are to be avoided, policy must ensure that the economic climate becomes more employment friendly.

2.3.3 The Condition of the People

Poverty in India has been diminishing, though at an uncertain rate: data problems abound. The numbers in income poverty are in the region of 300 million. In today's understanding, poverty is not just a lack of income but includes deprivation in health, in education, and other aspects of well-being. The country has a very mixed record. Only two indicators have shown accelerated improvement in the last decade, fertility decline and education. However, nearly a third of the population is still illiterate. Nutrition has also improved modestly in recent years, but malnutrition is still widespread – despite slowly improving diets. It seems to be only partially a problem of income. Other aspects of health also show only modest improvements, with some worsening due to environmental factors and HIV/AIDS.

Numerous inequalities are present: most poverty is rural, and there are large discrepancies in wellbeing between different regions and social groups. The numbers in poverty are still projected to be 190 million in 2026, if the trends of the recent past continue. Again, these are mechanical projections – much can be done to improve this prospect. But the country shows divergent movement, with the better-off states making significant progress, and the worse off (and most populous) experiencing only slow improvement. Recent research suggests there is a link between high fertility and poverty, at the family level and even at the macroeconomic level. Unfortunately the states where poverty is worst and economic growth slowest are also mostly those where population growth is fastest. But continuing fertility decline should contribute to the amelioration of poverty.

2.3.4 The Economy

India's economy grew at about 6 per cent a year during the decade up to 2001 – an increase in performance over previous decades. But there are some worrying signs that raise questions about whether the speed of growth can be maintained. The economic reforms of the 1990s played a considerable part in the acceleration of economic growth, but the large agenda of reforms still to be completed is stalled, mainly for political reasons. Difficulties in the export sector, partly related to the backlog of reforms, and lack of human capital and infrastructural investment, are also likely to impede future growth.

Progress has been very mixed at the state level, with some southern and western states growing much faster than others, particularly those in the Gangetic plain. Many of the same factors explain this differential performance, with the additional problem in several states of poor economic management. A key issue is the heavy subsidies for electricity and water, which play major parts in several states' fiscal deficits. They are detrimental to public expenditure for health and education, which are the province of state governments, and they hinder environmental conservation. Resource constraints also hamper much-needed social and economic investment.

One positive factor for the future is the so-called 'demographic bonus' that results from the labour force's growing faster than the dependent population of younger people, and permits increased savings. It presents an opportunity that has to be grasped over the next thirty years, before a larger ageing population begins to reverse the early benefits of fertility decline.

2.4. Population, Food and the Environment

2.4.1 Food and Agriculture

What of the country's food prospects? Population growth and increases in food production are intimately entwined. During 1951-2001 India's population grew by 285 per cent and cereal production by 441 percent - figures which suggest that over half of cereal production growth was attributable to rising demand from population growth. The data are often patchy and inconsistent. But by 2026 the level of total cereal demand is projected to be roughly 250 million tons - of which perhaps 30 million will be needed to cover feed, seed and wastage. There should be no insurmountable problems to producing this quantity of cereals, which will require an average cereal yield over twenty-five years of just over three metric tons per hectare.

People are diversifying their patterns of food consumption, however. Taste, lifestyle, income and other changes are contributing to particularly fast demand growth for non-cereal foods - like vegetables, fruits and milk - while consumption of coarse cereals and pulses is either constant or declining. This trend towards diversification in food consumption will continue. And, especially in vegetable and fruit production, it will mean that farmers working close to major towns and in agriculturally more productive states like Punjab and Haryana, are likely to shift some of their land out of cereal cultivation. Growers everywhere are going to have to be very much more careful in their use of water. The application of chemical fertilisers per hectare will probably double by 2026. There could be a small but significant loss of agricultural land due to urban growth. But this loss will be more than outweighed by the expansion of the harvested area that will come from increased multiple cropping. Indeed by 2026 India's gross harvested area will probably significantly exceed 200 million hectares.

It is clear that current policy stances towards agriculture are unsustainable. Despite the associated political difficulties, policies will certainly have to change. For many farmers electricity, fertilisers and water are going to become increasingly expensive in the years ahead. And government food support prices for wheat and rice - which have produced mountains of wasted grain - will be reduced. Within a context of a general reduction in agricultural subsidies, policies will also have to become more targeted on the poor - whether they be farmers requiring water pumps in Bihar, those cultivating coarse grains and oilseeds in the country's semi-arid regions, or the poorest sections of society who rely upon fair price shops. Farmers will face increased international competition as trade barriers come down; the country's production of sugar, for example, is profligate with water. But export possibilities will also arise, such as in fruits, vegetables and pulses.

India's food outlook will be one of slow, modest improvement. There will probably be fewer hungry people in 2026 than in 2001, despite considerable population growth. But there may still be several hundred million people suffering from mild or moderate nutritional problems. Meat consumption will probably rise, but average levels of per capita meat consumption will remain extremely low by international standards.

These expectations are for average results over the whole country and over a long time horizon. From year to year there can be considerable fluctuations, and India's many different regions will inevitably face varying fortunes. A particular source of variation will arise from climate change, whose main feature under present knowledge may be to make the future less predictable, and possibly more volatile. In late 2002, thirteen of India's states were gripped by one of the worst droughts of recent years. Failure to address the difficult policy problems confronting agriculture, and water especially, would compromise the potential improvements analysed here.

2.4.2 Modeling the Environment

Energy use is likely to grow very considerably as both the economy and the population expands. In the recent past the use of commercial energy has been growing considerably faster than population, indicating that it is economic growth, and the pattern of growth, that has been the driving force. But population is a strong background factor adding to demand. Hitherto growing energy use has been accompanied by significant pollution, but the analysis here suggests that this trend need not continue.

Cleaner technologies already exist and are becoming steadily less expensive. Future expansion is modeled with clean technologies introduced at different stages; the earlier they are introduced, the lower the levels of pollution reached. This effect is dominant, considerably outweighing demographic growth. The key factor is the economics of introducing the beneficial technology: it is assessed here as eminently affordable. The conclusion is that India can aspire to a greatly improved environment and a higher rate of economic growth. In fact, on account of the economic benefits of environmental improvement, which are likely to exceed the costs by an appreciable margin, India's economic prospects would be improved.

Similar accounts are suggested for other sources of pollution, including industry and transport. The message is a positive one. There is no need for India to become a polluting giant. But there are caveats. The results apply mainly to large-scale production; the small-scale sector is polluting, and has not benefitted to nearly the same extent from improved technologies. And the analysis only says what is possible. Whether India in fact undertakes the appropriate investments and policies is another question. In some cases the cleaner technologies pay for themselves, so the producers should take them up. In others there are costs to the investor, while the benefits are to the wider society: then it is up to the government to regulate or give appropriate incentives by taxation and subsidy.

2.4.3 The Urban Environment

Urban environmental quality in India is set to become an increasingly important issue. Towns and cities draw heavily on natural resources such as water, forests and soils. Where not properly managed, urban areas generate waste in a manner that pollutes air and water sources, and degrades renewable resources. Many of these problems of waste, air and water pollution have increased in India beyond both the absorptive capacity of nature and the handling capacity of institutions.

Solid waste is a major problem. The expanding volume of waste comes both from rising numbers of people and increasing per capita generation of waste; but most of the country's towns and cities are not coping successfully with its growth: uncollected refuse, unmanaged disposal sites and the presence of hazardous waste are all too common, while land for disposal becomes ever scarcer. Options do exist; successful examples of good management can be found, commonly with the involvement of non-governmental organisations, and some remarkable recycling is carried out, not least by poorer households. It is possible to manage waste and in many cases to generate wealth at the same time.

Urban water and sewage present further challenges, linked to population growth. A large proportion of India's towns and cities lack sewage disposal, and water supplies are inadequate, especially for the poor, and often unsafe. All urban areas experience rising volumes of human and municipal liquid waste, commonly growing faster than treatment capacity. This presents considerable dangers to health. The threat to water-courses if nothing is done is very considerable.

Air pollution is a scourge of most urban areas. But here the main culprits are vehicle traffic, industry and thermal power production, which have all grown much faster than population. Domestic burning of low-grade fuels and vegetable matter makes a further contribution. There is considerable variety of experience across India, with some notable improvements, not least in Delhi in the recent past. Cleaner fuels and improved vehicle and manufacturing technologies can make major differences.

It is the combination of a lack of institutional capability, demographic pressures, and economic growth that explains the current state of the environment in India's cities. Future trends will depend on the way in which demographic factors change, but also very largely on the ways in which urban governance is transformed over the coming decades. India has positive experiences to show in all fields of urban environmental management; the challenge is to have these best practices far more widely spread.

2.4.4 Water

Perhaps the strongest of all population impacts is on the demand for water. There will be growing needs for residential and industrial supplies, but it is agriculture which takes most of India's water, and as long as the country tries to remain broadly self-sufficient in food, demand for water will grow with the population requiring to be fed. Yet India will not have more water available in the future than it has now – and as a result of pollution, it could well have less. Climate change could produce more rainfall, although with greater seasonal fluctuations, and uncertain impacts on the Himalayan snowmelt and glacier flow. Very large increases will be needed in the efficiency with which water is used.

A number of studies have examined the future balance between water supply and demand, and found that growing national demand can be met. Apart from uncertainties attaching to climate change, the account here takes the same view. But much depends on the manner in which demand is met. At present there is little incentive for farmers or residential consumers to conserve water. On the contrary, the mix of prices and subsidies in agriculture favours excessive water use without provision for maintenance of supplies, while better-off urban consumers have mostly free or subsidised water, and only the poor pay. At the same time, pollution is affecting the quality and quantity of useable water, and the situation is worsening rather than improving. Water is hardly a problem for the future alone: it is already apparent in water scarcity, and frequent conflicts over water use in cities and countryside alike. The challenge is considerable: to find ways of overcoming pollution, and to give the right incentives to users and consumers that will induce them to conserve water, while not hurting the poor.

Much of policy has been directed at supply management. There has been an engineering tradition of large-scale dams and water works, now giving way to increasing emphasis on smaller-scale schemes, watershed development and water harvesting. The view is taken here that large dams will still be required, but they should be regarded as instruments of last resort, and only adopted with far more attention to environmental concerns and the care and resettlement of affected populations than has been shown in the past. More attention to demand management is also needed; indeed, as water problems become more acute, life-style changes may well be required as part of any solution. Water policy is complex, and not to be seen in simple demand and supply terms. It involves laws, institutions, society and politics. But however difficult, there will have to be change. "Business as usual" is not an option for India where water is concerned.

Activity B:

1. India is known for penalty of natural resources but simultaneously facing the water crisis also. What are measures to be adopted to reserve the water. Find out the way where water may be reserved and kept for long period for purposeful mission.

2.4.5 Common Pool Resources

Fuel-wood, fodder, crop wastes, cow-dung, forest products, water – these and other common pool resources make valuable contributions to livelihoods, especially of rural populations, and most importantly in arid and semi-arid areas and the Himalayan region. They may be the principal assets of landless people. But they are subject to conflicting claims, including those from industry and commerce. One study suggests that these resources contribute on average 3 per cent of household expenditures, but there has been a quinquennial rate of decline in the land area of common pool resources of close to 2 per cent in recent times; more detailed local studies show higher rates of decline, and higher contributions to household expenditures, especially for the poor.

Population growth contributes to increasing demand on these resources; at the same time, income growth can lead to changing preferences and demand switching to other products. There are possibilities of substitution also, and supplies can regenerate as well as be depleted. An index is developed here for access and use of these resources; Bihar and UP turn out to be the worst placed states in terms of the combination of population growth and poverty relative to the availability of common pool resources.

While there has been much past emphasis on the safety-net and livelihood functions of common pool resources, the analysis here suggests a need for a wider focus, including market-based opportunities for their use, and their role in the provision of ecological services. At the same time, the main philosophy of management, stressing decentralised local governance and collective institutions and values, sits uneasily with national and global forces pointing to an expanding and individualised market economy. Need for a major effort of reconceptualisng the issues and reformulating policy is foreseen if the problems of conflicting claims are to be resolved.

2.4.6 Policies

World population, 5.5 billion in 1992, will, according to the United Nations medium projection, reach 8.04 billion in 2025 and 9.4 billion in 2050. Over the next decade, more than half the population growth will be in Africa and South Asia where land degradation potential is most severe.

UNFPA is charged with extending sustained assistance to developing countries, at their request, in dealing with their population problems. Today, UNFPA supports programmes, policies and activities in some 160 countries.

All the actions and policies recommended the integration of demographic trends and population factors into all aspects of sustainable development planning and environmental protection. Thus, in the span of not quite 20 years, three major international conferences have called for concerted action on population, the environment and development, pointing to the continuing nature of the task. The following numbered paragraphs are highlights from three programme areas comprising 65 paragraphs:

(A) “Formulating integrated national policies for environment and development, taking into account demographic trends and factors;

In this programme area, UNFPA, in collaboration with the International Institute for Applied Systems Analysis (IIASA), has undertaken a major research and policy analysis project entitled, “Population and Sustainable Development: Mauritius.” This project measured the interdependence between the size and structure of populations, their socio-economic and technological development, and their physical environment.

(B) “Developing and disseminating knowledge concerning the links between demographic trends and factors and sustainable development;

As part of its effort to ensure the integration of the population-resource balance in sectoral planning, UNFPA sponsored a guidebook on population, resources and environment in collaboration with the World Conservation Union (IUCN). This guidebook, which is available in English, French and Spanish, is used by planning officials in national planning ministries, and for awareness-creation at workshops and seminars. In 1997, a second guidebook prepared by IUCN with UNFPA's support, was published. The book, entitled "Population and Strategies for Sustainable Development", serves as a resource and a guide to assist national-level policy makers and the staff of conservation organizations in linking population and environment in strategies for sustainable development.

(C) "Implementing integrated environment and development programs at the local level, taking into account demographic trends and factors."

In Vietnam, UNFPA and the Japanese Organization for International Cooperation in Family Planning (JOICFP) implemented an integrated project on Environmental Sanitation (ES), Intestinal Parasite Control (IPC), and Maternal and Child Health and Family Planning (MCH/FP) for Family Health designed to increase the contraceptive prevalence rate while reducing the parasite infestation rate. This project strengthened the MCH/FP/ES delivery system through the integrated approach by conducting training of project personnel, developing and supplying the appropriate information, education and communication strategy and materials

Activity C:

1. "World population, 5.5 billion in 1992, will, according to the United Nations medium projection, reach 8.04 billion in 2025 and 9.4 billion in 2050."
2. What are suggestion you would like to provide to control the increasing population and your business strategy? Prepare a presentation.

2.5 Summary

Demography means the study of population and its characteristics. Demographic environment reflects the population growth rate in cities, town, urban areas, villages, age distribution of population, educational level and household patterns, regional characteristics and migration of population

To understand the demographic environment, one has to study the three parts in details, these are

A. Demography
B. Social Sector and Economy
C. Population, Food and Environment

Having grown very slowly in earlier times, India's population reached about 211 million by the first decennial census in 1871. Mortality continued to improve fairly steadily during the last three decades of the twentieth century.

Fertility has declined throughout the country, though at varying pace in rural and urban areas and in different states, with Kerala and Tamil Nadu already reaching the replacement level. India's economy grew at about 6 per cent a year during the decade up to 2001 – an increase in performance over previous decades.

During 1951-2001 India's population grew by 285 per cent and cereal production by 441 percent - figures which suggest that over half of cereal production growth was attributable to rising demand from population growth. Many of these problems of waste, air and water pollution have increased in India beyond both the absorptive capacity of nature and the handling capacity of institutions.

2.6 Self Assessment Questions

1. Why is it necessary to study the demographic environment? Explain its importance.
2. Define demography? What elements are constituted in demography?
3. India comes in developing country's category, it is visualized that till 2049, India will come in one of the developed Nation, review the answer with respect to demographic environment?
4. What are government existing policies and what new measure should be done for the development of demographic environment?
5. Write short notes in view of demographic environment:
   a. India's population: past
   b. Fertility
   c. Food and Agriculture
   d. Employment
   e. Water
   f. The urban environment
   g. India's population: future

2.7 Reference Books

- K. Aswathappa, Essentials of Business Environment, Himalya Publishng House
- Shaikh Saleem, Business Environment, Pearson education
- Indian Development Report from various leading news papers i.e. Economic Times. Business line, Business Standards etc.
- Contents taken from Economic Survey and Union budget 2010-11 AND 2009-10.
- Tapan K. Panda, Marketing management, Excel Books
- Arthur A., Thompson and A.J. Strickland, Strategic Management, Tata Mcgraw Hill

Unit - 3 Economic Environment

Structure of Unit:

3.0 Objectives

After completing this unit, you will be able to:

- Discuss the nature and importance of economic environment
- Understand the effect of economic environment on industries
- Understand the recent trends in economic policies
- Analyze the recent data of the of Indian economy
- Analyze the Government policies for economic improvements

3.1 Introduction

Nature of Economic Environment

All activities in the industry related with economic environment, beginning from raw material purchase, production, finance to marketing. Many economists are playing vital role in business units. They are building their career in the field of management and business. Trained economists analyze macro-economic factors and they forecast happening in business which may helpful n manufacturing, commerce and finance departments.

There are mostly three types of economics systems, these are capitalism, communism and mixed Different countries have their own freedom to follow these economic systems:

1. Capitalism means the citizens believe in private ownership of production and distribution facilities. USA, Japan and the UK are the nation who follows the capitalism.
2. Where state reserve all right of all the factors of production and distribution are known as

communism. Cuba, Russia, China and Chechnya are example of the communism.

3. Mixed economic system is one where major units of business are controlled and owned by the state. India, France, Holland and India are example of mixed economies.

3.2 Economic Factors

Economics factors are constituent of the economic environment of business. There are many macro and micro economic factors which influence the business decisions. Business strategies are decided on the basis of these economic factors. Such factors are

3.2.1 Growth Strategy and Economic Planning
3.2.2 Economic System
3.2.3. Industry and Services
3.2.4. Agriculture
3.2.5 Financial and Fiscal Sector
3.2.6 Natural Resources
3.2.7 Petroleum and Natural Gas
3.2.8 External Trade and Investment
3.2.9 Foreign Direct Investment in India
3.2.10 Per Capita and National Income
3.2.11 Human Resource

The above factors are explained in details as:

3.2.1. Growth Strategy and Economic Planning

Our growth strategy was based on Soviet Model. It gave central role to control and direction of economic activity. It was believed that saving rate and growth rate could be increased if India invested heavily in the capital goods and heavy industry sector at the expense of the consumer goods sector. Due to low profitability in private sector, the responsibilities had taken by the state government for those investments.

During the first plan (1951-56), the annual growth rate of Net National Product was only 3.6 per cent, which improved to 4% in the second plan (1956-61). The second five year plan was known as mobiliser for saving. The policy had been decided to control and regulate the private sector so that state government may conform the objectives of the policies.

In the third plan (1956-61), the annual average increased in National Income slumped to 2.4 per cent, which was sufficient to neutralize the growth of population.

After 1967-68, the growth rate in the nation's economy showed the sign of improvement and from that period to till now i.e. during the ninth plan (1997-2002), Net National Product (NNP) growth rate of 5.5 percent was achieved with per capita growth of 4.6 per cent. The growth strategy also meant, in the early years of planning, state government and policy makers neglect the public investment in agriculture. The ultimate aim of the policy makers were faster economic development of industry. The developing countries had more unemployment and that could match higher speed of industrial growth by supplying more and more labour to industries.

However, since the rich countries themselves grew at a very rapid clip of 2.7 percent during the period 1960-2000, few developing countries consistently managed to close the economic gap between them and the advanced nations. The countries of East and Southeast Asia constitute the sole exception. Excluding China, this region experienced per-capita GDP growth of 4.4 percent over 1960-2000. Despite the Asian financial crisis of 1997-98 countries such as South Korea, Thailand and Malaysia ended the century with productivity levels that stood significantly closer to those enjoyed in the advanced countries.

Table below here is showing the annual average growth rate in various plans:

Plans	At 1980-81 Prices NNP at Factor Cost (Growth Rate)	Prices per capita NNP (Growth Rate)
First Plan (1951-56)	3.6	1.8
Second Plan (1956-61)	4.0	2.0
Third Plan (1961-66)	2.4	0.2
Fourth Plan (1969-74)	3.3	1.0
Fifth Plan (1974-79)	5.0	2.7
Sixth Plan (1980-85)	5.4	3.2
Seventh Plan (1985-90)	5.9	3.6
Eighth plan (1992-97)	6.8	4.9
Ninth Plan (1997-2002)	5.5	3.6

Elsewhere, the pattern of economic performance has varied greatly across different time periods. China has been a major success story since the late 1970s, experiencing a stupendous growth rate of 8.0 percent (as compared to 2.0 percent in 1960-80). Less spectacularly, India has roughly doubled its growth rate since the early 1980s, pulling South Asia's growth rate up to 3.3 percent in 1980-2000 from 1.2 percent in 1960-1980. The experience in other parts of the world was the mirror image of these Asian growth take-offs. Latin America and Sub-Saharan Africa both experienced robust economic growth prior to the late 1970s and early 1980s—2.9 percent and 2.3 percent respectively—but then lost ground subsequently in dramatic fashion.

The aggregate picture hides tremendous variety in growth performance, both geographically and temporally. We have high growth countries and low growth countries; countries that have grown rapidly throughout, and countries that have experienced growth spurts for a decade or two; countries that took off around 1980 and countries whose growth collapsed around 1980.

Activity A:

1. What do we learn about growth strategies from the above study material. Make small points and compare? Learn, how to make strategic decision.

3.2.2 Economic System

The economy of India is the eleventh largest economy in the world by nominal GDP and the fourth largest by purchasing power parity (PPP). In the 1990s, following economic reform from the socialist-inspired economy of post-independence India, the country began to experience rapid economic growth, as markets opened for international competition and investment. In the 21st century, India is an emerging economic power with vast human and natural resources, and a huge knowledge base. Economists predict that by 2020, India will be among the leading economies of the world.

History

India's economic history can be broadly divided into three eras, beginning with the pre-colonial period lasting up to the 18th century. The advent of British colonization started the colonial period in the early 19th century, which ended with independence in 1947. The third period stretches from independence in 1947 until now.

Economy of The Republic of India	
Currency	1 Indian Rupee (INR) (?) = 100 Paise
Fiscal year	1 April — 31 March
Trade organizations	WTO, SAFTA, G-20 and others
Statistics	
GDP	$1.367 trillion (2010) (nominal; 11th) $3.862 trillion (2010) (PPP; 4th)
GDP growth	6.7% (2008/2009)
GDP per capita	$1,124 (2010) (nominal; 139th) $3,176 (2010) (PPP; 128th)
GDP by sector	agriculture (17.5%), industry (20%), services (62.6%) (2009 est.)
Inflation (CPI)	9.9% (Mar. 2010) Food inflation (17.7%) (Mar. 2010)
Population below poverty line	37.2% (2010) 410 million (2010)
Gini index	36.8 (List of countries)
Labour force	467 million (2009 est.) (2nd)
Labour force by occupation	agriculture (52%), industry (14%), services (34%) (2003)
Unemployment	9.5% (2009 est.)
Main industries	telecommunications, textiles, chemicals, food processing, steel, transportation equipment, cement, mining, petroleum, machinery, information technology
External	
Exports	$155 billion f.o.b (2009 est.)
Export goods	software, petroleum products, textile goods, gems and jewelry, engineering goods, chemicals, leather manufactures
Main export partners	US 12.3%, UAE 9.4%, China 9.3% (2008)
Imports	$232.3 billion f.o.b (2009 est.)
Import goods	crude oil, machinery, gems, fertilizer, chemicals
Main import partners	China 11.1%, Saudi Arabia 7.5%, US 6.6%, UAE 5.1%, Iran 4.2%, Singapore 4.2%, Germany 4.2% (2008)
FDI stock	$156.30 billion (31 December 2009 est.)
Gross external debt	$232.5 billion (31 December 2009 est.)
Public finances	
Public debt	$163.8 billion (2009) 60.1% of GDP
Revenues	$153.5 billion (2008 est.)
Expenses	$223 billion (2009 est.)

(Main data source: CIA World Fact Book, *All values, unless otherwise stated, are in US dollars.*

Pre-colonial

The citizens of the Indus Valley civilization, a permanent settlement that flourished between 2800 BC and 1800 BC, practiced agriculture, domesticated animals, used uniform weights and measures, made tools and weapons, and traded with other cities. Evidence of well planned streets, a drainage system and water supply reveals their knowledge of urban planning, which included the world's first urban sanitation systems and the existence of a form of municipal government.

Religion, especially Hinduism, and the caste and the joint family systems, played an influential role in shaping economic activities. The caste system functioned much like medieval European guilds, ensuring the division of labour, providing for the training of apprentices and, in some cases, allowing manufacturers to achieve narrow specialization. For instance, in certain regions, producing each variety of cloth was the specialty of a particular sub-caste.

Colonial

Company rule in India brought a major change in the taxation environment from revenue taxes to property taxes, resulting in mass impoverishment and destitution of majority of farmers and led to numerous famines. The economic policies of the British Raj effectively bankrupted India's large handicrafts industry and caused a massive drain of India's resources. Indian Nationalists employed the successful Swadeshi movement, as strategy to diminish British economic superiority by boycotting British products and the reviving the market for domestic-made products and production techniques. India had become a strong market for superior finished European goods. This was because of vast gains made by the Industrial revolution in Europe, the effects of which was deprived to Colonial India.

The Nationalists had hoped to revive the domestic industries that were badly affected by polices implemented by British Raj which had made them uncompetitive to British made goods.

Independence to 1991

Compare India (orange) with South Korea (yellow). Both started from about the same income level in 1950. The graph shows GDP per capita of South Asian economies and South Korea as a percent of the American GDP per capita.

Indian economic policy after independence was influenced by the colonial experience (which was seen by Indian leaders as exploitative in nature) and by those leaders' exposure to Fabian socialism. Policy tended towards protectionism, with a strong emphasis on import substitution, industrialization, state intervention in labor and financial markets, a large public sector, business regulation, and central planning. Five-Year Plans of India resembled central planning in the Soviet Union. Steel, mining, machine tools, water, telecommunications, insurance, and electrical plants, among other industries, were effectively nationalized in the mid-1950s.

Since 1991

In the late 80s, the government led by Rajiv Gandhi eased restrictions on capacity expansion for incumbents, removed price controls and reduced corporate taxes. While this increased the rate of growth, it also led to high fiscal deficits and a worsening current account. The collapse of the Soviet Union, which was India's major trading partner, and the first Gulf War, which caused a spike in oil prices, caused a major balance-of-payments crisis for India, which found itself facing the prospect of defaulting on its loans. India asked for a \$1.8 billion bailout loan from IMF, which in return demanded reforms.

In response, Prime Minister Narasimha Rao along with his finance minister Dr. Manmohan Singh initiated the economic liberalisation of 1991. Since 1990 India has emerged as one of the fastest-growing economies in the world; during this period, the economy has grown constantly, but with a few major setbacks. This has been accompanied by increases in life expectancy, literacy rates and food security.

While the credit rating of India was hit by its nuclear tests in 1998, it has been raised to investment level in 2007 by S&P and Moody's. In 2003, Goldman Sachs predicted that India's GDP in current prices will overtake France and Italy by 2020, Germany, UK and Russia by 2025 and Japan by 2035. By 2035, it was projected to be the third largest economy of the world, behind US and China. India is often seen by economist as a rising economic superpower and is believed to play a major role in the global economy in the 21st century. In 2009 India purchased 200 Tons of Gold for $6.7 billion from IMF as a total role reversal from 1991.

3.2.3 Industry and Services

India has Asia's largest outsourcing industry and is the world's second most favorable outsourcing destination after the United States. India has one of the world's fastest growing automobile industries.

Industry accounts for 54.6% of the GDP and employ 17% of the total workforce. However, about one-third of the industrial labour force is engaged in simple household manufacturing only. In absolute terms, India is 16th in the world in terms of nominal factory output. India's small industry makes up 5% of carbon dioxide emissions in the world.

Economic reforms brought foreign competition, led to privatization of certain public sector industries, opened up sectors hitherto reserved for the public sector and led to an expansion in the production of fast-moving consumer goods. Post-liberalization, the Indian private sector, which was usually run by oligopolies of old family firms and required political connections to prosper was faced with foreign competition, including the threat of cheaper Chinese imports. It has since handled the change by squeezing costs, revamping management, focusing on designing new products and relying on low labour costs and technology.

Textile manufacturing is the second largest source for employment after agriculture and accounts for 26% of manufacturing output. Tirupur has gained universal recognition as the leading source of hosiery, knitted garments, casual wear and sportswear. Dharavi slum in Mumbai has gained fame for leather products. Tata Motors' Nano attempts to be the world's cheapest car.

India is fifteenth in services output. It provides employment to 23% of work force, and it is growing fast, growth rate 7.5% in 1991–2000 up from 4.5% in 1951–80. It has the largest share in the GDP, accounting for 55% in 2007 up from 15% in 1950.

Business services (information technology, information technology enabled services, business process outsourcing) are among the fastest growing sectors contributing to one third of the total output of services in 2000. The growth in the IT sector is attributed to increased specialization, and an availability of a large pool of low cost, but highly skilled, educated and fluent English-speaking workers, on the supply side, matched on the demand side by an increased demand from foreign consumers interested in India's service exports, or those looking to outsource their operations. The share of India's IT industry to the country's GDP increased from 4.8 % in 2005-06 to 7% in 2008. In 2009, seven Indian firms were listed among the top 15 technology outsourcing companies in the world. In March 2009, annual revenues from outsourcing operations in India amounted to US$ 60 billion and this is expected to increase to US$225 billion by 2020.

Organized retail such supermarkets accounts for 24% of the market as of 2008. There are taxes for moving goods to states, from states, and even within states.

Tourism in India is relatively undeveloped, but growing at double digits. Some hospitals encourage medical tourism.

3.2.4 Agriculture

India ranks second worldwide in farm output. Agriculture and allied sectors like forestry, logging and fishing accounted for 16.6% of the GDP in 2007, employed 60% of the total workforce and despite a steady decline of its share in the GDP, is still the largest economic sector and plays a significant role in the overall socio-economic development of India. Yields per unit area of all crops have grown since 1950, due to the special emphasis placed on agriculture in the five-year plans and steady improvements in irrigation, technology, application of modern agricultural practices and provision of agricultural credit and subsidies since Green revolution in India. However, international comparisons reveal the average yield in India is generally 30% to 50% of the highest average yield in the world.

India is the largest producer in the world of milk, cashew nuts, coconuts, tea, ginger, turmeric and black pepper. It also has the world's largest cattle population: 193 million. It is the second largest producer of wheat, rice, sugar, cotton, silk, peanuts and inland fish. It is the third largest producer of tobacco. India is the largest fruit producer, accounting for 10% of the world fruit production. It is the leading producer of bananas and mangoes.

India is the second largest producer and the largest consumer of silk in the world, with the majority of the 77 million kg (2005) production taking place in Karnataka State, particularly in Mysore and the North Bangalore regions of Muddenahalli, Kanivenarayanapura, and Doddaballapura, the upcoming sites of a INR 700 million "Silk City".

3.2.5 Financial and Fiscal Sector

The Indian money market is classified into: the organised sector (comprising private, public and foreign owned commercial banks and cooperative banks, together known as *scheduled banks*); and the unorganised sector (comprising individual or family owned indigenous bankers or money lenders and non-banking financial companies (NBFCs)).

Prime Minister Indira Gandhi nationalised 14 banks in 1969, followed by six others in 1980, and made it mandatory for banks to provide 40% of their net credit to priority sectors like agriculture, small-scale industry, retail trade, small businesses, etc. to ensure that the banks fulfill their social and developmental goals. Since then, the number of bank branches has increased from 10,120 in 1969 to 98,910 in 2003 and the population covered by a branch decreased from 63,800 to 15,000 during the same period. The total deposits increased 32.6 times between 1971 to 1991 compared to 7 times between 1951 to 1971. Despite an increase of rural branches, from 1,860 or 22% of the total number of branches in 1969 to 32,270 or 48%, only 32,270 out of 5 lakh (500,000) villages are covered by a scheduled bank.

More than half of personal savings are invested in physical assets such as land, houses, cattle, and gold.

3.2.6 Natural Resources

India has the world's fifth largest wind power industry, with an installed wind power capacity of 9,587 MW. India's total cultivable area is 1,269,219 km² (56.78% of total land area), which is decreasing due to constant pressure from an ever growing population and increased urbanisation. India has a total water surface area of 314,400 km² and receives an average annual rainfall of 1,100 mm. Irrigation accounts for 92% of the water utilisation, and comprised 380 km² in 1974, and is expected to rise to 1,050 km² by 2025, with the balance accounted for by industrial and domestic consumers. India's inland water resources comprising rivers, canals, ponds and lakes and marine resources comprising the east and west coasts of the Indian ocean and other gulfs and bays provide employment to nearly 6 million people in the fisheries sector. In 2008, India had the world's third largest fishing industry.

India's major mineral resources include coal, iron, manganese, mica, bauxite, titanium, chromite, limestone and thorium. India meets most of its domestic energy demand through its 92 billion tonnes of coal reserves (about 10% of world's coal reserves).

India's huge thorium reserves — about 25% of world's reserves — is expected to fuel the country's ambitious nuclear energy program in the long-run. India's dwindling uranium reserves stagnated the growth of nuclear energy in the country for many years.

3.2.7 Petroleum and Natural Gas

India's oil reserves, found in Bombay High, parts of Gujarat, Rajasthan and eastern Assam, meet 25% of the country's domestic oil demand. India's total proven oil reserves stand at 11 billion barrels, of which Bombay High is believed to hold 6.1 billion barrels and Mangala Area in Rajasthan an additional 3.6 Billion Barrels.

In 2009, India imported 2.56 million barrels of oil per day, making it one of largest buyers of crude oil in the world. The petroleum industry in India mostly consists of public sector companies such as Oil and Natural Gas Corporation (ONGC), Hindustan Petroleum Corporation Limited (HPCL) and Indian Petrochemicals Corporation Limited (IPCL). There are some major private Indian companies in oil sector such as Reliance Industries Limited (RIL) which operates the world's largest oil refining complex.

3.2.8 External Trade and Investment

In March 2008, India's annual imports and exports stood at US$236 and US$155.5 billion respectively. India's economy is mostly dependent on its large internal market with external trade accounting for just 20% of the country's GDP. In 2008, India accounted for 1.45% of global merchandise trade and 2.8% of global commercial services export. Until the liberalization of 1991, India was largely and intentionally isolated from the world markets, to protect its economy and to achieve self-reliance. Foreign trade was subject to import tariffs, export taxes and quantitative restrictions, while foreign direct investment (FDI) was restricted by upper-limit equity participation, restrictions on technology transfer, export obligations and government approvals; these approvals were needed for nearly 60% of new FDI in the industrial sector. The restrictions ensured that FDI averaged only around US$ 200 million annually between 1985 and 1991; a large percentage of the capital flows consisted of foreign aid, commercial borrowing and deposits of non-resident Indians.

India is a founding-member of General Agreement on Tariffs and Trade (GATT) since 1947 and its successor, the WTO. While participating actively in its general council meetings, India has been crucial in voicing the concerns of the developing world.

3.2.9 Foreign Direct Investment in India

As the fourth-largest economy in the world in PPP terms, India is a preferred destination for foreign direct investments (FDI); India has strengths in telecommunication, information technology and other significant areas such as auto components, chemicals, apparels, pharmaceuticals, and jewellery. Despite a surge in foreign investments, rigid FDI policies resulted in a significant hindrance.

Share of top five investing countries in FDI inflows. (2000–2007

Rank	Country	Inflows (Million USD)	Inflows (%)
1	Mauritius	85,178	44.24%
2	United States	18,040	9.37%
3	United Kingdom	15,363	7.98%
4	Netherlands	11,177	5.81%
5	Singapore	9,742	5.06%

India's recently liberalized FDI policy (2005) allows up to a 100% FDI stake in ventures. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment FDI. The upward moving growth curve of the real-estate sector owes some credit to a booming economy and liberalized FDI regime. In March 2005, the government amended the rules to allow 100 per cent FDI in the construction business. This automatic route has been permitted in townships, housing, built-up infrastructure and construction development projects including housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, and city- and regional-level infrastructure.

3.2.10 Per Capita and National Income

Percentage of population living under the poverty line of $1 (PPP) a day, currently 356.35 rupees a month in rural areas (around $7.4 a month).

As of 2005:

- 85.7% of the population lives on less than $2.50 (PPP) a day, down from 92.5% in 1981. This is much higher than the 80.5% in Sub-Saharan Africa.
- 75.6% of the population lives on less than $2 a day (PPP), which is around 20 rupees or $0.5 a day in nominal terms. It was down from 86.6%, but is still even more than the 73.0% in Sub-Saharan Africa.
- 24.3% of the population earned less than $1 (PPP, around $0.25 in nominal terms) a day in 2005, down from 42.1% in 1981.
- 41.6% of its population is living below the new international poverty line of $1.25 (PPP) per day, down from 59.8% in 1981. The World Bank further estimates that a third of the global poor now reside in India.

Today, more people can afford a bicycle than ever before. Some 40% of Indian households owns a bicycle, with ownership rates ranging from around 30% to 70% at state level. Housing is modest. According to Times of India, "a majority of Indians have per capita space equivalent to or less than a 10 feet x 10 feet room for their living, sleeping, cooking, washing and toilet needs." and "one in every three urban Indians lives in homes too cramped to exceed even the minimum requirements of a prison cell in the US." The average is 103 sq ft (9.6 m^2) per person in rural areas and 117 sq ft (10.9 m^2) per person in urban areas.

3.2.11 Human Resource

Agricultural and allied sectors accounted for about 60% of the total workforce in 2003 same as in 1993–94. While agriculture has faced stagnation in growth, services have seen a steady growth. of the total workforce, 8% is in the organised sector, two-thirds of which are in the public sector. The NSSO survey estimated that in 1999–2000, 106 million, nearly 10% of the population were unemployed and the overall unemployment rate was 7.3%, with rural areas doing marginally better (7.2%) than urban areas (7.7%). India's labor force is growing by 2.5% annually, but employment only at 2.3% a year.

Official unemployment exceeds 9%. Regulation and other obstacles have discouraged the emergence of formal businesses and jobs. Almost 30% of workers are casual workers who work only when they are able to get jobs and remain unpaid for the rest of the time. Only 10% of the workforce is in regular employment. India's labor regulations are heavy even by developing country standards and analysts have urged the government to abolish them.

Unemployment in India is characterized by chronic or disguised unemployment. Government schemes that target eradication of both poverty and unemployment (which in recent decades has sent millions of poor and unskilled people into urban areas in search of livelihoods) attempt to solve the problem, by providing financial assistance for setting up businesses, skill honing, setting up public sector enterprises, reservations in governments, etc. The decreased role of the public sector after liberalization has further underlined the need for focusing on better education and has also put political pressure on further reforms.

Activity B:

1. Out of following points mentioned below here, to whom you blame for increase in unemployment and poverty in India and why?
   1. Government policies
   2. Illiteracy
   3. Indian Customs and Culture
   4. Cast

3.3 Economic Trends

In the revised 2007 figures, based on increased and sustaining growth, more inflows into foreign direct investment, Goldman Sachs predicts that "from 2007 to 2020, India's GDP per capita in US$ terms will quadruple", and that the Indian economy will surpass the United States (in US$) by 2043. In spite of the high growth rate, the report stated that India would continue to remain a low-income country for decades to come but could be a "motor for the world economy" if it fulfills its growth potential. Goldman Sachs has outlined 10 things that it needs to do in order to achieve its potential and grow 40 times by 2050. These are

1. Improve Governance
2. Raise Educational Achievement
3. Increase Quality and Quantity of Universities
4. Control Inflation
5. Introduce a Credible Fiscal Policy
6. Liberalize Financial Markets
7. Increase Trade with Neighbours

8. Increase Agricultural Productivity
9. Improve Infrastructure and
10. Improve Environmental Quality.

3.4 Issues

Agriculture in India

The low productivity in India is a result of the following factors:

- According to "India: Priorities for Agriculture and Rural Development" by World Bank, India's large agricultural subsidies are hampering productivity-enhancing investment. Overregulation of agriculture has increased costs, price risks and uncertainty. Government interventions in labor, land, and credit markets are hurting the market. Infrastructure and services are inadequate.
- Illiteracy, slow progress in implementing land reforms and inadequate or inefficient finance and marketing services for farm produce.
- The average size of land holdings is very small (less than 20,000 m^2) and is subject to fragmentation, due to land ceiling acts and in some cases, family disputes. Such small holdings are often over-manned, resulting in disguised unemployment and low productivity of labour.
- Adoption of modern agricultural practices and use of technology is inadequate, hampered by ignorance of such practices, high costs and impracticality in the case of small land holdings.
- World Bank says that the allocation of water is inefficient, unsustainable and inequitable. The irrigation infrastructure is deteriorating. Irrigation facilities are inadequate, as revealed by the fact that only 52.6% of the land was irrigated in 2003–04, which result in farmers still being dependent on rainfall, specifically the Monsoon season. A good monsoon results in a robust growth for the economy as a whole, while a poor monsoon leads to a sluggish growth. Farm credit is regulated by NABARD, which is the statutory apex agent for rural development in the subcontinent.

India has many farm insurance companies that insure wheat, fruit, rice and rubber farmers in the event of natural disasters or catastrophic crop failure, under the supervision of the Ministry of Agriculture.

India's population is growing faster than its ability to produce rice and wheat. The most important structural reform for self-sufficiency is the ITC Limited plan to connect 20,000 villages to the Internet by 2013. This will provide farmers with up to date crop prices for the first time, which should minimise losses incurred from neighbouring producers selling early and in turn facilitate investment in rural areas.

Corruption in India

The Right to Information Act (2005) and equivalent acts in the Indian states, that require government officials to furnish information requested by citizens or face punitive action, computerisation of services and various central and state government acts that established vigilance commissions have considerably reduced corruption or at least have opened up avenues to redress grievances. The 2009 report by Transparency International ranks India at 84^{th} place and states that significant improvements were made by India in reducing corruption.

Government of India

The current government has concluded that most spending fails to reach its intended recipients.

Lant Pritchett calls India's public sector "one of the world's top ten biggest problems — of the order of AIDS and climate change". The Economist's 2008 article about the Indian civil service stated that the Indian central government employs around 3 million people, including "vast armies of paper-shuffling peons".

Education in India

India has made huge progress in terms of increasing primary education attendance rate and expanding literacy to approximately two thirds of the population. The right to education at elementary level has been made one of the fundamental rights under the Eighty-Sixth Amendment of 2002. However, the literacy rate of 65% is still lower than the worldwide average and the country suffers from a high dropout rate.

Infrastructure

Development of infrastructure was completely in the hands of the public sector and was plagued by corruption, bureaucratic inefficiencies, urban-bias and an inability to scale investment. India's low spending on power, construction, transportation, telecommunications and real estate, at $31 billion or 6% of GDP in 2002 had prevented India from sustaining higher growth rates. This has prompted the government to partially open up infrastructure to the private sector allowing foreign investment which has helped in a sustained growth rate of close to 9% for the past six quarters. Some 600 million Indians have no mains electricity at all. While 80% of Indian villages have at least an electricity line, just 44% of rural households have access to electricity. According to a sample of 97,882 households in 2002, electricity was the main source of lighting for 53% of rural households compared to 36% in 1993. Some half of the electricity is stolen, compared with 3% in China. The stolen electricity amounts to 1.5% of GDP. Almost all of the electricity in India is produced by the public sector. Power outages are common. Many buy their own power generators to ensure electricity supply. As of 2005 the electricity production was at 661.6 billion kWh with oil production standing at 785,000 bbl/day. In 2007, electricity demand exceeded supply by 15%. Multi Commodity Exchange has tried to get a permit to offer electricity future markets.

Indian Road Network is developing. Trucking goods from Gurgaon to the port in Mumbai can take up to 10 days. India has the world's third largest road network. Container traffic is growing at 15% a year. Some 60% of India's container traffic is handled by the Jawaharlal Nehru Port Trust in Navi Mumbai. Internet use is rare; there were only 7.57 million broadband lines in India in November 2009, however it is still growing at slower rate and is expected to boom after the launch of 3G and wimax services.

Indian Labour laws

India's labor regulations — among the most restrictive and complex in the world — have constrained the growth of the formal manufacturing sector where these laws have their widest application. Better designed labor regulations can attract more labor- intensive investment and create jobs for India's unemployed millions and those trapped in poor quality jobs. Given the country's momentum of growth, the window of opportunity must not be lost for improving the job prospects for the 80 million new entrants who are expected to join the work force over the next decade.

Economic Disparities in India and Poverty in India

Lagging states need to bring more jobs to their people by creating an attractive investment destination. Reforming cumbersome regulatory procedures, improving rural connectivity, establishing law and order, creating a stable platform for natural resource investment that balances business interests with social concerns, and providing rural finance are important.

One of the critical problems facing India's economy is the sharp and growing regional variations among India's different states and territories in terms of per capita income, poverty, availability of infrastructure and socio-economic development. Six low-income states - Chhattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan, and Uttar Pradesh - are home to more than half of India's population.

The five-year plans have attempted to reduce regional disparities by encouraging industrial development in the interior regions, but industries still tend to concentrate around urban areas and port cities. After liberalization, the more advanced states are better placed to benefit from them, with infrastructure like well developed ports, urbanisation and an educated and skilled workforce which attract manufacturing and service sectors. The union and state governments of backward regions are trying to reduce the disparities by offering tax holidays, cheap land, etc., and focusing more on sectors like tourism, which although being geographically and historically determined, can become a source of growth and is faster to develop than other sectors.

On Yale and Columbia's Environmental Performance Index, India's score is 21/100 on sanitation, compared with 67/100 for the region and 48/100 for the country income group.

Activity C:

1. Read the economic issues mentioned above and prepare a essay on each points on your language

3.5 Summary

Economic factors constituent of the economic environment of business. India growth strategy was based Soviet Model. It is based on five years plan growth strategy.

India's currency is Indian Rupees (INR) and GDP US $ 1.367 trillion (nominal: 11th Plan) and GDP growth is 6.7%. India's has 37.2% i.e. 410 (year 2010) million people who are living below poverty line. Unemployment rate is 9.5% (2009 est.).

India normally export software, petroleum products, textile goods, gems and jewellery. Engineering goods, chemical, leather manufactures to different countries of the world. This constituent US $ 155 billion (2009 est.)

India imports crude oil, machinery, gems fertilizer, chemicals etc, and outward remitted US $ 232.3 billion f.o.b(2009 est.).

Industry accounts for 54.6 % of the GDP and employ 17% of the total workforce. India is the second largest producer of the rice in the world after China.

Percentage of population living under the poverty line of $ 1 (PPP) a day, currently 356.35 rupees a month in rural areas (around US $ 7.4 a month)

3.6 Self Assessment Questions

1. What do you mean by economic environment? Explain its importance.
2. Business strategies are decided on the basis of economic factors, explain these economic factors.

3. India's economy can be broadly divided into three eras, explain the history of economic development.

4. Bring out the salient features of the economic systems.

5. What will be the likely growth of the economy? Explain

6. What reforms are needed at the agricultural front?

7. What can we do to accelerate industrial growth/

8. What are the shares of top five investing countries n FDI inflows (2000-2007).

3.7 Reference Books

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- www.rbi.otg.in
- K. Aswathappa, Essentials of Business Enviroment, Himalya Publishng House
- Shaikh Saleem, Business Environment, Pearson education
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- Contents taken from Economic Survey and Union budget 2010-11 AND 2009-10.
- Tapan K. Panda, Marketing management, Excel Books

Unit - 4 Political and Legal Environment

Structure of Unit:

4.0 Objectives

After Completing this unit, you will be able to:-

- To discuss the various forms of political environment.
- It explicate the different types of legal frame work
- To elucidate the risk in international business.
- Explain the methods of measuring & managing risk.
- Explain the significance of the political & legal environment in international business.

4.1 Introduction

There are various environmental forces which influences international business. The types of these forces vary from political, legal & cultural. There are various types of risk also which are associated with the firms doing international business. When the various forms of political system prevail in the world it is difficult for the firms to deal with it in the different legal system prevailing across the global and resolve the international disputes.

The various players in international business have diverse and sometimes conflicting business interest that considerably influence their political agenda and constraints, for example:- foreign multinationals use diplomatic channels to get a favourable climate for foreign investments, whereas domestic firms often build up political pressures to oppose foreign investment to put off competition foreign firms. The environment of international business is regarded as the sum total of all the external forces working upon the firm as it goes about its affairs in foreign & domestic markets.

The environment can be classified in terms of domestic, foreign and international sphere of impact. The domestic environment is familiar to managers and consists of those uncontrollable external forces that affect the firm in its home market.

However some of these forces (eg. the cost of capital & export restrictions) can also have a significant effect on global operations of a firm. The foreign environment can be taken as those factors which operate in those other countries within which the MNC operates. Generally the factors are the same, but they can have widely different impacts from the home country situation. For this purpose of study, the international environment is concerned as the interaction between domestic and foreign factors and indeed they cover a wide spectrum of forces.

4.2 The Forces of Environment

For the sake of clarify we divided the environmental factors into:
(1) Political (2) Legal (3) Technological (4) Cultural groups.

In this chapter only political & legal environment is discussed.

4.3 Political Environment

The political environment includes the characteristics and policies of the political parties, the nature of constitution and government system and the government environment encompassing the economic and business policies and regulations are among the factors of utmost importance in the market selection and business strategy formulation. These factors may vary considerably between different nations. Important economic policies use indeed often political decisions. They include.

- Industrial Policy
- Policy towards Foreign Capital & Technology
- Fiscal Policy
- Foreign Trade Policy

A political system that is stable, honest, efficient and dynamic which ensures political participation to the people and answers personal security to the citizens is a primary factor for economic development. The political environment of the country of operation becomes increasingly important for an internationalizing firm as it moves from exports to foreign, direct investment (FDI) as the mode of international Market entity.

Example I:- Due to economic liberalization in the China, Multi level marketing firms such as Amway, Avon, Tupperware etc. grew rapidly.

Amway had approximately 80,000 sales representatives who generated $ 178 million in sales, whereas Avon had really 50,000 representatives who generate sales of $ 75 million. It was reported that some other companies using the so called pyramid schemes were cheaping consumers. Consequently the Chinese government banned direct selling in April 1998.

As a result the direct marketing companies were prohibited to operate their business model in China. It was only after diplomatic pressures & negotiations between the US $ Chinese governments that policy was reversed.

4.4 Economic Systems

1) **Communism:-** Communist philosophy is non market & weak economies and the government had an active role in economic planning. These countries had rigid bureaucratic & political economic system which is indulged in huge foreign debts. eg.-China, Russia, North Korea etc. These are also known as centrally planned economies.

2) **Socialism:-** In this type of economic system, basic and heavy industries are operated by the government, whereas small businesses may be privately owned. The extent of government control under socialism is lower than communism. eg:- Sweden, France, Poland etc.

3) **Capitalism:-** In this economic system in which there is a complete freedom of private ownership of productive resources & Industries. eg :- USA

4) **Mixed:-** In this system both public & private ownership of industries are there. Only strategic important industries are part of public (govt.) ownership. Others are left to private ownership. eg:- India

4.5 Political Systems

1) **Democracy:-** It refers to a political arrangement, in which supreme power is vested in the people. Democracies maintain stable business environments primarily through laws protecting individual property rights.

   In theory, business prospers when the private sector enjoys freedom to decide, freedom to earn and freedom to spend. But in practice this all does not guarantee economic growth.

   eg:- Indian is the largest democratic country in the world yet experience slow economic growth.

2) **Totalitarianism:-** It is also called authoritarian Individual freedom is completely subordinate to the power of authority of state and concentrated in the hands of one person or in a small group which is not constituently accruable to the people. The doctrines of fascism and erstwhile communism are examples of totalitarianism.

   eg:- China which is ruled by authoritarian regime is the fastest growing economy, recently.

4.6 Types of Totalitarianism

(1) **Theocratic:-** When country's religious leaders are also its political leaders. Its political system is a theocracy. eg:- Afghanistan.

(2) **Secular:-** A political system in which political leaders are guided by military and bureaucratic power is called secular totalitarianism. eg:- South Korea, Taiwan etc.

(3) **Tribal:-** When a political party that represents the interest of a particular tribe monopolises power. eg:- Zimbabwe, Kenya

(4) **Right Wing:-** Private ownership of property is endorsed by government, Market forces are also allowed free play, but political freedoms are rarely granted. eg:- Brazil, Chile in the 1980s.

Activity A:

1. Select any 20 countries of the world and identity their economic & political system. Countries must be picked from all the continents of the world.

4.7 Types of Government Structure

1) Parliamentary:- The government consult its citizens from time to time and the parliament has power to formulate & execute laws, Major forms of government are:-

(a) Parliamentary Republics:- In this, the prime Minster is the executive head of the government and also the leader of legislature. The president is more of a it titular head of the state with little executive power. eg:- India, Germany, Italy etc.

(b) Semi Presidential System:- Under this system a president and a prime minister co-exists. The president has genuine executive authority, unlike in a parliamentary republic. But the prime Minster is the head of the legislature and also head of the government. eg:- France, Pakistan etc.

(c) Fully Presidential System:- The president is the both head of state and head of the government is fully presidential system. There is no prime minister. eg:- US, Brazil, Mexico etc.

2) Common Weal Countries:-

These countries represent constitutional monarcies that recognize the British Monarch as head of the state over on independent government. A Governor- general is majorly appointed by the monarch of the country. Active head of the government is always the Prime Minister. eg:- UK, Australia, Canada etc.

3) Monarchies:-

a) Constitutional Monarchies:- A form of government in which a king or queen acts as a head of states, while the ability to make & pass legislation resides with an elected Parliament. Under such form of government, the monarch governs according to the constitution. eg:- Japan, Spain, Denmark etc.

b) Absolute Monarchies:- It includes countries that have monarchs as the executive heads of the government, exercising all powers, such as in UAE, Oman, Bhutan etc.

4) Theocracy:- Derived from Latin word theocratic which means the rule of God. The civil leader is blinded to have a direct personal connection with God in a pure theocracy. eg:- Religious leadership in Iran.

Activity B:

2 Compare the government structure of

(a) Indian $ US. ____________________

(b) UK $ Australia ____________________

(c) Japan $ Bhutan ____________________

4.8 Trade Embargos and Sanctions

Trade Embargos:- They are often used as hostile political measures rather than being based on economic considerations. They prohibit trade completely with a country so as to economically isolate it and exert political pressure on the Government. eg:- The UN imposed a trade embargo on Iraq, following invasion on Kuwait in the 1990's.

Trade Sanctions:- They are used to impose selective coercive measures to restrict trade with a country. eg:- The sanctions under the nuclear proliferation Act failed to deter India & Pakistan from testing Nuclear Weapons in May 1994, US impose trade sanction of these countries.

4.9 Bureaucracy

Bureaucracy refers to the form of administration based on hierarchical structure, government by a set of written rules and established procedures. The Indian bureaucracy has become apt at the art of shunning any direct responsibility in decision making leading to avoidable delays. An international firm often finds it difficult to deal with a foreign bureaucratic system.

4.10 Risk in International Business

(1) **Political Risk:-** Corporate face political risk when they conduct business with the outside world. If we see the possibility of political decisions, events, and conditions in an overseas market or country that adversely affect international business is termed as political risk.

Types of Political Risk

(a) **Macro Political Risk:-** This types of risk affects all international business in the same way, eg:- A farm or a factory, by government with little or no compensation to the owners is a macro political risk.

(b) **Micro Political Risk:-** This types of risk affects specific foreign business. Firms which have high visibility in host countries are targets of micro political risk. If agitations are caused by animosity between factions in the host country and the government of a foreign country agitations may target only the most visible companies from that foreign country.

(2) **Commercial Risks:-** As a firm has to deal with an overseas buyer operating in a different legal & political environment in an international transactions, the risks to smooth conduct of the commercial transaction increases minefield. eg:- In solvency of the Purchaser.

(3) **Economic Risks:-** Countries often impose restrictions on business activities on the ground of national security, conserving human and natural resources, scarcity of foreign exchange, to curb unfair trade practices, and to provide protection to domestic industries.

Types of Economic Risk:-

(a) **Import Restrictions:-** In order to protect domestic industry, national governments often impose selective restrictions on import of good.

(b) **Local Contact Requirements:-** Trade polices often make provisions for local content requirement for extending expert in continues or putting a country of origin lable.

(c) **Exchange Controls:-** In view of sea city of foreign exchange, countries often adopt stringent exchange control measures. It adversely affects the repatriation of profits & sales proceeds of the home country.

4.11 Measuring International Business Risks

A number of risk analysis agencies provide specialized services for country risk ratings. The most significant and widely-used country risk ratings include Business Environment Risk Intelligence (BERI) Index, Economist Intelligence Unit (EIU) Indices, and PRS Group's International Country Risk Guide. These country risk ratings generally use different criteria to arrive at political, financial, economic, and overall risks. These ratings may be subscribed by international firms.

(1) Business Environment Risk Intelligence Index:-

BERI provides risk forecasts for about 50 countries throughout the world and a broad assessment of the country's business climate. The index was developed by Frederich Haner of the University of Delaware in the US. It has since expanded into country specific forecasts and country risk forecasts for international lenders, but its basic service is the Global subscription service. BERI's Global subscription service assesses about 48 countries, four times a year, on 15 economic, political, and financial factors on a scale from zero to four.

(2) EIU's Risk Indices (Economic Intelligent Unit)

EIU brings out indices to monitor Business Environment Ranking so as to facilitate assessment of countries for doing business. It also monitors operational risks for 150 countries on a scale of 0 to 100, where 0 indicates the least risky and 100, the most risky place to operate. The overall score includes an aggregate of 10 categories of risks, such as security, political stability, government effectiveness, legal and regulatory, macroeconomic foreign trade and payments, financial, tax policy, labour markets, and infrastructure. eg:- Switzerland has been rated 8 whereas Iraq 84.

(3) Global Political Risk Index:-

The Global Political Risk Index (GPRI) developed by the Eurasia Group serves as a comparative index to monitor political risks in 24 emerging markets, including India, China, Brazil, Russia, and South Africa. It serves as an 'early warning' system to anticipate critical trends and provides a measure for the country's capacity to withstand political, economic, security-related, and social shocks. The index is based on 20 indicators in four equally weighted categories-government, society, security, and economy on a scale of 0 to 100. Pakistan is reported to have the highest level of political risks in the emerging markets monitored.

(4) Failed States Index:-

The Failed States Index, brought out by Fund for Peace, an independent organization and Foreign Policy magazine, is a useful tool to carry out the cross-country comparison of the world's weakest states. It uses 12 indicators covering social, economic, political, and military conditions and ranks on a scale of 0-120 (0 being the most stable and 120 the least stable) to assess about 177 states in order of their vulnerability to violent internal conflict and societal deterioration. These indicators cover a wide range of the elements of the risk of state failure, such as extensive corruption and criminal behaviour, inability to collect taxes or draw on citizen support, large-scale involuntary dislocation of the population, sharp economic decline, group-based inequality, institutionalized persecution or discrimination, severe demographic pressures, brain drain, and environmental decay.

For Example:- Somalia tops the list of the world's failed state with a score of 114.2, followed by Sudan (113), Zimbabwe (112.5), Chad (110.9), and Iraq (110.6). As indicated, India is surrounded by some of the world's highly unstable countries, such as Afghanistan (105.4), Pakistan (103.8). and the UK (32.9) rank among the most stable countries of the world.

Activity C:

1. On the basis of Global Political Risk Index and failed states Index for measuring International Business Risk find out the countries rating on the basis of these Index.

4.12 Managing Risks

(I) Management of Political Risk:-

(1) Avoiding Investment: The simple way to manage political risks is to avoid investing in a country ranked high on such risks. Where investment has already been made, plants may be wound up or transferred to other country which is considered to be relatively safe. This may be a poor choice as the opportunity to do business in a country will be lost.

(2) Adaptation: Another way of managing political risk is adaptation. Adaptation means incorporating risk into business strategies. MNCs incorporate risk by means of the following three strategies: local equity and debt, development assistance, and insurance.

(a) Local Equity and Debt: This involves financing subsidiaries with the help of local firms, trade unions financial institutions, and government. As partners in local business, these groups ensure that political developments do not disturb operations. Localization entails modifying operations, product mix, or any such activity to suit local tastes and culture. When McDonald's commenced franchisee operations in India, it ensured that sandwiches did not contain any beef.

(b) Developmental Assistance: Offering development assistance allows an international business to assist the host country in improving its quality of life. Since the firm and the nation become partners, both stand to gain. In Myanmar, for instance, the US oil company Unocal and France's Total have invested billions of dollars to develop natural gas fields and also spent $6 million on local education, medical care, and other improvements.

(c) Insurance: This is the last means of adaptation. Companies buy insurance against the potential effects of political risk. Some policies protect companies when host governments restrict the convertibility of their currency into parent country currency. Others insure against losses created by violent events, including war and terrorism. Most developed countries have created agencies to insure the firms against risk. These agencies are generally state owned/sponsored. The Overseas Private Investment Corporate (OPIC), for instance, insures US overseas investments against nationalization, revolutions and foreign exchange inconvertibility. Similarly, the Multilateral Investment Guarantee Agency (MIGA), a subsidiary of the World Bank, provides insurance against political risks.

(3) Threat: Political risk can also be managed by trying to prove to the host country that it cannot do without the activities of the firm. This may be done by trying to control raw material, technology, and distribution channels in the host country. The firm may threaten the host country that the supply of materials, products, or technology would be stopped of its functioning is disrupted.

(4) **Lobbying:** Influencing local politics through lobbying is another way of managing political risks. Lobbying is the policy of hiring people to represent a firm's business interests as also its views on local political matters. Lobbyists meet with local public officials and try to influence their position on issues relevant to the firm. Their ultimate goal is getting favourable legislation passed and unfavourable ones rejected.

II. Insurance and Guarantees:

The political and commercial risks involved in international business can be managed by way of insurance and guarantees. Exporters are subject to risk of receiving payments from overseas buyers. Due to the fast-emerging and far-reaching political and economic changes, the payment risks in international transactions have considerably increased an outbreak of war or civil war may block or delay payment for goods exported. A coup or an insurrection may also bring about the same result. Economic difficulties or balance of payment problems may lead a country to impose restrictions on either import of certain goods or on transfer of payments for goods imported.

III. Export Credit Guarantee:

Corporation: In India, the Export Credit Guarantee Corporation (ECGC) is the principal organization offering a variety of schemes for export credit and guarantee. The major types of insurance protection provided by the ECGC include a range of credit risk insurance covers to exporters against loss in export of goods and services and guarantees to bans and financial institutions to investment insurance to Indian companies investing in joint ventures abroad in the form of equities or loans.

IV. MIGA's guarantees against non-commercial (political) risks:

MIGA, a World Bank Group subsidiary, help foreign investors cover political risks by offering guarantees against the types of coverage discussed here.

Currency Transfer Restrictions: The coverage protects against losses arising from an investor's inability to convert local currency for example, capital, interest, principal, profits, royalties, or other monetary benefits foreign exchange for transferring outside the host country. The coverage also insures against excessive delays in acquiring foreign exchanges caused by the host government's actions or failure to act. However, it does not cover risks arising due to currency devaluation.

Expropriation: The coverage offers protection against loss of the insured investment as result of acts by the host government that may reduce or eliminate ownership of, control over, or rights to the insured investment. This policy also covers partial losses, as well as the 'creeping' effect. However, non-discriminatory measures taken by the host government in the exercise of its legitimate regulatory authority are not considered expropriatory.

War and Civil Disturbance: The coverage protects against loss, due to destruction, disappearance, or physical damage to tangible assets caused by politically motivated acts of war or civil disturbance, including revolution, insurrection, and coup d'etat. Terrorism and sabotage are also covered. It also extends to events that result in the total inability of the project enterprise to conduct operations essential to its overall financial viability.

Breach of Contract: Coverage protects against losses arising from host government's breach or repudiation of a contractual agreement with investor. In the event of such an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (e.g., arbitration) under contract and obtain an award for damages. If the payment is not received even after a specified period of time, the investor may file for a claim.

MIGA's guarantee premiums are based on a calculation of both country and project risk ranging from 0.45 per cent to 1.75 per cent basis points per year for three coverage. Investigators may choose from any combination of the four types of coverage discussed above. Equity investment can be covered up to 90 per cent and debt up to 95 per cent. MIGA may insure up to US$200 million.

4.13 International Legal Environment

Firms operating internationally face major challenges in conforming to different laws, regulations, and legal systems in different countries. The legal framework to protect small and medium enterprises (SMEs), mainly to achieve social objectives, adversely influences the expansion of manufacturing capacities and achieving economies of scale in certain countries. International managers need to develop basic understanding of the types of legal systems followed in the countries of their operations before entering into legal contracts.

Judicial Independence and Efficiency

The independence of a country's judicial system from political influences of the members of governments, citizens, or firms is crucial for the fair treatment a firm receives in its overseas operations. A fair judicial system also reduces political risks in overseas markets. The level of judicial independence and efficiency differs widely among countries. Germany had the highest level of judicial independence with a score of 6.5 on a 7 point scale whereas Netherlands and Australia had a score of 6.4, the UK (6.0), Singapore (5.6), Japan and South Africa (5.5) and India (5.3).

The legal system prevailing in India should be emulated by all the countries. The legal resource is available to all-Indian or foreigners. Justice is meted to any petitioner, depending on the martis of the case. GE, for example, got back the entire investments of $115 million from Dhabol once the latter vent bust. Scott Bayman, the CEO, admitted that nowhere else this would have been possible.

Laws do not change overnight. They change over a long period of time and may lag behind important cultural changes which are taking place in a country. In many cases, it is not cultural changes which invite changes in the law but ambiguities in the law themselves which are challenged in the courts.

The legal system in a country is also influenced by its political system. The government of a country defines the legal framework within which firms conduct business and often the laws that regulate business reflect the ruler's' political ideology. Totalitarian states, for example, tend to enact laws that severely restrict private enterprise, while democratically elected governments pass laws that are pro-private enterprises and pro-consumer.

4.14 System of Law

There are four basic legal systems prevailing around the world: (1) Islamic law, derived from the interpretation of the Quran and practices in countries where Muslims are in majority; (2) Common law, derived from English law, is prevalent in countries which were under British influence; (3) Civil or Code law, derived from Roman law, practiced in Germany, Japan, France, and non-Marxist and non-Islamic countries, and (4) Marxist legal system which has takers in Communist countries.

Islamic Law:- The idea of law in Islamic societies is quite different from that in most Western cultures. Where most Western nations perceive law as an expression of the will of the people acting through their legislatures, Islamic law is the product of divine revelation. It cannot be changed as the people believe in the will of the God. The immutability of the law requires Islamic nations to look to other sources of law to govern and resolve disputes. Among the unique aspects of Islamic law is the prohibition of paying or receiving interest. The Islamic law of contracts states that any given transaction should be devoid of riba, which is understood as unlawful gain by way of interest. Prohibiting receipt and payment of interest is the nucleus of the Islamic system. Prohibition against interest affects banking and business practices severely. However, risk sharing, property rights, individual rights and duties, and sanctity of contracts are advocated. Investments in alcohol, gambling, and casinos are prohibited.

Followers of Islam and their financial institutions have had to develop alternative financing arrangements to source and finance capital. Businesses often rely on leasing arrangements, rather than borrowing money, in order to obtain fixed assets. In Iran, banks often charge up-from fees that act as a substitute for interest payments, and depositors receive shares of the bank instead of interest payments. Banks in Pakistan are in the process of adopting similar policies, often referred to as Islamic banking, as Pakistan's Supreme Court issued a ruling in 1999 declaring all interest-bearing transactions to be unislamic. The ruling gave the government, bankers and investors two years to revise laws, rewrite existing laws and eliminate interest payments.

Socialist Law:- This law evolves from the Marxist socialist system and continues to influence regulations in former communist countries, particularly those from the former Soviet Union, as well as present day China, Vietnam, North Korea, and Cuba. Extensive codes are the primary sources of socialist law. From this perspective socialist law can be classified as civil law, but the ideology thrust on the codes makes socialist law different from others. The legislature is the primary branch of government and judiciary comes next. This structure owes its origin to the founding fathers of the socialist legal system who were trained as civil lawyers and pre-revolutionary Russia was essentially a civil law country. Ideology plays a crucial role in socialist law. Unlike a civil law code, which can be used by governments of widely differing political viewpoints, socialist legal codes are designed to achieve personal and societal transformation. The legal system is not just a set of institutions, but means to achieve a Communist society, where each gives according to his or her abilities and takes according to his or her needs.

Communist ideology permeates socialist law. The legal environment provides for state ownership of the means of production and distribution, including most businesses. It also calls for state ownership of land and, is most cases, collective use of land. There is little tolerance of private property rights. The codes support centralized planning, allowing the cultural government to set national and uniform standards for business practices. At the centre of the socialist legal tradition is the Communist party. The party is the keeper of the ideology of the state and through its power to nominate officers, staff the bureaucracy, and monitor workplaces, it determines the norms that become law. Russia and China are the two countries which come to one's mind while discussing socialist law.

Common Law:- Common law comes from English law and It is the foundation of the legal system in the US, Canada, England, Australia, New Zealand, India, and many other countries. Common law is based on the cumulative wisdom of judges' decisions in individual cases. In common law countries, vast areas of law, such as contract's torts, and agency are controlled by collections of principles deduced from specific disputes resolves in an adversary process.

A key concept in common law is that similar disputes should achieve similar legal results. Thus, parties to a dispute will look for similar earlier cases with favourable decisions. These earlier cases have presidential value to a current dispute. If an earlier case is from a higher court in the same jurisdiction, a subsequent judge is expected to follow the earlier decision. This practice of relying on past precedence's provides the stability required for business people to plan their future actions. But there is also the flip side. Laws affecting business practices vary somewhat in countries which follow common law, creating potential problems for the not so well-informed international business manager. For example, manufacturers of defective products are more vulnerable to lawsuits in the US than in New Zealand as a result of evolutionary differences in the law of negligence in the two countries.

Civil Law:- The civil law system, also called a codified legal system, is based on a detailed set of laws that make up a code. Rules for conducting business are a part of the code. Over 70 countries including Germany, Fancy, and Japan follow civil law. The civil law system originated with he Romans in the ancient times, who spread it throughout the Western world.

The roles of judges and lawyers make civil law different from common law. In a common law system, the judge serves as a neutrally reference, defining points of law and ruling on various motions put forth by the opposing party's lawyers. These layers are responsible for developing their client's cases and choosing which evidence to submit on their client's behalf. In a civil law system, the judge takes on man of the tasks of the lawyers, for example, determining the scope of evidence to be collected and presented to the court.

Comparative Law:- Comparative law is not a source or system of law but an emerging discipline that examines differences between legal systems prevailing in different countries. Before a manager is posted on a foreign assignment, he or she is briefed about the host country's legal system. Understanding the legal system of a host country is not enough. The international manager needs to know how the laws of one country compare with those obtaining in another national. Taking own country's experience and generalizing them as applicable to other countries may be a costly mistake.

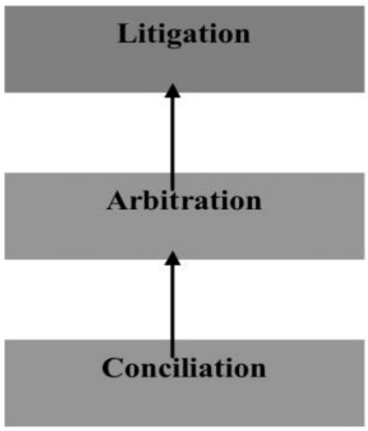
The comparison of foreign criminal law is important to business people who find themselves under the control of a foreign government and accused of crimes. For example, a businesswoman was arrested in Nigeria for selling oil without a license The penalty (changed after she was arrested) was death. She was tried and finally acquitted – the acquittal occurred because of active intervention by the counsel and US Congressional representatives. Another interesting case relates to a consultant named Flynn who was assisting a US printing company that was unable to comply with the contract terms with a Mexican company. Flynn flew to Mexico to resolve the issue and was arrested and sentenced to six years in prison. After three years of imprisonment, the conviction was overturned on the ground that he had not been a party to the contract.

4.15 International Disputes Resolution

Legal disputes can arise in three situations: between governments, between a firm and a government, and between two firms. Disputes between governments are resolved through the intervention of the World Court at the Hague and the international Court of Justice, the principal judicial organ of the United Nations. Disputes of the other two situations must be handled in the courts of the country of one of the parties involved or through arbitration.

Which country's court should handle a dispute is a relevant question. This is so because each party to a contract is likely to want any dispute arising from it to be settled in its own country according to that nation's laws. But this is obviously not possible when businesses from different countries are involved. Often, contracts contain jurisdictional clauses which specify that the law of a particular country will apply, as agreed by the parties to the contract. Often, the law of England is specified even though neither party resides in the UK. This is because English law has dealt with questions of international trade for many countries, is well documented, and has ready answers for most questions arising from across-border transactions.

Conciliation: Also known as mediation, this is a nonbonding agreement between parties to resolve disputes by asking a third party to mediate. The function of the mediator is to carefully listen to each party and to explore, clarify, and discuss the various practical options and possibilities for solution with the intent that the parties will agree to it. Unlike arbitration and litigation, conciliating sessions are private and al conferences between parties and the mediator are confidential; the statements made by the parties may not be.



Conciliations is considered to be especially effective when resolving disputes with Chinese business partners because they feel less threatened by conciliation than arbitrations. The Chinese believe that when a dispute occurs, informal, friendly negotiation should be used first to solve the problem; if that fails, conciliation should be tried. In fact, some Chinese companies may avoid doing business with companies that resort first to arbitration. Conciliation can be either formal or informal. Both sides agreeing on a third party to mediate can establish informal conciliation.

Arbitration: If conciliation is not used or an agreement cannot be achieved, the next step often used is arbitration. When all else fails, arbitration, rather than litigation, is the preferred method for resolving international commercial disputes. The usual arbitration procedure is for the parties involved to select a disinterested and informed party or parties as referee to determine the merits of the case and make a judgment that both parties agree to honour. Although informal arbitration is workable, most arbitration is conducted under the auspices of one of the more formal domestic or international arbitration groups organized specifically to facilitate the resolution of commercial disputes. These groups have formal rules for the process and experienced arbitrators to assist. In most countries, decisions reached in formal arbitration are enforceable under the law.

The popularity of arbitration has led to a proliferation of arbitral centers in countries, organizations, and institutions. All have adopted standardized rules and procedures to administer cases and each has its strengths and weaken3esses. Some of the more active are the following:

- The Inter-American Commercial Arbitration Commission
- The Canadian-American Commercial Arbitration Commission (for disputes between Canadian and US businesses)
- The London Court of Arbitration (decisions are enforceable under English law and English courts)
- The American Arbitration Association
- The International Chamber of Commerce
- The Commercial Dispute Resolution Center of the Americas

The procedures used by formal arbitration organizations are similar. Arbitration under the rules of the International Chamber of Commerce (ICC) affords an excellent example of how most organization operate. When an initial request for arbitration is received, the Chamber first attempts conciliation between the disputants. If this fails, the process of arbitration is started. The plaintiff and the defendant select one person each from among acceptable arbitrators to defend their case and the ICCC Court of Arbitration appoints a third member, generally chosen from a list of distinguished lawyers, jurists, and professors. However, arbitration can be expensive and even lengthy, despite its reputation as the quicker and cheaper alternative to litigation. A new trend is emerging-inclusion of a resolution mechanism for immediate problems in addition to arbitration, including a neutral advisor or special dispute passed.

Litigation: Seeking justice in a court is generally avoided by parties to an agreement. The costs incurred, the frustrating delays involved, and extended aggravation make victories in law suits spurious. There are other grey areas also in litigation:

1. Fear of creating a poor image and damaging public relations
2. Fear of unfair treatment in a foreign court
3. Difficulty in obtaining judgment that may otherwise have been possible in a mutually agreed settlement through arbitration.
4. The relatively high cost and time required to settle the dispute. The issue of paying compensation to victims of the Bhopal gas tragedy has been only recently decided though decades have gone by since the disaster occurred.
5. Loss of confidentiality. Unlike arbitration and conciliation that are confidential, litigation is public.

Activity D:

1 List various countries on the basis of their system of laws and highlight their special features.

4.16 Summary

International business environment comprises political-legal, economic, technological and cultural factors. Each of these is explained in detail in this, and the next few chapters.

Political environment refers to the system of government and judiciary n a national. Two system of government prevail across the world, democracy and totalitarianism. Totalitarianism has four facets; theocratic, secular, tribal and right-wing. Majority of the countries in the world have democratic dispensations, though followers of other systems are not non-existent.

MNC needs to assess the political risk prevailing in a country before investing in it. Political risks include macro and micro risks. Macro risks affect all businesses adversely in the same way. Micro risk affects one specific foreign business.

After having made risk assessment, it should be managed effectively. Strategies available to manger risks may be direct or indirect and reactive or proactive.

Legal environment is placed in tandem with political environment. Legal environment refers to the legal system or judiciary in a country. Theocratic law, civil law, common law and socialist law are the systems prevailing across nations. Each system either promotes or impedes international business in its own way.

International disputes are resolved through conciliation, arbitration or litigation. Of the three, conciliation is highly effective.

As far as an MNC is concerned, specific legal areas of concern relate to protection of IPRs, product liability and safety, competition, bribery and corruption, advertising and sales promotion, contracts, shipping of goods, labour and environmental issues.

Therefore we can say that International political and economic systems are mutually interdependent. As a firm expands internationally, it needs to operate in multiple countries with diverse politico-economic environments. Understand the basic dynamics of international, political, and legal environments is crucial for effective decision-making in international business. The set of ideas or beliefs people hold about political regime and its institutions, known as political ideology, influences business environment considerably.

4.17 Self Assessment Questions

1. What is business Environment? How does its study help international managers.
2. What is Political risk assessment? How do MNCs manage political risks?
3. Explain in detail:-
   (a) Economic system
   (b) Political system
   (c) Government structure
4. What are the risks associated with the international business?

5. How you can measure and manage the International business risk?

6. Explain the international legal environment and various system of law related to it.

7. Case Study:-

Discuss the legal system of India with special reference to the income tax legislation in the world with the help of following information:-

India's Income tax legislations are the most complex in the world. With 9,000 pages of code dedicated to income tax (IT), India beats the largest economy of the world, the US, in sheer volume of legislations, according to a Price water house Coopers-World Bank study. A comparison of the top 20 economics measures by GDP to the volume of IT legislations, India (GDP rank 10) topped the list with 9,000 pages, flowed by the UK (GDP rank 4) with 8,3000 pages. Australia (GDP rank 13) was third with 7,750 pages, followed by Japan (GDP rank 2) with 7,200 pages. The US (GDP rank 1) came fifth with 5,100 pages of IT legislation. Switzerland (GDP rank 17) has the least number of pages just 300. High volume of legislation leads to thriving business by tax consultants and the complicated procedures lead to tax evasion, often due to tax-payers' ignorance.

4.18 Reference Books

- International Business: K Aswathappa
- International Business: Rupesh Mohan Joshi
- International Business Environment: IGNOU, New Delhi

Unit - 5 Technological Environment

Structure of Unit:

5.0 Objectives

After completing this unit you will be able to:

- Describe the features of technology.
- Understand the impact of technology on society, economy and business.
- Understand the issues in managing technology.
- Analyze the importance of technology as a competitive advantage.

5.1 Introduction

Technological Environment is a key determinant of the extent of a nation's economic development as well as its Business Environment. It is responsible for the ways and means through which goods and services will be introduced, produced, marketed in the country. In fact the entire global business scenario has transformed over the years because of this strong governing force called technology. Technology has changed the entire life style, business, economy, social and political scenes sometimes gradually and sometimes rapidly to such an extent, that now the world has shrinked, boundaries dividing nations, have blurred and today's cosmopolitan world citizen is highly informed, tech savy, compatible to changes and a witness of rapidly lessening product life cycles. Here, it is useful to understand the links between technology and human development.

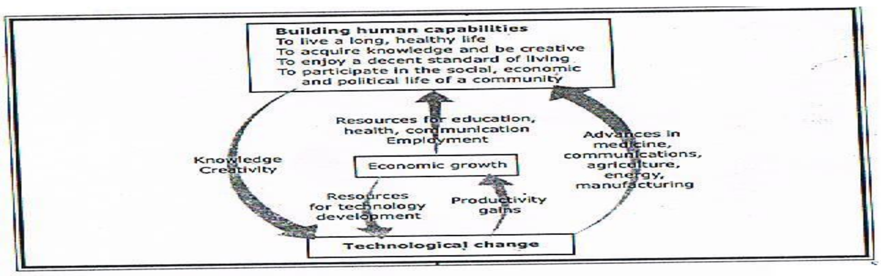


Fig. 5.1: ***Links between technology and human development***
(Adopted from UNDP, *Human Development Report, 2001*)

Thus technology is a strong force which influences people all over the world. Technological innovations prove to be a boon in many areas like medicine, a source of sophistication through facilities and appliances, faster economic development, generation of employment and breaking of geographical, barriers through ICT (Information and Communication Technology) and beginning the era of knowledge workers.

5.2 Definition of Technology

To define technology we begin with its origin, that is science. Science can be defined as a systematized body of knowledge. When science is put into practice, it becomes technology. While science is essentially related to gaining and understanding knowledge, technology refers to application and utilization of this knowledge for socio economic gains. According to UNCTAD's draft TOT code, technology is described as "systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods."

Technology includes not only knowledge or methods that are necessary to carry on or to improve the existing production and distribution of goods and services, but also entrepreneurial expertise and professional know-how. The technological environment refers to a combination of those factors related to knowledge applied and the material and machines used in the production of goods and services that have an impact on the business.

Some of the important factors of technological environment are-

1. Sources of technology, cost of technology acquisition, collaboration and transfer of technology.
2. Technological development, stages of development, change and rate of change of technology and status of research and development.
3. Impact of technology on human, social, political and ecological systems.
4. Communication and infrastructural technology.

Activity A:

1. In your group discuss and find out the major technological changes that have changed your life style and work manner tremendously. Make a list and describe each component.

5.3 Characteristics of Technology

Before understanding the technology- business relationship it is worthwhile to understand the basic characteristics of technology.

1. Change

The most characteristic feature of technology is that it changes and also as a result brings about changes. The technology changes rapidly and also it forces business, products, processes and people to change. Now it has become the pre condition existence– adopt new developments, explore new ideas or become obsolete and perish.

2. Effects of Technology are Wide Spread

Apart from the immediate technological impact, technology affects many people, nations, communities and processes. It has ripple effect where the ripples go on emanating and touching the lives of people, societies, economies and the ways of business. The effect of technology is so widespread that it is almost impossible to isolate from it and it reaches in various forms to the remotest parts of world and various aspects of life.

3. Technology is Self Reinforcing

This means that technology acts as a multiplier to encourage its own faster development. It acts with other parts of society so that an invention in one place leads to a sequence of inventions in other places. A simple invention, generates a variety of applications and these applications again influence a variety a systems, modifying them. In the similar way the multiplier effect of technology goes on. Thus as aptly stated by Alvin Toffler, "Technology feeds on itself. Technology makes more technology possible."

4. Technological Process is a Gradual Continuous Process

Technology is a complex set of knowledge ideas and methods. It is a result of variety of activities, experiments, research, innovation and development. This indicates that technological process is gradual and continuous.

5.4 Innovation

Innovation may be defined as "the technical industrial and commercial steps which lead to the marketing of new manufactured products and to commercial use of a technical process and equipment."Innovation can take any of the following forms: The introduction of a new product, the use of a new method of production, the opening of a new market, the conquest of a new source of a raw material, the reorientation of an industry.

Innovation is a very important determinant of competitive advantage and success. Innovations help firms to increase market share, capture new markets, create new market segments as well as sometimes entirely new industries and markets.

According to Betz, innovations can be classified on the basis of amount of impact, a technology change can make on applications, as follows-

1- **Radical Innovation-** a basic technological innovation that establishes a new functionality.

2- **Incremental Innovation-** a change in an existing technology system that does not alter functionality but incrementally improves performance, features, safety, or quality or lowers cost.

3- **Next Generation Technology Innovation-** a change in an existing technology system that does not alter functionality but dramatically improves performance, features, safety or quality or lowers cost and opens up new applications.

Activity B:

1. In your group, discuss the meaning of innovation and then find out the major technological, marketing and other innovations that have been done to make life more easy and comfortable.

5.5 Technology S-Curve

The commonly observed pattern of development of technology indicates that the rate of progress in a new technology follows on S-shaped curve, with an initial exponential rate, slowing to a linear rate and turning off toward a natural limit.

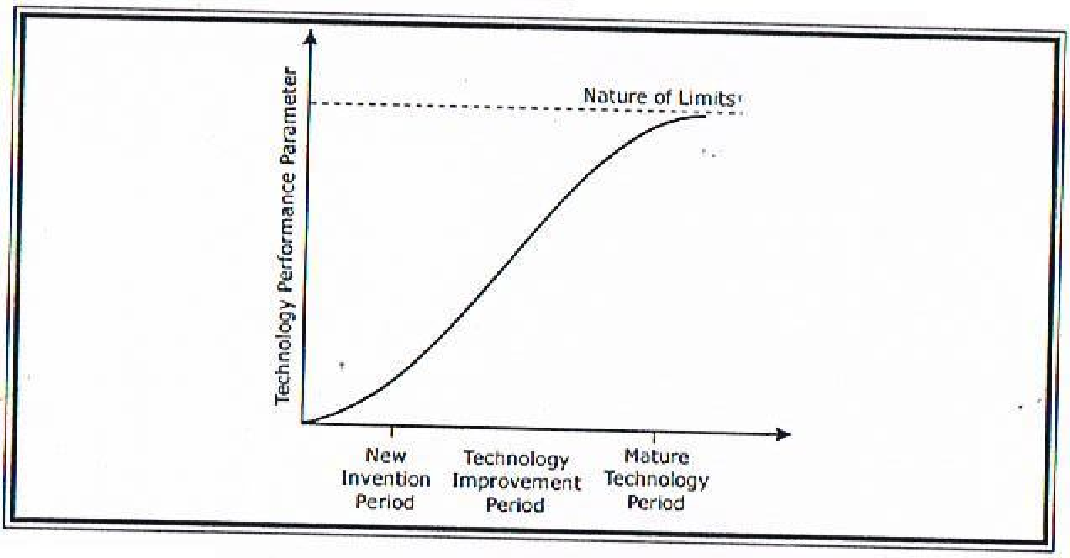


Fig. 5.2: Technology S Curve

Betz describes this curve as- "At first, all new basic inventions for a new technology show poor performance, are awkward and dangerous to use, and are costly to produce. Yet the opportunities for technical improvement begin as inventors and engineers seek ways of overcoming the limitations of the original invention. There is usually a rapid flush of new ideas that provides exponential increase in performance. Eventually, and rather soon all the obvious ideas get tried. Further progress in the new technology gets harder. Thus begins the linear phase of technology progress on the S-curve. In due course the rate of improvement slows down as it approaches its limit, which may be technological (eg., some physical limit on performance), economic (eg., diminishing returns from further research and development), or social (eg., production of undesirable by products). At this point there will be a considerable economic and competitive benefit in changing to an alternative technology to which the limit does not apply, and consequently in due course a new technology will emerge and be adopted.

5.6 Implications of Technology

The implications of technology can be understood from the following three perspectives.

A- Social Implications of Technology

B- Economic Implications of Technology

C- Micro Level Implications of Technology.

A- Social Implications of Technology-

Technology has a very strong influence on the society as people's lives have changed extensively on account of technological developments. Consequently all the aspects of society and social life have undergone respective changes.

1- Technology Reaches People through Business-

The scientific discoveries lead to development of useful products and services by means of business activities. People benefit from new discoveries in the form of new and sophisticated goods and services, easy access to goods and services and comfortable long life with higher standards of living. All this is result of technology transformed and utilized by business organizations productively.

2- Ever Rising Expectations of Consumers-

The societies with higher standards of living and higher sophistication have ever rising expectations of new products, more variety of products, higher quality and more sophisticated products. This leads to high expenditure in R&D activities as well as more business opportunities.

3- System Complexity-

Technology makes living more complex. Modern machines are complex and so are modern manufacturing systems. They need experts to operate and repair and sometimes this high level of complexity results in machine failure. Also the higher dependence of technology leads to interdependent systems. Failure of one system leads to failure or breakdown of all the interdependent systems.

4- Technology is a Cause of Social Change-

Technology is a cause of social change in many ways.

- Changes in life style, living standards and social life are highly noticeable.
- It leads to creation of economic basis for development of society and at the same time it may take away the economic basis of society and result in mass social displacement.
- The adoption of a controversial technology may cause a social turmoil and rebel.
- The inventions, discoveries and innovations may change the entire employment and occupation structure by generating new employment opportunities, drying up of some employment avenues, obsolescence of certain skills, demand for new and rare skills, jobs for different sections of society, changes in work hours, work patterns and composition of work force.
- Technology largely influences the way we perform our work, the way we communicate, and even the language that we use.
- The way we perform our activities, the way we spend our leisure time, the way we behave and expect behavior of others, the way we commute and food habits etc. all are determined by technology.

5- Emergence of a New Social System Called Knowledge Society-

Technology has led to emergence of a new social system called knowledge society wherein, the use and transfer of knowledge and information, rather than manual skill dominates work and employs the largest portion of labour force.

B- Economic Implications of Technology-

1- Increase in Productivity-

The most striking influence of technology is on productivity as technology leads to increase in productivity in both qualitative and quantitative aspects. Technology enables business to provide high quality and reliable goods and services and also helps in attaining more production at less cost. In fact, this is the factor which is essentially responsible for adoption of technology at all levels. Technology has now enabled factories to produce more in shorter time spans and with fewer defects.

The increased productivity results in rise in real wages of employees and lowering in prices of some goods. Thus many economic benefits are generated for the society by means of technology.

2- Higher Expenditure on R&D-

Advancement in technology requires organizations to spend large amount of money on R & D. In fact in many of the businesses, a significant and high percentage of net sales is spent on R & D, which becomes the essential for survival and growth. The allocation of resources to R & D is necessary to gain market share in the era of global competition, where all the companies competing have advanced product lines, sophisticated processes and synergised operations as a result of R & D efforts. The time between innovation and commercialization is consistently reducing. Therefore the rate of technology transfer (meaning the rate of the process of taking new technology from laboratory to market place) should be faster so that company can reap the benefits of investment in R & D before imitations of the innovation reach market at lower prices. The investment in R & D also deals with decision whether to invest on product innovation or process innovation. Product innovation refers to improving the performance, physical attributes, capabilities and safety of the product while process innovation refers to improving theproduction process to make the product cheaper and with better production quality. In the early stages product innovations are more important as the product's attributes affect financial performance considerably. Later, process innovations like improved manufacturing facilities, and faster distribution become important in maintaining product's economic returns. Thus the technology is utilized as a competitive tool bybusiness firms and it is very essential for them to be fast in developing and acquiring new technology. Thisobviously calls for increasing R & D intensities. R & D intensity refers to a company's spending on R & D as a percent of sales revenue.

3- Upgradation of Jobs-

The technological advancement necessities educated and competent workers and it brings about considerable changes in the skill distribution in business. This is evident from the very fact that all the factories and companies demand for skilled workers at all levels, and even the simplest and most routine tasks in organizations demand workers with computer skills. Organizations recruit more and more engineers, scientists and specialists now a days. The skill distribution is changing and more peoplewith higher skills are hired by the companies as compared to earlier times. The workers with less of the desired skills or who cannot work on new machines are dislocated. In lack of training facilities, many of such workers lose their jobs. Thus the technological advancement has led to upgradation of jobs at all levels and posed a rising need for more education and training facilities.

4- Technology Demands Changes in Organizational Structure and Practices-

As the jobs are upgraded the job incumbents are highly professional and knowledgeable. These highly skilled employees demand a different type of organization structure as it is difficult to motivate and retain them. The professional employees often switch over from one to another organization for reasons other than financial ones, also. The desires for professional growth, utilization of their potentialare the desires that drive them towards various organizations. Also they influence the managerial decision making and social structure of the organization. The presence of technocrats moves the organization at a greater speed from mechanistic structure to organic structure.

5- Ever Rising Demand for Capital-

The technology necessitates huge money outlays in research, development, experimentation and commercialization of new ideas. Education training, upgradation and maintenance costs also are equally large. This calls for not only a great amount of money to be mobilized, but also its efficient management. Thus efficient financial management also acquires equal importance.

6- Shorter Product Life Cycles-

As we know products follow a typical life cycle of introduction, growth, maturity, decline and abandonment. The technology has made this life cycle very shorter. A new and best product today may be replaced by a better product very soon, and this span from growth to abandonment is continuously on a decreasing trend.

C- Micro Level Implications-

At the micro level technology refers to the level of sophistication with which a factory uses inputs such as labour, finance machines and raw materials to produce output.

1- Change in Organization Structure-

The impact of technology on organization structure is considerable. Three types of technology may be distinguished in this context.

Low Technical Complexity High

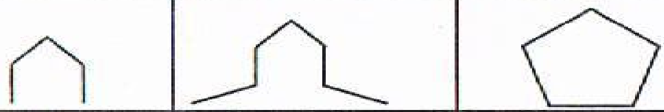
Structural Characteristics	Small – Batch Technology	Mass Production Technology	Continuous Process Technology
Level in the hierarchy	3	4	6
Span of control of CEO	4	7	10
Span of control of first line supervisor	23	48	15
Ratio of managers to nonmanagers	1 to 23	1 to 16	1 to 8
Approximate shape of organization	 Relatively flat, with narrow span of control	Relatively tall, with wide span of control	Very tall, with very narrow span of control
Type of structure	Organic	Mechanistic	Organic
Cost of operation	High	Medium	Low

Fig. 5.3: Technological Complexity and Organisational Structure

Each of these types of technology has its impact on levels of hierarchy, span of control, ratio of managers to non managers, shape of organization, type of structure and cost of operation.

Also technological advancement influences some other areas of organization as it leads to

i. More products and services
ii. Capital intensity
iii. Higher productivity and lower costs
iv. Environmental effects
v. Increase in competitive advantage

2- Change Management-

At the unit level the technology faces resistance. The commitment to order practices and products, the ambiguity, fear and risk associated with technology, fuel the resistance to change which already is expected for basic psychological reasons. Managers have to practice change management to successfully adopt new technology.

3- E-Commerce-

Technology has made E-commerce possible through internet. The world wide web has dissolved geographical boundaries and enabled each and every organization's global presence and access at a lower cost. E-commerce and E-business have the following benefits for business-

a) World wide communication which is faster, easier and cheaper.
b) Brought together buyers and sellers from all over the world.
c) Information availability
d) Efficiency in reaching more and more people and faster business processes.

4- Flexible Manufacturing System (FMS)-

FMS refers to system of manufacturing where machines are designed to produce batches of different products. By the help of computer aided design and engineering, the manufacturing system has changed from mass production to low volume production with scale economies. FMS enables manufacturers to produce at low-unit costs. The new components and products can be made in larger varieties by the same machine by only changing the computer programming.

Activity C :

1. In your group discuss the role played by ICT (Information and Communication Technology) in business. List the major changes and trends ICT has brought about in business.

5.7 Technology as a Competitive Advantage

Michael Porter has stated- "Technology is one of the principal drivers of competition. It plays a major role in industry structural change, as well as increasing new industries. It is also a great equalizer, eroding the competitive advantage of even well entrenched firms and propelling others to the forefront. Many of today's great firms grew out of technological changes that they were able to exploit. Of all the things that can change the rules of competition, technological change is among the most prominent."

Technology can influence all the five competitive forces viz- inter firm rivalry, threats of new entrants and substitutes and bargaining power of buyers and suppliers. Technological changes become a source of competitive advantage for a firm in the following ways:

a) Lowering of costs
b) Differentiation of products
c) First mover advantages
d) Favourable bargaining positions
e) Efficient supply chain management and distribution

Activity D:

1 List some of the leading company's who have been able to gain success because of advanced technology and discuss how and which technology acted as a source of competitive advantage for them.

5.8 Transfer of Technology

Transfer of technology refers to the process by which commercial technology is disseminated. It is the formal process of transfer of technology from proprietor to the other firms.

1- Forms of Technology Transfer-

There are two forms of Technology Transfer, viz. internalized and externalized forms of technology transfer.

a) Internalized Form of Technology Transfer- means investment associated TT (Technology Transfer), where control resides with the technology transferor. The transferor normally holds the majority or full equity ownership.

b) Externalised Form of Technology Transfer- means all other forms such as joint ventures with local control, licensing, strategic alliances and international sub contracting.

2- Channels of Technology Flow-

a) Foreign Investment

b) Technology License

a. Foreign Investment- Through Foreign Direct Investment by MNCs the technology flows to developing companies. The MNCs have led to flow of sophisticated technology to host country for variety of reasons including expansion, growth, cheap labour, utilization of resources and lessening the impact of tax laws.

b. Technology License Agreements and Joint Ventures- A large scale of technology transfer is taking place by means of license agreements and joint ventures. As a result of government restrictions on foreign investment and foreign trade, joint ventures are rapidly growing.

3- Methods of Technology Transfer-

Following are the important methods of technology transfer:

a) Training or Employment of Technical Expert- By training personnel, simple and unpatented manufacturing techniques/ processes can be transferred. Also foreign technical experts are employed to acquire such technology.

b) Contracts for Supply of Machinery or Equipment- In cases where the nature of operational technology is comparatively simple, TT can be done by contracts for supply of machinery or equipment.

c) Licensing Agreements- When foreign direct investment is not possible or desirable licensing agreements provides means for TT. Under this, the licensor enters into an agreement with a licencee in another country to use the technical expertise of the former.

d) Turnkey Contracts- Turnkey project contracts are methods of technology transfer in case of transfer of complex technology. Turnkey project contracts refer to the supply of such services as design, creation, commissioning or supervision of a system by the transferor for the client.

4- Issues in Transfer of Technology-

Cost, appropriateness, dependence and obsolescence are the four important issues associate with the transfer of technology, which are explained below in detail:

a) Cost: Developing countries in majority cases, has obtained foreign technology at unreasonably high price, be the case of foreign direct investment related with technology transfer, the mode of payment, by way of dividend, interest, royalties and technical fees, etc.

b) Appropriateness: The appropriateness of the foreign technology to the physical, economic and social conduct of the developing countries is an important aspect to be considered in technology transfer.

c) Dependence: Further, heavy reliance on foreign technology may lead to technological dependence, along with the displacement of the traditional indigenous technology, de-motivated scientists and experts of the host country to take initiative in research efforts, may result into an attitude of subservient dependence adversely affecting the capacity to do even relatively research or to adopt processes, developed locally.

d) Obsolescence: It has also been observed that there is a tendency to transfer outdated technology to the developing countries, not enabling them to take advantage of the latest technology and keep them behind technologically.

Activity E:

1. In your group, discuss and find out the next generation technologies which will emerge and what changes will they result into, your life style and business.

5.9 Measures for Technology Transfer

1. Promotion and Regulation:

Despite the problems or shortcomings of foreign technology, it is widely recognised that if properly regulated and promoted, technology transfer plays a positive role, particularly in the technologically backward LDCs. The government of India and number of other countries in order to take full advantage of the positive role of foreign technology, have initiated promotional measures, which includes, Assessing technological requirements; Dissemination of information in foreign countries regarding foreign investment potent and scope for technical collaboration in the domestic economy, government policy regulation in respect of foreign capital and technology, institutional assistance infrastructural and other facilities for industrial development and provision of advisory services to Indian entrepreneurs in respect of foreign techno including the techniques and process of technology transfers.

2. Areas of Regulation:

Number of regulatory measures, like, the extent and terms of equity participation, phasing of domestic manufacturing as well as the appropriateness of the technology, have been taken by different countries to ensure that the technology chosen is the best available, appropriate to domestic conditions and that indiscriminate and unnecessary import of foreign technology is not undertaken.

3. Payment Terms and Foreign Exchange Outflow:

Most governments take measures to ensure disproportionately high payments are not paid for any technology. Restrictions were imposed on dividend payments and pricing. The Government of India's guidelines clearly laid down that there should be no requirement the payment of minimum guaranteed royalty, regardless of the quantum and value of production.

4. **Restrictive Terms in the Agreement**:

Technology imports with highly restrictive terms on importing parties are not generally favored. For instance, according to the Government of Ind. policy, to the fullest extent possible, there should be no restrictions on free exports to all count. Further agreements or clauses which in any manner bind the Indian party with react to procurement of capital goods, components, spares, raw materials, pricing policy and sell arrangements should be avoided.

Activity F:

1. What are the various technology transfer rules and regulations announced by the Government of India, affecting the international business?

5.10 Summary

Technological environment is very important in determining the extent of development and success of a business. Technological advancement has revolutionized the global business scenario. Wide ranges of new and innovative products with sophisticated manufacturing operations are available and easily accessible round the globe. Information Technology has drastically changed the marketing, financial and distribution processes. Technology has emerged as a main source of competitive advantage for firms.

The product life cycles are shortening and new organizational structures, practices and policies are emerging. The money and effort spent on R & D is increasing each new day and technology driven foreign collaborations and joint ventures are also increasing along with other ways of technology transfer. Government is taking a number of regulatory and promotional measures to take advantage of foreign technology without sacrificing national interests

5.11 Self Assessment Questions

1 What is technology? Describe its characteristics.

2 What is the impact of technology on business?

3 What are the social implications of technology?

4 Explain the influence of technology at the micro level.

5 How technology is a source of competitive advantage for a firm?

6 What are the various methods of Technology Transfer?

5.12 Reference Books

- Economic Growth and Development - Hendrik Van Den Berg, Publisher- Mc. Graw Hill.
- Transfer of Technology -T.S. Mans Publisher- Himalaya Publishing House
- Marketing in the New Millennium- M.J. Xavier Publisher- Vikas Publishing House

Unit - 6 Socio - Culture Environment

Structure of Unit:

6.0 Objectives

After Completing this unit, you will be able to:-

- Define socio-cultural environment, its characteristics and elements of culture.
- Understand impact of culture on business and its traits.
- This chapter also helps in understanding other socio-cultural factors.

6.1 Introduction

The socio-cultural environment immensely influences almost all the aspects of a business. The type of products and services to be produced, the marketing practices, the management, trouble shooting, planning, policy making, the values and ethics of a business are all governed by the socio-cultural factors. Business is an integral part of the society. The socio-cultural factors affect the business and are also affected by the business. The ignorance of certain socio cultural factors may give rise to serious problems and failures in business.

6.2 Definition

Culture can be defined as a complex whole which includes knowledge, belief, art, morals, law, customs and other capabilities and habits acquired by an individual as a member of a society.
According to Elbert W.Steward and James A.Glynn, "Culture consists of, the thought and behavioural patterns that members of a society learn through language and other forms of symbolic interaction- their customs, habits, beliefs and values, the common view points which bind them together as a social entity. Cultures change gradually, picking up, new ideas and dropping old ones." Geert Hofstede defines culture as "the software of the mind- the social programming that runs the way we think, act and perceive ourselves and others." Thus we can say that culture is the sum total of accumulated and evolved social norms, perceptions and behaviour.

Activity A:

1. Discuss in your group, the main characteristics of Indian Culture. List them. Also ask each member of the group to write a short essay on why he feels proud to be of Indian culture.

6.3 Characteristics of Culture

Following are the major characteristics of culture-

1. **Culture is Learned and not Innate –**
   The culture is not an inherited characteristic owned by an individual, it is acquired and learned through social interaction and experience.
2. **Culture is Shared –**
   Culture is not person specific. It is shared by people as part of society, organization or group.
3. **Culture is Transferred-**
   One generation transfers culture the next generation in society and it continues until the functioning of society continues.
4. **Culture is Symbolic-**
   Culture is based on the human capacity to symbolize or use one thing to represent another.
5. **Culture is Adaptive-**
   Culture is based on the human capacity to change or adapt, as opposed to the more genetically driven adaptive process of animals.
6. **Culture Changes Gradually-**
   Culture changes in a gradual and rather continuous manner evolving through dropping of some old ideas and picking up new ones.

Activity B:

1. List the typical traditions, customs, habits and preferences of your regional culture, or your sub-culture which differentiate it from rest of Indian and International culture. Suggest a marketing mix for promoting some product or service to your regional culture- sub-culture.

6.4 Elements of Culture

The elements of which culture is composed are:

1- **Knowledge and Beliefs-** Knowledge and Beliefs refer to a people's prevailing notions of reality. These relate to people's conceptions, perceptions, gained and transferred information, their notions of ethical and ethical practices, their understanding of things and phenomena. This also includes peoples' myths, superstitions and accepted norms about life and behaviour.

2- **Ideals-** Ideals can be described as societal norms which define what is expected, customary, right or proper in a given situation. Ideals are formed by knowledge, beliefs as well as precedents. Norms are enforced by sanctions, i.e. by rewarding the desired or correct behaviour and punishing the wrong behaviour.

3- **Preferences-** Preferences refer to a society's definitions of those things which are considered desirable. A culture tends to provide standards of tastes in specific lines of human activity. What is tasteful or desirable to one culture may be distasteful and undesirable to another culture.

Activity C:

1. Find out the difference in non-verbal communication (gestures) and etiquettes of different nations.

6.5 Impact of Culture on Business

An understanding of the impact of culture on business is significant because culture determines the ethos, behaviour, practices and motivations of people within the organization. The manner of work, dedication towards work, decisions and work ethics and practices of people are highly correlated to the particular cultures to which they belong. Thus we can easily observe the cultural differences amongst Indians, Japanese, Americans, etc. Also it should be understood that not all people are alike in a particular culture. There are subcultures within a culture. People have their own idiosyncrasies and are a blend of heredity, cultural experience, sub cultural experience, family experience and unique personal experience.

1- Organizational Culture and Business-

Organizations are formed of people from different cultural backgrounds and as a result of their interactions, distinct organizational cultures develop. The organizational culture has functional and dysfunctional consequences. The functions of organizational culture are:

i) It is distinct and unique to an organization and it creates distinction between one organization and another.

ii) Culture provides a shared identity and a sense of belongingness in the organizational members towards the organization.

iii) Culture creates a commitment towards the organization and enables individuals to consider combined interests to be nobler than the self interests.

iv) Culture enhances and facilitates the social system stability within the organization. In fact culture is the social glue that helps hold the organization together by providing appropriate standards for the behaviour of organizational members.

2- Management of Cultural Diversity-

As the globalisation has resulted in to expansion of business across political boundaries the organization are largely facing the challenge of managing cultural diversity. Because of work force diversity managers have to understand work motivation, profit motivation, business goals, negotiating styles, attitudes towards the development of business relationships, gift-giving customs, greetings, significance of gestures, etc. which vary from culture to culture. Cultural diversity if properly managed ensures employee retention and greater productivity. But if cultural diversity is not managed efficiently the effects can be increased turn over, reduced communication and heightened interpersonal conflict.

3- Culture Determines Goods and Services to be Produced-

It is essential for the survival of a business organization that it realizes the cultural differences and brings out products and services accordingly. As culture determines the type of food people eat, the type of clothing, housing, life styles, etc., the business should offer compatible products and services to different cultures.

4- Culture Governs the Organizational Behaviour-

Hodgets and Luthans highlight some specific examples where the culture of a society directly affects management approaches and organizational behaviour:

i) Centralized v/s Decentralized Decision Making- In some cultures important decisions are concentrated at the top while in others these decisions are diffused throughout the middle and lower hierarchical levels, and managers at all levels actively participate in making key decisions.

ii) **Safety v/s Risk-** In some societies, organizational decision makers are risk aversive and have great difficulty with conditions of uncertainty. In others risk taking is encouraged and decision making under uncertainty is common.

iii) **Individual v/s Group Reward-** In some countries personnel who do outstanding work are given individual rewards in the form of bonuses and commissions. In others, cultural norms require group rewards, and individual rewards are frowned on.

iv) **Informal v/s Formal Procedure-** In some societies much is accomplished through informal means. In others, formal procedures are set forth and followed rigidly.

v) **High v/s Low Organizational Loyalty-** In some societies, people identify very strongly with their organization or employer. In others, people identify with their occupational group.

vi) **Cooperation v/s Competition-** Some societies encourage cooperation between their people and others encourage competition between their people.

vii) **Short Term Horizon v/s Long Term Horizon-** Some nations focus most heavily on short term horizons such as short-range goals of profit and efficiency. Others are more interested in long range goals, such as market share and technological development.

vii) **Stability v/s Innovation-** The culture of some countries encourages stability and resistance to change. The culture of others put high value on innovation and change. These cultural differences highly influence the way business should be conducted.

5- Religion-

People from different cultures have their own religious convictions, beliefs, sentiments, customs, rituals, festivals, etc. The ignorance of religious aspects may be creating serious problems for the business organization. Religion influences the eating habits, like eating beef is condemned in some religious, eating pork is considered unreligious by some. The way and mannerisms of eating, the wedding seasons and festive seasons and life styles are highly influenced by religion.

Religion influences attitude towards work and wealth. Americans are said to have Protestant work ethic, which holds that people should work hard, be industrious and save money. Asians are said to have confucian work ethic which also dictates hard work. Religion determines the festival times which are great shopping periods. Also holidays and working hours are determined by religious considerations.

The customs of marriage, naming ceremony of child, other religious rituals and practices vary from religion to religion. These influence heavily businesses like textile, jewellery, catering, consumer durables, etc.

6- Ethno Domination-

Ethno domination is a situation where an ethnic group occupies a majority position in a business, industry or trade through ownership and control of physical or financial resources, or through the manipulation of social environment. For example the automobile spare parts business is dominated by Sikhs, dominance of Chettiars and Vysyas in money lending and banking etc. The ethnic business are observed internationally also like Chinese restaurants, Udupi restaurants etc.

7- Language-

The language differences influence business operations and decisions and sometimes create unexpected problems. Apart from the large number of languages and dialects in different countries causing a lot of communication problems, there are more aspects to this. Different meanings of the same words, in the same language cause a lot of confusion. This poses a challenge for the businessmen to choose appropriate brand names and marketing communication in different countries. For example Ford's third world truck named Fiera meant "ugly old woman" in Spanish. Ford's another Brand "Cliente" faced problems in Mexico, as there, Cliente is a slang for a street walker. Chevrolet's brand name Nova in Spanish means "it doesn't go"

The translation of advertisements and marketing communication is difficult for two reasons. One is that sometimes the appropriate word does not exist in several languages. The second problem is that literal translations many a time do not convey the right meaning. For example in some languages, Pepsi Cola's slogan "come alive" translates as "come out of the grave".

Non verbal communications and body language can create problems, as they have different interpretations in different cultures. The same symbols and gestures, may mean different things in different countries and sometimes in different regions of the same country. For example the thumbs up sign, with the thumb held straight up and four fingers kept folded represents approval in USA, UK and Russia where as it is highly offensive in Iran and regarded rude in Australia. Shaking head left to right while conveys no in USA and most of the world, it means yes in some countries like Bulgaria, Saudi Arabia and Malaysia.

Activity D:

1. Find out the difference in colour and symbol connotations in different cultures.

6.6 Cultural Traits

Cultures consist of some important traits. An understanding of these cultural traits is helpful in business:

1. Low Context and High Context Cultures-

A high context culture is one that places great value on the intangible aspects of a negotiation or business deal. Individuals from such cultures look beyond the facts and figures and take into consideration such factors as personal relationships, atmosphere and attitude towards respect, religion and trust.

A low context culture, on the other hand, assumes a high degree of shared knowledge on the behalf of transaction partner and thus deals only in such tangible aspects of the deal as facts, figures and performance. The atmosphere and the personal relationships with the business partners means little.

2. Masculine and Feminine Cultures-

Cultures with masculine values appreciate aggressiveness and assertiveness while respecting the goals of material acquisition. A culture with feminine values appreciates interpersonal relationships, put quality of life before material acquisition and applaud concern for individuals and less fortunate.

3. Monochromic and Polychromic Societies -

In monochromic cultures, time is used for ordering one's life, for setting priorities and for doing tasks in a sequential order- one thing at a time. In polychronic cultures time is used to accomplish diverse goals simultaneously and to interact with as many individuals as possible- even at the same time.

4. Universalism v/s Particularism-

Universalism is the belief that an idea or practice can be applied as it is universally, where as

Particularism is the belief that environmental factors play a dominant role in the manner ideas and practices should be applied. In cultures with high Universalism the focus is more on rules than on relationships, business contracts are adhered to very closely, and people believe that “a deal is a deal”.

In cultures with high Particularistic, the focus is on relationships and trust, than on formal rules. In Particularism culture, legal contracts are often modified, and as people get to know each other better, they often change the ways in which deals are executed.

5. Individualism v/s Communitarianism-

In Individualistic culture people regard themselves as individual where as in communitarianistic cultures people regard themselves as a part of a group. A dutch researcher Fons Trompeenars recommends that when individuals from cultures with high individualism deal with those from communitariansim cultures, they should have patience for the time taken to consent and to consult, and they should aim to build lasting relationships. When people from cultures with high communitariansim deal with those from individualist cultures they should be prepared to make quick decisions and commit their organization to these decisions. Also communitarianistics dealing with individualists should realize that the reason they are dealing with only one negotiator (as opposed to a group) is that this person is respected by his or her organization and has its authority and esteem.

6. Neutral v/s Emotional-

A neutral culture is one in which emotions are held in check where as an emotional culture is one in which emotions are openly and naturally expressed. Japan and UK are high neutral cultures and examples of high emotional cultures are Mexico, Netherlands and Switzerland. Trompeenars recommends that when individuals from emotional cultures do business in neutral cultures, they should put as much as they can on paper and submit it to the other side. They should realize that lack of emotion does not mean disinterest or boredom, but rather that people from neutral cultures do not like to show their hand. Conversely, when those from neutral cultures do business in emotional cultures, they should not be put off stride when the other side creates scenes or grows animated and boisterous, and they should try to respond warmly to the emotional affections of the other group.

7. Specific v/s Diffuse-

A specific culture is one in which individuals have a large public space, they readily let others enter and share and a small private space, they guard closely and share with only close friends and associates. A diffuse culture is one in which both public and private spaces are similar in size and individuals guard their public space carefully, because entry into public space affords entry into private space as well. Examples of specific culture are Austria, UK, USA, and Switzerland while examples of diffuse culture are Venezuela, China and Spain. In specific cultures people are often open and extroverted and there is a strong separation of work and private life. In diffuse cultures, people often appear to be indirect and introvert, and work and private life are often closely linked.

Trompeenars recommends that when those from specific cultures do business in diffuse cultures, they should respect a person’s title, age and background connections, and they should not get impatient when people are being indirect or circuitous. Conversely when individuals from diffuse cultures do business in specific cultures, they should try to get to the point and be efficient, learn to structure meetings with judicious use of agendas, and not use their titles or acknowledge achievements or skills that are irrelevant to the issues being discussed.

8. Achievement v/s Ascription-

In achievement culture people are accorded status based on how well they perform their functions. In ascription culture, status is attributed based on who or what a person is. Achievement cultures give high status to high achievers while ascription cultures accord status based on age, gender or social connections.

Trompeenars recommends that when individuals from achievement cultures do business in ascription cultures, they should make sure that their group has older senior and formal position holders who can impress the other side, and they should respect the status and influence of their counterparts in other group. Conversely, when individuals from ascription cultures do business in achievement cultures, they should make sure that their group has sufficient data, technical advisors and knowledgeable people to convince the other group that they are proficient, and they should respect the knowledge and information of their counterparts on the other team.

Activity E:

1. Find out and list some major failures of MNC's in foreign countries as a result of ignorance of socio-cultural factors of the foreign market.

6.7 Other Socio-Cultural Factors

As described in the preceding sections, socio-cultural environment encompassing the language, religion, customs, beliefs, traditions, tastes, preferences etc. are of great importance for business. A major reason for the failure of a number of companies in the foreign markets has been their inability to modify their products and strategies in accordance to the socio-cultural environment of those markets. In this section, we will describe a few more socio-cultural factors affecting business.

1. Customer Preferences, Habits and Beliefs -

The people of different cultures and societies have varied tastes, preferences, consumption patterns, habits and beliefs. These pre dominantly determine whether or not they will purchase a particular product or service. The marketers have to develop an appropriate strategy considering these to sell factors the products and services. That is why even companies like Mc Donalds who have highly standardized offerings, change their recepies and modify them to suit the taste and liking of the people in various markets they enter. Another example can be of the very successful international company Nestle, which is offering noodles and pastas with Indian spices and flavours to capture Indian market.

There is difference in attitude towards packaging in different cultures. Nature of use, occasion of use varies between markets. For example, in India people take coffee at any time, like in morning, or with breakfast, with snacks, or in evening and is commonly served to guests, where as in European and Middle Eastern Culture, coffee is served after dessert or after the cheese course which concludes the meal. Where as in Japan Coffee is considered as a luxurious drink.

Different cultures have different connotations (including joy and sorrow) towards different colours, symbols, flowers and even numbers. Marketers have to be careful in understanding these connotations and then offer products and services.

2. Etiquettes -

The manner of greeting people, the physical distance between people, the laughter, similes, handshakes etc. all these behaviours and etiquettes are perceived and practiced differently in different cultures. For example handshakes while greeting and bidding good-bye are common in many societies, but it is not common in many others. Even the manner of doing handshakes is different in different cultures. The manner of inviting and responding to invitation by a person also differs from culture to culture and affects negotiations and dealings.

Gift giving also has many aspects, customs and connotations which differ from culture to culture. The sufficient amount of understanding of these is necessary when giving or receiving gifts in other cultures, which many other wise sometimes, lead to mistakes and misunderstandings.

3. Social Trends -

A number of social and demographic factors such as age and sex composition of population, family size, habitat, attitude towards employment, occupational pattern etc. influence the business heavily.

a) The Number and Proportion of Women in Work Force- The greater this number is, the more trends in spending, consumption and life style are visible. Double income families spend heavily on luxury and life style as well as higher education and recreations as a result of higher disposable incomes. Also ready to eat food, and other services are availed more.

b) Age Composition of Population- If more people in the country are young, the economies tend to boom as there are more productive human assets like in India, while many countries have a threat of economic slowdown because a large proportion of population are older people, no longer productively contributing to economy. Example Japan. This proportion dictates the spending patterns and economic policies of different countries.

c) Divorce Rates, Attitude Towards Marriage and Children- The higher divorce rates in some countries have led to increasing number of single parent families and blended families. Also attitude towards marriage and children largely affect family compositions which in turn determine the market structure and purchase norms.

Activity G:

1. Discuss in your group the importance of understanding of social and demographic trends for marketers. Explain the implications of various social and demographic trends for business with suitable examples.

6.8 Summary

The socio-cultural environment of a country influences the business significantly and in a variety of ways. The type of products and services to be offered, the marketing strategies and marketing mix to be adopted, the way business is conducted, its norms and values all are highly influenced by the socio-cultural environment. The attitudes and behaviour of employees, associates and customers, their needs and motivations, all are a resultant of the socio-cultural phenomena.

The religion, social structures, traditional festivals, values, beliefs, language, connotations and life styles, all influence the purchase and consumption patterns. The etiquettes, socio-cultural traits and demographic composition, all are determinants of market trends and organizational behaviour. Thus a business in order to succeed in a given market has to modify its offerings, strategies and practices in convergence to the socio-cultural environment. Ignorance of the socio-cultural factors may lead to blunders in the business. Also, the multinationals have to learn to deal efficiently with cultural differences. An understanding of the cultural idiosyncrasies is a must for successful business performance in multicultural environment.

6.9 Self Assessment Questions

1 Define culture. What are its elements?

2 Describe the nature and importance of culture.

3 What are the major factors constituting the socio-cultural environment?

4 What is the impact of socio-cultural environment on business?

5 Describe the major cultural traits.

6 Why is it important for a business to manage cultural diversity? Explain with examples.

7 Explain some important socio-cultural factors influencing business strategies.

8 Discuss the importance of understanding social trends for determining business strategies.

9 Discuss the relationship between business and society.

10 Explain how religion, language and etiquettes affect business and marketing decisions.

6.10 Reference Books

- Business and Society, Environment and Responsibility : Keith Davis and Robert L. Blomstorm Publisher- Mc. Graw Hill, New York.
- International Business : ndrew Harrison Publisher- Oxford
- Introduction to Sociology: Elbert W. Steward and James A. Glynn Publisher- Mc.Graw Hill

Unit - 7 Natural (Physical) Environment

Structure of Unit:

7.0 Objectives

After completing this unit, you will be able to:

- Discuss the concept of natural environment and its compositions;
- Recognize the importance of the natural environmental components for the various economic activities;
- Explain the impact of human economic activities on the natural environmental resources;
- Develop into a well-equipped environment explorer with the insight of effective and efficient environment utilization strategy.

7.1 Introduction

An environmental study is a multi-disciplinary activities, its focus varies with the objective of the interest of the investigators and its dimensions varies on the basis of the components at the time of study.

The term, 'Environment' is derived from the word 'environs' which means 'to be around'. Webster's dictionary defines the environment as, "the circumstances, objects, conditions by which one is surrounded, the complex of physical, chemicals and biotic factors, that act upon an organism, or an ecological community and determine its form and survival, the aggregate of social, cultural factors that influence the life of an individual or community."

Environment in its broader perspective includes natural and cultural or human environment. It is a live functioning system comprised of living and non-living components, interacting in a very complex network. In simple words, it refers to the surroundings in which we live, and includes air, soil, water, plants, birds and animals around us. Every factor of the environment has its effects on our life. Environment is highly delicate and so we have to live in harmony with it; to protect our rich bio-diversity.

Environment holds the key in the economic growth and the survival of living things. As Watrick and Wood observe, "the natural environment ultimately is the source and support of every thing used by businesses (and almost any other human activity) – every raw material, every energy source, every life-sustaining factor, even every waste disposal site.

The natural environment determines what can be done in a society and how institutions can function as resource availability is the fundamental factor in the development of business in societies". Hence, geographical and ecological factors, such as natural resources endowments, weather and climatic conditions, topographical factors, locational aspects in the global context, port facilities, etc., are all relevant to business. Differences in geographical condition between markets may sometimes call for changes on the marketing mix. Geographical and ecological factors also influence the location of certain industries. For example, industries with high material index tend to be located near the raw material sources. Climatic and weather condition affects the location of certain industries like the cotton textile industry. Topographical factors may affect the demand pattern in some cases. For example, in hilly areas with a difficult terrain jeeps may be in greater demand then cars. Weather and climatic factors affect the demand for certain type of products. For example, in several regions where the temperature in very high in summer, there is good demand for desert coolers, but they are not at all used in some of the States in India. In region characterized by very cold climate in winter and very hot climate in summer both room heaters and air conditioners may in good demand in the respective seasons. It may also call for modifications to the product, packaging, storage conditions etc., as it affects the demand pattern for clothing, building materials and designs, foods, medicines etc. The dreadful earthquakes that ravaged several areas of Gujarat in early 2001 and the potential for such occurrences in a number of other places would influence the decision making in respect of location of business. It is also likely to affect the demand for flats and accommodating in high rise buildings, along with the choice of building technology, design, material etc.

Ecological factors have recently assumed great important with the depletion of natural resources, rising environmental pollution and the continuous disturbance of the ecological balance. Government policies, aiming at the preservation of environmental purity and ecological balance, conservation of non-replenishable resources, etc., has resulted in additional responsibilities and problems for businesses, with its effect on increasing the cost of production and marketing. Externalities have become a very important problem the business has to confront with. Moreover, the natural environment in combination with the technological environment presents the impulsive potential for development while other environments like the economic, social and political and government factors represent the propulsive potential for development. At the core of any social system is the natural environment and the available technology, defining the possibilities for human action in the society – the natural environment through its resources and constraints and technology through the tools and processes available for human use. To some extent the ecology and technology are interdependent; as technology can always be built upon what is physically possible in the natural environment, and the natural environment can be degraded or enhanced, made more productive for human uses or depleted for any use, by the application of technology. Thus, given the natural and technological environments, the propulsive factors determine the extent of exploitation of the development potential and the direction, pace and pattern of development.

7.2 Composition of Natural (Physical) Environment

The word "Natural Environment" increases one's curiosity and attention on the composition/

components, comprising it. Primarily understood as Land (Atmosphere), Air (Hydrosphere), Water (Lithosphere) and Diversity of living organisms (Biosphere), and the study of the environment generally refer to the study of these four spheres:

1. Atmosphere:

Various observations made through sensitive instruments on the ground as well as in space, has enable an individual to understand the structure, composition and functioning of the atmosphere. On the basis of atmospheric changes, from the ground up, major atmospheric layers are identified, which are Troposphere, Stratosphere and Mesosphere.

Troposphere is the lowermost layer of the atmosphere, where the density of the air is highest. It extends from 8 to 16 km. above the surface of the earth. About 75 per cent mass of the atmosphere is found here, along with the water vapour, comprising of major gases such as N_2, O_2 and CO_2. The layer above the troposphere is called the Stratosphere which extends upto an altitude of 50 km, and is dry and very less dense. The temperature in this region increases slowly; due to the absorption of (UV) radiation. The important gases here are O, O_2 and O_3. Ozone gas is mainly responsible for absorbing the ultraviolet radiation from the sun. Mesosphere is layer above the stratosphere, which extends upto 85km.

2. Hydrosphere:

One of the important features of our planet is the presence of water, often referred as the elixir of life. It is present in the Atmosphere, Lithosphere and Biosphere. The survival of all living things totally depends on the availability and quality of water. It is an essential requirement for all agricultural and industrial activities of man. Lack of water can cause both starvation and dehydration in humans and animals. Even mild dehydration will slow down the metabolism very fast. It is the main solvent and medium of transportation for all foods, vitamins and minerals and their transportation. Water carries every nutrient, mineral, vitamin, protein, hormone, and chemical in the body to its destination. It lubricates and flushes wastes and toxins from all cells.

About 71 per cent of the surface of the earth is covered with water. The total volume of water on the earth is about 1.4 billion cubic kilometers. About 97.6 per cent water in the seas and oceans is salty. The remaining water is fresh water, which is in the rivers, lakes, underground, moisture in the atmosphere, wetlands, vegetation, etc. Out of the total fresh water, about 87 per cent of water is found in glaciers in polar areas and high mountains. 12 per cent water is underground water and only 1 per cent water is in our lakes, rivers, atmospheric water and biospheric water.

At room temperature water is colourless, tasteless and odourless liquid. It freezes at zero degree Celsius and boils at 100 degree Celsius. The pattern of water consumption is dependent on its availability, quality, designated use, the economic value, etc. On an average, 10 per cent of the world's runoff is used by man for his various activities. On a per capita basis economically developed countries use more water as compared to poor developing countries. For example, per capita consumption of water in the US is 400 litres as against only 100 litres in India.

3. Lithosphere:

Lithosphere is the physical link, connecting the Hydrosphere, Atmosphere and Biosphere. Lithosphere denotes the earth's crust comprising the geographical components, such as rocks, soils, and other associated constituents and is the sources of all our vital requirements such as building materials, minerals, fuels and ground water. Of which, soil is the medium for the cultivation of various food-grains, vegetation, construction of houses.

Rocks and soil are the two most important parts of the lithosphere. Rocks are solid mass of mineral of two or more than two minerals. The physical, chemical and biological weathering break rocks into pieces and the agents of erosion convert these pieces into small particles, forming soil, which is also the most important part of the Lithosphere. Generally, 95 per cent of soil is made of inorganic materials and only 5 per cent is organic materials. Micro nutrients which are present in the soil in large quantities are important for supporting plant life and define the availability of the various species of vegetation and plants.

Types of soil vary from place to place, depending upon the parent material i.e., types of rocks undergoing weathering and erosion. Soils are classified on the basis of the size of individual mineral particles and the size of soil particles. The texture of soil depends upon size of mineral particles and soil particles.

4. Biosphere:

Biosphere is of great importance to us, not only because of the fact that we (humans) are a part of it; but also for the presence and interactive nature of living (biotic) and non-living (abiotic) systems. Biosphere deals with all aspects of living systems – micro-organisms, macro plants and macro animals.

The term, 'Biosphere' was coined by the geologist, Eduard Suess in 1875 and in 1929, Russian scientist, Vladimir Vernadsky, put forth the concept of biosphere. According to Wikipedia, "the biosphere is the part of a planet's system which includes Air (Atmosphere), Land (Lithosphere) and Water (Hydrosphere), in which life develops and life processes transforms. There is creation of variety of species and organisms, forming diversity of ecosystems. Broadly speaking, it is the global ecological system that integrates all living beings and their inter-relationship, interactions with the elements of the Lithosphere, the Hydrosphere and Atmosphere.

The earth is made up of the biotic and abiotic components. The biotic part includes plants and animals. The abiotic part includes climate, soil, rocks and mineral. It means biosphere is the life zone of the earth which includes all living organism, including human being.

Plants, animals and micro organisms need nutrients like carbon, oxygen, nitrogen and hydrogen in very large quantities and some other nutrients like iron, calcium, zinc, etc in small quantities for their growth and living processes. Since the organism remains in dynamic flux in acquiring materials and returning this to the environment as excretory products and dead tissues, and since these nutrients are found in fixed quantities in the environment they must be recycled. This aspect of ecosystem functioning is termed as 'cycling of materials'. The energy flow in the eco-system is one way process whereas the circulation of material is cyclic. During the cycle the material moves back and forth from their non-living reservoir pool and body of plants and animal, called as Biogeochemical Cycles. Hydrological Cycle, Carbon Cycle and Nitrogen Cycle are some of the Biogeochemical Cycles.

7.3 Natural Resources

Zimmarman in his famous book, "Introduction of World Resources", defines natural resources as "means of attaining given ends", the ends, being the individual goals or social objectives. Natural Resources are dynamic and not static. On the bases of an individual's efforts to tap and utilize the natural resources, these natural resource change in quality and quantity in response. The availability of different types of resources determines the scope of development of various economic and commercial activities of human beings. Science and technology has revolutionized the means of producing economic goods from natural resources. Technological advancements enable man to use existing resources as well as add new resource and decrease of the consumed resources. Thus, it becomes economic goods or real wealth only when an individual/business unit recognizes its utility and exploits it to meet their economic/social objectives.

Natural resources are not uniformly distributed on the surface of the earth. Some resources like air and solar energy are generally found everywhere and the resources like water are found in many places. On the other hand, some resources are found at a few places. This uneven distribution of natural resources is made still more uneven by different rates of exploitation of resources and by people with different cultural developments. This has not only influence the development of economic activities, but, has also influences the distribution of the population, thus determines the demographic characteristics of a particular region. All those regions with rich mineral and power resources have well-developed countries, emphasizing secondary and tertiary activities and improved level of economic development, and are the most densely populated areas of the world. While developing the resources, all the countries must keep in mind not only their immediate or short-term needs but also the availability of resources in the long run to assure regular supply, even in future life. This requires various measures to be followed to conserve natural resources.

Conservation refers to the careful and rational use of resources and their presentation from reckless exploitation and destruction, i.e., the judicious use of resources to preserve for the future needs. It included the control and management of resources in such a way that they will be useful to man forever. Conservation of exhaustible or fund resources is very important. There are some resources which when once used, their re-use is not possible. For example – Coal. The conservation of such resources, therefore, is a must, for maintaining the reserves of such natural resources for the future economic development.

7.4 Types of Natural Resources

The natural resources, such as climate, water, soil, vegetation, animals, minerals, forests, etc. are provided by Nature. These natural resources are classified in different ways:

1. Flow and Fund Resources

i. **Flow Resources:** The natural resources, with continuous and permanent supply, are called as flow resources. For example- Air, water and solar energy. These resources get renewed on their own after some time. Organic resources, such as forests, fish, animals and even soils are flow resources if they are used wisely. But, many a times, unwise use of such resources makes it exhaustible.

ii. **Fund Resources:** Fund resources are those which have only fixed and limited reserves, i.e., they are not self-renewable. For example, iron-ore, coal, petroleum, gold, etc. Once they are extracted from the crust of the earth they cannot be replaced. Fund Resources are classified into recyclable and non-recyclable. Recyclable resources are those which do not get destroyed completely by one use; but they can be reused repeatedly by further processing, e.g., Steel. On the other hand, fuel resources like coal, petroleum and natural gas are non-recyclable resources, because they can be used only once. Once they are burnt they are destroyed forever.

2. **Organic and Inorganic Resources:**

i. **Organic Resources:** Organic resources are living resources. They include animals, fish and other forms of marine life, forests, etc. Organic resources are also known as animal resources.

ii. **Inorganic Resources:** Inorganic resources are air, water, minerals, fuels, solar energy, etc. Inorganic resources are also known as inanimate resources. Soil is both organic and inorganic resources since it is composed of both organic and inorganic components.

3. **Cultural Resources or Human Resources:**

An individual's intelligence, imagination and skill are the cultural or human resources. Exploitation and utilization of natural resources very much depends upon the development of cultural resources. If cultural resources are not developed, natural resources will remain idle.

Natural Resources are also classified as Individual resources, National Resources and World Resources. People's property like land, house, money, machines, etc. are personal resources; Nation's property like railways, roads, water, State-owned land, etc. are national resources and combined resources of all the countries of the world are the world resources.

7.5 Limitations in the Use and Development of Natural Resources

A number of problems have been experienced by both, the developed and the underdeveloped countries in the use and development of natural resources. Some of the important problems of the use and development of resources are briefly discussed here:

1.) **Cost-Benefit Ratio:** Only low-cost resources are exploited and high-cost resources are avoided. For example, Coal and Oil-fields of the Siberian region and coniferous forests and mineral wealth on the slopes of mountains are not used or developed solely because of as very high cost of explanation. Similarly, minerals and power resources found at great depths and at great distances from the market are not exploited due to higher cost of production and the transportation.

2.) **Cheaper Substitutes:** Availability of cheaper substitutes can put a limit on resource development. When cheap and good quality coal is available, hydel power is not generated. Similarly, the use of jute bags has started declining with the availability of cheap plastic and paper material for packing food grains, cement, fertilizers, etc.

3.) **Lack of Capital:** Most of the developing and underdeveloped countries have no capital to exploit their resources. For example, due to lack of capital rich water resources in India are undeveloped. In fact, water resources of India are thousand times richer than oil resources of the Gulf Countries. Only 15 per cent water resources of India are used for irrigation and for the development of hydel power.

4.) **Lack of Market:** Lack of market in thinly populated areas are responsible for the slow development of the natural resources lying idle in such areas, like Canada, Australia, Siberia, etc.

5.) **Shortage of Skilled Labour:** The continent of Africa has got very rich mineral, water and forest resources. Due to shortage of skilled labour in this continent, most of the resources are not used.

6.) **Customs**: Orthodox customs also prevent utilization of certain natural resources. Many animals are not killed for food in India because of religious restrictions. Since drinking wine is prohibited in Islam, wine-making industry has not developed in North Africa.

7.) **Political Factors**: Sometimes, even political factors are responsible for the slow development of some natural resources. For example, the water despute between Maharashtra and Karnataka States on the sharing of water is responsible for the slow development of water resources, resulting into waste of very valuable resource, water.

8.) **Resource Policy**: Many countries have different resources exploitation policies. Accordingly, many restrictions on resource utilization and development are imposed by the Government. For example, in India, to check soil erosion, the Government has imposed restrictions on forest cutting. Similarly, to preserve wild life and fish, a number of restrictions are imposed on hunting and fishing activities.

7.6 Man- Environment Relationship

Man-nature relationship is natural. Nature is capable of influencing human life and man has the ability to utilize nature to satisfy his needs. Humans are good managers and with the help of technology and suitable methods of conservation can develop a sustainable future by sustainable development. It refers to the development that meets the needs of the present, without compromising the ability of the future generations to meet their own needs, thus, reducing the rates of consumption without sacrificing economic growth. Sustainable Development is based on the principles of Ecological Harmony, Economic Efficiency, Conservation of resources, Liquidity with social justice and Local Self-Reliance. Man has the capacity to modify the physical environment to suit his ever-growing needs. Technology is a branch of human knowledge and it plays an important role in primary, secondary and tertiary activities related to resource exploitation that is required for the economic development of the human environment. Individual can bring about great economic change and advancement if the human resource is healthy, educated and skilled. Economic progress of any country depends upon the needs of the people and the capacity of man to exploit and utilize the resources. When resources are used judiciously, it leads to proper utilization of resources, lower wastage and eventually leads to better standard of living.

The relationship between man and nature has always been a crucial factor in the developmental programmes of different countries, which has changed with the change in human societies. The changing relationships between human being and the natural environment started with the increase in population, having direct relationship with the environmental degradation and related problems. As a result of the needs and demands of the growing population i.e., food, shelter and clothing, etc., the reserves of resources are depleting very fast. For example, fossil fuels and minerals are available in a limited stock, forest lands are disappearing fast and fresh water is in limited supply.

The population increased at very slow pace during the early stages of the history. The reasons for the slow growth of population were harsh climatic conditions; migrating character of man engaged in hunting and food gathering; poor nourishment.

The world population in the last ten thousand years has shown two distinct periods of population increase associated with the Agricultural Revolution and Industrial Revolution. At present growth rate, human population may reach 7 billion in 2012, 8 billion in 2025 and 10 billion in 2050. After a specific period of time, the size of the population may cross the carrying capacity of the environment and lead to a resource crunch. The increased population growth of any country leads to the following criticalities:

1. An increased pressure on land to produce more food and raw materials to sustain the growing population

2. Inadequate facilities of housing, water, transport and health care facilities.
3. Rise in unemployment and under-employment.
4. Migration and increased concentration of population from rural areas in search of jobs.
5. Decline in the standards of living.

No doubt the population of a country is known as its labour force, but it is a known fact that a rapidly growing population exhausts the natural resources of country and retards the process of development leading to an underdeveloped economy.

7.7 Role of Man/Human Being

The ongoing relationship between Man and Nature is dynamic. Man is known for his ability, skills and an innovative mind enabling to manage all spheres of business of the present day environment. Man is a Resource Producer, Resource Distributor and Consumer. Human being is known for his will, skills abilities and an innovative mind. Role of this important resource in resource utilization is explained below:

1. Man as Resource Producer:

Man has the capacity to modify the physical environment to satisfy his ever-increasing and complex needs, by applying his awareness and acquired efficiencies along with technology, thus, fulfills the needs of the society. An individual is capable of planning and using innovative methods of production to use the available resources rationally because it is a known fact that ‘wants’ are ‘unlimited’ and the resources which satisfies it are ‘limited’. To carry on with sustainable production, man has to employ eco-friendly methods of production and use soft technology to help conserve the natural resources.

2. Man as Resource Consumer:

Today, human being has progressed from producing and consuming the basic necessities of life to modern civilizations with high standards of living. Development in the science and technology has facilitated acquiring high levels of production and consumption, consequently, rapid diminution of natural resources. The relationship can be expressed as a simple equation:

Environment Impact = Population Size X Affluence X Technology

I = P X A X T

Where,

I = The impact on the environment.

P = The number of people or population size.

A = The affluence of each individual or per capita consumption of goods and Services

T = Technology

3. Man as Resource Distributor:

The essence of sustainable development depends upon the harmonious blend between resource exploitation and ecological balance/stability. Swiftly depleting resources caused due to heavy demand on the resources by the mounting global population, has intensified the matter of grave concern for the future generations. Conservation of this natural resources can play an important role, by better utilization and sustainability of land, water and air, Thus, the need of the present society with the mind set of ‘Throw-away Society’, has to be transformed into emerging ‘Sustainable Society’, who will reduce wastes and encourage optimum use of resources, aiding better distribution of natural materials.

7.8 Human Beings and the Endless Desires to Grow

Man's needs have grown with modernization and globalization has made him greedy. The biomes of the world supply man with diverse bio-diversity and physical resources to satisfy needs and wants. But, the human being has unwittingly become the cause of pressure on the environment and extinction of various species.

From being a food gatherer to a food producer, man has come a long way. Today, man has created an 'Economic Environment' with the help of various economic activities viz., farming, mining, animal grazing, fishing, manufacturing and trade. Each of these occupations develops through resource utilization. Aided with technology, man has acquired greater capabilities to bring about lager-scale changes in the natural environment, as it has provided them with the tools and techniques to overcome environmental resistance and enhance production capacity. Consequently, the stress on the natural environment has increased. Human greed should not change man into destructor of nature. The man-environment relationship brings out the ever changing role of man from:

Explorer → Exploiter → Processor → Producer → Consumer →

→Destructor → Conserver → Protector of Natural Environment

Undoubtedly, the survival of man depends upon how effectively and judiciously he manages the earth and maintains the quality of overall environment. It is an expression of the total responses among and between its components, and depends upon the factors which can either affect the stability of the ecosystem or are capable of bringing about changes in the environment. As the components of the environment are inter-linked and mutually inter-dependent, the changes in any of them may lead to a sort of chain reaction in other components of the environment.

Since the time man has started modifying the environment to suit his requirements, drastic changes in the quality of environment have emerged. The effects of human economic activities on the natural environment are noticeable within a short period and may continue for a long time e.g., deforestation for cropland and commercial purposes leads to soil erosion resulting in gully erosion and loss of soil fertility. Moreover, increase in sediment loads in rivers causes floods. But, the indirect impacts of human occupations are experienced after long periods of time and sometimes, these effects are not reversible. These effects may change the natural ecosystems and the chain effects may prove fatal for man himself e.g., the release of industrial wastes into water bodies causes several diseases and death of organisms. Human activities are affecting the heat balance of the earth and its atmosphere which in turns affects the weather and climate at the regional and global levels.

Today, the period of science, technology and industrialization has added to the period of conflict between man and nature which can be changed to a symbiotic relationship by treating nature as an ally/ friend. With the fast development of science and technology, man has acquired the power to transform his environment in countless ways on an unbelievable scale. Throughout the development history, man has been trying to become a master of nature, has destroyed nature and the environment to a considerable extent. Environmental degradation is no more a local, regional or national issue but it has become a global issue. A number of developmental projects are responsible for air, water, noise pollution and the generation of hazardous wastes, problems of water logging, etc.

Global Warming, Greenhouse Effect Ozone Depletion, Acid Rains, Marine Pollution, over exploitation of resources, etc., are some of the environmental problems at the global level. For effective environmental management proper understanding of the physical interaction among the living and non-living components is the starting point. The pressure on natural and human resources is increasing because of the rapid growth of population and, water, forests, mineral, energy resources, etc, is increasing at an alarming rate. We are very close to upsetting the delicate balance in the natural environment. Over exploitation and unwise utilization of natural resources lead to a decline in productivity of ecosystems as well as loss of bio-diversity.

Activity A:

1. Identify the various human economic activities affecting the environmental resources adversely in your locality, and provide suggestions on controlling the same, thereby conserving and preserving the natural resources.

7.9 Issues/Concerns Related to Natural Environment

The natural environment has been affected by the advent of the industrial revolution and the process of industrialization profoundly as outlined above, is discussed in the followed part.

The larger environmental repercussions of our industrial age have to do with the pollution as it accompanies every outshoot of industrialization, be it industrial production, generation of electric power, or vehicular transport. In other words, such pollutions and resulting imbalance in the natural environment has become a marked feature of the lifestyles that have come to market the end of the twentieth century.

Various Such Imbalances are Discussed Below:

1. **Anthropogenic Waste:** Waste means something that can be discarded. It includes the disposal, recycling and recovery of material. There are three classes of waste. E.g. household, industrial and commercial. There are certain wastes known as Special wastes which are subject to extra control. The management of such wastes includes keeping, treating or disposing and requires a license from the Environmental Agency or designated authority prescribed or nominated by it.

   Wastes are generally of three kinds, namely, Liquid waste, Gaseous Waste and Solid waste. Anthropogenic waste may be of three kinds, namely, domestic waste, industrial waste and hospital waste or bio-domestic waste. Anthropogenic waste creates problem of human health and the environment.

a.) Municipal waste and Domestic Waste:

Domestic refuse, Municipal garbage and other waster like animal waste and garbage are mainly domestic and municipal wastes. It consists of water containing food waste, water form toilets, bath etc. Inorganic impurities are sand, clay, particles of ore, chalk, mineral salt, mineral oils, etc., are used by man for various purposes. Municipal and Domestic wastes consist of various micro-organisms like bacteria, algae, viruses, etc. An average Indian family throws away wastes of about 50 kg per week. Mumbai city alone produces more than 3500 tones of garbage and 200 million tones of sewage everyday. Discharge of untreated or partially treated sewage into the rivers and other water bodies produces depletion in the oxygen content, stimulation of algal growth and shift in algal diversity towards green, blue algae, leading to production of obnoxious blooms. The public sewage containing various micro-organisms, bacteria and viruses are dangerous in respect of epidemic diseases of man and animal.

b.) Industrial Wastes:

Industrial Wastes consists of raw materials, processed chemicals, processed intermediates, processed by-products and impurities from industries. Industrial pollutants may be of different types. For e.g. Organic substances deplete the oxygen content and increase the biological oxygen demand (BOD). Inorganic substances like carbonates, chlorides and nitrogen makes the water body unfit and encourages growth of fish and other organic life-forms. Oil and other floating substances interfere with self-purification of water bodies.

c.) Agricultural Wastes:

The most dangerous wastes are fertilizers and pesticides that results from the modern agricultural practices. Some of these fertilizers are washed off the lands through irrigation, rainfall and drainage into rivers, seriously disturbing the aquatic ecosystem. The indiscriminate use of inorganic fertilizers sometimes leads to the accumulation of nitrated in the water. The nitrated when enters the human body, gets converted to toxic nitrates by the intestinal bacteria, combining with the haemoglobin to form methaglobin further reduces the oxygen carrying capacity of the blood. It damages the vascular and respiratory system imparts blue colourization to the skin and may even cause cancer. When phosphates enter into the water bodies causes luxuriant growth of algae that results into the depletion of dissolved oxygen content and deteriorates water resources by eutrophication.

Pesticides are biologically active chemicals used for pest control; are poisonous agricultural chemicals. Many of these chemicals persist for long time in the environment and toxic to the aquatic organisms. Pesticides used to control the pest population at a particular time are considered harmful to eve human welfare. The increasing use of pesticides in modern land has posed a potential hazard, not only to livestock and wildlife but also to fish and other animals. Every year about 300 million tones of mineral fertilizers and 4 million tones of pesticides are used in agriculture. D.D.T and its derivatives retard photosynthesis in water bodies and their concentration in livestock and human tissues is increasing considerably.

d.) Bio-medical Wastes:

The Government of India has framed rules called The Bio-Medical Waste (Management and Handling) Rules, 1998, under section 6, 8 and 25 of the Environment (Protection) Act, 1986. These rules apply to all persons who generate, collect, receives, stores, transports, treats, disposes or handles bio-medical waste in any form. Bio medical waste means any waste, which is generated during the diagnosis, treatment or immunization of human being or animals, or in research activities, pertaining thereto or in the production or testing of biological and including categories mentioned in Schedule I. A polluter of the environment can be prosecuted and punished under Section 268 and Section 290 and 291 of the Indian Penal Code (IPC).

Biological means any preparation made from organisms or micro-organisms or product of metabolism and bio-chemical reactions intended for use in the diagnosis, immunization or the treatment of human beings or animals or in research activities pertaining thereto. Bio-medical waste treatment facility means any facility where treatment, disposal of bio-medical wastes or process incidental to such treatment or disposal is carried out. Occupier in relation to any institution generating the biomedical waste includes hospitals, nursing homes, clinics, dispensary, veterinary institutions, animal houses. Operator of bio-medical waste facility means a person who owns or controls or operates a facility for the collection, reception, storage, transport, treatment, disposal or any other forms of handling bio-medical waste. Moreover, it shall be the duty of every occupier to take all the steps to ensure that waste should be handled without any adverse effect on the human health and the environment by setting up bio-medical waste treatment facilities like incinerator, autoclave, and microwave system for the treatment of waste, in accordance with Schedule I and in compliance with the standards prescribed in Schedule V.

While separating the bio-medical waste, special care has to be taken for its segregation, packing, transport and storage. It shall be segregated into containers/bags at the point of generation prior to its storage, transportation, treatment and disposal. If a container is transported from the premises to outside the premises, the container must also carry information prescribed in Schedule IV. Untreated bio-medical waste shall be transported only in such vehicles as may be authorized by the competent authority as specified by the Government. Bio-medical waste shall not be mixed with other waste. No untreated waste shall be kept stored beyond a period of 48 hours and must seek permission to keeping it beyond 48 hours to ensure that the waste does not adversely affect human health.

Activity B:

1. Review the Waste Treatment System adopted by the various hospitals in your city and the local government authorities (Municipal Corporations/Nagar Palika/ Gram Panchayats) in your locality. Give your valuable comments on the same.

2. Environmental Degradation:

Environmental Degradation is the deterioration of the environment through the depletion of resources such as air, water, and soil; the destruction of ecosystems and extinction of wildlife. Environmental degradation is one of the ten threats officially caution by the High Level Threat Panel of the United Nation's. The World Resources Institute (WRI). The United Nations Environment Programmed (UNEP), the United Nations Development Programme (UNDP) and the World Bank (WB) have made an important report on health and environment public on May 1, 1988. Environmental degradation is a result of the dynamic interplay of socio-economic, institutional and technological activities. Environmental changes may be driven by many factors including economic growth, population growth, urbanization, intensification of agriculture, rising energy use and transportation. Poverty still remains a problem at the root of several environmental problems.

Various social factors like increasing population, poverty, urbanization etc, economic factors like the level and pattern of Economic Development, transport, agriculture, etc., and various Institutional factors influences the environmental balances and the ecological cycles/eco-systems.

3. Global Warming:

The interaction of the human economic activities with the variety of resources by its excessive exploitation has resulted in number of irreversible damages to the natural environment. The heating of atmosphere has propelled the climate into a new state of instability. The present climate change could be the most profound threat to the present humanity. It will not only impact economic and political lives; but also its basic existence. The eleven hottest years in recorded history has occurred since 1983. The period from 1991 to 1995 was the hottest five-year period on record. 1988 was the hottest year in human history. Now our planet is heating at a faster rate than ever before in the last 10,000 years. The decade of 1990 was the hottest in this millennium. All these temperature changes are due to the Greenhouse Effect.

a.) Greenhouse Effect: Our planet gets heat from the sun. Solar radiation passes through the atmosphere and is absorbed by the earth's surface. This heat is emitted from the surface of the earth as infra-red radiation. However, this infra-red radiation cannot escape the atmosphere as fact as solar radiation can enter. Some of it is trapped by a number of gases. Thus, heat is allowed to get in but it cannot go out. This is called Natural Greenhouse Effect. In the absence of this natural greenhouse effect, our planet would have been at least 30^oC cooler and life that we see today would not exist. With the increasing industrialization, urbanization, agricultural activities, development of transportation, urbanization, agricultural activities, development of transportation facilities, etc. are enhancing the natural green house effect. The concentration of green house gases in the atmosphere is increasing and therefore, more infrared radiation is emitted by the earth's surface is being trapped. Various Green house gases comprises of, namely, Water-Vapour, Carbon-dioxide, Methane, Nitrous Oxide, CFCs and Ozone. Some of these gases occur naturally, some occur only from human activities and some from both, naturally as well as from human activities. Today, planet is losing less heat and therefore experiencing Global Warming.

There is difference of opinion over the degree by which temperatures will increase and what will be the effects of this rising temperature. At the same time, there is no doubt that the earth's temperature has increased by 0.5^oC in the last one hundred years, resulting into the adverse effects on the Oceans, Sea-level, Agriculture, Forestry, Water Resources, Terrestrial Ecosystems, Human Health and other Economic consequences.

4. Non-degradable Wastes:

Non- degradable includes synthetic materials like plastic, thermocole, nylon, rayon and other synthetic polymers. It also includes a variety of electronic waste e.g. communication equipments like computers, mobile phones, telephones, etc. which contain large volumes of inert materials like plastic and polymers.

a.) Electronic Waste, "E-Waste": E-waste consists of many broken or unwanted electrical or electronic appliance, many of which are considered toxic and not bio-degradable. Responding to these concerns, many European countries banned e-waste from landfill in the 1990s. As per an advanced e-waste policy in Europe, "Waste Electrical and Electronic Equipment in 2002" holds manufacturers responsible for e-waste disposal. Some activists define "Electronic Waste" that include all secondary computers, entertainment devices, mobile phones and other items, whether they have been sold, donated or discarded by their original owner.

While, a protectionist may broaden and the definition of "waste" electronics, the high value of working and reusable laptops, computers, and components (e.g. RAM), can help pay the cost of transportation for a large number of worthless "commodities". Broken monitors, obsolete circuit boards, short circuited transistors, and other junk are difficult to spot in a container load of used electronics. Significant growth in consumption of electronics items, accompanied by a very high rate of obsolescence of these products has resulted into generation of the waste in the country. A total of 3.3 lakh tones of e-waste generate annually in India, while an additional 50,000 tonnes is imported legally in the country, of which, only 19,000 tonnes is recycled due to high refurbishing, reuse of electronics products and poor recycling infrastructure. 94 per cent of the organizations do not have any policy on disposal of obsolete IT products/e-wastes. Only 40 per cent of the waste finds its way into the recycling stream while the rest 60 per cent remains in warehouses/

store-houses due to poor/inefficient collection system. E-waste is expected to touch 4.7 lakhs tones in India by 2011, according to the study unveiled by MAIT, the apex body representing India's IT hardware, training and R & D services sectors, together with GTZ, the German Technical Co-operation Agency, Electronic Waste or "Waste Electrical and Electronic Equipment" (WEEE), the MAIT-GTZ assessment study focused only on the waste stream of computers, televisions and mobile handsets.

Industries can reduce e-waste by controlling materials used in the manufacturing process. A system should be developed to review the purchase of materials regularly. Before purchase, production materials can be checked for hazardous constituents and whether a non-hazardous substitute is available. Changes can also be made to the production process to reduce waste generation. Hazardous portions of waste can also be separated from non-hazardous portions. This reduces the volume and cost of disposing of dangerous e-waste. Segregation is in many cases simple and economical technique for waste reduction.

E-waste is valuable source for secondary raw materials, if treated properly otherwise, it is the major source of toxins and carcinogens. Rapid technological change, low initial cost and even planned obsolescence has resulted into number of problem around the globe. Technical solutions are available, which requires implementation of prior legal frame work, a collection system, logistics and other services, for its applications. Due to lower environmental standards and working conditions in China, India, Kenya, and elsewhere, electronic waste is being sent to these countries for processing –in most cases illegally. Guiyu in Shantou region of China, and Delhi and Bangalore in India, all have e-waste processing areas. Such un-controlled burning, disassembly, and disposals are causing environmental and health problems, including occupational safety and health effects among those directly involved. Trade in electronic waste is controlled by the Basel Convention. E-waste is of concern largely due to the toxicity and carcinogenicity of some of the substances if processed improperly. However, electronic waste processing systems have matured in recent years following increased regulatory, public, and commercial scrutiny, and a commensurate increase in entrepreneurial interest. In developing countries, e-waste processing usually first involves dismantling the equipment into various parts – metal frames, power supplies, circuit boards, and plastics – which are separated, often by hand. Alternatively, material is shredded, and sophisticated expensive equipment separates the various metal and plastic fractions, which are then sold to various smelters recyclers. From 2004, the State of California has introduced an Electronic Waste Recycling Fee on all new monitors and televisions sold to cover the cost of recycling. Canada has also begun to take responsibility for electronics recycling. The typical electronic waste recycling plant as found in some industrialized countries combines the best of dismantling for component recovery with increased capacity to process large amounts of electronic waste in a cost-effective-manner. Material is fed into a hopper, which travels up a conveyor and is dropped into the mechanical separator, which is followed by a number of screening and granulating machines. The entire recycling machinery is enclosed and employs a dust collection system. The European Union, South Korea, Japan and Taiwan have already demanded that sellers and manufacturers of electronics be responsible for recycling 75 per cent of them.

Many Asian countries have legislated or will do so for e-waste recycling. The Unite States Congress is considering a number of e-waste bills including the National Computer Recycling Act introduced by Congressman Mike Thompson (D-CA). This bill however, has been continually stalled.

b.) **Plastic Waste:** Plastic is one of the few chemical materials which pose environmental problems. Polyethylene, polyvinyl chloride, polystyrene are largely used in the manufacturing of plastic. It can be formed into fibres or thin transparent films. These properties have made them popular in many durables or disposable goods and for packing materials. Plastics are used because they are easy and cheap to make and they last for long time. The importance of this sector to the national economy can be gauged from the fact that the domestic demand had crossed 4 million tones, announcing the use of plastic as a material of choice in numerous applications due to the depletion of already scarce natural resources. Packing is the major application, accounting for nearly 52 per cent of plastic consumption.

Unfortunately, these, useful qualities has made plastic a huge pollution problem. Because plastic is cheap, it gets discarded easily and its persistence in the environment can do great harm. Urbanization has added to the plastic pollution in concentrated form in cities. The important sources of plastic wastes are packaging, carry bags, bottles, containers, trash bags, from health and medicare, from hotels and catering industry, from air, rail, road travelers. Plastic carry bags have environmental implications from cradle to grave. While, carry bags made from virgin plastics are accepted as user friendly, the problem arises when plastic are recycled for repeated use. For consumer acceptance recycled material of first grade should be used. In respect of other cases when second grade material is used they will find greater acceptance by blending virgin and recycled plastics in 50:50 ratio. Carry bags manufactured using third and low grade materials are unacceptable and are main environmental culprits. The Indian Ministry of Environment and Forests (MoEF) has notified "The Recycled Plastic Manufacture and Usage Rules 1991". These rules require that carry bags or containers used for the purpose of storing shall be made of virgin plastic and in a natural shade or white, with the thickness of the carry bags not be less than 20 microns. It was reported in one of the programmes on a T.V. channel that eating plastic bags had resulted in death of 100 cattle per day in U.P. In the stomach of 1 dead cow about 35 kg plastic waste was found. The amount of plastic waste in oceans is steadily increasing. More than 90 per cent of the articles found on the sea-beaches contained plastic. This plastic affects the marine wildlife, by entangling creatures and by being eaten. Turtles are badly affected by plastic pollution, and all seven of the world's turtle species are already either endangered or threatened for a number of reasons. In one dead turtle found off Hawaii in the Pacific Ocean more than 1,000 pieces of plastic were found in the stomach.

One of the types of waste in this category is the Man-made fibres, used in the Textile Mills, with wide variation with regard to quantity and quality and type of fabrics, concentration of wastes containing a variety of dyes, salts, acids, alkalies, peroxide and organic materials like starch, oil, wax, etc. Textile production includes spinning, knitting and weaving of natural and man-mande fibres, finishing of textiles and the production of made-up garments. The industry uses vegetables fibres such as cotton, animal fibres, such wool and silk, and a wide range of synthetic materials, such as nylon, polyester and acrylics. The textile industries have been regarded as water-intensive sector. The main environmental concern is therefore, also about the amount of water discharged and the chemical load it carries. Other important issues are energy consumption, air emissions, solid waste and odours, which can be a significant nuisance in certain treatments.

7.10 Environment Impact Assessment

Environment Impact Assessment (EIA) is an important instrument of reconciliation between the development needs and environmental value. It is based on the principle of prevention and not on the principle of cure. It is very important and essential to assess the consequences of project, plans and or policies at different levels. Environment Impact Assessment enables the local planning authority to understand beforehand the environmental effects of development and helps to take decisions whether or not to grant permission for the proposal. EIA is an assessment made by planning authority on the basis of environmental impact of the project and mitigating measures to reduce the impact. It helps the project planners to make the best choice among various available options.

If during an assessment of the development project, plan or policy, it is found that it is likely to result in adverse environmental effects, then it is possible either to modify it or abandon it. Even private projects which are likely to have major effects on the environment because of their location, size, or nature will be assessed with respect of their environmental impact before the permission is granted for development. The next stage of the Environment Impact Assessment is to find out whether there are secondary effects of socio-economic importance. These include, whether there will be concentration of population, loss of jobs opportunities and impact on the civic amenities.

EIA is compulsory in U.S.A., if any project has trans-boundary effects on another country. In India, before January 1994, EIA was carried out under the administrative guidelines issued by the Ministry of Environment and Forest (MoEF), requiring the clearance for major irrigation projects, power stations and harbours, etc. EIA was carried out by the Appraisal Committees in the Ministry. After having discussions with the project authority, either they were approving or rejecting the site. On 27th January 1994, the Ministry of Environment and Forest (MoEF), notified mandatory Environment Impact Assessment for 29 designated projects. The notification made it obligatory to prepare and submit an EIA on Environment Management Plan (EMP) and project report to an Impact Assessment Agency for clearance. The Summary of the project report and the detailed MEP/EMP will be made available to any citizen. By 1997, an amendment to the 1994 notification was made. Now, a project manager has to submit only a summary report and not a detailed project report. He can start land acquisition proceedings and fell trees even before the clearance is given. As per the amendment, only the bonafide member will have access to execute the summary of the Environment Impact documents and will have the right to the access to documents.

A new notification was issued on 10th April, 1997. According to this notification, thermal power projects can get clearance from the State Government. There is a provision for public hearing. The Parliament passed the National Environment Appellate authority in 1997. The Appellate Authority is empowered to hear appeals filled by any aggrieved person by the order granting environmental clearance in any area where industrial activity restricted under Environmental Protection Act or clearance given by the Impact Assessment Agency.

a.) Environmental Audit:

Environmental audit can be undertaken for a variety of reason on site, they can be specific to a particular subjects, i.e., water use, or more general such as initial reviews. Audits are also undertaken accredit companies to environmental management systems (EMS), such as those under ISO 14001 and EMAS. An environmental audit is the method used to obtain accurate, comprehensive and meaningful information on environmental impact of a company on which management decisions can be based. According to UMEP "an Environmental Audit" is a management tool comprising a systematic, documented, periodic and objective evaluation and how well environmental organization, management and equipment are performing , with an aim of helping to safeguard the environment by facilitating management control of environmental practices and assessing compliance with company policies, which would include meeting regulatory requirements. Environmental Auditing is the methodological examination, involving analysis, tests and confirmations of a facility's procedures and practices with a goal of verifying whether they comply with legal requirement s and internal policies and evaluating whether they confirm with good environmental practices.

Various Environmental audit tools are, namely, Check list; Questionnaire; Interviews; Observations; Discussions and Reporting. Environmental Audit can be classified into following types:

1. Environment Review
2. Waste Audit
3. Waste Disposal Site Audit
4. Water Audit
5. Compliance Audit
6. Environmental Management System (EMS) Audit
7. Acquisition Audit
8. Due Diligence Audit

b.) Benefits of Environmental Audit:

The benefits of carrying out environmental audits are numerous and it includes:

1. Reducing liability and the potential for the environmental fines.
2. Insuring compliance with legislation
3. Reducing waste costs
4. Reducing water and energy costs
5. Good Public relations (If results are published)

7.11 Environmental Legislations in India

The World Charter on Nature adopted by the U.N. General Assembly on 28th October, 1982 declared that nature shall be respected and its essentials shall not be impaired. Conservation of nature should be the part of total planning. It is further emphasized that the principles of the Charter must be enacted into law of each State and put into practice at the State as well as the International level, mandating the co-operation of the States, public authorities, international organisation, individuals and groups. Consequently, the General Assembly of the United Nations passed a resolution on 15th December, 1974, emphasizing the need for co-operation among the States to conserve and protect the environment. June 5th is designated as the "World Environment Day". About 130 States participated in the Stockholm conference resolved and affirmed that preservation and improvement of human environment was their moral duty. Declaration of Stockholm, 1972 and Charter of Economic Rights and Duties of the States, 1974 are the important and significant documents which reflect the concern of the international organization to protect and preserve the environment for human living.

India being one of the signatories at the Stockholm Conference took note of all these environmental problems and expressed concern about the environmental issues. In the Fourth Five-Year Plan (1969-74) the Government of India, emphasized that it was an obligation of each generation to maintain the productive capacity of land, water, air and wild life in a manner which leaves its successors some choice in the creation of healthy environment. The successive Fifth, Sixth and Seventh Fiver-Year Plans also emphasized the need and importance of environment protection. International conference on Environmental Education held in New Delhi in December 1982, called for a massive programme of environmental education research and monitoring. Under the Fundamental Rights, Article 21 of the Constitution guarantees the right to life, a life of dignity to be lived in a proper environment free of danger of disease and infection. The Directive Principles of State Policy of the Indian Constitution in Article 47 clearly declared to raise the level of nutrition and the standard of living of its people and the improvement of public health as one of the Fundamental Duties of the State. Article 40A which was incorporated in the 42nd Amendment of the Constitution provides that "the State shall endeavour to protect and improve the environment and to safeguard forests and wild life of the country."

The 42nd Amendment also added certain Fundamental Duties of the citizens in part IVA of the Constitution, under these Fundamental Duties, Article (51A) specifically provides as such –"it shall be the duty of every citizen of India to protect and improve the natural environment including forests, lakes, rivers, and wildlife and to have compassion for living creatures, empowering the Centre and the State Governments to take legislative and administrative measures to protect, preserve and improve the quality of the environment. There are a number of general and special laws and Environmental Protection Acts which empower the Government to maintain and improve the environment and control the environment pollution. Under the Indian Penal Code, spreading of infection of any disease dangerous to life, fouling of water of public spring or reservoirs and rendering it unfit for human consumption, making the atmosphere noxious to health, creating public nuisance, mischief are all acts of offence. There are number of special laws for specific purpose to protect and improve the environment. The Factories Act, 1948, the Insecticides Act, 1958 and Motor Vehicles Act, 1939 are some of the old laws which deal with the maintenance of the environment against pollution. There are number of other newly enacted laws which are directly related to pollution control and environment protection, such as the Wildlife (Protection) Act, 1972, the Water (Prevention and Control of Pollution) Act, 1974, the Air (Prevention and Control of Pollution) Act, 1981, the Forest (Conservation) Act, 1980, the Wildlife (Protection) Amendment Act, 1986.

Under the Environment Protection Act, 1986, the Central Government can exercise comprehensive powers for the purpose of protecting and improving the quality of the environment and preventing, controlling and abating pollution. The act further empowers the Government to make rules for:

a.) standards of quality of air, water or soil for various areas and purposes;
b.) procedure and safeguards for the handling of hazardous substances;
c.) permissible limits of pollutants (including Noise) for different areas;
d.) prohibiting and restricting the hazardous substances in different areas;
e.) procedures and safeguards for preventing accidents which may cause environmental pollution.

Various high-powered committees are also set up. In 1980, the Government of India appointed a high-powered Committee under the Chairmanship of the Deputy Chairman of the Planning Commission to take a review of the existing administrative framework and to recommend sound legislative measures for improving the quality of the environment and ensuring its protection. Some of the suggestions were as follows:

a) Comprehensive legislation for biosphere reserves;
b) Protection of grazing land;
c) Protection of endangered species;
d) Toxic substances Control Act;
e) Suitable legislative provisions to prevent the growing abuse of land and for enforcing strict reclamation of soil after it is removed for brick-making;

f) Prevention of Noise Pollution and
g) Prevention of denudation of forests

The National Committee of Environmental Planning has constituted Environmental Board in every State and Union Territory and Department of Environment at the Central level in 1980. The various departmental functions here, are under the control and supervision of the Prime Minister and is assisted and advised by the National Committee on Environment Planning (NCEP), and the Development Board at the National level. The Botanical Survey of India was set up with a country wide network with regional offices.

The Department of Environment, Forest and Wildlife was created under the Ministry of Environment and Forests (MoEF) in 1985. The main function of the department includes Social Forestry, Farm Forestry, Extension Forestry, etc. In 1992, the Central Government decided to establish an Environmental Relief Fund to provide immediate relief to the victims of industrial accidents by amending the Public Liability Insurance Act 1991. Under the act every industrial unit must take one or two policies covering its liability to provide immediate relief to a person who suffers injury or damage or death.

In fact, India is one of the first in formulating environmental laws in the world. Among these laws, are the Water Pollution Control Act, 1974; the Forest (Consennation) Act, 1980 and the Environmental Protection Act, 1986. The Factories Act was amended in 1987, making it mandatory for hazardous manufacturing units to submit a disaster management plan and environment impact assessment. The environment audit introduced in 1992, along with the National Environment Tribunal Bill and the Public Liability Insurance Bill are further strengthening of the Government's power. Thus, these laws can enforce environmental discipline on nay industrial unit. If Air and Water Pollution Act and Environment Protection Act are taken together, polluting units can be closed or their water and electricity supply discontinued.

But, unfortunately, these clauses were never invoked by the implementing agencies which are the State and it is because of this that public interest litigations (PIL) has enterd the area of environmental protection.

Activity C:

1. Comment on the Environmental Protection Legislation performance in your locality and provide valuable suggestions for the better implementation of framed rules and regulations.

7.12 Role of NGOs in Environmental Protection in India

The Environmental Movement in India is in many ways a legacy of Mahatma Gandhi. Under the leadership of the Mahatma who had a self-reliant, village-oriented concept of free India, the Freedom Movement had spawned a large number of voluntary groups and individuals committed to social work. The voluntary sector has since grown not only in numbers but also in ideology and today, consists of more than just the erstwhile Gandhian groups though their contribution continues to be crucial widespread.

The environmental services group and the Ministry of Environment Forests and Wildlife have published a directory of Environment. Non- Governmental Organisations (NGOs) in India in 1989 enumerated the work of voluntary agencies in the field of environment. The number of environmentalists listed in the directory is around 700. But as this is an incomplete list, there must be over a few thousand groups, and even more numerous individuals involved in environmental protection.

The activities of the environmental groups can be broadly categorized as follows:

a) Creation of environmental awareness and dissemination of information.
b) Campaigns and public interest litigations to oppose projects detrimental to the environment.
c) Field projects to develop innovative and participatory models of natural resources management.
d) Policy research and lobbying with policy-makers and
e) Support for field and action groups

The awareness of environmental issues have been created through publication and pamphlets, padayatras, marches and rallies, workshops, seminars, films and numerous other ways. The most famous padayatras was the, "Save the Western Ghats March". Amongst publications, the two citizen's reports on State of India's Environment have been quite popular.

Some of the important Environment Movements in India are listed below:

a) Chipko Movement- 1973, the first and to date the most famous environmental movement, the 'Chipko Andolan'
b) Save the Silent Valley Campaign – 1980, the first major campaign against a dam in India which started in the early 1980s.
c) Save the Taj Campaign – The most recent threat to the Taj is far more serious. Environmentalists feared that the pollution from the Mathura Oil Refinery, located 40 kms from Mathura and 160 kms from Delhi. It was Professor J.M. Dave, Dean of the School of Environmental Sciences at the prestigious Jawaharlal Nehru University (JNU) in New Delhi, who first raised grave doubts about the impact of the Mathura Oil Refinery.
d) Save the Soil Campaign – 1977, known as the Mitti Bachao Abhiyan, against the water-logging and salinity caused by the Tawa Dam in Madhya Pradesh
e) The Vaishet Campaign – The silting of the world's biggest urea plant just 21 kms, from Mumbai at Thal Vaishet evoked enormous opposition from the city groups, who feared that the plant will increase Mumbai's pollution and over congestion, notably by the Mumbai Environmental Action Group.
f) Bedthi Campaign – This hydro-electric project located in Karnataka was the second in India after the Silent Valley to be abandoned after environmental protests.
g) Stop Bhopal Patnam-Inchampalli Dams: These two dams on the Indravati river, in Maharashtra were stopped due to local protests from the tribals, led by the Jungal Bachao Manc Bachao Andolan, a local coalition of activists, politicians and social workers.
h) Doon Mining: Limestone mining in the Doon Valley and Mussorie hills has left permanent scars on the famous hill, destroying forests and permanent water sources. The Rural Litigation and Environment Kendra in Dehradun filed a public interest case in the Supreme Court and the Court in a historic judgment ordered the closure of the mines on grounds of environmental destruction.
i) Protect Karnataka Commons: The Karnataka Government's decision to grant nearly 80,000 acres of degrade forest land and revenue land to a joint sector company for afforestation in being opposed by the Environmentalists, Samaj Parivartana Samudaya, a local voluntary agency has filed a petition in the Supreme Court contending that people's access to Government forest land is crucial to their survival and so the Government's decision to underatake afforestation through commercial interests affects their fundamental right to live.

j) Kaiga Campaign - 1984, Opposition to nuclear power plant at Kaiga in Karnataka started in 1984 and has since gained momentum. In spite of the Governments's decision to go ahead with the project, local groups compromising farmers, betelnuts growers, fisher folks, journalists and writers want the project to fold up.

k) Gandhamardhan Bauxite Mining – The proposal to mine the Bauxite in the Gandhmardhan Reserve Forest, even though formally cleared by the Government has been stalled because of the intense agitation of the local tribals who do not want to see their forests destroyed.

l) Besides, Narmada Campaign, Save the Western Ghat March, Save Water Save Life, a Tehri Dam Campaign and others, are the forms of the voice raised against the human economic activities accompanied by the modern technology, but affecting the environment considerably and adversely.

Activity D:

1. Identify any one NGOS operating in your locality and comment on the environmental protection steps, if any, taken.

7.13 Summary

An environmental study is a multi-disciplinary activities, its focus varies with the objective of the interest of the investigators and its dimensions varies on the basis of the components at the time of study. Webster's dictionary defines the environment as, "the circumstances, objects, conditions by which one is surrounded, the complex of physical, chemicals and biotic factors, that act upon an organism, or an ecological community and determine its form and survival, the aggregate of social, cultural factors that influence the life of an individual or community."Environment holds the key in the economic growth and the survival of living things. Moreover, the natural environment in combination with the technological environment presents the impulsive potential for development while other environments like the economic, social and political and government factors represent the propulsive potential for development. The word "Natural Environment" is understood as Land (Atmosphere), Air (Hydrosphere), Water (Lithosphere) and Diversity of living organisms (Biosphere)

Natural resources are the "means of attaining given ends", the ends, being the individual goals or social objectives and are dynamic. On the bases of an individual's efforts to tap and utilize the natural resources, these natural resource change in quality and quantity in response. The availability of different types of resources determines the scope of development of various economic and commercial activities of human beings. Science and technology has revolutionized the means of producing economic goods from natural resources. A number of problems have been experienced by both, the developed and the underdeveloped countries in the use and development of natural resources. Man is known for his ability, skills and an innovative mind enabling to manage all spheres of business of the present day environment. Man is a Resource Producer, Resource Distributor and Consumer. But, Man's needs have grown with modernization and globalization has made him greedy and has unwittingly become the cause of pressure on the environment and extinction of various species.

The man-environment relationship brings out the ever changing role of man from:

Explorer →Exploiter →Processor →Producer à Consumer →

→Destructor →Conserver→Protector of Natural Environment

Since the time man has started modifying the environment to suit his requirements, drastic changes in the quality of environment have emerged. Today, the period of science, technology and industrialization has added to the period of conflict between man and nature which can be changed to a symbiotic relationship by treating nature as an ally/friend. Throughout the development history, man has been trying to become a master of nature, has destroyed nature and the environment to a considerable extent. Global Warming, Greenhouse Effect Ozone Depletion, Acid Rains, Marine Pollution, over exploitation of resources, etc., are some of the environmental problems at the global level.

There are a number of general and special laws and Environmental Protection Acts which empower the Government to maintain and improve the environment and control the environment pollution which are discussed in the material as well as the role of NGOs in the environmental protection is outlined.

7.14 Self Assessment Questions

1. Discuss various role of man in "Man-Nature Relationship" in detail.
2. Define the Natural Environment. Discuss the compositions of natural environment in detail.
3. Define Natural Resources. Discuss various types of natural resources and it limitations in its use and development.
4. What is the meaning of Anthropogenic wastes. Discuss various types of Anthropogenic wastes in detail
5. Write a short note on the following:
   a. Environmental Degradation
   b. Global Warming
   c. Plastic Waste
6. Discuss in detail the issue of "E-Waste" with suitable examples.
7. List out the Environmental Protection Legislations in India, with the brief note on the objectives for their establishment.
8. Write a short note on the role of NGOs in environment protection in India.
9. Write a short not EIA- Environment Impact Assessment.

7.15 Reference Books

- Mittal V.; Business Environment; Excel Books;
- Watrick S. L. and Wood D. J.; International Business and Society; Blackwell Publishers Inc; Massachusetts; 1998;
- Shinde P. G., Pendse S., Ganguli M., Basu R., Environment Management; BMS Series; Sheth Publishers; Mumbai; December 2008;

Unit - 8 Environment Analysis and Forecasting

Structure of Unit:

8.0 Objectives

After completing this unit, you will be able to:

- State the meaning and benefits/importance of environmental analysis,
- Enumerate the stages of environment analysis.
- Outline the approaches and techniques of environment analysis.
- Methods of assessing environment risk
- Meaning of forecasting and its importance.
- Explain the types of forecasting and steps involved in environmental forecasting.
- List out the techniques and limitation of environmental forecasting.

8.1 Introduction

The term "environment" refers to the totality of all the factors which are external to and beyond the control of individual business enterprises and their managements. Environment furnishes the macro-context; the business firm is the micro-unit. The environmental factors are essentially the "givens" within which firms and their managements must operate.

For example, the value system of society, the rules and regulations lay down by the Government, the monetary policies of the central bank, the institutional set up of the country, the ideological beliefs of the leaders, the attitude towards foreign capital and enterprise, etc., all constitute the environment system within which a business firm operates. These environmental factors are many in numbers and various in form. Some of these factors are totally static, some are relatively static and some are very dynamic – they are changing every now and then.

Some of these factors can be conceptualized and quantified, while other can be only referred to in qualitative terms. Thus, the environment of business is an extremely complex phenomenon. Environmental analysis refers to the evaluation of possible or probable effects of external forces and conditions on an organization's survival and growth strategies. The process of

Environmental analysis consists of four steps—scanning, monitoring, forecasting and assessing. Environmental analysis is the study of the organizational environment, to pinpoint environmental factors that can significantly influence organizational operations. It will help a business environment understand what happens to both inside and outside to their organization and to increase the probability that the organizational strategies that is developed will appropriately reflect an organizational environment. Business environment largely refers to all external forces outside the firm which have a bearing on the functioning of the firm either by leading to further productive opportunities or by causing threats to the firm.

In order to perform an environmental analysis, organizations must understand how organizational environments are structured. For the purposes of environmental analysis, an organization can divide the environment of their organization into three distinct levels: internal environment, operating environment, and general environment.

Strategic analysis is basically concerned with the structuring of the relationship between a business and its environment. The environment in which business operates has a greater influence on their successes or failures. There is a strong linkage between the changing environment, the strategic response of the business to such changes and the performance. It is therefore important to understand the forces of external environment the way they influence this linkage. The external environment which is dynamic and changing holds both opportunities and threats for the organizations. The organizations while attempting at strategic realignments, try to capture these opportunities and avoid the emerging threats. At the same time the changes in the environment affect the attractiveness or risk levels of various investments of the organizations or the investors.

The objectives of environmental analysis are: (a) to provide an understanding of current and potential changes taking place in the task environment.(b)to provide inputs to strategic decision making.(c) to facilitate and foster strategic thinking in organizations.

Business decisions, particularly strategic ones, need a clear identification of the relevant variables and a detailed and in-depth analysis of them to understand their impact and implications for the organization. For example, what is the impact of the different aspects of liberalization on a company? What are the implications of the liberalizations for the company? In other words, what are the threats posed by the liberalization and what are the opportunities unfolded by the liberalization? A thorough analysis of the environment is necessary for finding answers to these.

8.2 Benefits/Importance of Environmental Analysis

Environmental analysis has several benefits which are as follows:

1. An environmental analysis makes one aware of the environment-organization linkage.
2. It helps an organization to identify the present, so that necessary changes could be made in case of

future threats and opportunities, treat means who are the new entrants in market or the competitive firm, opportunities means whether an organization could go for expanding business or product line.

3. It would provide a necessary and very useful picture of the important factors which influence the business.
4. Environmental analysis helps to understand the transformation of the industrial environment.
5. Technological forecasting will indicate some of the future opportunities and challenges. It means whether a time has come to change the technology or an organization can survive with the same technology.
6. The risk identification is the very important benefit of environmental analysis.
7. Environmental analysis is required before formulation of right strategies-corporate business and functional.
8. Environmental monitoring helps suitable modifications of the strategies as and when required.
9. Environmental analysis keeps the managers informed, alert, and often dynamic.

Activity A:

1. The risk identification is the very important benefit of environmental analysis. Explain how will it benefit the domestic organization.

8.3 Stages of Environmental Analysis

The process of environmental analysis may be divided into the following four stages:

1. Scanning the environment to detect warning signals.
2. Monitoring specific environmental trends.
3. Forecasting the direction of future environmental changes.
4. Assessing current and future environmental changes for their organizational implications.

1. Scanning

It is the process of analyzing the environment for the identification of the factors which influence or have implications for the business. Such factors may include those which have appeared suddenly or evolved over time. Identification of emerging trends is a critical purpose of the environmental scanning. The scanning focuses on identifying indicators of potential environmental changes and issues. Environmental scanning is thus aimed at making the organization aware of the external problems before it affects the organization. Successful environmental scanning draws attention to possible changes and events in advance to the occurrence, allowing time for suitable strategic action."

2. Monitoring

Monitoring entails the follow up and a more in-depth analysis of the relevant environmental trends identified at the scanning stage .The effort in monitoring is more focused and systematic than in scanning. Scanning is essentially exploratory in nature and, therefore, it involves a very wide examination of the environment. As the relevant factors have already been identified, .Monitoring looks forward for a focused and systematic approach. "The purpose of monitoring is to assemble sufficient data to find out whether certain patterns are emerging." So, "they are likely to be a complex of discrete trends. For example, an emergent life-style pattern may include changes in entertainment, education, consumption, work habits and domicile—location preferences. In the initial stages of monitoring, the patterns are likely to be not very clear as they are the outputs of scanning: the analysts are not very clear about what to look."

The outputs of monitoring are threefold: a specific description of environmental patterns to be forecast; identification of trends for further monitoring and identification of patterns requiring further scanning.

3. Forecasting

Anticipating the future is essential for identifying the future threats and opportunities and formulating strategic plans. "Forecasting is concerned with the development of possible directions the, scope, speed, and intensity of environmental change, to lay out the evolutionary path of anticipatory change.

The characteristics of the variables or their trends may undergo changes. Further, new variables may emerge as critical or the relevance of certain variables may decline. It is necessary to monitor changes that take place. Some times the changes may be very significant so as to call for a re-forecasting.

4. Assessment

The purpose of environmental analysis is to assess the impact of the environmental factors on the organization's business or their implications for the organization. Assessment, involves drawing up implications of the possible impacts. "In assessment, the frame of reference moves from understanding the environment— of the focus of scanning, monitoring and forecasting—to identifying what that understanding of environment means for the organization."

Activity B:

1. The purpose of monitoring is to assemble sufficient data to find out whether certain patterns are emerging or not. Justify it with an example.

8.4 Approaches to Environmental Analysis

There are broadly two approaches to environmental analysis:

1. Outside-in (macro) approach
2. Inside-out (micro) approach

The outside-in or macro approach takes a very broad view of the business environment, for a long period of time and develops alternative scenarios for the future. The implications of the alternative scenarios for the industry and the organization are taken into consideration with various references to the different scenarios.

The scenario analysis is a technique used to forecast the occurrence of complex environmental events. It is particularly useful for forecasting events in which many variables play a role. A scenario allows the integrated consideration of these multiple variables in explaining the occurrence of future conditions. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organization."

The following steps have been suggested to develop scenarios.

1. Identify strategic environmental issues that are likely to affect the industry or firm. Prioritize these issues in order of their importance to the firm.
2. Select the most important issues as the focus for scenario development. List the organizational assumptions with respect to these issues and identify the possible variation in these assumptions.

3. Prepare a preliminary description of these issues and how they evolved. Include the key economic, social, political, and cultural influences that affect them. This could be done with the help of outside industry experts.
4. Draw out the implications of the issue for organizational performance. What has the organization done and what can it do to cope with the issues? Identify those variables shaping the issue that the management can control and partially control. Also, identify those variables over which management has no control.
5. Develop detailed descriptions of the future in the form of scenarios. Scenarios are constructed under a worst case, best case, and most likely case set of assumptions. Draw' out the implications of these scenarios for future performance of the company.
6. Discuss the scenarios with top management and refine them.
7. Develop contingency action plans for each scenario.

The inside-out (micro) approach, which takes a narrow view of the environment, forecasts the immediate future environment on the basis of the ongoing environmental monitoring and derives the implications of it for the industry and firm out of it.

Activity C:

1. Scenarios are constructed under a worst case, best case, and most likely case set of assumptions. Draw' out the implications of these scenarios for future performance of any one company while doing environmental analysis.

8.5 Techniques for Environmental Analysis

Techniques for environmental analysis refer to the methods of gathering the relevant information for appraising the environment.

William Glueck mentions four techniques for environmental analysis:

1. Verbal and Written Information.
2. Search and Scanning.
3. Spying and
4. Formal Forecasting

1. Verbal and Written Information:

A lot of information, published or unpublished, are available on many matters. There are people who may not like to put information on record, but they may disclose certain information orally, for confidentiality.

Tact and proper approach are required to obtain such information. Verbal information is significant in several other situations. The situation might have changed after the documentation of the information, necessitating personally contacting knowledge people to get the latest information. Personal contacts will be helpful in getting more details of the written information. Personal contacts will also be useful in obtaining diverse views of different people.

There are indeed many matters on which written information is non-existent or not available. All these highlight the importance of verbal information in environmental analysis. While using written information, several factors such as the purpose for which it was prepared, the methodology used for collection of the information, reliability of the sources of information, the orientation of the individual/

organization that prepared the information etc. need to be evaluated. Such cautions should also be exercised while going in for verbal information. Sources of verbal information also include electronic media, seminars, workshops etc.

2. Search and Scanning:

Even when the required information exists somewhere, it may not become readily available. Search and scanning are, therefore, needed, many a time, to identify the sources of information and to manage the timely availability of the required information. A number of organizations have clipping service which constantly scans newspapers; periodicals etc. and prepare clippings containing information required by different departments/executives of the organization. Many organizations have Management Information System for systematic gathering, processing, storing and disseminating information An MIS is generally regarded as very useful.

3. Spying

Spying, is regarded unethical by many, is not much in business. This has been used to obtain secret information regarding defense and space research. There are many instances of industrial environment. This is used mostly to gather competitive information.

4. Formal Forecasting

The fourth approach to environmental analysis is formal forecasting. This is described in the steps in environmental forecasting.

8.6 Motives behind Environmental Analysis

There are three main motives that drive organizations to conduct environmental analyses:

1. To provide an understanding of current and potential changes taking place in the task environment. It is important for an organization to not only be fully aware of the existing environment but also have a long term perspective by understanding the direction of change in the environment.
2. To provide inputs for strategic decision making. The collection of data from the external environment is not enough. The data needs to be assessed and the results of such assessment should be used to make strategic decisions for the organization.
3. To facilitate and foster strategic thinking in organizations. Strategic thinking gives rise to a rich source of ideas and understanding of the context within which a firm operates. Strategic thinking helps challenge existing norms and ideas to bring fresh viewpoints to the organization.

8.7 Methods of Assessing Environment Risk

All types of risks keep changing and a firm's reaction or response depends mainly on its own perception of assessment of risk. The large domestic firms and multinational enterprises are more concern of the risk factors and make efforts to reduce them. Some of the following environment risk assessment methods are useful for both domestic and foreign firms.

1. **Expert Opinion:** This method of analyzing environmental changes relies on expert opinion. The firm seeks the subjective judgment of people who are well informed about the current state of the environment and its reading determinants.

   In this method, questionnaires designed to assess environment risk are sent to acknowledged experts and their opinions, observations, and comments are obtained. A variant of this method is the Delphi Technique in which a panel of experts is constituted and they are asked to give an assessment or prediction of risk, individually and separately. The process may be repeated and the final response is recorded as risk assessment.

2. **Checklist:** It consists of a number of economic, social, and political variables which affect the business environment and point out some risk element in it. The risk also contains elements relating to the various issues that the country is facing. This method gives a rough approximation of the business environment risk and the future outlook. Checklists are used to assist in the interpretation of the political system and conational change.

3. **Rating and Ranking Systems:** This system is similar to the scoring system whereby country rating is done on the basis of a number of economic, financial, political, and social parameters. Each of these parameters is weighted according to its importance in the total environmental risk. The weighted parameters are assigned scores according to present guidelines and different sectors within a country are rated and ranked on a scale.

4. **Economic Methods:** This method is complex and sophisticated and is used to quantify economic risk and related aspects. These methods are used both for estimation and forecasting. In such methods, identification of the factors are done on priority basis (called independent variables) which affect environment risk (called dependent variables) and then establish a- model -of their cause-effect relationship. The relationship is specified in a functional form usually stated as mathematical equation on a linear or non-linear form), which involves certain parameters whose values are estimated. In this approach it is possible to state, quantitatively the strength of each variable (or causative factor) that affects or determines business environment risk.

8.8 Managing Environment Risk

1. **Developing the Local Economy:** In order to develop good public relations around the area of location and to avoid any possible local confrontation and criticism, it is a beneficial policy for a firm to contribute to the development of the local economy. The firm may form joint ventures with local shareholder. Participation of local shareholders will also help to build links with the local community and provide the benefit of local management advice and knowledge. The firm may make-local purchases; employ local people in unskilled or semiskilled activities. This strategy is helpful for the firm to gain acceptance by people.

2. **Good Corporate Citizenship:** Corporate behavior conforming to what is usually referred to as a good citizen policy is one of the most popular prescriptions for avoiding adverse political initiative .This is amongst the best strategies to deal with political risk. Firms follow this policy by responding promptly to government requests, contributing to national goals, and developing a corporate image. With such an image, a firm may- find- it easy to obtain licenses, permits, power connections, government land, and other facilities from the government.

3. **Tie-up and Collaboration with other Firms:** Firms can manage risk by not standing alone. This strategy helps a firm to share risk with other firms.

4. **Private Insurance:** Even after the firm has committed its resources, it can resort to private insurance schemes to hedge against future loss.

5. **Avoiding Politically Sensitive Products:** Firms can reduce risk by avoiding product lines which

affect exchange rates, national security, and public health, or are contrary to the general beliefs and moral values of people, for example, Alcohol, cigarettes explosives.

6. **Avoiding Sensitive Regions**: Firms can avoid politically sensitive regions and choose safer or more peaceful locations. Multi-plant and multi-product firms are to avoid risk to a considerable extent.

7. **Maintaining Good Political Relations:** Many business firms find wisdom in maintaining politically neutral postures but it is believed that they must have normal to cordial relations with the political parties in power for having a say in the government.

Activity D:

1. Enumerate few of the technological advances in the field of pharmaceutical industry. Discuss how this industry would manage environment risk

8.9 Limitation of Environmental Analysis

Some of the limitations of environmental analysis are as follows:

1. Environmental analysis does not foretell the future and hence does not eliminate uncertainty.
2. Environmental analysis by itself is not a sufficient guarantor of organizational effectiveness.
3. Environmental analysis places too much reliance on information collected through environmental scanning.
4. The full potential of environmental analysis is often not utilized because it is practiced not in a systematic manner.

8.10 Some Basic Propositions

The description and analysis of the business environment in any economy, onemay examine the three basic propositions given below:

1. Business is an economic activity.
2. A business firm is an economic unit.
3. Business decision-making is an economic process.

These propositions may be examined separately or jointly to justify the study of the economic environment of business in any country.

1. **Business is an Economic Activity:** An economic activity involves the task of adjusting the means (resources) to the ends (targets), or the ends to the means. An economic activity may assume different forms such as consumption, production, distribution, and exchange. The nature of business differs deepening upon the form of economic activity being undertaken and organized For example, manufacture is concerned with production and the stock exchange business of Government, and it is to be run by the administration. The Government may also own, control and mange public enterprises. The business of banks is to facilitate transactions with short-arm and long-term ends. These examples can be easily multiplied. Each business has a target to achieve, and for this purpose each business has some resources at its disposal. Sometimes the target has to be matched with the given resources, and sometimes the resources have to be matched with the given target, either way, the task of business is to optimize the outcome of economic activities.

2. **A Business Firm is an Economic unit:** A business firm is essentially a transformation unit. It transforms input into outputs of goods or services, or a combination of both. The nature of input requirements and the type of output flows are determined by the size, structure, location and efficiency of the business firm under consideration. Business firms may be of different sizes and forms. They may undertake different types of activities such as mining, manufacture, farming, trading, transport, banding etc. The motivational objective underlying all these activities is the same viz., profit maximization in the long run. Profit is essentially "a surplus value"- the value of outputs in excess of the values of inputs or the surplus of revenue over the cost. A business firm undertakes the transformational progress to generate this "surplus value". The firm can grow further if the surplus value is productively invested. The firm, therefore, carefully plans the optimum allocation of resources (i.e., men, money, material, machine's time, energy, etc.) to get optimum production. The entire process of creating, mobilization and utilization of the surplus constitutes the economic activity of the business firm.

3. **Business Decision-Making is an Economic Process:** Decision-making involves making a choice from a set of alternative courses of action. Choice is at the root of all economic activity. The question of choice and evaluation arises because of the relative scarcity of resources. If the resources had not been scarce, an unlimited amount of ends could have been met. As the situation of resources constraint is very real. A business firm thinks seriously about the optimum allocation of resources because resources are limited in supply and most resources have alternative uses. The firm, therefore, intends to get the best out of given resources or to minimize the use of resources for achieving a specific target. In other words, when "input" is the constraining factor, the firm's decision variable is the "output". And when "output" is the constraining factor, the firm's decision variable is the "input". Whatever may be the decision variable, procurement or production, distribution or sale, input or output, decision-making is invariably the process of selecting the best available alternative. That is what makes it an economic pursuit. As business is an economic activity, a business firm an economic unit, and business decision-making an economic process, it is the economics environment of business which is the primary consideration in evaluating the business policies, business strategies and business tactics of a corporate entity in any national economy.

8.11 Meaning of Forecasting

Fore casting is the process of estimating the relevant events of future, based on the analysis of their past and present behavior. The future cannot be proved unless one knows what has happened and what is happening. Thus the past and present analysis provides the information about the future. Business leaders and economists are continually involved in the process of trying to forecast, or predict, the future of business in the economy. Business leaders engage in this process because much of what happens in businesses today depends on what is going to happen in the future.

For example, if a business is trying to make a decision about developing a revolutionary new automobile, it would be better to know whether the economy is going to be in a recession or whether it will be booming when the automobile is released to the general public. If there is a recession, consumers will not buy the automobile unless it can save them money, and the manufacturer will have to spend millions or billions of dollars on the development of a product that might not be profitable.

Forecasting in business is closely related to understanding the business cycle. The foundations of modern forecasting were laid in 1865 by William Stanley Jevons. A forecasting exercise is usually carried out in order to provide an aid to decision-making and in planning the future. It is the process of making estimation in unknown situations.

Forecasting is the process of making statements about events whose actual outcomes have not yet been observed. It might be estimation of the expected value for some variable of interest at some specified future date. Forecasting is the process by which companies ponder and prepare for the future. It involves predicting the future outcome of various business decisions. This includes the future of the business as a whole, the future of an existing or proposed product or product line, and the future of the industry in which the business operates. Forecasting has become big business around the world. Forecasters try to predict what the stock markets will do, what the economy will do, what numbers to pick in the lottery, who will win sporting events, and almost anything one might name. Regardless of who does it, forecasting is done to identify what is likely to happen in the future so as to be able to benefit most from the events

Applications for Forecasting Include:

1. Inventory control/production planning - forecasting the demand for a product enables us to control the stock of raw materials and finished goods, plan the production schedule, etc
2. Investment policy - forecasting financial information such as interest rates, exchange rates, share prices, the price of gold, etc. This is an area in which no one has yet developed a reliable (consistently accurate) forecasting technique.
3. Economic policy - forecasting economic information such as the growth in the economy, unemployment, the inflation rate, etc is vital both to government and business in planning for the future.

8.12 Importance of Forecasting

The need and importance of forecasting is likely as it plays key role in management process and helps management in many ways:

1. **Promotion of Organization:** An organization has certain objective and these objectives could only be attained only through the performance of certain activities. As expected outcome depends on the future events and the way in which activity is being performed, forecasting of events is of direct relevance in achieving an objective.

2. **Key to Planning:** It is an essential ingredient of planning .It is key to planning process .Forecasting generates the planning process. It provides the knowledge of planning premises within which managers can analyze their strength and weaknesses and can take appropriate action in advance before something goes wrong .It provides the knowledge of future conditions, so that business can create an environment to safe guard their business.

3. **Coordination and Control:** Forecasting indirectly provides the way for effective coordination and control. Forecasting requires various information regarding internal and external factors. Most of the information is collected from internal sources. Almost all units of the organization are involved in this process which provides interactive opportunities for better unity in and coordination in the planning process. It also provide relevant information for exercising control.

4. **Success in Organization:** Every business organization has to face risk and go through the ups

and downs of industry. Profit is the reward for bearing risk and working under uncertainties. The risk depends on future happenings and forecasting provides help to overcome the problem of uncertainties. Though forecasting does not check the future happenings but it provide clues about those and indicate when the alternative action should be taken.

8.13 Types of Forecasting

The various types of Forecasting are important for the business environments, viz; economic environment, social environment, political environment etc. would be useful in formulating plans and strategies.

1. **Economic Forecast:** The economic environment is a very critical determinant of business prospects determines the importance of economic forecasts. Important economic factors often include general economic conditions, GDP growth rate per capita income, distribution of income, structural changes in GDP, investment and output trends in different sectors and sub sectors / industries, price trends, trade and BOP trends etc.

The macro economic forecasts serve as a base for deriving industry and company forecasts. There are indeed a number of sources of short, medium and long-term forecasts. International organizations like World Bank, IMF, UNCTAD, UN, WTO etc. and regional organizations like Asian Development Bank have periodic and occasional publications which provide economic forecasts.

It becomes more useful when disaggregated details of the estimates / forecasts are available. When reliable forecasts are not available from the secondary source, a firm has to make its own forecasts. Reliable forecasts give very useful picture of the future scenario which is very helpful to planning and strategy making. For example, details of power development would indicate the scope of investment in the power sector itself and the prospects of related industries like generators, transformers, cables, switch gears, other electrical goods and materials used by power projects etc. Plans of rural electrification will give some indication of the additional demand for pump sets and certain categories of consumer durables and non-durables.

Short-term economic forecasts are very useful for demand and sales forecasting and marketing strategy formulation. Both quantitative methods such as econometric methods, and time series models and qualitative techniques like judgment models can be used for economic forecasts.

2. **Social Forecasts:** There are a number of social factors which have profound impact on business. It is, therefore, very essential to forecast the possible changes in the relevant social variables. Important factors include population growth / decline, age structure of population. Ethnic composition of population, occupational pattern, rural-urban distribution of population, migration, factors related to family, life-style, income levels, expenditure pattern, social attitudes etc.

As in the case of economic factors, there is a considerable amount of data available regarding future trends in birth and death rates and population size, age structure, ethnic composition etc. of different nations. Social trends have significant implications for business strategy. Quantitative techniques like time series analysis and econometric methods and qualitative methods like Delphi method or a combination of both quantitative and qualitative techniques may he used for social forecasts. One of the most popular methods is scenario building which involves 'drawing up alternative future scenarios, based on different assumptions or predictions of Developments.

3. **Political Forecasts:** Political forecast has an important part in envisioning properly the future scenario of business. There are even chances of a country undergoing a drastic shift in the political system (Example; USSR and Eastern Europe in the late 1980's). Changes in the relative power of political parties, changes in the internal power structure of political parties (including changes in leadership and its implications), political alliances and political ideologies etc. may have implications for business. Some political factors may be embedded in social factors. Political forecasts also cover industrial policy, commercial policy and fiscal policy.

Some political changes are sudden and unpredictable. Several changes are there. Which are reasonably predictable? For example the political and economic changes in most of the countries will have an impact on India as the market is globalized. The decentralization and government pronouncement on the prediction of administrative decentralization, in several States in India. With the decentralization, decision making process in the Government has changed and this has important implications for business.

Increasing world interdependence makes it imperative for firms of all sizes to consider the international political implications for their strategies. Companies, research organizations and consultants have developed a variety of approaches to international forecasts of which political factors are an important component. Harner's Business Environmental Risk Index, for instance, monitors a number of economic and political variables in many countries. The World Economic Forum brings out annually a Global Competitiveness Report based on eight set of factors including government, openness and institutions.

4. **Technological Forecast:** Innovation and other technological developments can drastically alter the business environment. Technological forecasts, therefore, assumes great significance. Technological forecast encompass not only technological innovations but also the pace and extent of diffusion and penetration of technologies and their implications. For example, what will be the pace and extent of penetration of PCs and the internet and their implications for business? How far can and will the existing and new technologies be applied in diverse areas and what are, their implications?

It may be noted that one of the eight components of the world competitiveness index used in the World Competitiveness Report is technology which measures computer usage, the spread of new technologies, the ability of the country to absorb new technologies and the level and quality of Research and Development.

The Technology Information, Forecasting and Assessment Council (TIFAC) established in 1988 have done considerable work to draw up a Technology Vision 2020 for India. It is among the tasks of TIFAC to look ahead at the technologies emerging worldwide and pick those technologies which are relevant for India and should be promoted. Brainstorming and Delphi methods are popular in technology forecasting.

Activity E:

1 Identify few key active political forces. Discuss how they are shaping the overall Environment in the country.

8.14 Making Forecasting Effective

Forecasting could be made effective only when certain measures are taken such as:

1. To forecast all relevant facts should be collected taking into account the cost involved and the benefits to incur.

2. There should be critical analysis of all the relevant factors which have impact on the operation of the organization.
3. There should be continuous process of monitoring variables which need forecast. When something happens in the environment, more intensive could be started to make forecast.
4. Various assumption in forecasting, particularly where qualitative criteria are applied, should be based on certain facts and not on the guesses.
5. The various techniques of forecasting and the situation in which they can be applied should be properly known by the people involved in this.
6. Forecasters should be free from biases. They should pay more emphasis on facts and figure and not on what they feel personally.
7. The support of top management should be there to forecast which not only facilitates forecasting process but also makes the way for using forecast in planning process.

8.15 Steps in Environmental Forecasting

The steps in environmental forecasting are similar to the steps in formulating and executing a research project; the important steps in environmental forecasting are as follows.

1. Identification of Relevant Environmental Variables:

The first most important step in environmental forecasting is identification of the environmental variables critical to the firm. All environmental variables do not have the same relevance to all the industries or firms. A variable that is relevant to one industry may not be relevant for another. Again, important developments in some market may not have any implications for some other markets. For example, the high level of penetration of microwave ovens in some of the developed countries like USA is a critical variable as far as food processing industry in that market is concerned; but it is not relevant in markets where the microwave ovens have not penetrated — if micro-waveable packaging increases the cost of the product it could be a negative factor in such markets. Similarly, a factor relevant in one technological environment may not be relevant in a different environment. Diesel price is a critical factor for railways which use that energy source but not for those which depend on electricity (assuming that there is no competition between those depending on these two different energy sources).

Some demographic trends have implications for certain business .A falling birth rate is a threat to several businesses (for example, for companies like Johnson & Johnson depends heavily on the baby segment of the market). The increase in the longevity and the resultant increase in the number of aged generate good demand for several goods and services. To envision the future environment it is- essential to identify the critical environmental variables and to predict their future trends. Omission of any critical variable will affect the assessment of the future environment and strategies based on that premise. Similarly, inclusion of variables which are not adequately relevant could have misleading effects.

Pearce and Robinson point out that the list of key variables that would have make or break consequence for the firm can be kept to manageable size by limiting key variables in the following ways.'

1. Include all variables that would have a significant impact although their probability occurrence is low. Delete others with little impact and low probability.
2. Disregard major disasters, such as nuclear war.
3. Aggregate when possible into gross variables (e.g., a bank loan is based more on the dependability of a company's cash flow than on the flow's component sources),

4. If the value of one variable is based on the value of the other, separate the dependent variable for future planning.

2) Collection of Information:

The key environmental variables having been determined, the next important step is the coll ection of the needed information. This involves identification of the sources of information, determination of the types of information to be collected, selection of methods of data collection and collection of the information.

3) Selection of Forecasting Technique:

The dependability and usefulness of the forecast depend a lot on the appropriateness of the forecasting technique used. The choice of forecasting technique depends on such considerations as the nature of the forecast decision, the amount and accuracy of available information, the accuracy required, the time availability the importance of the forecast, the cost, and the competence and interpersonal relationships of the managers and forecaster involved.

One issue often debated is the quantitative technique versus qualitative techniques. The fact that each has its own merits and limitations. The people have a notion that quantitative techniques are highly dependable and qualitative techniques are often too subjective that they are not reliable. The dependability of the quantitative techniques is affected by the accuracy / reliability of the data used.

It is pointed out that the difference in the predictions using each type of approach is often minimal. Additionally, subjective or judgment approaches may often be the only practical method forecasting political, legal, social, and technological trends in the remote external environment. The same is true of several trends in the task environment, especially customer and competitive considerations.

4. Monitoring:

The characteristics of the variables or their trends may undergo changes. Further, new variable may emerge as critical or the relevance of certain variables may decline. It is, therefore, necessary monitor such changes. Sometimes the changes may be very significant so as to call for a re-forecasting.

8.16 Techniques for Environmental Forecasting

As mentioned earlier, there are a number of quantitative and qualitative techniques used in environmental forecasting. Some important techniques ate mentioned below.

1. **Econometric Techniques:** Economic techniques involve casual models to predict major economic indicators. When there is a well established relationship between two or more variables, that casual relationship can be used to forecast the future. For example, if demand is a function of consumer income, the impact of an increase in consumer income on demand can be predicted using the equation representing the relationship between these two key variables.

   The econometric models may "utilize complex simultaneous regression equations to relate economic occurrences to areas of corporate activity. They are especially useful when information is available on casual relationships and when large changes are anticipated." The most commonly used econometric environmental forecasting techniques are multiple regression analysis and time series regression models.

2. **Trend Extrapolation:** Time series models assume that the past is a prologue to the future and extrapolate the historical data to the future. The technique may use simple linear relationship or more complex non-linear relationships to forecast trends.

3. **Scenario Development: A** very popular and useful forecasting method is development of alternative scenarios. When it is not possible to accurately forecast the future, the alternative scenarios help managers to formulate strategies to cope with different possible future situations. "Scenario analysis is a technique used to forecast the occurrence of complex environmental events. It is particularly useful for forecasting events in which many variables play a role. Scenarios allow the integrated consideration of these multiple variables in explaining the emergence of future conditions. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organization."

Shrivastava suggests the following steps to develop scenarios.'

1. Identify strategic environmental issues that are likely to affect the industry/firm. Prioritize these issues in order of their importance to the firm.
2. Select the most important issues as the focus for scenario development. List the Organizational assumptions with respect to these issues and identify the possible variations in these assumptions.
3. Prepare a preliminary description of these issues and how they evolved. Include the key economic, social, political, and cultural influences that affect them. Do this with help of outside industry experts.
4. Draw out the implications of the issue for organizational performance. What has the organization done and what can it do to cope with the issues? Identify those variables shaping the issue that the management can control and partially control. Also, identify those variables over which management has no control.
5. Develop detailed descriptions of the future in the form of scenarios. Scenarios are constructed under a worst case, best case, and most likely case set of assumptions. Draw out the implications of these scenarios for future performance of the company.
6. Discuss the scenarios with top management and refine them.
7. Develop contingency action plans for each scenario.

Developing alternative scenarios is common in economic planning too. The Planning Commission of India, for example, have drawn up alternative scenarios regarding growth rates of different sectors, poverty ratios etc. under different assumption.

Many forecasts which use the scenario method draw up three alternative scenario — a most likely scenario, a pessimistic scenario and an optimistic scenario. However, forecasts having more than three scenarios are not uncommon.

Methods of Scenario Building

a. Premising Method: In this method, a series of premises is drawn up from which projection of the future scenarios is made. The premises might consist of basic assumptions about certain important variables, current trends etc. Sometimes extreme projections may also be made focusing on a few tendencies and exaggerating their evolution. For example, the extreme possible outcome of some ethnic issues in a country.

b. Systems Diagram Method: The systems diagram method seeks to explore policy and strategic options based on the present system of the organization's activities. For example, a newspaper firm may think of entering other media, extending the publication business, starting information service business etc. using and developing its existing capabilities.

c. Critical Site Method: This method which bases the scenario projection on the policy making structure of an organization identifies the key decision making points and dynamics of the system focuses on the critical site where the key decisions are taken, such as the meeting of the Board of a company, the national convention or the meeting of the policy decision making body of the relevant political party, critical meetings of organizations like OPEC or WTO etc. Scenarios are drawn up based on the anticipation of the possible critical decisions made at such sites and their future implications.

d. The Newspaper Headline Method: In this method the scenario writer posits one or more hypothetical headlines for some future date such as: New Delhi, January 20, 2010: "The three surviving car manufactures in India intensify the battle for market share." The scenario writer then tries to map out the possible developments in the industry during the course and chart out a strategy for the company to successfully navigate through.

e. Logical Possibilities Method: This method which generates alternative scenarios based on those already developed is used as a supplement to other methods.

4. **Judgment Models:** Judgment models involve the use of opinion of people who have intimate knowledge of relevant factors. For example, sales force opinion of the sales potential, competitive challenges, customer behavior etc. Another method is juries' executive opinion which "combines estimates made by executives from marketing, production, finance and purchasing and then averages their views". The Delphi method described below is a refined judgment model.

5. **Brain Storming:** Brain storming is a creative method of generating ideas and forecasts. Under this method, a group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. With a view to encouraging throwing up new ideas without any reservation, the discussion and evaluation of the ideas generated is often done only after the idea generation process is over. Brain storming is a popular technique of technological forecasting.

6. **Delphi Method:** The Delphi method, which is also a common technique of technological forecasting, is a more systematic technique than brain storming. This method uses a panel of experts on the subject from whom opinions are gathered, may be by using a semi-structured questionnaire and/or interview. The opinions of the experts are documented and consolidated and circulated among the panel members, preferably anonymously, for their evaluation and comments. The experts are requested to review their opinion in the light of the feedback. This process may be continued until a consensus view is arrived at.

   The RAND Corporation which pioneered the use of this technique used it to predict the impact of the formation of the OPEC on oil supplies and oil prices. Other applications of this technique included assessing trends in terrorist activities and their influence on international businesses and prioritizing domestic social programmes.

7. **Strategic Issues Analysis**

   Strategic issue analysis is a qualitative technique that can be used for assessing emerging strategic environmental issues. It consists of systematically monitoring of social, regulatory and political changes that can affect corporate performance and identifying their impact on the company. For example, companies which were doing business in South Africa used this technique to assess the impact of racial tensions there on their worldwide business.

8.17 Limitation of Forecasting

Forecasting is an essential ingredient, but it should not be concluded that forecasting is the only element which goes into planning and other areas of organizational process. Forecasting provide base for assuming the behavior of certain events which may not be fully true. Future uncertainties always keep managers in fear. Therefore, managers should be well aware about the limitation of forecasting while using it while arriving at certain decision. But, adequate attention should be given to the following limitations of forecasting.

1. **Based on Assumption**: It is based on certain assumption .It merely suggest if an event has happened in the past, it will happen that way in the future. The basic assumption is that events do not change so drastically and speedily but change on a regular pattern .A change in a particular factor may be so unpredictable and important that it may affect the total business situation.

2. **Not Absolute Truth:** Forecast are not always true, they merely indicate the trend of future happenings, as the factors which are taken into account for making forecast are affected by human factor which is highly unpredictable. Various techniques for forecasting suggest the relationship among various known facts .They can project the future trends but cannot guarantee that this would happen in future.

3. **Time and Cost Factor:** It is also an important aspect of forecasting .For making forecast of any event ,certain information and data are required .Some of them are highly disorganized form, some may be in qualitative form .The collection of information and conversion of qualitative data into quantitative ones involves lot of time and money. The managers needs to tradeoff between the cost involved in forecasting and resultant benefits.

8.18 Limitation of Environmental Forecasting

Environmental forecasting has several limitations. Some of the limitations arise from forecasting techniques used. Further there are also chances of certain errors affecting the reliability of the forecasts. Error may occur in:

1. The selection of the variables included in the predictive model.
2. The selection of the functional form for linking these predictor variables to the variable(s) being predicted and
3. The estimation of the 'correct' values for the predictor variables. Several techniques use opinions of people and they may be affected by subjectivity.

8.19 Summary

Environmental analysis refers to the evaluation of possible or probable effects of external forces and conditions on an organization's survival and growth strategies. The process of Environmental analysis consists of four steps—scanning, monitoring, forecasting and assessing. Environmental analysis has several benefits such as it makes one aware of the environment-organization linkage, the technological forecasting would indicate some of the future opportunities and challenges. There are broadly two approaches to environmental analysis: (I) Outside-in macro) approach. Which takes a very broad view of the business environment with a long term perspective and develops alternative scenarios of the future? (2) Inside-out (micro) approach, which takes a rather narrow view of 'the environment, forecasts the immediate future environment on the basis of the ongoing environmental monitoring and derives the implications of it for the industry and firm out of it. Techniques for environmental analysis refer to the methods of gathering the relevant information for appraising the environment the techniques used are verbal and written information, search and scanning, spying and forecasting and formal studies.

There are three main motives that drive organizations to conduct environmental analyses they understand of current and potential changes, providing inputs for strategic decision making and to facilitate and foster strategic thinking in organizations. The large domestic firms and multinational enterprises are more concern of the risk factors and make efforts to reduce them by assessing risk through certain methods such as expert opinion, checklist, rating and ranking systems, economic methods.

Fore casting is the process of estimating the relevant events of future, based on the analysis of their past and present behavior. The future cannot be proved unless one knows what has happened and what is happening. The need and importance of forecasting is likely as it helps in planning, promotion of organization, success in organization and coordination and control. The various types of forecasting is important for the business environments, viz; economic environment, social environment, political environment etc. which would be useful in formulating plans and strategies. There are a number of quantitative and qualitative techniques used in environmental forecasting. Some of the important techniques such as econometric techniques, trend extrapolation, scenario development. Though environmental analysis and forecasting have certain limitation, but it is essential for an organization to grow and face competition.

8.20 Self Assessment Questions

1 Briefly summarize what you understand by the general environment and its importance for business.

2 Briefly explain the Importance of environmental analysis.

3 Discuss the stages of environmental analysis in detail?

4 Write short notes on

a) The motives behind environmental analysis.

b) Limitation of environmental analysis.

c) Steps in environmental forecasting.

d) types of forecasting.

5 Identify an industry of your choice and do a social forecast analysis. Draw up few inference points.

6 What do you mean by forecasting .How can you make forecasting effective?

8.21 Reference Books

- Prasad L.M,(2005)Principles and Practices of Management, Sultan Chand & Sons educational publishers New Delhi.
- Francis Cherunilam ,(2006) Business Environment ,Himalaya publishing House Delhi.
- Shaik Saleem (2006) Business Environment ,Pearson Education New Delhi.

Unit - 9 Industrial Policy of India

Structure of Unit:

9.0 Objectives

After reading this unit, you should be able to:

- Understand historical background of the industrial policy
- Define industrial policy and its utility
- Explain various industrial policy resolutions since independence
- Explain industrial policy, 1991
- Critically evaluate 1991 industrial policy

9.1 Introduction

The industrial policies and regulations determine business opportunities and threats. They also determine the rules and regulations for the smooth conduct of the business in an economy. The Industrial policies are laid down by the government of the country. The Industrial policy of a country affects the growth pattern and pace of the industrial development in that country and in turn affects the development of overall economy. Before 1991 a watershed year in Indian economy, public sector was more dominant sector of the economy. But after the declaration of NIP in 1991, the role of private sector gained prominence and hence new business environment. This unit will present various industrial policy resolutions and its impact on the Indian economy.

9.2 Historical Background

An economy can be divided into three sectors; namely agricultural, industrial and service sector. All three sectors have their role and importance to play in the economic development of an economy. Industries play an important role and are an important component of the economic environment of the economy. India was known for its fabulous wealth and therefore the Britishers came to India in year 1600 as traders of East India Company for having commercial relations with India. After 1850, industries started developing in India with the starting of Railways. First World War in second decade of the 1900 gave an opportunity for the development of the industries in India. Indian Industrial Commission was set up in 1916 to examine and report the possibilities of Industrial development of India, and submit recommendation for a policy for Industrial growth. The Second World War was an important event in the development of government-business relations in India. India became the main supply base of Allied forces. This particular event provided the boost to the industrial development in India. India became the supplier of the goods for the war. In response to the needs of the war time economy, the government in its efforts to conserve and control the resources of the country and under the provisions of the Defence of India Rules, brought a series of controls affecting various aspects of the economy like capital investment, foreign exchange, export-import etc. All these policies related decisions were taken keeping in mind the interest of British regime and not Indian economy. They were more exploitative rather than developmental.

India attained independence from the British Empire in August 1947. At that point of time Indian economy was in ruins and the industries of India were in shatters. Pandit Jawahar Lal Nehru laid the foundation of the modern India. His vision and determination have left lasting impression on every facet of national endeavor since independence. The goals and objectives set out for the nation by Pandit Nehru on the eve of independence were:

- Rapid agricultural and industrial development of the country.
- Rapid expansion of opportunities for gainful employment.
- Progressive reduction of social and economic disparities
- Removal of poverty and attainment of self-reliance.

Since independence, India had resorted to five year planning based on socialistic pattern of planning. Since 1950-51, India has passed through ten five year plans and several annual plans and is now in the Eleventh five year plan. Over the time period the nature of the industrial policy of India has evolved from being restrictive and too cumbersome and perplexing to be more liberal and simple.

Activity A:

1. Contact your history teacher or any historians and interview him/ her for the status of Indian economy under the Mughals, British Regime and at the time of Independence. Write down your inference:

9.3 Meaning of Industrial Policy

The concept of 'Industrial policy' is a comprehensive concept. It covers all principles, policies, rules, regulation and regulations that control the industrial undertakings of a country and shape the pattern of industrialization. The term 'industrial policy' refers to the government policy towards industries – their establishment, functioning, growth and management. It is the most important document which indicates the relationship between government and business.

Industrial policy means rules, regulations, principles, policies and procedures laid down by government for regulating, developing and controlling industrial undertakings in the country. It prescribes the respective roles of the public, private, joint and co-operative sectors for the development of industries. It also decides the role of large, medium and small scale sector in the economy. It incorporates fiscal and monetary policies, tariff policy, labour policy and government attitude towards foreign capital and role to be played by external agencies or Multinational Corporation in the development of the industrial sector.

After independence, the government of India has formulated policies for industrial growth and development. For administering and regulating these industrial policies, adequate measures were also adopted by way of Industrial Licensing policies. These policies have substantially regulated the business environment in the country.

The industrial policy has no legal sanction and its violation cannot be challenged. There is only a moral commitment on the part of the government to implement the policy in word and spirit.

9.4 Objectives of Industrial Policy

Industrial policy statements have been announced since 1948. They are:

- Industrial Policy Resolution, 1948
- Industrial Policy Resolution, 1956
- Industrial Policy Statement, 1973
- Industrial Policy Statement, 1977
- Industrial Policy Statement, 1980
- New Industrial Policy, 1991

Number of objectives has been projected by the government of India while making these industrial policy resolutions. Some of the important objectives can be identified as:

- Achieving industrial development
- Achieving a socialistic pattern of the society
- Achieving a self-sustained economy
- Expanding the public sector for achieving socialism
- Achieving rapid and faster economic growth
- Alleviating poverty
- Preventing undue concentration of economic power
- Providing opportunities for and enhance gainful employment
- Reducing disparities in regional development
- Developing heavy and capital goods industries
- Protecting and developing a healthy small-scale sector
- Building up a large and growing co-operative sector
- Updating technology and modernization of industry
- Liberalization and globalization of the economy
- To maintain a sustained growth in productivity
- To achieve optimal utilization of human resources
- To attain international competitiveness and
- To transform India into a major partner and player in the global area.

Activity B:

1. List the objectives, which you would like to incorporate in the next resolution of the industrial Policy:

9.5 Industrial Policy Resolutions of 1948, 1956, 1973, 1977 and 1980's

Industrial Policy Resolution, 1948

On April 6, 1948, Government of India announced and introduced the first Industrial Policy Resolution. This outlined the approach to industrial growth and development. It emphasized the importance to the economy of securing a continuous increase in production and ensuring its equitable distribution. The resolution laid stress on the role of state in the development of industry. The industrial activities were divided into four broad areas:

1. Industries where state had a monopoly: Arms and ammunition production and control of atomic energy, ownership and control of railway transport and others.
2. Mixed Sector: Coal, iron and steel, aircraft manufacture, ship building, manufacture of telephones, telegraphs and wireless apparatus.
3. Industries of government control: The government did not take the responsibility of developing these industries but considered them of such importance that their regulation and direction was necessary, for example salt, automobiles, tractors, heavy machinery, fertilizer, cement, sugar, paper and so on.
4. Items for private sector: All other items were left to the private sector.

This policy resolution visualized a mixed economy accepting the importance of both private and public sectors with a tilt towards public sector. The emphasis was on the development and growth of consumer goods rather than capital goods as this was the need of the hour. The 1984 resolution accepted the importance of small and cottage industries in Industrial development. These industries are particularly suited for the utilization of local resources and for creation of employment opportunities. The foreign capital was required and was welcome but with a rider that majority stakes should be in Indian hands.

Industrial Licensing Act 1951

For implementation of the industrial policy in 1951 an act related to licensing of the industries was passed, which was complimentary to industrial policy. Industrial licensing became a part of industrial economy of India with the passing of *Industries (Development and Regulation) Act, 1951* (IDRA).The act came into effect on May 8, 1952. It had three important objectives:

1. To implement the Industrial policy
2. To ensure regulation and development of important industries
3. To ensure planning and future development of new undertakings.

From time to time this licensing policy has changed as per the requirement of the time and as per the industrial policy. The Industrial Policy Resolution of 1948 was followed by the Industrial Policy Resolution of 1956 which had as its objective the acceleration of the rate of economic growth and the speeding up of industrialisation as a means of achieving a socialist pattern of society. In 1956, capital was scarce and the base of entrepreneurship not strong enough. Hence, the 1956 Industrial Policy Resolution gave primacy to the role of the State to assume a predominant and direct responsibility for industrial development.

The Industrial Policy statement of 1973, inter alia, identified high-priority industries where investment from large industrial houses and foreign companies would be permitted. The Industrial Policy Statement of 1977 laid emphasis on decentralization and on the role of small-scale, tiny and cottage industries.

The Industrial Policy Statement of 1980 focused attention on the need for promoting competition in the domestic market, technological upgradation and modernization. The policy laid the foundation for an increasingly competitive export based and for encouraging foreign investment in high-technology areas. This found expression in the Sixth Five Year Plan which bore the distinct stamp of Smt. Indira Gandhi. It was Smt. Indira Gandhi who emphasized the need for productivity to be the central concern in all economic and production activities.

These policies created a climate for rapid industrial growth in the country. Thus on the eve of the Seventh Five Year Plan, a broad-based infrastructure had been built up. Basic industries had been established. A high degree of self-reliance in a large number of items - raw materials, intermediates, finished goods - had been achieved. New growth centres of industrial activity had emerged, as had a new generation of entrepreneurs. A large number of engineers, technicians and skilled workers had also been trained.

The Seventh Plan (1985-86 to 1989-90) recognised the need to consolidate on these strengths and to take initiatives to prepare Indian industry to respond effectively to the emerging challenges. A number of policy and procedural changes were introduced in 1985 and 1986 under the leadership of Shri Rajiv Gandhi aimed at increasing productivity, reducing costs and improving quality.

The stress was on opening the domestic market to increased competition and readying our industry to stand on its own in the face of international competition. The public sector was freed from a number of constraints and given a larger measure of autonomy. The technological and managerial modernisation of industry was pursued as the key instrument for increasing productivity and improving our competitiveness in the world. The net result of all these changes was that Indian industry grew by an impressive average annual growth rate of 8.5% in the Seventh Plan period. While Government continued to follow the policy of self-reliance, there had been greater emphasis placed on building up our ability to pay for imports through our own foreign exchange earnings. Government was also committed to development and utilisation of indigenous capabilities in technology and manufacturing as well as its upgradation to world standards. Government continued to pursue a sound policy framework encompassing encouragement of entrepreneurship, development of indigenous technology through investment in research and development, bringing in new technology, dismantling of the regulatory system, development of the capital markets and increasing competitiveness for the benefit of the common man. The spread of industrialisation to backward areas of the country was actively promoted through appropriate incentives, institutions and infrastructure investments. Government provided enhanced support to the small-scale sector so that it flourished in an environment of economic efficiency and continuous technological upgradation. Foreign investment and technology collaboration was welcomed to obtain higher technology, to increase exports and to expand the production base.

Government abolished the monopoly of any sector or any individual enterprise in any field of manufacture, except on strategic or military considerations and opens all manufacturing activity to competition. The Government ensured that the public sector plays its rightful role in the evolving socio-economic scenario of the country. Government ensured that the public sector is run on business lines as envisaged in the Industrial Policy Resolution of 1956 and continue to innovate and lead in strategic areas of national importance.

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

Government ensured the full protection of the interests of labour, enhance their welfare and equip them in all respects to deal with the inevitability of technological change. Government believes that no small section of society can corner the gains of growth, leaving workers to bear its pains. Workers' participation in management was promoted. Workers cooperatives were encouraged to participate in packages designed to turn around sick companies. Intensive training, skill development and upgradation programmes were launched.

The major objectives of the new industrial policy package are:

- Self-reliance to build on the many sided gains already made
- Encouragement to Indian entrepreneurship, promotion of productivity and employment generation
- Development of indigenous technology through greater investment in R & D and bringing in new technology to help Indian manufacturing units attain world standards
- Removing the regulatory system and other weaknesses
- Increasing the competitiveness of industries for the benefit of common man
- Incentives for the industrialisation of backward areas
- Enhanced support to the small-scale sector
- Ensure running of Public Sector Undertakings (PSUs) on business lines and cut their losses
- Protect the interests of the workers
- Abolish the monopoly of any sector in any field of manufacture except on strategic or security grounds
- To link economy to the global market so that we acquire the ability to pay for imports and to make us less dependent on aid.
- All sector of industry whether small, medium or large, belonging to the public, private or cooperative sector will be encouraged to grow and improve on their past performance.

In pursuit of the above objectives, Government has decided to take a series of initiatives in respect of the policies relating to the five areas. The 1991 policy comprised of following five dimensions:

A. Industrial Licensing.

B. Foreign Investment

C. Foreign Technology Agreements.

D. Public Sector Policy

E. MRTP Act.

A package for the Small and Tiny Sectors of industry is being announced separately.

9.6 New Industrial Policy (NIP)

A. Industrial Licensing Policy

Industrial Licensing is governed by the Industries (Development & Regulation) Act, 1951. The Industrial Policy Resolution of 1956 identified the following three categories of industries: those that would be reserved for development in public sector, those that would be permitted for development through private enterprise with or without State participation, and those in which investment initiatives would ordinarily emanate from private entrepreneurs. Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalised from time to time. A full realisation of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for the 1990s and beyond it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts. This can be done only if the role played by the government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change have been with us for some time. The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservations for public sector undertakings has been evolving towards an ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation, while at the same, ensuring that over-riding national interests are not jeopardised.

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

B. Foreign Investment

While freeing Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. In view of the significant development of India's industrial economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy, the relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development.

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it has been decided to provide approval for direct foreign investment upto 51% foreign equity in such industries. There shall be no bottlenecks of any kind in this process. These groups of industries have generally been known as the "Appendix I Industries" and are areas in which FERA companies have already been allowed to invest on a discretionary basis. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. To the extent that expertise of this nature is not well developed so far in India, Government will encourage foreign trading companies to assist us in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involves interaction with some of the world's largest international manufacturing and marketing firms. The Government will appoint a special board to negotiate with such firms so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest.

C. Foreign Technology Agreement

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. In the fast changing world of technology the relationship between the suppliers and users of technology must be a continuous one. Such a relationship becomes difficult to achieve when the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty. The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances of his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

With a view to injecting the desired level of technological dynamism in Indian industry, Government will provide automatic approval for technology agreement related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free exchange. Indian companies will be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgement. The predictability and independence of action that this measure is providing to Indian industry will induce them to develop indigenous competence for the efficient absorption of foreign technology. Greater competitive pressure will also induce our industry to invest much more in research and development and they have been doing in the past. In order to help this process, the hiring of foreign technicians and foreign testing of indigenously developed technologies, will also not require prior clearance as prescribed so far, individually or as a part of industrial or investment approvals.

D. Public Sector Policy

The public sector has been central to our philosophy of development. In the pursuit of our development objectives, public ownership and control in critical sector of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Today key sectors of the economy are dominated by mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilution. The most striking example is the takeover of sick units from the private sector. This category of public sector units accounts for almost one third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the economy, is the plethora of public enterprises which are in the consumer goods and services sectors.

It is time therefore that the Government adopt a new approach to public enterprises. There must be a greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Measures must be taken to make these enterprises more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable must be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following.

- Essential infrastructure goods and services.
- Exploration and exploitation of oil and mineral resources.
- Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate.
- Manufacture of products where strategic considerations predominate such as defence equipment.

At the same time the public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations, Government will review the existing portfolio of public investments with greater realism. This review will be in respect of industries based on low technology, small scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations or public purpose, and areas where the private sector has developed sufficient expertise and resources.

The Government will strengthen those public enterprises which fall in the reserved areas of operation or are in high priority areas or are generating good or reasonable profits. Such enterprises will be provided a much greater degree of management autonomy through the system of memoranda of understanding. Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises. There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to. The country must be proud of the public sector that it owns and it must operate in the public interest.

E. Monopolies and Restrictive Trade Practices ACT (MTRP ACT)

The principal objectives sought to be achieved through the MRTP Act are as follows:

i. Prevention of concentration of economic power to the common detriment, control of monopolies, and

ii. Prohibition of monopolistic and restrictive and unfair trade practices.

The MRTP Act was enacted 1969 but became effective in June 1970. With the emphasis placed on productivity in the Sixth Plan, major amendments to the MRTP Act were carried out in 1982 and

1984 in order to remove impediments to industrial growth and expansion. This process of change was given a new momentum in 1985 by an increase of threshold limit of assets.

With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the interference of the Government through the MRTP Act in investment decisions of large companies has become deleterious in its effects on Indian industrial growth. The pre-entry scrutiny of investment decisions by so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly house to obtain prior approval of Central Government for expansion, establishment of new undertakings, merger, amalgamation and takeover and appointment of certain directors. The thrust of policy will be more on controlling unfair or restrictive business practices. The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on acquisition of and transfer of shares will be appropriately incorporated in the Companies Act.

Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation suo moto or on complaints received from individual consumers or classes of consumers. MRTP Act has been replaced in by competition Act, 2002.

Decisions of Government

In view of the considerations outlined above, Government has decided to take a series of measures to unshackle the Indian industrial economy from the cobwebs of unnecessary bureaucratic control. These measures complement the other series of measures being taken by Government in the areas of trade policy, exchange rate management, fiscal policy, financial sector reform and overall macro-economic management.

A. Industrial Licensing Policy

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

ii. Areas where security and strategic concerns predominate will continue to be reserved for the public sector.

iii. In projects where imported capital goods are required, automatic clearance will be given
    a. in cases where foreign exchange availability is ensured through foreign equity or
    b. if the CIF value of imported capital goods required is less than 25% of total value (net of taxes) of plant and equipment, upto a maximum value of Rs. 2 crore. In view of the current difficult foreign exchange situation, this scheme (i.e. (iii) b) will come into force from April, 1992.

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

iv. In locations other than cities of more than 1 million population, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing. In respect of cities with population greater than 1 million, industries other than those of a non-polluting nature such as electronics, computer software and printing will be located outside 25 kms. of the periphery, except in prior designated industrial areas. A flexible location policy would be adopted in respect of such cities (with population greater than 1 million) which require industrial re-generation. Zoning and Land Use Regulation and Environmental Legislation will continue to regulate industrial locations.

v. Appropriate incentives and the design of investments in infrastructure development will be used to promote the dispersal of industry particularly to rural and backward areas and to reduce congestion in cities.

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

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

viii. The exemption from licensing will apply to all substantial expansions of existing units.

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

Procedural Consequences

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

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

xii. The lists at Annex II and Annex III will be notified in the Indian Trade Classification (Harmonised System).

B. Foreign Investment

i. Approval will be given for direct foreign investment upto 51 percent foreign equity in high priority industries. There shall be no bottlenecks of any kind in this process. Such clearance will be available if foreign equity covers the foreign exchange requirement for imported capital goods. Consequential amendments to the Foreign Exchange Regulation Act (1973) shall be carried out.

ii. While the import of components, raw materials and intermediate goods, and payment of knowhow fees and royalties will be governed by the general policy applicable to other domestic units, the payment of dividends would be monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.

iii. Other foreign equity proposals, including proposals involving 51% foreign equity which do not meet the criteria under (I) above, will continue to need prior clearance. Foreign equity proposals need not necessarily be accompanied by foreign technology agreements.

iv. To provide access to international markets, majority foreign equity holding upto 51% equity will be allowed for trading companies primarily engaged in export activities. While the thrust would be on export activities, such trading houses shall be at par with domestic trading and export houses in accordance with the Import Export Policy.

v. A special Empowered Board would be constituted to negotiate with a number of large international firms and approve direct foreign investment in select areas. This would be a special programme to attract substantial investment that would provide access to high technology and world markets. The investment programmes of such firms would be considered in totality, free from pre-determined parameters or procedures.

C. Foreign Technology Agreements

i. Automatic permission will be given for foreign technology agreements in high priority industries (Annex III) upto a lumpsum payment of Rs. 1 crore, 5% royalty for domestic sales and 8% for exports, subject to total payment of 8% of sales over a 10 year period from date of agreement or 7 years from commencement of production.

ii. The prescribed royalty rates are net of taxes and will be calculated according to standard procedures.

iii. In respect of industries other than those in Annex III, automatic permission will be given subject to the same guidelines as above if no free foreign exchange is required for any payments.

iv. All other proposals will need specific approval under the general procedures in force.

v. No permission will be necessary for hiring of foreign technicians, foreign testing of indigenously developed technologies. Payment may be made from blanket permits or free foreign exchange according to RBI guidelines.

D. Public Sector

i. Portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for areas of exclusivity to be opened up to the private sector selectively. Similarly the public sector will also be allowed entry in areas not reserved for it.

ii. Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.

iii. In order to raise resources and encourage wider public participation, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.

iv. Boards of public sector companies would be made more professional and given greater powers.

v. There will be a greater thrust on performance improvement through the Memoranda of understanding (MOU) systems through which managements would be granted greater autonomy and will be held accountable. Technical expertise on the part of the Government would be upgraded to make the MOU negotiations and implementation more effective.

vi. To facilitate a fuller discussion on performance, the MOU signed between Government and the public enterprise would be placed in Parliament. While focussing on major management issues, this would also help place matters on day to day operations of public enterprises in their correct perspective.

E. MRTP Act

With the growing complexity of the industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the interference of the government through MRTP Act in investment decisions of large companies has become detrimental in its effect on India's industrial growth. The pre-entry scrutiny of investment decisions by the MRTP companies will no longer be required. The following measures were taken with reference to MRTP:

i. The MRTP Act will be amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings. This eliminates the requirement of prior approval of Central Government for establishment of new undertakings, expansion of undertakings, merger, amalgamation and takeover and appointment of Directors under certain circumstances.
ii. Emphasis will be placed on controlling and regulating monopolistic, restrictive and unfair trade practices. Simultaneously, the newly empowered MRTP Commission will be authorised to initiative investigations suo-moto or on complaints received from individual consumers or classes of consumers in regard to monopolistic, restrictive and unfair trade practices.
iii. Necessary comprehensive amendments will be made in the MRTP Act in this regard and for enabling the MRTP Commission to exercise punitive and compensatory powers.
iv Now MRTP Act has been abondoned and competition Act (2003) as in operation.

9.7 Critical Evaluation of New Industrial Policy (NIP)

Positive Aspects of 1991 Policy

i. The policy of 1991 had been the watershed and historic policy, which has opened the doors of Indian economy, which was long overdue.
ii. It was a bold initiative which was aimed at making Indian industry more competitive both on domestic as well as international front.
iii. The control or bureaucratic regime has been done away with, which will enable entrepreneurs to concentrate on their core activities of production and distribution.
iv. The inordinate delays in the expansion process and new investments had been done away, which will enhance the competitive power of Indian industries.
v. Policies related to Foreign investment and import of technology became liberalised, which will enhance the inflow of foreign investment and import of latest technology will become easier.
vi. The performance of Public Sector Undertakings will improve. Disinvestment will help in reducing the size public section i.e. down sizing.
vii. This policy is a bold initiative which will lead to the development of more resilient Indian industries.
viii Only four industries (enlier 17) are now reserved for public sector.

Negative Aspects of 1991 Policy

i. Infrastructural deficiencies will hinder the growth which can be attained through the industrial policy.
ii. Scrapping of licensing means absence of mechanism to determine priorities and to develop backward areas.
iii. There is lack of clarity related to the growing problem of Industrial Sickness. No clear exit policy has been laid down.
iv. Off-loading of the 20% equity in profit making public sector units to mutual funds is revenue

raising exercise rather than genuine attempt at privatization.

v. The reformative decisions are taken under the pressure of International Monetary Fund (IMF) and other lending agencies, which have agenda of promoting their own interests.

9.8 Summary

Before 1991, the industrial policy of India was identified by the monopoly or dominant role for the public sector in strategic basic and heavy industries, preference for small scale units and reservation of a large number of items for the SSI sector, preference to cooperative sector, lots of entry, growth, operational and functional restrictions on private sector and a very restrictive attitude towards foreign capital and technology.

The 1991 Industrial policy announced in July along with other economic reforms have tried to remove earlier restrictions.

9.9 Self Assessment Questions

1. What do you understand by Industrial Policy?
2. What are the objectives of the Industrial Policy?
3. Discuss the main features of the Industrial Policy resolution of 1956?
4. Review the Industrial Policies of the government of India since 1948?
5. Examine critically New Industrial Policy?
6. Discuss the role of private sector in light of New Industrial Policy of 1991?
7. Examine critically the new small scale Industrial policy of 1991?

9.10 Reference Books

- Ashwathappa, K. (2008), *Essentials of Business Environment*, Himalaya Publishing House, 10th Revised Edition
- Paul, Justin, (2006), *Business Environment: Text and Cases*, Tata McGraw Hill
- Saleem, Shaikh (2006), *Business Environment*, Pearson Education
- Cherunilam, Francis, (2008), *Business Environment: Text and Cases*, Himalaya Publishing House, 18th Revised Edition
- Industrial Policy Resolution of Government of India.

ANNEX I

PROPOSED LIST OF INDUSTRIES TO BE RESERVED FOR THE PUBLIC SECTOR

1. Arms and ammunition and allied items of defence equipment, Defence aircraft and warships.
2. Atomic Energy.
3. Railway Transport
4. Hazardous and Environmentally sensitive industries.

ANNEX II

LIST OF INDUSTRIES IN RESPECT OF WHICH INDUSTRIAL LICENSING WILL BE COMPULSORY

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

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

ANNEX III

LIST OF INDUSTRIES FOR AUTOMATIC APPROVAL OF FOREIGN TECHNOLOGY AGREEMENTS AND FOR 51% FOREIGN EQUITY APPROVALS

1. Metallurgical Industries
   - i. Ferro alloys fessous.
   - ii. Castings and forgings.
   - iii. Non-ferrous metals and their alloys.
   - iv. Sponge iron and pelletisation.
   - v. Large diameter steel welded pipes of over 300 mm diameter and stainless steel pipes.
   - vi. Pig iron.
2. Boilers and Steam Generating Plants
3. Prime Movers (other than electrical generators)
   - i. Industrial turbines.
   - ii. Internal combustion engines.
   - iii. Alternate energy systems like solar wind etc. and equipment therefor.
   - iv. Gas/hydro/steam turbines upto 60 MW.

4. Electrical Equipment
   i. Equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers.
   ii. Electrical motors.
   iii. Electrical furnaces, industrial furnaces and induction heating equipment.
   iv. X-ray equipment.
   v. Electronic equipment, components including subscribers' end telecommunication equipments.
   vi. Component wires for manufacture of lead-in wires.
   vii. Hydro/steam/gas generators/generating sets upto 60 MW.
   viii. Generating sets and pumping sets based on internal combustion engines.
   ix. Jelly-filled telecommunication cables.
   x. Optic fibre.
   xi. Energy efficient lamps and
   xii. Midget carbon electrodes.

5. Transportation
   i. Mechanised sailing vessels upto 10,000 DWT including fishing trawlers.
   ii. Ship ancillaries.
   iii. (a) Commercial vehicles, public transport vehicles including automotive commercial three wheeler jeep type vehicles, industrial locomotives.
   (b) Automotive two wheelers and three wheelers.
   (c) Automotive components/spares and ancillaries.
   iv. Shock absorbers for railway equipment and
   v. Brake system for railway stock and locomotives.

6. Industrial Machinery
   i. Industrial machinery and equipment.

7. i. Machine tools and industrial robots and their controls and accessories.
   ii. Jigs, fixtures, tools and dies of specilised types and cross land tooling, and
   iii. Engineering production aids such as cutting and forming tools, patterns and dies and tools.

8. Agricultural Machinery
   i. Tractors.
   ii. Self-propelled Harvestor Combines.
   iii. Rice transplanters.

9. Earth Moving Machinery
   i. Earth moving machinery and construction machinery and components thereof.

10. Industrial Instruments
    i. Indicating, recording and regulating devices for pressures, temperatures, rate of flow weights levels and the like.

11. Scientific and Electromedical Instruments and Laboratory Equipment.

12. Nitrogenous & Phosphatic Fertilizers falling under
    i. Inorganic fertilizers under '18-Fertilizers' in the First Schedule to IDR Act, 1951.

13. Chemicals (other than fertilizers).

- i. Heavy organic chemicals including petrochemicals.
- ii. Heavy inorganic chemicals.
- iii. Organic fine chemicals.
- iv. Synthetic resins and plastics.
- v. Man made fibres.
- vi. Synthetic rubber.
- vii. Industrial explosives.
- viii. Technical grade insecticides, fungicides, weedicides, and the like.
- ix. Synthetic detergents
- x. Miscellaneous chemicals (for industrial use only)
  - a. Catalysts and catalyst supports.
  - b. Photographic chemicals.
  - c. Rubber chemicals.
  - d. Polyols.
  - e. Isocyanates, urethanes, etc.
  - f. Speciality chemicals for enhanced oil recovery.
  - g. Heating fluids.
  - h. Coal tar distillation and product therefrom.
  - i. Tonnage plants for the manufacture of industrial gases.
  - j. High altitude breathing oxygen/medical oxygen.
  - k. Nitrous oxide.
  - l. Refrigerant gases like liquid nitrogen, carbondioxide etc.in large volumes.
  - m. Argon and other rare gases.
  - n. Alkali/acid resisting cement compound
  - o. Leather chemicals and auxiliaries.

14. Drugs and Pharmaceuticals

According to Drug Policy.

15.
- i. Paper and pulp including paper products.
- ii. Industrial laminates

16.
- i. Automobile tyres and tubes.
- ii. Rubberised heavy duty industrial beltings of all types.
- iii. Rubberised conveyor beltings.
- iv. Rubber reinforced and lined fire fighting hose pipes.
- v. High pressure braided hoses.
- vi. Engineering and industrial plastic products.

17. Plate Glass

- i. Glass shells for television tubes.
- ii. Float glass and plate glass.
- iii. H.T. insulators.
- iv. Glass fibres of all types.

18. Ceramics
    i. Ceramics for industrial uses.
19. Cement Products
    i. Portland cement.
    ii. Gypsum boards, wall boards and the like.
20. High Technology Reproduction and Multiplication Equipment.
21. Carbon and Carbon Products
    i. Graphite electrodes and anodes.
    ii. Impervious graphite blocks and sheets.
22. Pretensioned High Pressure RCC Pipes.
23. Rubber Machinery
24. Printing Machinery.
    i. Web-fed high speed off-set rotary printing machine having output of 30,000 or more impressions per hour.
    ii. Photo composing/type setting machines.
    iii. Multi-colour sheet-fed off-set printing machines of sizes 18"x25" and above.
    iv. High speed rotograture printing machines having output of 30,000 or more impressions per hour.
25. Welding Electrodes other than those for Welding Mild Steel
26. Industrial Synthetic Diamonds.
27.
    i. Photosynthesis improvers.
    ii. Genetically modified free living symbiotics nitrogen fixer.
    iii. Pheromones.
    iv. Bio-insecticides.
28. Extraction and Upgrading of Minor Oils
29. Pre-fabricated Building Material.
30. Soya Products
    i. Soya texture proteins.
    ii. Soya protein isolates.
    iii. Soya protein concentrates.
    iv. Other specialised products of soyabean.
    v. Winterised and deodourised refined soyabean oil.
31. (a) Certified high yielding hybrid seeds and synthetic seeds and
    (b) Certified high yielding plantlets developed through plant tissue culture.
32. All food processing industries other than milk food, malted foods, and flour, but excluding the items reserved for small-scale sector.
33. All items of packaging for food processing industries excluding the items reserved for small scale sector.
34. Hotels and tourism-related industry.

Unit - 10 Industrial Sickness

Structure of Unit:

10.0 Objectives

After reading this unit, you should be able to:

- Understand the meaning of sickness especially with reference to industries
- Reasons for sickness
- Internal and external causes for sickness
- Remedial measures for removal of sickness

10.1 Introduction

Sickness in industry is a universal phenomenon. In common parlance, sickness means 'not being healthy'. A sick unit will be one which cannot satisfy the normal expectations of the stakeholders like, workers do not get the wages/ salaries on time and their due increments are not given to them, investors do not get the adequate returns on their investment and the financial institutions do not get the repayment of their lending in time or do not get at all.

A healthy unit is one which earns a reasonable return on capital employed and which builds up receives after providing reasonable return on capital invested and creates reserves after providing for depreciation. Industrial Sickness is a gradual process, which takes some 3 to 5 years to set in. One of the visible sign is that the firm starts incurring cash losses and current ratio is less than 1:1.

10.2 Definition

Different perceptions are prevalent with reference to the symptoms and characteristics of industrial sickness. "To a layman, a sick unit is one which is not healthy." Sickness is not defined in precise terms in the various Acts. Sickness is a symptom of ailment and not an ailment in itself.

Sickness of physical body indicates that some part of the body or the organ is not functioning normal and requires diagnosis. Thus defining sickness in absolute terms has been slightly a tedious job. Defining sickness in industry is still a tough exercise. There has been no standard definition of sickness in industry and probably whatever exists or has been stated as sickness is not definition of sickness but the existence of various parameters which, if present, would indicate that the industrial unit is sick. The financial institutions pay reliance on the following parameters for the categorisation of the unit in the sick category.

1. Continuous default in repaying the dues of industry.
2. Continuous default in repaying the installments which have fallen due.
3. Continuous losses.

"Cash-loss" is a fairly acceptable term and stands for the losses before providing depreciation. A unit may not incur cash losses yet it may make default in paying the institutional dues. A unit may be incurring cash losses on a continued basis yet the promoters of the project might be resourceful enough that they might be pumping in additional funds and paying the dues of the institutions in time. The situation thus becomes analogous i.e. a unit which is making cash losses is paying the dues because the promoters are resourceful and a unit which is generating cash accruals is committing default; say due to temporary liquidity problems. Hence the parameters of industrial sickness, as defined above, also do not provide any foolproof yardstick for measuring sickness.

As per provisions of the Sick Industries (Special Provisions) Act 1985 a Company may be declared sick if it is registered for seven years; it has accumulated losses which are equal to the net worth of the Company; and if it has incurred cash losses during the financial year in which the reference to Board is made and the year preceding the financial year. Thus the occurrence or cash loss i.e. loss after deducting depreciation should be for 2 years.

As per the definition of Reserve Bank of India (RBI), an industrial unit is considered as sick if it has incurred cash loss for one year and in the judgment of the bank, it is likely to continue to incur cash loss in the two following years and it has imbalance in its financial structure such as current ration being less than 1:1 and worsening debt-equity ratio.

Common symptoms of industrial sickness include failure to pay statutory liabilities like provident funds and E S I Contributions, failure to pay timely installments of capital and interest on loans taken from financial institutions and public deposits, increase in inventories, high rate of rejection of goods manufactured, low capacity utilization and frequent industrial disputes.

Sickness concerns the Government, employees, bankers and others having direct contact with the company. However it is also a national problem in as much as companies which consistently make losses result, inter-alia in:

a. Under utilisation of productive capacity.
b. Lack of product demand.
c. Loss of revenue in various forms of indirect taxes.
d. Over Staffing.
e. Possible loss of exports.

The best remedy to prevent sickness to spread is preventive rather than curative.

Activity A:

1. Visit a small scale unit in your locality and collect the data related to the various parameters related to the health of the unit by interviewing the owner of that unit.

10.3 Signals and Process

In a normal industrial unit all the functional areas of management work in co-ordination with each other and all generate profits, current ratio is more than one and debt equity ratio is satisfactory. If in an industrial unit there is a decline in profits of functional areas, current ratio starts to decline and losses incurred in the current year and in last two years and anticipated for coming 2-3 years.

The existence of various signals over a long period of time becomes symptoms of sickness. Some important symptoms are as follows:

1. Continuing shortage of cash
2. Deteriorating financial ratio
3. Wide spread usage of creative accounting
4. Frequent requests to banks and financial institutions for delayed or deferring of payments
5. Delay in audit of accounts
6. Degradation in the employee morale
7. Continuous decrease in prices
8. Disparities among top and middle management level

10.4 Causes of Industrial Sickness

The reasons for industrial sickness may differ from industry to industry and within the industry from unit to unit. Industrial units may become sick at the different stages and due to different reasons. Some are born sick, some achieve sickness and some have sickness thrust upon them.

Causes of sickness can be classified into two categories. They are as follows:

- Internal Causes: The causes or reasons, which are specific and internal to the firm. They are controllable reasons to a very large extent. The owner or management can to a larger extent manage these reasons.
- External Causes: The causes or reasons, which are extraneous and common to all the firms in an industry. These factors are beyond the control of an individual unit.

The industrial sickness can be due to many factors such as:-

- Bad strategy and policy
- Mismanagement
- Underestimation of the cost of the project
- Delay in the implementation of the project
- Increase in cost due to delay in implementation of project
- Under Utilisation of resources
- Diversion of Funds
- Lack of Management depth
- Bad Industrial Relations
- Bureaucratic management
- Inadequate working capital
- Heavy Expenditure in Advertisements
- No diversification, product obsolescence
- Company went into new project which was badly conceived
- Delays in execution of new project
- Poor organisation and staffing
- No modernisation
- Old and expensive manufacturing process
- Poor Marketing Organisation

- Inadequate emphasis on marketing as opposed to selling
- Did not change from seller's to buyer's market
- Lack of any formal Planning, especially financial planning
- Wrong Capital Structure
- Diversion of funds
- Unwarranted expansion and diversion of resources
- Poor inventory management
- Energy crisis
- Absence of proper exit policy in India

Born Sick Industries are those which are destined for disaster right from their conception due to various reasons. The following can be the reasons for the born sick units: Lack of experience of the promoters, wrong selection of the project, faulty project planning, paucity of funds and poor financial management, time and cost overruns, locational issues, poor selection of technology, wrong assessment of the market potential etc.

Activity B:

1. Differentiate between the internal and external causes of sickness by interviewing three local entrepreneurs.

10.5 Preventive and Curative Measures

What steps should a company and all concerned with it Government, management and bank should take to revive a sick undertaking. A comprehensive study of the under taking problems and preparing a composite plan of action must be the starting point of the exercise. Piece-meal and adhoc solutions are rarely adequate. What is needed is a detailed assessment of the compny's existing situation and future prospects covering corporate strategy, Investment, markets, organisation, productivity, labour relations, profitability and finance. An undertaking is ostensibly sick because it is short of working capital and systems have not kept pace with its growth, therefore receiving funds alone will not help. Fortunately, revival is possible in a majority of cases, if timely action is taken and revival programme is implemented with sincerity and commitment.

The old Jute mills and textile mills became sick because they were not modernized, technology were not upgraded. Due to rising costs, the operations of these units became unviable. Eventually, the units became sick. Some of the blue chip companies of today are sick units of yesteryear. Take the case of Goldline, now better known as LG. At one point of time everyone wrote off the company and but thanks to revival efforts of new management LG not only recovered from sickness but grew in a spectacular way.

At one stage, Apollo Tyre, Tata Tea HMV etc. were among the sick units. But the Management did not lose heart. They revived them with a clear vision and suitable strategies. Unfortunately managements of several undertaking think wrongly that once they get funds, the undertaking can be revived. However, providing funds, without attending to the underlying causes of sickness could be throwing money into a bottomless pit. From the long list of possible causes of sickness it will be apparent that the single most important cause of sickness is ineffective management.

Well managed undertaking can even overcome and deal effectively with difficulties which are due to external factors such as poor demand for the industry's products. Therefore what a sick undertaking needs more than anything else or its revival is a good and stable management. Under the provisions of SICA, the Central Government has established Board for Industrial and Financial Reconstruction (BIFR) situated at New Delhi, consisting of experts for timely detection of sick and potentially sick companies, speedy determination of remedial and other measures with respect to such companies and for expeditious implementation of these measures.

Obligation of such company to make reference to BIFR within sixty days from the date of finalisation of the duly audited accounts of the company for the financial year at the end of which the company has become sick. The date of finalization of the duly audited accounts means the date on which the audited accounts of the company are adopted at the annual general meeting of the company.

- Even before finalization of the accounts for the relevant year, If the Board has enough sufficient reasons to form an opinion that the company has become sick, the Board of directors must within sixty days from the date of forming such opinion make a reference to the BIFR.
- In case of the potentially sick industrial company, the company shall within sixty days from the date of finalization of the duly audited accounts of the company for the relevant financial year report to BIFR and shall hold a general meeting of the shareholders for considering such erosion
- For Industrial Companies becoming sick in India, the Government has formulated 'The Sick Industrial Companies (Special Provisions) Act, 1985' (SICA) which got amended in the year 1993 with a prime objective of ;-
- To timely detect the sick and potentially sick industrial companies,
- To speedily take preventive, ameliorative, remedial & other measures and
- To enforce the measures so determined
- Such Companies has to comply with the The BIFR Regulations, 1987and application has to be made under Form A (in respect of an industrial company other than a Government Company) with BIFR and in Form AA in respect of a Government Company.
- The BIFR will make such enquiry as it may deem fit for determining whether the concerned company has become sick
- Such enquiry can be made by BIFR upon the receipt of information from the Board of Directors of the concerned company or from other agencies like Central Government, RBI, etc. or upon its own knowledge as to the financial position of the company
- The BIFR may if deems necessary, appoint any Operating Agency (any Public Financial Institution, State Level institution, scheduled bank or any other person as may be specified by BIFR) to enquire into and make a report
- BIFR or the operating agency, as the case may be shall complete the inquiry within sixty days from the commencement of the inquiry
- If the Board decides to institute inquiry then it may appoint one or more persons as special director(s) of the company concerned with a view to safeguarding the financial and other interests of the company or in the public interest
- If the Board is satisfied after the completion of inquiry that the company has become sick, the BIFR has to make an order in writing whether it is possible for the sick industrial company to make its net worth exceed the accumulated losses within a reasonable time
- If the Board is not satisfied after the completion of inquiry that it is not practical possible to make its net worth exceed the accumulated losses within a reasonable time, may direct operating agency to prepare a scheme for such measures in relation to such company

- The operating agency than shall within a period of ninety days from the date of such order shall prepare a scheme which may provide any or more of the following measures:
- Financial Reconstruction
- Change in Management
- Amalgamation
- Sale or lease of a part or whole of any industrial undertaking of such company
- Rationalisation of managerial personnel
- Such other preventive, ameliorative and remedial measures as may be appropriate
- The BIFR may on such recommendation sanction the scheme and will periodically monitor the sanctioned scheme
- Considering all the relevant facts, if the BIFR is of the opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time, may after opportunity of being heard to all concerned parties may form a opinion to wind up the company and forward its opinion to the concerned High Court.
- The High Court on the opinion of the Board may order winding-up of the sick industrial company by complying the provisions of the Companies Act, 1956

10.6 Summary

Industrial Sickness is a serious problem that has affected all type of industries. It is a cause of serious concern as it relates to the wastage of national resources and can lead to social and economic unrest as the stakeholders in all the industrial units get affected, which forms the society.

10.7 Self Assessment Questions

1. Define Industrial Sickness?
2. What are the symptoms of potential industrial sickness in a unit?
3. What are the causes of industrial sickness? Discuss.
4. What steps according to you should government take to curb the menace of Industrial Sickness?
5. What impact does industrial sickness have on an economy?
6. Due to economic reforms, what has been the impact on industrial sickness?

10.8 Reference Books

- Ashwathappa, K. (2008), *Essentials of Business Environment*, Himalaya Publishing House, 10th Revised Edition
- Paul, Justin, (2006), *Business Environment: Text and Cases*, Tata McGraw Hill
- Saleem, Shaikh (2006), *Business Environment*, Pearson Education
- Cherunilam, Francis, (2008), *Business Environment: Text and Cases*, Himalaya Publishing House, 18th Revised Edition
- Industrial Policy Resolution of Government of India.

Unit - 11 Public Private Partnership (An Overview)

Structure of Unit:

11.0 Objectives

After studying this unit you should be able to:

- Understand the meaning and important features of public private partnerships
- Describe the benefits weaknesses and some misconceptions of PPPs
- Explain suitability, structures, models and roles of PPPs
- Will be able to understand development of PPPs in India
- Able to understand PPPs in few selected sectors in India

11.1 Introduction

In the Indian economy, both the public sector and the private sector have an important placing. Both operate in almost all the sectors of the economy, although their relative positions differ widely in different sectors. Industrial policy resolutions of 1948 and 1956 gave an important role to the public sector in the industrial development of the country. At the time of independence, Indian economy was industrially under-developed. In fact, it was predominantly and agrarian economy with a weak industrial base and lack of infrastructural facilities.

Therefore, Indian economy needed a big push and it was visualized that public sector would provide this big push. It was thought, private sector had neither adequate resources, nor the right mind-set to invest and develop the basic heavy industries. The First Five Year Plan allocated relatively more resources to agriculture and infrastructure development. From the Second Plan onwards and till mid seventies public sector was assigned the role of developing basic heavy industries and plan resources were allocated accordingly.

Further, the Mahalanobis strategy of development which was adopted from the Second Plan onwards, import-substitution type of industrial development was considered so that public sector would mainly invest in those industries which would substitute imports. With import substitution, it was thought, Indian economy would become self-reliant.

The functions and importance of public sector includes help in accelerating economic growth; building up of economic infrastructure; investment in basic heavy industries; occupying commanding heights of the economy; preventing concentration of economic power; balanced regional development and investment in social sectors. It is worth mentioning that under the ongoing economic reforms being implemented since 1991 under the new economic policy of structural adjustment, the role of public sector has been greatly reduced. In the new economic policy, private sector and foreign investment have been given more important role to promote economic growth in India.

Pressure to change the standard model of Public Procurement arose initially from concerns about the level of public debt, which grew rapidly during the macroeconomic dislocation of the 1970s and 1980s. Governments sought to encourage private investment in infrastructure, initially on the basis of accounting fallacies arising from the fact that public accounts did not distinguish between recurrent and capital expenditure. The idea that private provision of infrastructure represented a way of providing infrastructure at no cost to the public has now been generally abandoned, interest in alternatives to the standard model of public procurement persisted. In particular, it has been argued that models involving an enhanced role for the private sector, with a single private sector organization taking responsibility for most aspects of service provisions for a given project, could yield an improved allocation of risk, while maintaining public accountability for essential aspects of service provision.

Initially, most Public-Private Partnerships [PPPs] were negotiated individually, as one-off deals. In 1992, however, the Conservative Government of John Major in the United Kingdom introduced the Private Finance Initiative (PFI), the first systematic programme aimed at encouraging public-private partnerships. In the 1992 programme, the main focus was on reducing the Public Sector Borrowing Requirement, although, as already noted, the effect on the public accounts was largely illusory. The Labour Government of Tony Blair elected in 1997, persisted with the PFI sought to shift the emphasis to the achievement of "value for money" mainly through an appropriate allocation of risk. A number of Australian state Governments have adopted systematic programmes based on the PFI. The first, and the model for most others, is Partnerships Victoria.

11.2 Meaning of Public Private Partnerships (PPP)

Public Private Partnerships [PPPs] means involvement of private enterprise, in the form of management expertise and/or monetary contributions, in the Government projects aimed at public benefit.

Public-private partnership (PPPs) describes a Government service or private business venture which is funded and operated through a partnership of Government and one or more private sector companies. PPPs involve a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project. In some types of PPPs, the cost of using the service is borne exclusively by the users of the service. In other types, capital investment is made by the private sector on the strength of a contract with Government to provide agreed services and the cost of providing the service is borne wholly or in part by the Government.

In projects that are aimed at creating public goods like in the infrastructure sector, the Government may provide a capital subsidy in the form of a one-time grant, so as to make it more attractive to the private investors. In some other cases, the Government may support the project by providing revenue subsidies, including tax breaks or by providing guaranteed annual revenues for a fixed period.

According to the Government of India, PPPs can be defined as a partnership between a public sector entity (sponsoring authority) and a private sector entity (a legal entity in which 51 per cent or more of equity is with the private partner/s) for the creation and or management of infrastructure for public purpose for a specified period of time (concession period) on commercial terms and in which the private partner has been procured through a transparent and open procurement system.(Department of Economic Affairs, Ministry of Finance, Government of India, 2007a).

PPPs involve a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project. PPPs are an initiative to improve efficiency, effectiveness and equity in the provision of healthcare services.

According to, International Monetary Fund (IMF), PPPs is an arrangements where the private sector supplies infrastructure assets and services that traditionally have been provided by the Government. According to the World Bank, PPPs programs are projects that are for services traditionally provided by the public sector, combine investment and service provision, see significant risks being borne by the private sector, and also see a major role for the public sector in either purchasing services or bearing substantial risks under the project.

The Asian Development Bank (ADB) has defined PPPs as long-term, contractual partnerships between the public and private sector agencies, specifically targeted towards financing, designing, implementing, and operating infrastructure facilities and services that were traditionally provided by the public sector.

According to the European Union, PPPs are the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector.

Many other countries too have offered legal definitions of the PPPs in order to be clarify which projects should fall under contractual relations to be established under PPPs arrangement.

Examples of countries that have sought to define PPPs arrangements in law are :

To illustrate, In case of the Brazil, the PPPs law has defined Public Private Partnerships Contracts as agreements entered into between Government or public entities and private entities that establish a legally binding obligation to manage (in whole or part) services, undertakings and activities in the public interest where the private sector is responsible for financing, investment and management.

In case of Ireland, PPS is any arrangement made between a state authority and a private partner to perform functions within the mandate of the state authority, and involving different combinations of design, construction, operations and finance.

In case of South Africa, PPPs has been legally defined as a contract between a Government Institution and a Private Party where the latter performs an institutional function and or uses State property, and where substantial project risks are passed to the third party.

In some types of the PPPs, the cost of using the service is borne exclusively by the users of the service and not by the taxpayer. In other types notably the private finance initiative, capital investment is made by the private sector on the strength of a contract with Government to provide agreed services and the cost of providing the service is borne wholly or in part by the Government.

Government contributions to PPPs may also be in kind notably the transfer of existing assets. In projects, that are aimed at creating public goods like in the infrastructure sector, the Government shall provide a capital subsidy in the form of a one-time grant, so as to make it more attractive to the private investors. In some other cases, the Government may support the project by providing revenue subsidies, including tax breaks or by providing guaranteed annual revenues for a fixed period.

Typically, a Private Sector Consortium forms a special company called a "Special Purpose Vehicle" (SPV) to develop, build, maintain and operate the asset for the contracted period. In cases where the Government has invested in the project, it is typically but not always allotted an equity share in the SPV. The Consortium is usually made up of a building contractor, a maintenance company and bank lender(s). It is the SPV that signs the contract with the Government and with sub-contractors to build the facility and then maintain it. In case of the Infrastructure Sector, complex arrangements and contracts that guarantee and secure the cash flows, make PPPs projects prime candidates for Project Financing. A typical PPPs example would be a hospital building financed and constructed by a private developer and then leased to the hospital authority. The private developer then acts as landlord, providing housekeeping and other non medical services while the hospital itself provides medical services.

11.3 What is Public Private Partnership (PPP)?

There is no hard and fast definition of the PPPs.

The Public Privet Partnership [PPPs] are partnerships between the public sector and the private sector for the purposes of designing, planning, financing, constructing and or operating projects which would be regarded traditionally as falling within the remit of the public sector. Infrastructural projects such as roads and bridges are prime examples. PPPs involve a sharing of responsibility between Government and the private sector. For example, the private sector contributes design, construction, operation, maintenance, finance and risk management skills while the Government is responsible for strategic planning and industry structure, obtaining permits, some customer interface issues, regulation, community service obligations and sometimes payment on behalf of the service users.

The PPPs are a legally-binding contract between Government and business for the provision of assets and the delivery of services that allocates responsibilities and business risks among the various partners. In a PPPs arrangement, Government remains actively involved throughout the project's life cycle. The private sector is responsible for the more commercial functions such as project design, construction, finance and operations. The PPPs can take a variety of forms, with varying degrees of public and private sector involvement, and varying levels of public and private sector risk. In fact, risk transfer from the public to the private sector is a critical element of all the PPPs. The goal is to combine the best capabilities of the public and private sectors for mutual benefit.

For example, if a private company assumes responsibility for financing and building a highway, it also assumes responsibility for related risks: interest rates could rise; construction could be delayed; labour costs could increase; and so on. If the company also takes responsibility for highway operation and maintenance, it assumes even more risks. For example, traffic volumes might not be as high as anticipated, and unforeseen circumstances such as mudslides, snowstorms or an earthquake could add significantly to maintenance costs. Why would the private sector be willing to assume these risks? Because where risk exists, so does opportunity. The private sector partner gains a relatively stable, long-term investment opportunity.

Revenues are in the form of either a fee for service, paid by Government, or fees collected from users, as in the case of highway tolls. Private firms also use their own strengths and abilities to add value to PPP arrangements. For example, in the hypothetical case above, the private sector partner might find efficiencies or employ innovation to offset risks and costs. The private firm could also potentially increase its revenues, for example, ensuring the most efficient vehicle flow possible. Further, the private partner would also be building the PPPs expertise, which could then be marketed in other sectors or jurisdictions.

11.4 The Key Features of PPP

The main features of PPPs shall include following:

- Cooperative and Contractual Relationships:

The PPPs represent cooperation between the Government and the private sector. The PPPs are not the same as privatization in that both public sponsors and private providers function as partners throughout project development and delivery, and often in operation and maintenance.

The most successful partnership arrangements draw on the relative strengths of both the public and private sector in order to establish complementary relationships between them. PPPs arrangements are long-term in nature, typically extending over a 15 to 30 year period.

This is a factor which helps to which establish productive and lasting relations between the public and private sectors. Demonstrating an enduring public sector commitment to the provision of quality services to consumers, under terms and conditions agreeable to both the Government and the private sector, PPPs are used to develop and operate public utilities and infrastructure. These collaborative ventures are built around the expertise and capacity of the project partners and are based on a contractual agreement, which ensures appropriate and mutually agreed allocation of resources, risks, and returns.

- Shared Responsibilities:

While the specific responsibilities for delivery will vary according to each project, a key feature of the PPPs is that these responsibilities will be shared between the public body and the private consortium. In some initiatives, this might require the private sector company to play a significant role in all aspects of delivery of the service, while in others its functions may be more limited. However, unlike instances of privatization, the overall role of Government remains unchanged in the PPPs. It is the Government which remains ultimately accountable and responsible for the provision of high quality services that meet the public need.

- A Method of Procurement:

The PPPs are instruments for Government bodies to deliver desired outcomes to the public sector, by making use of private sector capital to finance the necessary assets or infrastructure. The private company is rewarded for its investment in the form of either service charges from the public body, revenues from the project, or a combination of the two. This renders affordable those projects that might not otherwise have been feasible, because the public body was unwilling or unable to borrow the requisite capital. The PPPs allow the private sector to play a greater role in the planning, finance, design, operation and maintenance of public infrastructure and services than under traditional public procurement models. Moreover, where traditional procurement models begin with the question of what assets the public body has as its disposal and how these might be used to deliver required services. The PPPs arrangements place the emphasis on the desired service or outcome as identified by the public organization and how the private sector might help to make this happen.

- Risk Transfer:

A key element of the PPPs is its potential to deliver public projects and services in a more economically efficient manner. At the beginning of the relationship, potential risks associated with the project are identified and each party adopts those which it is best equipped to manage. The public sector can therefore transfer appropriate risks to the private partner, who has the necessary skills and experience to manage them. For example, overall risk to the public sector can be reduced by transferring those associated with design, construction and operation to the private partner. The incentive for the private body comes in the form of higher rates of return related to high standards of performance.

- Flexible Ownership:

The PPPs enable flexible arrangements between public and private bodies, where the public body may or may not retain ownership of the project or facility that is produced. In some cases, the private organization may be contracted only to construct facilities or supply equipment, leaving the public body as owners, operators and maintainers of the service. Alternatively, the public sector may decide it is more cost-effective not to own directly and operate assets, but to purchase these instead from the private entity. Services may be purchased for use by the Government itself, as an input to provide another service, or on behalf of the end user.

What are the Characteristics of a Viable PPP Project?

A project might be considered as a viable project under the PPPs format. If it possess following characteristics:

- Proceeding with a PPP may be most appropriate when,
- There is a significant opportunity for private sector innovation in design, construction, service delivery, or use of an asset;
- Clearly definable and measurable output specifications can be established suitable for payment on a services delivered basis;
- An opportunity exists for the private sector partner to generate non-Government streams of revenue, to help offset public sector costs;
- Some risks can be transferred to the private sector;
- Projects of a similar nature have been successfully developed using a similar method, and,
- The private sector has sufficient PPP capacity (expertise and availability) to successfully deliver project objectives.

Activity A:

1. List out various PPPs in India and choose any one of them for its review, identify its major features considering features discussed in this unit.

11.5 Major Benefits of Public Private Partnerships

By combining the skills and expertise of public and private partners, the PPPs are able to provide services which meet the needs of the public in a more efficient and cost- effective manner. When appropriately designed and implemented, PPPs can yield better quality services without compromising public policy objectives or broader public need.

At the outset of the PPPs relationship, the desired quality of service to be achieved from the development of the infrastructural asset is clearly specified, and the expectation is that high standards will be maintained throughout the duration of the project. This contrasts with traditional procurement methods, where the construction of assets is formally separated from operation and maintenance, and consequently, levels of service and conditions of assets will frequently decline over time.

Benefits of PPPs to Public & or Government Sector:

The benefits of PPPs to public sector and private sector are discussed in brief as follows:

The major strength of the PPPs is its ability to deliver value for money in public service procurement and operation. By utilizing the differing skills, resources and experience of each party, they allow the public and private sectors to complement each other - the public sector provides its expertise in identifying public needs, service requirements and desired outcomes, and the private sector brings its capacity to effectively utilize assets and manage the construction and operation of services.

The foremost benefit of the PPPs is the scope such partnerships allow for public authorities to raise capital for high priority works that might otherwise not be possible in the face of budgetary and borrowing constraints.

Here, the PPPs can draw on private sector expertise in order to deliver services and infrastructure efficiently and cost-effectively, and to bridge the gap between the resources required and those available from the public purse.

Gains in efficiency and effectiveness can be realized in a number of ways. Most importantly, the PPP approach encourages private sector innovation by allowing Government to delegate responsibility for service design and construction to the private contractor. This enables the public body to identify desired services, outcomes and outputs, while allowing room for the private contractor to innovate in the search for the most appropriate solution to meet those requirements.

Additionally, the PPPs can enable the optimum allocation of public resources in the pursuit of infrastructural development. Whereas traditional models of public procurement focus on achieving the lowest upfront costs in delivering infrastructural projects PPPs concentrate on delivering cost effectiveness over the duration of the asset - including, in particular, those costs associated with operation and ongoing maintenance. This allows the public sector to realize value for money for the entire life of the project or service, rather than just in its initial construction phase.

Possible Opportunities Offered By PPPs to Public Sector:

The PPPs can provide following opportunities to public sector:

- Improve Service Delivery:

Improve service delivery by allowing both sectors to do what they do best. Government's core business is to set policy and serve the public. It is better positioned to do that when the private sector takes responsibility for non-core functions such as operating and maintaining buildings.

- Improve Cost-Effectiveness:

By taking advantage of private sector innovation, experience and flexibility, the PPPs can often deliver services more cost-effectively than traditional approaches. The resulting savings can then be used to fund other needed services.

- Increase Investment in Public Infrastructure:

Investments in hospitals, schools, highways and other provincial assets have traditionally been funded by the Province and, in many cases, have added to levels of overall debt. The PPPs can reduce Government's capital costs, helping to bridge the gap between the need for infrastructure and the Province's financial capacity.

- Reduce Public Sector Risk:

To reduce public sector risk by transferring to the private partner those risks that can be better managed by the private partner. For example, a company that specializes in operating buildings may be better positioned than the Government to manage risks associated with the changing demands of commercial real estate.

- Deliver Capital Projects Faster:

The PPPs can deliver capital projects faster making use of the private partner's increased flexibility and access to resources.

- Improve Budget Certainty:

For transferring risk to the private sector, one can reduce the potential for Government cost overruns from unforeseen circumstances during project development or service delivery. Services are provided at a predictable cost, as set out in contract agreements.

- Make Better Use of Assets:

The Private sector partners are motivated to use facilities fully, and to make the most of commercial opportunities to maximize returns on their investments. This can result in higher levels of service, greater accessibility, and reduced occupancy costs for the public sector.

Governments are attracted to the PPPs because they may provide value for money at least in the short term, and are better able to manage the risk. The PPPs can contain incentives for the private sector party to perform well.

For example, under a contract to construct a road, the developer has an incentive to do the minimum necessary to meet the contract terms. However, under a design, construct and maintain arrangement, the developer has an incentive to build the road to the standard necessary to provide services for the period of the contract.

For heavily indebted Governments, an attraction of having the private sector finance infrastructure is that it obviates the need to borrow, and can allow projects to be brought forward. But even if the private sector finances a project, the Government has to fund payments to the private partner for the services provided.

Possible Opportunities Offered By PPPs to Private Sector:

The PPPs give the private sector access to secure, long-term investment opportunities. Private partners can generate business with the relative certainty and security of a Government contract.

Payment is provided through a contracted fee for service or through the collection of user fees, and the revenue stream may be secure for as long as 50 years or more.

Private sector partners can profit from the PPPs by achieving efficiencies, based on their managerial, technical, financial and innovation capabilities. They can also expand their PPPs capacity and expertise, or their expertise in a particular sector, which can then be leveraged to create additional business opportunities. For example, the company can market its experience in other jurisdictions, once it has established a track record of working successfully with the public sector.

For engaging in PPPs, private sector companies offer a wide range of business opportunities that were previously confined to public agencies. Given the long term nature of these relationships, undertaking work under the PPPs arrangements provides a stable foundation for the growth of the business. In addition, the PPPs arrangements encourage the private sector to engage in a broader spectrum of activities, throwing open the possibility of designing and delivering innovative solutions, rather than merely constructing assets to existing standards and designs.

11.6 Disadvantages and Drawbacks of PPPs

A common problem with the PPPs projects is that private investors obtained a rate of return that was higher than the Government's bond rate, even though most or all of the income risk associated with the project was borne by the public sector.

Advocates of private sector finance claim that it provides incentives for the private partner to deliver projects to time and budget, and operate infrastructure soundly. Critics of the PPPs claim that Public Sector Finance is cheaper than private sector finance and so the private sector finance should not be used. But, critics of this argument claim that the Government's ability to borrow cheaply is a function of its capacity to levy taxes. It is stated that what determines the real cost of finance for a project is its risks. The private sector explicitly prices these risks into the cost of finance.

The PPPs, like conventional service delivery mechanisms, also have disadvantages and drawbacks.

In order to minimize or eliminate these, it is vital that public sector managers recognize and understand them in order to better address problems as they arise, through careful contractual arrangements and negotiations.

Firstly, there is the possibility that the public sector may lose managerial control of its services. Under the PPPs, the management of output is transferred to the private sector, meaning that the public sector has very limited ability to intervene, as long as services are being delivered. The public body has no day-to-day control over the management of the project and is reduced in its capacity to change the project or co- operate with wider public sector services, and indeed may not be able to make use of its own expertise in the area.

Secondly, the process of the PPPs procurement can be time consuming and expensive. In order for a PPP to be successfully realized, it is vital that before bidding starts, a detailed, clearly structured project appraisal and specification of desired outputs is drawn up.

Although, this is important to the development of projects that are affordable and provide value for money, it has the potential to make procurement a lengthy and costly procedure.

Thirdly, there is the problem of the higher cost of finance in the private sector. The weighted cost of finance in the private sector, including both debt and equity, is typically between 1 to 3 per cent higher than the public sector's cost of debt on a non- risk adjusted basis. This has the effect of increasing the overall cost of PPP in comparison to traditional procurement methods, unless this can be offset by the increased cost efficiencies that the private sector should deliver.

Fourthly, the PPPs can sometimes prove to be rather inflexible instruments-especially given the long term nature of most PPPs contracts. While there can be significant financial benefits in setting rigidly defined output specifications for the life of the PPPs, these should be weighed against the inflexibility this inevitably brings. Under the PPPs arrangements, there is limited potential for modifying services or flexible spending. Certain sectors of service provision may require a much greater degree of flexibility and in these cases, an approach which makes use of long-term rigid specifications of outputs may prove difficult or counterproductive.

Fifthly, in some areas of public service provision there may be greater public demand for accountability and responsiveness than in others. This may give rise to public criticism or even hostility towards PPP arrangements. Moreover, under the PPPs arrangements, lines of accountability can be less straightforward (and transparent) than under traditional methods of procurement where lines of accountability (for example, to Government ministers) are more direct and immediate. In these circumstances, there may be a need for greater Government involvement in the relationship, to ensure compliance and responsiveness to public concerns.

Activity B:

1. Enumerate various benefits of the PPPs and relate it with any sector where you find that such benefits are better realized by various projects in the chosen sector. Identify the areas in which the benefits can be realized by implementing some suggestion based on your own understanding.

11.7 Common Misconceptions About PPPs

Despite criticism of the PPPs, there have been rather more successes than failures in this innovative field. Where failure can be identified, it is largely confined to the early years of the PPPs use. Moreover, many of the initial teething problems have been overcome as a more sophisticated understanding of how best to use the PPPs has developed.

A few of the most common misconceptions of PPPs are outlined in brief as follows:

- Similar as Privatization:

All forms of the PPPs involve an ongoing partnership between private and public sectors. The one exception to this is Build-Own-Operate arrangements, which are similar in structure to a privatization of services, but even here the public sector agency can place regulations and conditions on the private partner. A key motivation behind the use of the PPPs arrangements is to introduce competition in public service provision; this directly contrasts with privatization, which transforms a public monopoly into a private one and does not achieve the synergistic benefits of partnership between public and private sectors on offer under PPPs.

- Public Authorities Lose Control Over Service Provision:

PPPs do not entail the loss of public authorities' ability to implement policies or regulate service provision. Done well, PPPs can be shaped by public authorities to integrate with their existing objectives, policies and regulations. Through well-defined PPPs contracts, the public sector can ensure retention of control over its assets and services.

- PPPs Only Apply to Infrastructural Projects:

While most public attention is focused on the use of the PPPs to develop large infrastructural projects, the PPPs can be used to deliver a wide range of public services in an effective and innovative manner. For example, they can be utilized in the delivery of services that do not involve major capital projects, such as data service provision, refuse collection or road maintenance.

- The Principal Reason to Follow A PPPs Route is to Avoid Public Sector Debt:

The primary motivation for entering into the PPPs relationships is to bring about greater efficiency, innovation and value for money. The public sector and the end users of the service will be ultimately responsible for servicing the debt one way or another, so the PPPs should not be entered into just to keep the debt off the balance sheet of the public agency.

- Service Quality Will Decline:

There is no obvious relationship between the manner of service delivery, whether the PPPs or more traditional methods, and the quality of the service. In fact, through contractual provisions concerning quality control, the public body has the ability to specify the standard of performance required, and the character of the PPPs arrangements suggest that service quality would be enhanced as a result. Given their financial interest in the project's success, private partners have a strong incentive to improve the quality of the service.

- Public Sector Staff Will Lose Out:

There is often anxiety among public sector staff that the PPPs invariably lead to job losses or to a worsening in employment terms and conditions. However any of the PPPs Contract must conform to local labour legislation and existing collective agreements. Any changes in staffing levels must be consistent with existing labour contracts, and should preferably come about through attrition rather than through redundancy.

- The Cost of the Service Will Increase to Facilitate Private Profit:

The Public authorities may be wary of entering into the PPPs because they fear that the costs of provision whether met through user charges or through public subsidy will be higher than those of publicly provided services that are by nature, non-profit. However, the PPPs only make sense in regard to value for money if they can provide services at a price lower than, or at least commensurate with, existing public provision. Under the terms of the PPPs, any profits must arise through increased productivity and expanded services, not increased fees.

- The Public Sector Can Finance Services at A Lower Cost than the Private Sector:

While the public sector may sometimes be able to finance projects at a lower cost than the private sector by borrowing through the public fund, this will not always apply. Moreover, it is crucial that public sector agencies focus on the overall benefits to be gained from the PPPs arrangements, rather than simply lower upfront costs.

11.8 Suitability of PPPs

In general, public authorities can consider the **PPPs arrangements in any of the following circumstances, in the following cases:**

- the project cannot be provided with the financial resources or expertise of the public sector alone;
- a private partner would increase the quality or level of service over that provided by the public sector on its own;
- a private partner would allow the project to be implemented sooner than if only the public sector were involved;
- there is support from users for the involvement of a private partner;
- there is an opportunity for competition among prospective private partners;
- there are no regulatory or legislative prohibitions to involving a private partner in the provision of a project;
- the outputs of the project can be measured and priced easily;
- the cost of the project can be recovered through the implementation of user fees;
- the project provides an opportunity for innovation; there is a track record of partnerships between Government and the private sector, and
- there are opportunities to foster economic development.

Activity C:

1. Try to develop guidelines to overcome various prevailing misconception about PPP, which help the people who are concerned with implementation of PPPs projects.

11.9 Structures, Models & Roles of PPPs

Structures of PPPs:

Various elements such as design, build, operation, maintenance, finance an ownership of the PPPs projects are combined in a variety of ways to produce a number of different partnership structures. Among these different approaches to structuring the PPPs, there are important variations in regard to the following: the extent of participation by the private sector in public service provision, the amount of risk transferred to the private partner, the nature of assets and facilities, and the arrangements for ownership of these. The degree of private involvement required by a particular project is determined by the public agency. Factors influencing this decision include the project's goals and objectives, the level of control the Government requires, and the PPP consortium's ability to provide the service needed. Such decisions will also be constrained by the existence of regulation and legislation affecting the arrangement, and the need to attract private resources and generate future revenue.

Under the PPPs arrangements, a single contract is drawn up between the public body and the private organization which covers all elements involved in the project. These will vary according to the specific requirements of an individual project. Key elements of a PPPs project will include some combination of Design, Build, Operate, Maintain, Finance and Ownership. These elements can combine in different ways to produce a range of different partnership structures. Below, the main PPPs structures in use around the11world are listed with a description of their relative strengths and weaknesses.

(A) Design-Build (DB) or Build-Transfer (BT):

Under this model, the private partner designs and builds the facility in accordance with the requirements specified by the Government. Once completed, ownership and responsibility for operation and maintenance are transferred back to the public agency.

Strengths of Design-Build (DB) or Build-Transfer (BT):

- access to private sector expertise;
- possibilities for financial savings and innovation in design;
- flexible procurement procedures;
- potential for more efficient construction;
- reduced construction time;
- transfer of risk from public to private sector;
- single point of accountability;
- Fewer construction claims.

Weaknesses of Design-Build (DB) or Build-Transfer (BT):

- loss of owner control;
- difficulty and increased cost of changing contract or including additional features into design
- a more complex award procedure;
  If life-cycle approaches not taken, there is the possibility of higher operating and maintenance costs, which may offset the benefits of lower capital costs to the public sector.
- the outputs of the project can be measured and priced easily;
- the cost of the project can be recovered through the implementation of user fees;
- the project provides an opportunity for innovation; there is a track record of partnerships between Government and the private sector, and
- there are opportunities to foster economic development.

Activity D:

1. Try to develop guidelines to overcome various prevailing misconception about PPP, which help the people who are concerned with implementation of PPPs projects.

(B) Design-Build-Finance-Operate/Maintain (DBFO, DBFM, or DBFO/M) or Build-Own-Operate (BOO):

Under this structure, the private organization finances, designs, builds, operates and maintains the project. It is paid by the Government throughout the duration of the contract, according to the services delivered and whether these meet specified standards of performance. There is no requirement that the private company will transfer ownership of the facility back to the public body.

Strengths of Design-Build-Finance-Operate/Maintain (DBFO, DBFM, or DBFO/M) or Build-Own-Operate (BOO):

- the public sector plays no role in either provision or operation of the facility;
- it allows public sector regulation of the private sector's delivery of a 'regulated' or 'monopolistic' service area;
- the service can be operated by the public sector in the most efficient manner, both in the short and long term;
- the public sector does not have to put up capital to finance the project;
- private facilities generate public revenues in the forms of income tax and property tax;
- The long-term nature of the arrangement gives the private developer an incentive to invest large amounts of capital.

Weaknesses of Design-Build-Finance-Operate/Maintain (DBFO, DBFM, or DBFO/M) or Build-Own-Operate (BOO):

- there is no guarantee that the private company will operate the service in the 'public good';
- unless the service is specifically regulated, the public sector cannot set or adjust its price
- all federal, provincial and municipal tax regulations apply
- Due to the lack of competition, it is necessary to develop rules and regulations concerning operations and pricing.

(C) Wrap Around Addition (WAA):

Here the private partner is contracted to construct an addition to an already existing public asset or facility. It may then operate that addition for a specified period of time or until there has been a reasonable return on the investment.

Strengths of WAA:

- the public sector does not have to find the capital to finance the upgraded service;
- the private partner assumes the financial risks;
- the public sector gains the construction expertise of the private entity;
- there is the potential for fast-tracked construction, using techniques such as design-build;
- procurement processes can be more flexible;
- construction can be made more efficient;
- The time period needed for implementation can be reduced.

Weaknesses of WAA:

- it may be difficult to incorporate at a later date any future upgrades of the facility not included in the original contract;
- altering existing contracts with the private partner can be expensive;
- perceived loss of control;
- Contract awarding procedures become more complex.

(D) Lease-Develop-Operate (LDO) or Buy-Develop-Operate (BDO):

Under this model, a private sector organization purchases a facility from the public sector, modernizes or improves it, and then assumes operational responsibility under a contract with the local Government. It is expected that the private partner will invest in modernization and then be given a specified period of time in which to realize a return on the investment.

Strengths OF Lease-Develop-Operate (LDO) or Buy-Develop-Operate (BDO):

- the local Government benefits from a significant cash infusion when the private company buys the facility;
- capital for financing the upgrade is provided by the private rather than public sector;
- both parties gain opportunities for increased revenue;
- users benefit from improved services and facilities;
- the public sector has access to the construction expertise of the private organization;
- there is the potential for fast-tracked construction, using techniques such as design-build;
- procurement processes can be more flexible;
- The time period needed for implementation can be reduced.

Weaknesses Strengths OF Lease-Develop-Operate (LDO) or Buy-Develop-Operate (BDO):

- loss of control of the service or infrastructure, either perceived or actual;
- there is potential difficulty in valuing assets for sale or lease;

- issues may arise if selling or leasing public assets that have received grant funding;
- in cases of private company failure, the local Government may need to revert to providing the service or facility;
- It may be difficult to incorporate at a later date any future upgrades of the facility not included in the original contract.

Bird Eye-view of Models of PPPs:

The PPPs can be used for existing services and facilities as well as procuring new services, utilizing one of the following models:

- Service Contract:

A private organization is contracted to provide services previously performed by Government.

- Management Contract:

In addition, to providing the service, under this scheme the private entity is also responsible for all aspects of facility operations and maintenance.

- Lease:

The private sector body is granted leasehold in a publicly owned asset, and then operates and maintains it in accordance with the terms of the lease.

- Concession:

Here a private company is granted exclusive rights to provide, operate and maintain a facility or service over a long time period, and is expected to meet certain performance standards set by the Government. Ownership of the original asset is retained by the public agency, while the private contractor gains ownership of any improvements made during the concession period.

- Divestiture, Complete or Partial:

An asset is transferred, either wholly or partially, from the Government to the private sector entity. Usually, continued service and substantial improvements are made a condition of sale.

What all of the above suggests is that when it comes to private sector involvement in public service provision, there is no standard model. Indeed, the specific circumstances of any given project will determine which approaches are most appropriate.

Brief Review of Roles of PPPs :

The private partner in a PPP may be a private company, a consortium of private interests, or a Non-Governmental Organization (NGO). Most often, a PPP project will comprise a public sector agency and a private sector consortium composed of contractors, maintenance companies, private in Vehicle' (SPV) to contract with the public authority as well as with the subcontractors whose task it is to build and maintain the facility in question.

The various parties and their respective roles in PPPs mainly include following:

- The Public Agency Purchase

The role of the public body is to specify clearly the desired outcomes or outputs, and to avoid identifying a particular means of delivering these. If services are delivered in accordance with the agency's performance standards, they then pay the PPP provider (most often, the SPV).

- Service Providers: Design, Construction, Operation and Maintenance:

Private actors have a crucial role in developing innovative solutions in order to meet the requirements of the PPP in an effective and efficient manner. Typically, the SPV will subcontract construction, operations and equipment supply to suitable providers, who may be the parent companies of the SPV and therefore, also equity investors in the project. The SPV also needs to raise the necessary capital to build the assets required for service delivery. Once service delivery has commenced, the payment it receives from the procuring agency can be used to pay suppliers and subcontractors and repay debts.

- Private Financiers: Equity Investment and Debt Provision:

Generally, the construction and operations companies which make up the SPV are also the equity investors. Equity stakes may also be taken by fund managers and other financial institutions. Because of their interest in generating a return on their outlay, equity investors have a strong incentive to ensure high standards of service performance. The PPP contract provides the sole source of revenue for the SPV and provided the latter meets the required standards, it will be paid by the public authority and so can service its debts.

- Consultants: Project Advice:

Both the public body and the private sector consortium may decide to engage technical, legal and financial consultants to assist in structuring the tender or composing a viable PPP proposal. Experienced advisors can bring their knowledge and expertise to highlight best practices, as well as identify potential problems and pitfalls.

Activity E:

1. Identify the services provided by Local State or Central Government in your local areas in which you think that PPP can not only improve the service but can provide services at a reasonable cost. Try to elaborate the answer by focusing how it is possible to improve the service with PPP model.

11.10 Developments of the PPPs in India

Despite its status as the world's fourth largest (and second fastest growing) economy, India continues to experience significant gaps in the supply of essential social and economic infrastructure and services. Water, power, roads, and ports are all in urgent need of additional supply and upgrade. In fact, what we might refer to as the 'infrastructure deficit' is widely regarded as a major constraint in India's attempts to sustain, deepen, and expand its economic growth and competitiveness. Recent estimates suggest that the lack of quality infrastructure is retarding India's GDP growth by per cent and 2 per cent each year.

Moreover, the deficit in infrastructural development is preventing the sectoral, regional, and broader socio-economic strengthening of the economy. It is slowing the growth not only in the knowledge intensive, high-tech sectors but also (and perhaps of greater import) in the manufacturing and agriculture sectors - both sources of jobs for the low-skilled. For example, rural roads, power grids, irrigation networks and national highways all have the potential to link poor rural producers to markets in towns, cities, and ports. An improved infrastructure is thus a necessary condition for both growth and poverty alleviation. It is no coincidence, then, that more than two- thirds of the Asian Development Bank's 2006-2008 assistance programme for India, oriented to poverty reduction, is now focused on infrastructural development.

How Much is Needed?

Recognizing the urgency of the need for ongoing infrastructural investment, the Government of India (GOI) has, over the past decade and more, increased spending through a series of important national programmes.

These include the National Highway Development Programme (NHDP), Bharat Nirman, Providing Urban Services in Rural Areas (PURA), Jawaharlal Nehru National Urban Renewal Mission (JNNURM), the Prime Minister's Rural Roads Programme, National Rail Vikas Yojana, the National Maritime Development Programme (NMDP), and a significant airport expansion programme.

Nevertheless, the Government has acknowledged that if the 'infrastructure deficit' is to be overcome, investment will need to be raised to a level in line with broader economic growth. In other words, gross capital formation in infrastructure (GCFI), which has remained in the region of 4 per cent of GDP, must increase rapidly. By comparison, other leading economies in the region, such as China, have been investing up to 10 per cent of GDP in infrastructural development. The Tenth Five Year Plan (2002-2007) projection on GCFI (at 2001-2002 prices) amounted to more than Rs 11,00,000 Crores (US$250 Billion).

For the Eleventh Five Year Plan (2007-2012), estimates vary and continue to be revised on a regular basis - and inevitably, upwards. According to one recent estimate, India needs to increase infrastructural spending gradually to 8 per cent of GDP (US$ 100 Billion per year) by the year 2010 in order to realize a sustained growth for the broader economy of 8-9 per cent. As per the Ministry of Finance Report, May 2007, it shall reach a figure of US$ 384 Billion by the year 2012. However, even this figure may be a considerable underestimate of the amount of capital investment required to sustain infrastructural development during the period of the Eleventh Plan.

Why public - Private Partnerships?

The scope for making improvements on the scale suggested above is fundamentally constrained by the State of Public Finances. The combined deficit of the central and state Governments is roughly 10per cent of GDP. Government borrowing has been capped through the Fiscal Responsibility and Budgetary Management Act. This necessarily limits state participation in infrastructure financing, opening the door to innovative approaches such as PPPs. Government preserves its basic role, but it is one that shifts from provider and manager to that of enabler and regulator of basic services

To that end, the Government of India has been encouraging private sector investment and participation in all infrastructure sectors. As the National Development Council has made clear that "'Increased private participation has now become a necessity to mobilize the resources needed for infrastructure expansion and upgrading."

Vinayak Chatterji, Chairperson of the Confederation of Indian Industry's Infrastructure Council, suggests that almost 70 per cent of the required funds for infrastructural development in India in the future will come from the public purse, while 20 per cent will be sourced from the private sector (foreign and domestic), and 10 per cent from overseas development assistance, such as the World Bank and Asian Development Bank (ADB). Indeed, the ADB itself suggests that the proportion of funding from the private sector for infrastructural investment is likely to be closer to 30 per cent.

To date, various PPPs models have been tried in India, including public contracting; passive public investment (equity, debt, guarantee, grants); joint ventures; and long- term contractual agreements

(BOT, BOOT, BOLT). Regardless of the model pursued, the overwhelming consensus is that PPPs are the primary means by which the Government of India will seek to close the very clear gap that has appeared (and will continue to widen) in funding the level of infrastructural development required if the Indian economy is to grow at its optimum rate

How Have PPPs Progressed Thus Far?

The PPPs are still a relatively new phenomenon in India. Until 2004, there were only 85 projects, but between the year 2004 and 2005, this figure leapt to 500. More than Rs. 1000 Billion worth of the PPPs projects is under development across the country, with the largest number of projects in the roads and bridges sector, followed by ports. These sectors dominate PPPs initiatives. The leading State users of PPPs by number of projects have been Madhya Pradesh and Maharashtra, followed by Gujarat, Tamil Nadu, and Karnataka.

Almost, all contracts have been of the BOT/BOOT type or close variants, which involve user payments. More state agencies are expected to participate in PPPs as the number and variety of PPP projects expand dramatically. At present, however, the National Highways Authority of India (NHAI), the Ministry of Shipping, and Road Transport and Highways (MOSRTH) - all central Government agencies - have tended to initiate the vast majority of PPP projects brought to successful financial close.

Key Constraints in PPPS:

While encouraging PPPs, there are broadly four constraints:

Weakness in enabling policy and regulatory framework is required. Substantial work need to be done in making sector policies and regulations PPP friendly. A large number of these projects are in the States and without the active participation of the States it would not be possible to achieve satisfactory results.

The market presently does not have adequate instruments and capacity to meet the long-term equity and debt financing needed by infrastructure projects. There is also a lack of shelf of credible, bankable infrastructure projects, which could be offered for financing to the private sector. Some initiatives have been taken both at the central as well as the states' level to develop PPP projects these tend to be isolated cases and have demonstrated a marked lack of consistency.

There is also lack of capacity in public institutions and officials to manage the PPP process. Since these projects involve long term contracts covering the life cycle of the infrastructure asset being created, it is necessary to manage this process to maximize returns to all the stakeholders.

The Government of India making serious efforts to address all these issues to encourage PPPs. Government has taken measures to create enabling framework for PPPs by addressing issues relating to policy and regulatory environment.

Progressively more sectors have been opened to private and foreign investment, levy of user charges is being promoted, regulatory institutions are being set up and strengthened, fiscal incentives are given to infrastructure projects, standardized contractual documents including the Model Concession Agreement are being notified, approval mechanism for PPPs in the Central sector had been streamlined and a website exclusively devoted to PPPs has been launched to serve as a virtual market place for PPP projects.

To address financing needs of these projects, various steps have been taken like setting up of India Infrastructure Finance Company and launching of a new Scheme to meet Viability Gap Funding (VGF) of PPPs projects. Setting up of infrastructure funds are also being encouraged and multilateral agencies such as ADB have been permitted to raise Rupee bonds and carry out currency swaps to provide long term debt to PPPs projects.

11.11 The PPPs in Few Selected Sectors of India

The Public-Private Partnership (PPP) has become a fashionable slogan in new development strategies, particularly over the last couple of decades. It is projected as an innovative idea to tap private resources and to encourage the active participation of the private sector in national development. It is more forcefully advocated when public resources are projected to be inadequate to meet needs. PPP is already being adopted in several infrastructure development sectors, such as the development of airports, railways, roads, and so on.

The PPPs in Education Sector of India:

The policy initiatives of the Indian Government are being extended to human development sectors such as education and health.

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But, going by media reports, these have mixed outcomes. The policy initiatives are no longer confined to these; they are being extended to human development sectors such as education and health.

In the case of education, the PPPs have been proposed as an important strategy in the Eleventh Five Year Plan. Among many things, the Eleventh Plan has proposed the setting up of 6,000 new model schools in secondary education, affiliated to the Central Board of Secondary Education. Of these, 2,500 are to be under the PPPs Model. The intention is to set up these schools in the backward regions and remote areas where good schooling facilities do not exist, so that quality education is accessible in the backward regions as well.

According to the PPPs Model finalized by the Planning Commission in consultation with the private sector, these schools will be set up by the year 2014, and will have the capacity to educate 65 lakh students, of whom 25 lakh will be from the deprived sections. Each school will have about 2,500 students, 1,000 of whom will be from deprived sections and charged a token fee. Fifty per cent of the 1,000 students will be from the Scheduled Castes, the Scheduled Tribes and the Other Backward Classes. They will be required to pay a monthly fee of Rs.25 each. The rest of the children, who will be from other deprived sections that is non-income tax paying families will be required to pay a fee of Rs.50 a month. The remaining costs of these students, estimated to be Rs.1,000 to Rs.1,200 a head per month, will be reimbursed by the Union Government to the schools. It is estimated that the Government will have to pay Rs.10,500 Crores until 2017. The amount is likely to go up with escalating prices, in general, and increasing costs of education, in particular. Over and above this, the schools may get access to relevant funds from the Centre and the State Governments under different schemes. The schools will be free to admit anyone to the remaining 1,500 seats and charge any amount of fee.

The companies from Corporate world with a minimum net worth of Rs.25 lakh are eligible to set up schools under this model. Each entity should deposit Rs.50 lakh with the Government for the first school it proposes to set up, and Rs.25 lakh per additional school. Each can set up as many as 25 schools. Non-Profit Companies with prior experience in education need to deposit Rs.25 lakh for each school. The schools will need to have the sort of infrastructure available in the best private schools.

There are a few important aspects that are clear in this model.

One, it involves a massive transfer of resources from the exchequer to private schools.

Two, the schools have unlimited freedom in all aspects of governance, including specifically the fees to be charged from the 1,500 students. The model thus allows the so-called non-profit institutions to work for, and actually make, profits.

Third, the Government has little control over these schools. Except to insist that 1,000 students from the deprived sections be admitted and that they be charged a certain fee, it cannot do much.

As a result, the model, which claims that it is not for privatization, and that it will not allow the profit motive to enter the field of education, will promote the opposite, privatization and, in practice, a high degree of commercialization. It is privatization and commercialization with a difference utilizing public funds. Most important, the PPP model does not feel the need to view education as being distinct from the production of commercial goods and building of infrastructure.

Another model with which India have vast experience, which is somewhat similar but different type of PPP in education, though it is rarely referred to as PPP. This is the Government-aided private school system, a system that is not being encouraged nowadays by any State Government for financial reasons.

This model involved the setting up of a school by a private, non-profit seeking organization, a trust or voluntary organization and, in some cases, business entity, with its own funds and running the school by the same body for a minimum number of years before it became eligible for Government aid for recurring expenditure. Essentially, but not exclusively, what was involved was the salary expenditure of the staff.

These schools are subject to Government regulation and are required to follow most of the Government rules and regulations in terms of admissions, fees, scholarships, other incentives and subsidies, recruitment of staff, salary structure, and so on. In effect, they are no different from Government schools, but for management by the private sector.

The main difference between the aided school system, which now forms a major part of the secondary school system in India, and the proposed PPPs Model, is with respect to Government control and correspondingly the role of the private management. The present PPP model conceived in the neo-liberal times provides for no Government or any type of social control on education. In fact, it provides for unlimited power to the private sector.

The PPPs in Road Transportation Sector of India:

Traditionally, the road projects were financed only out of the budgetary grants and were controlled/

supervised by the Government. The road sector has attracted very limited private sector participation in the past. While the traffic has been constantly increasing at a rapid pace, the traditional system of financing road projects through budgetary allocations has proved to be inadequate. It was in this context that the necessity for exploring the innovative means of financing the highly capital intensive road projects was felt.

The beginning of a significant private sector participation in road projects was made with the launching of India's largest road project called as the National Highways Development Project (NHDP).

The Transport has also become an important sector, attracting 18 percent of investment commitments in 2001–2006, and 34 percent in the year 2006. The main driver has been India's growing program of public-private partnerships in transport, which reached financial closure on more than 40 projects in 2006 alone. A large share of the transport projects in India has been public-private partnerships to expand the national highway system. Most of these are real-toll contracts, combining a long-term concession for an existing stretch of highway with a requirement to expand capacity to four lanes or more and, in some cases, a Government subsidy.

To encourage private sector participation, several initiatives have been taken by the Government which includes:

- declaration of the road sector as an industry;
- provision of capital subsidy up to 40 per cent of the project cost to make projects commercially viable;
- 100 per cent tax exemption in any consecutive 10 years out of the first 20 years of a project.
- provision of encumbrance free site for work, i.e. the government shall meet all expenses relating to land and other pre-construction activities;
- foreign direct investment up to 100per cent in road sector;
- easier external commercial borrowing norms;
- higher concession period, (up to 30 years),and
- right to collect and retain toll.

The PPPs in the Civil Aviation Sector of India:

Activity has also been on the rise outside of roads. In 2006 the Indian Government offered concession at the Delhi and Mumbai Airports, and it is now developing a private investment program in the Rail sector. As a result of the surge in the year 2006, investment commitments to transport projects in India were roughly equal to those in Telecommunications.

With a growth rate of 18 per cent Per Annum, the Indian Civil Aviation Industry has emerged as one of the fastest growing aviation industries in the world. The Government's 'Open Sky Policy' has lead to many overseas players entering the market and the industry has been growing both in terms of players and number of aircrafts.

With the liberalization of the Indian Civil Aviation sector, this industry of India has undergone a rapid transformation. From being primarily a Government-owned industry, the Indian aviation industry is now dominated by privately owned full-service airlines and low-cost carriers. Private airlines account for around 75 per cent share of the domestic aviation market.

Indian carriers currently have a fleet size of 310 aircrafts, but have 480 aircrafts on order, scheduled for delivery by the year 2012.

India has jumped to 9th position in world's aviation market from 12th in 2006. The scheduled domestic air services are now available from 82 airports as against 75 in the year 2006.

According to Shri Kapil Kaul, [CEO India & Middle East, Centre for Asia Pacific Aviation] India's Civil Aviation Passenger Growth, at 20 per cent, is among the highest in the world. This sector is slated to cruise far ahead of other Asian giants like China or even strong economies like France and Australia. The number of passengers who will be airborne by the year 2020 is a whopping 400 Million."

The Centre for Asia Pacific Aviation (CAPA) has forecast that domestic traffic will increase by 25 per cent to 30 per cent till the year 2010, and International Traffic Growth by 15 per cent, taking the total market to more than 100 Million passengers by the year 2010. India's civil aviation passenger growth, presently at 20 per cent, is one of the highest in the world, and is expected to surpass countries like China, France and Australia. By 2020, 400 Million Indian passengers are likely to be airborne. By the year 2020, Indian Airports are expected to handle more than 100 Million passengers including 60 Million domestic passengers, and around 3.4 Million tonnes of cargo Per Annum.

According to findings of the report of the market research firm PhoCus, domestic Air Traffic is likely to more than double, and shall touch 86.1 Million Passengers by the year 2010, up from 32.2 Million passengers of the year 2007. Moreover, significant measures to propel growth in the civil aviation sector are on the anvil. The Government plans to invest US$ 9 Billion to modernize existing airports by 2010. The Government is also planning to develop around 300 unused airstrips, and subsequently, Boeing and Airbus, along with Embraer (Brazil), Bombardier (Canada), Sukhoi (Russia), ATR (France) and BAE System (UK) are now looking at foraying into the Indian jet market.

The PPPs in the Health Sector of India:

The private sector is the most important source of healthcare services in India, providing close to 80 per cent of all services, according to the Government's own reckoning. A related fact is that nearly 75 per cent of health-related expenses are out of pocket and occur at the point of service delivery. Over the last few years there have been many initiatives to improve the efficiency, effectiveness and equity in provision of healthcare services in the country. Public-private partnership is one such initiative. Before considering emerging public-private partnerships in health in India, it may be worth recalling that healthcare has historically even in developed nations been a private sector activity. The emphasis on the Government's responsibility for providing or supporting healthcare services for the entire population is recent. The National Health Service in the United Kingdom, often seen as the model for delivering universal and comprehensive healthcare services, was established only in 1948, after World War II.

Starting from the Bhore Committee report in 1946 there has been an increasing emphasis on the state providing healthcare services through a three-tiered approach in India. However, despite these efforts and despite many healthcare and family welfare plans and programmes made since then, health outcomes in India have remained closer to those in sub-Saharan Africa than in industrialized nations among which India would like to be counted. Public-private partnerships aim to harness the large pool of private sector healthcare resources and draw them into the process of nation building.

A key difference in the public-private partnership approach in India today and earlier such initiatives around the world is that those were implemented in times of economic crisis when state funding for the health sector needed to be reduced. India, on the other hand, is experiencing unprecedented economic growth and there has been an explicit commitment to increasing state funding on health from 0.9 per cent to 2-3 per cent of the gross domestic product. Thus the primary reason to encourage private participation does not appear to be a lack of funds but a lack of managerial and technical ability.

It is too early to say whether these experiments have achieved the expected results of efficiency, effectiveness and equity. However, it may be useful to look at examples of public-private partnerships in different Indian states to learn some lessons before it is too late.

One of the earliest state Governments to start public-private partnerships since the NRHM was announced was Bihar. In some areas this was introduced to provide pathology and diagnostic services, operate ambulances services in the state and run additional Primary Health Centres. The ambulance contract ran into trouble right at the outset and had to be suspended.

Another area related to PPP was to run additional Primary Health Centres in which Some 30 such clinics were handed over to non-Governmental organizations (NGOs) in the year 2001 heard complaints that the Government did not release money on time, or that funds being given to NGOs was much less than what was being spent in a similar Government institution.

At present, the most high profile Public-Private Partnerships in India must be the 'Chiranjeevi Programme' launched by the Government of Gujarat. The Gujarat State is one of the most industrialized States of India, and a major hub of the Pharmaceutical Industry of India and worldwide. The experience is that the State's maternal mortality ratio is high, reflecting poor access to healthcare. There is also a great disparity between districts in access to healthcare. The State Government drew up an ambitious scheme to ensure institutional deliveries for the poor through the active engagement of the private sector. In a pilot project, obstetricians in five districts were offered a financial package roughly Rs 1.75 lakh for every 100 deliveries they conducted. The scheme sounds remarkably simple in its conceptualization and delivery and typifies what may be called a win-win situation. The State issues a service voucher worth about Rs 2,000 to each poor pregnant woman and ensure that the provider is reimbursed. It is something like a pre-paid taxi service but you do not have to pay for the receipt. There have been some reports from Gujarat that Government Centres are referring easy cases to private practitioners; private practitioners refer difficult cases to district hospitals. Government centers do not wish to operate outside fixed hours (and deliveries take place when least expected) and obstetricians under the Government contract do not want to handle complications.

As the bulk of poor Indians seeking care visit the private sector, efforts to include the private sector within a formal planning and monitoring system for healthcare service delivery through the public-private partnership approach should be welcome. However current efforts are inadequate on many counts and the problems must be addressed if a robust, accountable and quality public-private partnership mechanism has to be developed.

Some measures that need to be introduced are as follows:

- setting up a set of technical and ethical parameters and standards for service delivery common to different levels of the healthcare system. a beginning has been made with the Indian public health standards and these should be applicable to both the public and the private sector;
- there must be new regulatory mechanisms for the healthcare system including the pharmaceutical industry which is among the least regulated in India.
- the cost of healthcare should be regulated just as other consumer products are, through a system of maximum prices. the voucher system can be seen as a precursor of this mechanism, and

an efficient monitoring and enforceable system should be introduced of penalties for breach of regulations and standards.

One hopes that the poor will then receive the services they need and at a cost they can afford, and providers will receive a fair compensation for their services.

Activity F:

1. Choose any healthcare services and find out which structure of PPP is best suitable by relating it with various structures of PPP. Give supporting reasons for the suitability of structure to chosen healthcare service.

11.12 Managing PPPs Projects & Relationships

Given the long-term nature of PPPs Contracts, they can be more complex than other traditionally procured projects. If the project is to be realized successfully, it is vital to have a strong project management team within the public body monitoring implementation. This team should comprise people with expertise in the financial, legal and technical aspects comprising the PPP. It is equally important that the private sector partner possesses a strong project management team capable of delivering on the contract.

Project Management:

The public sector project management team will generally be required to fulfill the following broad aims:

- assess the feasibility of creating a PPPs arrangement for the project;
- structure the PPPs tender in a way that delivers value for money for the public sector while providing sufficient business opportunities to the private sector. this might entail conducting detailed studies to recommend a feasible scheme, including the identification of financial arrangements and pre- qualifying criteria of the potential PPPs provider. the preparation of initial PPPs documents may also occur at this stage;
- evaluate tender proposals and select the best provider for the contract;
- prepare the final PPPs contract after the preferred bidder has been selected, and
- monitor performance of the provider's work and the progress of the project.

Likewise, the private sector partner seeking to secure a PPP bid must have the capacity to:

- understand the PPP model proposed by the public body and the financial implications in terms of revenue, cost and cash-flow;
- recognize business opportunities and formulate innovative solutions to public sector requirements;
- identify the responsibilities assigned to the private entity by the public sector's proposed PPP model;
- locate sources of funding which offer the lowest financing costs;
- Structure and price a tender proposal which satisfies the Government's objectives, realizes value for money and generates a profit for the company, and
- Manage the project successfully in line with the contractual performance requirements.

There are a number of factors influencing the public sector's ability to effectively manage a PPP project.

It mainly includes following:

- the existence of clear decision-making processes, enabling critical decisions to be made swiftly;

- ongoing support and involvement from the sponsoring agency;
- regular communication between the various sub-teams within the project, allowing the impacts of decisions to be accurately estimated. For example, the financial sub-team can assess potential increases in expenditure caused if the legal sub-team introduces more restrictive clauses into a contract;

  an adequate stakeholder support, achieved through well managed consultation and communication;
- affordability to the public sector of the project. This requires the project team to maintain accurate information on potential costs and to regularly check that the project remains financially viable, and
- sufficient private sector competition for the PPP, which will ensure the best value for money. PPP procurement should only proceed if it delivers better value for money than other methods.

Managing Relationship:

It is crucial that public authorities have a clear understanding of the differences between PPPs projects and other methods of public procurement. PPP projects demand a different approach to managing relationships with providers. Public authorities should not seek to manage PPP projects in the way they would conventional construction projects, as this is likely to restrict the potential of the PPPs provider to innovate in design and build. In case of the PPPs projects, the provider is delivering services rather than assets, therefore emphasis should be on the provider's performance in delivering these to the specified standards. As risk allocation is more complex, the public authority must be careful that the risks assumed by the private entity, such as construction and operational risks, are not inadvertently transferred back to the public sector. Other aspects which are to be considered in managing relationships in PPPs contracts are as described below:

Getting the Contract Right in The First Place:

It is essential that the contract clearly stipulates the rights and responsibilities of both the public sector and the PPPs provider. Any ambiguity or omission may lead to disputes, possibly arising years later, when those staff involved initially might no longer be present to help resolve them. The contract must address pertinent issues such as risk allocation, required service quality, procedures for the variation of services, and finally, the resolution of disputes. Where possible, improvements in price or quality of service should be incorporated into the terms of the contract.

Getting the Right People with Necessary Skills:

It is crucial that at all levels in the public sector there are people with appropriate interpersonal and management skills. Early in the project, it is important to designate a contract manager or management team, who can be involved from the beginning in the process of selecting a PPPs provider. This contract manager will then be the first point of contact between the public sector and the private entity providing the project. For the duration of the project, it is the duty of the contract manager to protect the public sector's agreed contractual position, ensuring that value for money is achieved and risk remains appropriately allocated. Another significant role for the contract manager is to engage in dispute prevention strategies. Identifying and adhering to clear procedures for liaising with the PPPs provider and maintaining agreed records of performance will help to resolve disputes before they escalate.

The contract management team must have a full knowledge and understanding of the business, the contract documentation and the implications of problems throughout the duration of the contract. The team should possess the skills and competencies needed to effectively fulfill management responsibilities over the life of the project. These skills and knowledge are required in design and construction; facilities and services management; information especially for IT projects; statutory safety and regulatory responsibilities; contractual law; and finance.

Effective Succession Planning:

As a result of the long tenure of the standard PPPs relationship, continuity problems can occur. For example, in the majority of cases, the initial contract management team will not be present at the end of the PPPs contract, and staff is likely to change on numerous occasions throughout the project's life. For this reason, it is essential that effective succession planning takes place and that a clear understanding of the project and healthy working relationships are maintained when new staff take over. Well managed handovers, with adequate procedures for induction and exit, can assist the maintenance of good practices and relationships beyond the tenure of the individuals initially involved.

Effective Monitoring of Provider's Performance:

It is vital that the public sector closely monitors the performance of the PPPs provider and establishes that it is meeting agreed, specified targets. The contract should include incentives and measures to ensure the provider gives accurate and timely data to the public sector, and to ensure that the service continues to be delivered at a high standard. However, it is not the role of the public authority to engage in the detailed management of the private partner.

Rather, during the procurement process it should ascertain that the selected provider has adequate systems in place for monitoring performance, managing quality and information, as well as sufficient cash flows during construction and operation. These systems should be audited by the public authority through the use of random spot checks, in order to guarantee that performance is being measured reliably, accurately and comprehensively.

Flexibility:

For a partnership to be successful there must be flexibility and a willingness to adapt to changing circumstances on both sides. Rather than being entirely reactive, a good management relationship is one

which proactively anticipates and responds to changing business needs. PPP contracts should therefore be capable of change in terms, requirements or scope, and this depends, in turn, upon a strong, communicative and flexible PPPs relationship.

There should also be structures in place to manage unforeseen problems and their impact on the ongoing relationship between public body and provider.

11.13 Summary

In broad terms, PPPs refers to an arrangement between the public and private sectors with clear agreement on shared objectives for the delivery of public infrastructure and/or public services. It is an approach adopted by public authorities to increase private sector involvement in the delivery of public services. In many countries, PPPs are now a central feature of ongoing efforts to modernize public services and infrastructure. It is a Government service or private business venture funded and operated through a partnership of Government and one or more private sector companies. These schemes are sometimes referred to as PPP, P3 or P^3.

It involves a shift in the role of the public sector from supplying to buying services, with private firms designing, constructing, financing, operating and maintaining infrastructure, and the public sector paying for these services. If the private sector invests in infrastructure and provides related services to the Government the Government retains responsibility for the delivery of core services, and arrangements between the Government and the private sector are governed by long-term contract. It specifies the services the private sector has to deliver and to what standards. Payment depends on the private partner meeting these standards.

The PPPs take many forms such as Design, Construct and Maintain, and Build, Own, Operate and Transfer. The choice of form depends on factors such as the Government's objectives, the nature of the project, the availability of finance, and the expertise that the private sector can bring.

Ever since India embarked on its first phase of economic reforms in early 1990s, infrastructure development has remained the top priority of the Government. Unfortunately, the infrastructure growth has not been commensurate with the demands made on it by an economy that was growing at more than 6 per cent p.a. This period also witnessed a consistent move towards fiscal discipline that further curtailed room for accommodating increasing Government funding of major infrastructure projects. The pressures of globalization further accentuate the infrastructure gap in the country.

With the economy now clocking a growth rate of over 8 per cent, it is estimated that US$ 320 Billion would be required by the infrastructure sectors put together over the next 5 years. A significant percentage of this investment should come from the private sector.

Public Private Partnerships (PPPs) present the most attractive option of meeting the above targets, not only in providing resources to an extent but also in upgrading the standards of delivery through greater efficiency.

The Government of India has attempted to bring out several innovative schemes aimed at leveraging its position to the fullest given its various commitments, which at times could seem mutually conflicting.

Whereas to attract the private sector commercially viable projects should be on offer and to inculcate the discipline of 'user pay principle' provision of these services should be based on payment of tariff, Government must fulfill its commitment to inclusive growth which makes it obligatory to fix the tariffs based on the capacity of the common man to pay.

Due diligence is also essential given the substantial contingent liability that could devolve on the State in such projects. The opportunities for private investment in infrastructure projects are immense. As the reach of PPPs increases across the sectors, the capacity in the private sector to manage these projects over their entire life cycle of 20 to 30 years would also have to be enhanced. The Government of India now permits FDI in most infrastructure sectors to the extent of 100 per cent. It is time that the foreign strategic investors begin to take greater interest in project development and management activity in India.

11.14 Self Assessment Questions

1 What is Public Private Partnership? Discuss various features of PPP in terms of Telecommunication services provided in India.

2 Do you think the benefits of PPP, in theoretical sense, available to Private sector party in reality?

Give suggestion how such benefits can be better realized by them.

3 Discuss various constraints and weaknesses of PPP and try to develop guidelines which minimize the effect of such constraints in implementing PPP projects.

4 List out and discuss various Structures of PPP and also try to relate the suitability of model to any local services provided by Municipal Corporation in which you reside.

5 Consider the suitability of Build-Operate-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT) structure to services provided by Local Municipal Corporation in local area where you reside.

6 Write Short notes on following

(a) Common Misconceptions about PPP

(b) Models and roles of PPP

(c) Development of PPP in India

(d) The benefits of entry of private players in Indian Telecommunication services.

(e) Design-Build-Finance-Operate/Maintain (DBFO, DBFM, or DBFO/M) or Build-Own-Operate (BOO)

(f) Benefits of PPP in road sectors available to Public sector and general public.

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Unit - 12 Competition Law and Act

Structure of Unit:

12.0 Objectives

After reading this chapter, you should be able to

- Give the meaning of competition law
- Describe the competition commission of India
- Bring out the power and function of commission
- Point out the salient features of need for national competition policy for India

12.1 Introduction-Competition Law

Introduction

- It is useful to understand economics as a discipline is fundamentally focused on the following aspects:
  - (a) Driven to work towards optimal utilisation of scarce resources (allocative efficiencies),
  - (b) Seeking to maximise welfare (as distinct from mere profits), and
  - (c) Predicated upon the assumption that all human beings make rational choices.
- To achieve the above, economic theory treats "perfect competition" as the ideal which is a situation characterized, amongst others, by:
  - (a) Multiple buyers and sellers of diverse substitutable products/services,
  - (b) With perfect information, and
  - (c) No barriers to enter, competition, trade in a market place, or to exit from it.
- In the real world, perfect competition remains utopian since all economies and markets are characterized by:
  - (a) Rampant information asymmetry and
  - (b) Imperfect markets with:
    - (i) Policy/law/historical development-based monopolies or oligopolies,
    - (ii) Sunk-cost based barriers to entry, and

(iii) Political economy distorting competitive signals.

The recent global financial market failure has brought to the fore the role of robust and vigilant regulation to prevent perverse incentives and behaviour from distorting/hijacking the gains of competitive play. A significant part of the blame is being placed at the door-steps of the regulators (like the Fed, SEC, etc.) and their failure to regulate the market once the initial signals of market failure beganmanifesting over two years ago. This has once again established that while competitive market scenario can be the norm that cannot be left to its own mechanics without robust regulatory oversight.

In this construct, it is the mandate of a democratically elected Government to decide upon economic policies for the nation. Some of these policies are enacted as legislations in the Parliament. It is noteworthy that certain well-established trends and developments have further helped crystallize the raison detre' and the contours of competition regulation for India, being:

(a) The emergence of dominant trans-national corporations in the wake of economic liberalisation and globalisation that swept the globe, cross-border movement of resources-capital (equity and debt), raw material and manpower, commerce and trade.

(b) Certain industries have evolved as natural monopolies like the network infrastructure and industries with inherent economies of scale as also limited right of way/user rights. They constitute the essential or bottleneck facilities.

(c) In case of such natural monopolies, the costs to the economy would be much higher if the government tried to preserve a large number of smaller firms free market.

(d) While dominance of enterprises may not be a cause for concern, regulation is necessary to prevent abuse of dominance in light of the likely undesirable effects like:
   (i) Excessive and exploitative prices for products and services that exploit consumers,
   (ii) Resultant misallocation of resources,
   (iii) Efficiency problems including poor quality of service and disincentives to innovations,
   (iv) Denial of non-discriminatory open access to the bottleneck or essential facilities and
   (v) Depriving people of access to essential services: universal service obligations.

Competition Law focuses on the behaviour of business, and Competition Policy provides for comprehensive action of government on economic policies. Together they make the implementation of this economic principle workable. For a robust economy, competitive market scenario is the rule and sectoral regulation must be introduced as an exception to the general rule, where considered necessary. The Government of India appointed Mahalanobis Committee on Distribution of Incomes and Levels of Living which submitted its report in 1960 highlighting growing income inequalities in India in the post independence period. Such inequality in income was seen as being contrary to the constitutional ideal of "Justice-Social, Economic and Political" as also provisions contained in the Directive Principles of State Policy read with reasonable restrictions on fundamental rights and constitutional freedom relating to trade and commerce. This led to constitution of a high-powered Monopolies Inquiry Commission (MIC) which submitted its report in 1965. Based on the MIC recommendations, India enacted its first competition law called the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). The MRTP Act aimed at achieving twin objectives of preventing concentration of economic wealth by private enterprises, and ensuring non-prejudicial public interest in economic activities within India. The MRTP Act provided for a setting up of a Commission to implement the provisions of the law. In the wake of economic liberalisation and reforms introduced by Government of India since 1991 with a view to meet the challenges and avail of the opportunities offered by globalisation, the Raghavan Committee was set up in 1999 to assess the need to evolve India's competition regime.

The Committee in its report of 2000 recommended setting up of a modern competition law and phasing out of the MRTP Act. The Competition Act, 2002 ("the Act") was enacted by Parliament of India in December 2002. It received the Presidential assent on 13^{th} January, 2003, and as discussed below it is now being implemented. The Act has an overriding effect over any inconsistent provision in any other law for the time being in force, and provides for establishment of a commission to:

(a) Prevent practices having an adverse effect on competition,
(b) Promote and sustain the competition in the markets,
(c) Protect the interests of the consumers and
(d) Ensure the freedom of trade carried on by the other participants in the markets in India.

Competition is a process of economic rivalry between market players to attract customers. These market players can be multinational or domestic companies, wholesalers, retailers. Competitive market ensures efficiency resulting in best possible choice of quality; lowest price and adequate supplies to consumers. Firms, while competing with one another, often adopt unfair means to restrict competition. This relates to fixing prices which is lower than cost in order to throw out competitors from market, taking advantage of a monopoly position and charging unreasonable price, and the like. Competition law therefore, is intended to put a check on restrictive or unfair business practices by firms in the market.

The Competition Law enshrines the right of businesses to compete with each other. However, competitive practices must be within the framework of the law and must be undertaken on the principles of honesty and not infringing the national interest, the public interest, or the lawful rights and interests of other businesses and consumers.

Two broad categories of competitive practices are regulated under the Competition Law:

1. - Practices in restraint of competition:
   - Agreements in restraint of competition;
   - Abuse of dominant market position or monopoly position;
   - Economic concentration; and
2. Unfair competitive practices.

12.2 Objectives of Competition Law

The objective of the Competition Law's regulation of practices in restraint of competition appears to be protection of the process of competition, rather than the interests of competitors. By protecting the process of competition, which goods and services are produced and the price of those goods and services is determined by the market. The objective of the Law's regulation of unfair competitive practices is largely protection of consumers so they can make free and informed choices from amongst the goods and services in the market.

12.3 Brief Overview of the Competition Act

In line with prevailing pattern of modern competition laws, the Act seeks to –

I) Prohibit anti-competitive agreements (including cartels), which determine prices or control or limit or share markets among players or result in bid rigging.
II) Prohibit abuse of dominant position through unfair and discriminatory prices or conditions (including predatory pricing) limiting or restricting production, denying market access, etc.
III) Regulate combination (acquisition, mergers and amalgamations etc.) that causes or likely to cause appreciable adverse effect on competition.
IV) Entrust the Competition Commission the responsibility of undertaking competition advocacy, awareness and training about competition issues.

I) Anti-Competitive Agreements: Section 3 of the Act deals with agreements among enterprises or persons or association of persons, which causes or likely to cause appreciable adverse effect on competition. Such agreements are rendered void pursuant to this section. Act among other things prohibits anti competitive agreements the abuse of dominance72 and prohibits and /or regulates combinations. The Act gives wide ranging powers to CCI to achieve objects of the Act and implement the provisions of the Act.

The Act defines an agreement to include any arrangement, understanding or concerted action entered between parties. The agreement need not be in writing or formal or intended to be enforceable in law.

An agreement in respect of production, supply, distribution, storage, acquisition or control of goods76 or provision of services, which causes or is likely to cause to appreciable effect on competition within India is defined to be an Anti -Competitive Agreement. The Act prohibits such an agreement, such that it shall be a void agreement. It is noteworthy that the prohibition contained in Section 3 is not absolute and permits joint venture agreements in case certain parameters are met. Anti-Competitive Agreements could be both horizontal and vertical.

The CCI upon receipt of reference or its own knowledge or information received under Section 19 with regard to anti-competitive agreement has to come to a prima facie opinion that a case exists and once it comes to such conclusion, it shall direct the Director General (DG) to make an investigation into the matter.86 If the CCI does not find a prima facie case, it will close the case, pass an appropriate Order and forward the Order to the concerned persons.

DG is required to submit a report on his findings to the CCI within the time as may be specified by the Order of the commission such that:

(a) If the DG recommends that no case of anti-competitive agreement exists and/or there is no contravention of the provisions of the Act, the CCI shall invite objections/suggestions from the concerned parties. Upon consideration of these objections or suggestions if CCI agrees with the DG, it shall close the matter. If CCI does not agree with the recommendation of the DG, it may Order further investigation by DG or may itself conduct further investigation.

(b) If DG in its report recommends, that there is a contravention of the provisions of the Act and the CCI is of the opinion that a further inquiry is required, it shall inquire into such contravention in accordance with the provisions of the Act.

II) Horizontal Agreements, including cartels, which: - fix (determine) prices - limit or control production, supply, technical development etc. - allocate areas or customers - bid rigging or collusive bidding These type of agreements are presumed to cause appreciable adverse effect on competition.

The Act prohibits Horizontal Agreements79, in case the same are:

(a) Agreement to fix prices;
(b) Agreement to limit production, supply, markets, technical development, investments or provisions of services;
(c) Agreement to geographically allocate markets or source of production or provision of services – by allocation of geographical area, type of goods/services or number of customers;
(d) Bid rigging and collusive bidding.

III) Vertical Agreements such as tie in sales **-** exclusive supply or distribution **-** refusal to deal **-** resale price maintenance These type of agreements are not outright prohibited but subject to 'rule of reasoning'. Only if they cause or likely to appreciable adverse effect on competition, they are prohibited. However, exemption has been provided to agreements involving intellectual property rights (IPRs) and to the right of any person to export goods from India to the extent the agreement relates exclusively to production, supply, distribution or control of goods or provision of services for such exports.

The Act frowns upon Vertical Agreements,80 which are:

(a) Tie-in arrangement;
(b) Exclusive supply agreement;
(c) Exclusive distribution agreement;
(d) Refusal to deal;
(e) Resale price maintenance.

Horizontal agreements other than those mentioned above and the vertical agreements including those mentioned above are dealt with on rule of reason basis.

IV) Abuse of Dominance Position

Dominant position held by an enterprise or a group per se is not prohibited. The Act, however, prohibits abuse of dominance118 by an enterprise or a group. The Commission is empowered to inquire whether an enterprise or a group has the dominant position and whether it has abused such position on the basis of:

(a) Its own motion, or
(b) Information received from any person, consumer or their association or any trade association, or
(c) On a reference received from the central government, state government or a statutory authority.

The Act enumerates the following practices which if found to be conducted by an enterprise or a group will lead to the inference of abuse of dominant position by that enterprise/group; provided that the enterprise/ group is found to be dominant:

(a) Unfair or discriminatory condition on pricing including predatory pricing
(b) Limiting or restricting production of goods or provision of services;
(c) Limiting or restricting technical or scientific development relating to goods or services to the prejudice of consumers;
(d) Denying market access in nay manner;
(e) Making conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or commercial usage, have no connection with the subject of such contracts;
(f) Using its dominant position in one relevant market to enter into or protect, other relevant market.

V) Procedure for Inquiry into Abuse of Dominance

The Commission must arrive at a prima facie opinion that a case of abuse of dominance exists. Once it comes to such conclusion, it shall direct the Director General (DG) to investigate into the matter.127 If the Commission does not find a prima facie case, it will close the case, pass and DG is required to submit a report on his findings to the Commission within the time as may be specified by the Order of the

Commission, Such that:

(a) If the DG recommends that no case of abuse of dominance exists and/or there is no contravention of the provisions of the Act:

(i) The Commission shall invite objections/suggestions from the concerned parties.128

(ii) Upon consideration of these objections or suggestions if Commission agrees with the DG, it shall close the matter.

(iii) If Commission does not agree with the recommendation of the DG, it may Order further investigation by DG or may itself conduct further investigation.

(b) If DG in its report recommends that that there is a contravention of the provisions of the Act and the Commission is of the opinion that a further inquiry is required, it shall inquire into such contravention in accordance with the provisions of the Act.

Need for competition law:

1. The Need for Competition Arises from Following Factors.

To take care of anti-competitive practice adopted by firms to restrict the free play of competition in the market. To take care of unfair means adopted by firms against consumers and other market players to extract maximum possible benefits To maintain and promote competitive spirit in the market.

2. From MRTP Act to Competition Act

The history of the Indian Competition legislation goes back to the monopolies inquires Commission (1965) which had uncovered strong concentration of economies powers in various sectors of the economy. Consequently, the Monopolies and Restrictive Trade Practices Act(MRTP Act) was enacted in 1969 to prevent concentration of economic power, control monopolies and prohibit monopolistic and restrictive trade practices.

The MRTP act was unable to deliver as expected partly because of the inherent weaknesses in its own structure and the composition of the MRTP Commission and partly due to fact that the attributes of competition (Entry, price, scale, location etc.) were regulated by separate set of policies. Major amendments were made to the MRTP Act in 1991 but even these were considered inadequate accentuating the need for a new competition law. As a result, competition act, 2002 was enacted to replace the MRTP Act.

3. Regulation of Combinations (Competition Act)

The Competition Act seeks to regulate 'combinations' which include acquisitions or mergers or amalgamations of enterprises. Acquisition of one or more enterprise by one or more persons or merger or amalgamation of enterprises is a combination if it meets the jurisdictional thresholds based on total value of assets or turnover. Higher thresholds of assets or turnover have been prescribed when parties to combination belong to 'group' or have assets or turnover outside India.

The Competition Act prohibits enterprises from entering into combinations that cause or are likely to cause an appreciable adverse effect on competition within the relevant market in India. Any person or enterprise seeking to enter into a combination has the option under the Act to give notice to the Commission. Upon its own knowledge or information or on receipt of notice from parties or on a reference from statutory authority, CCI would initiate an investigation/enquiry when it is convinced, prima facie, that it has or likely to cause appreciable adverse effect on competition in the relevant market.

Various factors such as market concentration, entry barriers, degree of countervailing power, efficiency gains have been listed which CCI has to take into account for determining whether a combination will or is likely to have an appreciable adverse impact on competition in India. A combination, which in the opinion of the Commission, has or is likely to have an appreciable adverse effect on competition, the parties are required to publish the details of the combination. The Commission, after due inquiry into the combination, is required to pass an order thereon within ninety working days, failing which the combination is deemed to be approved.

The Competition Act Focuses on four Core Areas

Anti competitive Agreements
Abuse of dominance
Combination regulation (Mergers and alliances)
Competition Advocacy

Activity A:

1. Critically examine broad categories of Competitive practices of Competition law.

12.4 Economic and Policy Context of the Law

The emerging challenges and opportunities posed by the implementation of the Act at this stage may be evaluated in context of the following aspects, which can be reasonably expected to be brought to bear upon the concerned authorities in interpreting and implementing the Act.

(a) Stated objects of the Act.

(b) India's economic condition, opportunities and aspirations in the prevalent global economic scenario.

(c) Significant policy shift in Indian macro-economic policies, laws and jurisprudence since mid-1 980's characterised by A changed role of the Government:
  (1) From the controller of the "commanding heights of the economy" to a planner and partner in economic development with private capital and enterprise.
  (2) From a license-giver to a facilitator.

(d) Challenges of historical and policy/law based state owned monopolies/oligopolies in crucial sectors like infrastructure which are being unshackled through reforms (laws and policies) by:
  (1) Removing barriers to entry and exit.
  (2) Establishing a facilitative legal framework to enable private participation.
  (3) Creating a level playing field for new entrants.
  (4) Distancing government from day-to-day regulation of the markets – which are increasingly being left to be regulated by autonomous, empowered and accountable multi-disciplinary expert regulatory authorities.

(5) Distancing Government from day-to-day operations of economic enterprise.

It is noteworthy that Courts in India as a rule presume constitutional validity of enacted laws. While interpreting a statute, Courts adopt such construction as effectuates the legislative intent behind the statute, resorting to purposive interpretation to give effect to a statute in view of its context and scheme.

12.5 Competition Commission of India

In context of the needs of economic development of India, the Act was enacted to establish CCI as a multi-member regulator to:

(a) Promote and sustain competition in markets;
(b) Prevent practices having adverse effect on competition;
(c) Protect consumer interest;
(d) Ensure freedom of trade carried on by participants in Indian markets.

The Entity. The Commission is a body corporate having perpetual succession and common seal with power to acquire hold and dispose of property both movable and immovable and to contract and shall sue and be sued. The Commission is to consist of Chairperson11 and not less than two members and not more than six members.

Appointment. The Chairperson and the members are appointed by the central government from the panel of names recommended by the selection committee consisting of:

(a) The Chief Justice of India or his nominee (chairperson of the committee);
(b) Secretaries in the Ministries of Corporate Affairs and Law and Justice; and
(c) Two experts of repute having special knowledge of and professional

experience in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy.

For the Purpose of this Act, the Government Established a Commission to be Named Competition Commission of India:

1. Clause 8 of the Bill provides that the Commission shall consist of a chairperson and not less than two and not more than ten other members to be appointed by the Central Government. The Chairperson and everyother member shall be persons of ability, integrity and standing. The chairperson and every other member shall be appointed by the Central government on the recommendation of Selection Committee consisting of:

The Chief Justice of India or his nominee-Chairperson;

- The Union Minister in Charge of the Ministry of Finance-Member;
- The Union Minister in Charge of the Ministry or Department Dealing with this Act-Member;
- The Governor of the Reserve Bank of India-Member;
- The Cabinet Secretary-Member

2. The Secretary- in- charge of the Ministry or the Department of the Central Government dealing with this Act shall be the Convener of the Selection Committee. The Chairperson and every other

member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment.

Provided that no chairperson or other member shall hold office as such after he has attained:
a) In the case of the chairperson, the age of seventy years;
b) In the case of any other member, the age of sixty five years.

The central government may, by notification, appoint a Director General and as many additional Joint, Deputy or Assistant Directors General, as it may thing fit, for the purposes of assisting the Commission in conduction inquiry in to contravention of any of the provisions of this Act, for the conduct of cases before the Commission and for performing such other functions are, or may be, provided by or under this act. The 'Commission' has been established in October 2003. The Commission has one member/ acting chairman and a small complement of staff. The commission besides being a quasi-judicial adjudicator will also be a regulator on issues relating to competition matters and policy.

Provisions regarding competition advocacy have been notified. Substantive enforcement provisions are not yet notified. Hence, the MRTP Act 1969 has not been fully repealed. Some of the provisions relating to administration of the Act were challenged in Supreme Court. The court has issued some directives to the government. In the light of the above directions by the court, amendments to the Act have been proposed and the same has been referred to standing committee on finance.

12.6 Objectives of Competition Commission of India (CCI)

Objectives of CCI

In context of the needs of economic development of India, the Act was enacted to establish CCI as a multi-member regulator to:
(a) Promote and sustain competition in markets;
(b) Prevent practices having adverse effect on competition;
(c) Protect consumer interest;
(d) Ensure freedom of trade carried on by participants in Indian markets.

The CCI has been entrusted with the duty to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interest of consumers and ensure freedom of trade carried on by other participants in India. The Competition (Amendment) Bill, 2006 envisages establishment of a Competition Appellate Tribunal to hear appeals arising from the orders of CCI and to award compensation.

The CCI is a body corporate having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued. The Act provides that CCI shall consist of a Chairperson and also prescribes the minimum as well as maximum number of Members and sets the qualifying criteria for their appointment. .

The Act envisages a number of roles to be performed by CCI which, apart from the above mentioned regulatory and advocacy functions, also includes rendering of opinions on a reference on competition issues or on Competition Law or Policy, received from a statutory authority or the Central Government respectively.

The Act provides that CCI can inquire into any alleged contravention of the provisions contained in Section 3 & 4 of the Act either on its own motion or on

I. receipt of a complaint from any person, consumer or their association or trade association; or

II. a reference made to it by the Central Government or a State Government or a Statutory Authority.

The Act also prescribes the procedure for investigating and enquiring into combinations when notified by parties or on its own information.

The Competition (Amendment) Bill 2006, introduced by the Government on 9.03.2006 in the Parliament, proposes various changes to the Competition Act 2002, including establishment of a Competition Appellate Tribunal to hear appeals from the orders of the CCI and to determine applications for award of compensation.

12.7 Powers and the Functions of The Commission

Subject to the provisions of this Act, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interest of consumers, and ensure freedom of trade carried by other participants, in market in India.

The Commission may inquire into any alleged contravention of the provisions either of its own volition or on:

a) Receipt of a complaint from any person, consumer or their association or trade association

b) A reference made to it be the Central Government or a state government or a statutory or a statutory authority

The Commission can enquire whether an agreement has an appreciable adverse effect on competition. It can enquire whether an enterprise enjoys a dominant position or not, can enquire whether any combination is likely to cause an appreciable adverse effect on competition in India, or any other violation of the Act.

In a proceeding before any statutory authority, if an issue is raised by any parry that a decision which the statutory authority has taken or proposes to take, is or would be, contrary to any of the provisions of the Act, then such statutory authority shall make a reference to the Commission. On receipt of a reference under sub-section (1) the commission shall, after hearing the parties to the proceeding, give its opinion to such statutory authority which shall thereafter pass an order on the issues referred to in that sub-section as it deems fit.

The Commission has duty to eliminate the practices having adverse effect on competition, to promote and sustain competition in the market, to protect the consumer interests and to ensure freedom of trade carried on by other participants in the markets in India. The Act empowers the Commission to enter into any arrangement or memorandum, with prior approval of central government, with any agency of a foreign country for the purposes of discharging its duties and performing its functions. The Act prescribes that the Commission in discharge of its functions shall be guided by the principles of natural justice and the concerned parties can appear before the Commission in person or shall though authorized Chartered Accountants, Company Secretaries, Costs Accountants or Legal Practitioners.

In order to achieve the objectives of the Act, the Commission is vested with functions and powers to:

(a) Inquire into certain agreements and dominant position26 of an enterprise

(b) Conduct such inquiry and

(c) Pass certain orders which must meet the administrative law standards of reasonableness, fairness, proportionality and being consistent with the parent statute.

12.8 The Jurisdiction, Powers and Authority of the CCI

Upon receipt of a complaint or a reference from the Central Government or a state government or a statutory authority or on its own knowledge or information under section 19, if the Commission is of the opinion that there exists a prima facie case, it shall direct the Director General to cause an investigation to be made in to the matter. The Director General submits a report in a specified period.

If the commission is of the opinion that there exists no prima facie case, it shall dismiss the complaint and may pass such orders as it deems fit, including imposition of costs, if necessary. Where after inquiry the commission finds that any agreement or action, of an enterprise in a dominant position, is in contravention of section 3 or section 4, as the case may be, it may pass all or any of the following orders:

Direct any enterprise or association of enterprises, or person or association of persons, as the case may be, involved in such agreement, ore abuse of dominant position to discontinue and not to reenter such agreement, or discontinue such abuse of dominant position, as the case may be; Award compensation to parties in accordance with the provisions contained in section 34;

Direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the commission; Recommend, to the central Government, the division of an enterprise enjoying dominant position; Pass such other order as it may deem fit.

12.9 Need for a National Competition Policy for India

The reforms initiated since 1991 recognized the need for removing fetters on trade and industry with the view to unleash the competitive energies. The Industrial Policy Statement of 1991 emphasized the attainment of technological dynamism and international competitiveness. It noted that the Indian industry could scarcely be competitive with the rest of the world if it had to operate within an over regulated environment. To enhance competition in the domestic markets and to generate/promote a culture of competition in the country is part of this broader agenda of reforms.

Further reforms would be facilitated by means of a comprehensive overarching national competition policy. There are several policies and laws that can have significant bearing on competition. These are often not competition-friendly, sometimes by design and often due to ignorance; such policies are anachronistic in the present economic milieu and adversely affect the competitive forces and the competition culture in the economy. This situation can be addressed only by adopting a comprehensive National Competition Policy and harmonizing all other polices keeping in view competition dimensions.

The economic reforms undertaken by the Government have been generally on sector by sector basis and the progress across sectors has not been uniform. The sector by sector approach also carries the risk of inconsistency between sectoral policies. The national Competition Policy will facilitate creation of a national market. The competition policy recognises the need for removing the barriers on trade of goods and services across all states. It will help integrate the national market and create a uniform level playing field across the country.

Activity B:

1. Critically examine Competition Commission of India

12.10 Summary

In the present era of liberalization, MRTP has lost its relevance. The Government is today promoting the expansion of organizations. Mergers and Acquisitions are no longer, but are permitted and in some cases even encouraged by the government.

Organizations enjoying a dominant position in the market are prohibited by the Act from using their strength to affect competitions or consumers or the relevant market in its favour. The CCI regulates the combinations and mergers and acquisitions. The commission is not bound by the procedure laid down by the code of civil procedure, 1908, but guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the central Government.

12.11 Self Assessment Questions

1 Define Competition law and its objectives.

2 Discuss Economic and Policy context of the law.

3 Explain Need for National Competition Policy of India

4 Define Power and the function of the Commission

5 Discuss in brief about Jurisdiction, power and Authority of the CCI

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Unit - 13 Monetary Policy and Fiscal Policy

Structure of Unit:

13.0 Objectives

After reading this chapter, you should be able to

- Define monetary policy, understand techniques to measure the extent of money and evaluate RBI monetary policy.
- Understand the meaning and functions of money market, examine operations in money market and assess functioning of commercial banks.
- Define fiscal policy, know how budget operates and make critical assessment of fiscal policy.

13.1 Introduction

Monetary policy, in its narrow concept, is defined as the measures focused on regulating money supply. Monetary policy is defined as "the set of procedures and measures taken by monetary authorities to manage money supply, interest and exchange rates and to influence credit conditions to achieve certain economic objectives".

Monetary policy is the management of money supply and interest rates by central banks to influence prices and employment. Monetary policy works through expansion or contraction of investment and consumption expenditure.

The constraints on the economy as the RBI implicitly recognizes is in terms of infrastructure inclusive of power generation – electricity capacity increases in the past few years have been just over half of targeted levels – and skill shortages. Before inflation gets out of control and there is a hard landing for the economy it is better to control inflation and thereby sustain growth. With inflation high, real interest rates are low compared to the current rapid economic growth. The RBI may need to continue tightening monetary policy as a result and keep in mind the longer lead times required to keep inflationary pressure in check as inflation is not purely a monetary phenomenon.

Monetary policy has traditionally been viewed as the process by which a central bank uses its influence over the supply of money to promote its economic objectives." In fact, the very term monetary policy suggests a central bank's policy toward the supply of money or the level of some monetary aggregate.

In recent decades, however, central banks have moved away from a direct focus on measures of the money supply. The primary focus of monetary policy has instead become the value of a short-term interest rate. In the United States, for example, the Federal Reserve's Federal Open Market Committee (FOMC) announces a rate that it wishes to prevail in the federal funds market, where overnight loans are made among commercial banks. The tools of monetary policy are then used to guide the market interest rate toward the chosen target. For this reason, we follow the common practice of using the term monetary policy to refer to a central bank's interest rate policy. It is important to realize, however, that the quantity of money and monetary policy remain fundamentally linked under this approach. Commercial banks hold money in the form of reserve balances at the central bank; these balances are used to meet reserve requirements and make interbank payments. The quantity of reserve balances demanded by banks varies inversely with the short-term interest rate because this rate represents the opportunity cost of holding reserves. The central bank aims to manipulate the supply of reserve balances—for example, through open market operations that exchange reserve balances for bonds—so that the marginal. This link between money and monetary policy can generate tension with central banks' other objectives because bank reserves play other important roles in the economy. In particular, reserve balances are used to make interbank payments; thus, they serve as the final form of settlement for a vast array of transactions. The quantity of reserves needed for payment purposes typically far exceeds the quantity consistent with the central bank's desired interest rate. As a result, central banks must perform a balancing act, drastically increasing the supply of reserves during the day for payment purposes through the provision of daylight reserves (also called daylight credit) and then shrinking the supply back at the end of the day to be consistent with the desired market interest rate. Recent experience has shown that central banks perform this balancing act well most of the time. Nevertheless, it is important to understand the tension between the daylight and overnight need for reserves and the potential problems that may arise. One concern is that central banks typically provide daylight reserves by lending directly to banks, which may expose the central bank to substantial credit risk.

Such lending may also generate moral hazard problems and exacerbate the too-big-to-fail problem, whereby regulators would be reluctant to close a financially troubled bank. The tension is clearest during times of acute stress in financial markets. In the days following September 11, 2001, for example, the Federal Reserve provided an unusually large quantity of reserves in order to promote the efficient functioning of the payments system and financial markets more generally. As a result of this action, the fed funds rate fell substantially below the target level for several days. During the financial turmoil that began in August 2007, the tension was much longer lasting. Sharp increases in spreads between the yields on liquid and illiquid assets indicated a classic liquidity shortage: an increased demand for liquid assets relative to their illiquid counterparts. By increasing the supply of the most liquid asset in the economy—bank reserves—the Federal Reserve could likely have eased the shortage and helped push spreads back toward more normal levels. Doing so, however, would have driven the market interest rate below the FOMC's target rate and thus interfered with monetary policy objectives. Instead, the Federal Reserve developed new, indirect methods of supplying liquid assets to the private sector, such as providing loans of Treasury securities against less liquid collateral through the Term Securities Lending Facility. Recently, attention has turned to an alternative approach to monetary policy implementation that has the potential to eliminate the basic tension between money and monetary policy by effectively "divorcing" the quantity of reserves from the interest rate target. The basic idea behind this approach is to remove the opportunity cost to commercial banks of holding reserve balances by paying interest on these balances at the prevailing target rate. Under this system, the interest rate paid on reserves forms a floor below which the market rate cannot fall. The supply of reserves could therefore be increased substantially without moving the short-term interest rate away from its target. Such an increase could be used to provide liquidity during times of stress or to reduce the need for daylight credit on a regular basis.

13.2 Global and State Economy of the year 2010-2011

1. Global Economy

The global economy continues to recover amidst ongoing policy support and improving financial market conditions. The recovery process is led by EMEs, especially those in Asia, as growth remains weak in advanced economies. The global economy continues to face several challenges such as high levels of unemployment, which are close to 10 per cent in the US and the Euro area. Despite signs of renewed activity in manufacturing and initial improvement in retail sales, the prospects of economic recovery in Europe are clouded by the acute fiscal strains in some countries.

2. Domestic Economy

The Reserve Bank had projected the real GDP growth for 2009-10 at 7.5 per cent. The advance estimates released by the Central Statistical Organisation (CSO) in early February 2010 placed the real GDP growth during 2009-10 at 7.2 per cent. The final real GDP growth for 2009-10 may settle between 7.2 and 7.5 per cent. The uptrend in industrial activity continues. The index of industrial production (IIP) recorded a growth of 17.6 per cent in December 2009, 16.7 per cent in January 2010 and 15.1 per cent in February 2010. The recovery has also become more broad-based with 14 out of 17 industry groups recording accelerated growth during April 2009-February 2010. The sharp pick-up in the growth of the capital goods sector, in double digits since September 2009, points to the revival of investment activity. After a continuous decline for eleven months, imports expanded by 2.6 per cent in November 2009, 32.4 per cent in December 2009, 35.5 per cent in January 2010 and 66.4 per cent in February 2010.

The acceleration in non-oil imports since November 2009 further evidences recovery in domestic demand. Various lead indicators of service sector activity also suggest increased economic activity. On the whole, the economic recovery, which began around the second quarter of 2009-10, has since shown sustained improvement.

13.3 Monetary Policy and General Economic Policies

Monetary policy is basically a type of stabilization policy adopted by countries to deal with different economic imbalances. Since monetary policy covers the monetary aspect of the general economic policy, a high level of co-ordination is required between monetary policy and other instruments of economic policy.

Further, the effectiveness of monetary policy and its relative importance as a tool of economic stabilization various from one economy to an-other, due to differences among economic structures, divergence in degrees of development in money and capital markets resulting in differing degree of economic progress, and differences in prevailing economic conditions.

The weak effectiveness which is usually attributed to monetary policy in developing countries is caused by the fact that the economic problems in these countries are mainly structural and not monetary in nature, while the limited effectiveness of monetary policy in countries which lack developed money markets occurs because monetary policy is deprived of one of its major tools, the instrument of open market operations.

Monetary policy as ineffective in controlling the inflation that results from an imbalance between the demand and supply of goods and services originating from the supply side, while they confirm the effectiveness of monetary policy in controlling inflation that results from increased demand. However, this does not preclude the effectiveness of monetary policy as a flexible instrument allowing the authorities to move quickly to achieve stabilization, apart from its importance in realizing external equilibrium in open economies.

13.4 Objectives and Framework of Monetary Policy

1. Objectives of Monetary Policy

- The goal of increasing the efficiency of the financial system and maintaining the soundness and stability of the banking system.
- The increased relative importance of deposit money makes the protection of the banking system and to protect the mechanism of the payments system in the economy.
- The aim of monetary policy at present in both the developed and developing countries are price stability and high employment rates, enhancing economic growth rates and controlling imbalances in external payments, including the protection of the external purchasing power of the currency through maintaining relatively stable levels of exchange rates.
- The achievement of goals also depends upon how realistically the operating targets are set and how effectively the monetary policy instruments are deployed and integrated with other components of macroeconomic policy.

The intermediate objectives of monetary policy are defined as a number of variables linking the instruments of monetary policy with their ultimate goals. These variables are money supply, interest rates, disposable credit, the monetary base or any other variable deemed by the monetary authorities as an appropriate intermediate objective for monetary policy. In India, the objectives of monetary policy evolved as maintaining price stability and ensuring adequate flow of credit to the productive sectors of the economy.

With progressive liberalization and increasing globalization of the economy, maintaining orderly conditions in the financial markets emerged as an additional policy objective. Thus, monetary policy in India endeavours to maintain a judicious balance between price stability, economic growth and financial stability.

2. Framework of Monetary Policy

The monetary policy framework in India from the mid-1980s till 1997-98 can be characterized as a monetary targeting framework on the lines recommended by Chakravarty Committee (1985). Because of the reasonable stability of the money demand function, the annual growth in broad money (M3) was used as an intermediate target of monetary policy to achieve the final objectives.

Monetary management involved working out M3 growth consistent with projected GDP growth and a tolerable level of inflation. In practice, however, the monetary targeting approach was used in a flexible manner with 'feedback' from the developments in the real sector. For example, if the real GDP growth was expected to be higher, M3 projection was revised upwards.

In the 1990s, the increasing market orientation of the financial system and greater capital inflows imparted instability to the money demand function. Consequently, there was a shift to multiple indicators approach in the late 1990s. Under this approach, interest rates or rates of return in different markets along with movements in currency, credit, fiscal position, trade, capital flows, inflation rate, exchange rate, refinancing and transactions in foreign exchange – available on a high frequency basis are juxtaposed with output data for drawing policy perspectives.

The multiple indicators approach continued to evolve and was augmented by forward looking indicators and a panel of parsimonious time series models. The forward looking indicators are drawn from the Reserve Bank's industrial outlook survey, capacity utilization survey, professional forecasters' survey and inflation expectations survey. The assessment from these indicators and models feed into the projection of growth and inflation. Thus, the current framework of monetary policy can be termed as augmented multiple indicators approach.

13.5 Evolution of Monetary Policy Framework Globally

In order to achieve the objectives of monetary policy which are not under the direct control of central banks, monetary authorities typically set "intermediate targets", which bear a stable relationship with the overall objectives of monetary policy. The selection of intermediate target is also conditional upon the channels of monetary transmission – the process through which monetary policy actions impact the ultimate objectives. Historically, although credit targets were prevalent, the concept of a formal intermediate target emerged with the monetarist emphasis on money targeting in an environment of worsening inflation in the 1970s and observed stable relationship among money, output and prices. A number of major central banks such as Switzerland, Germany, Japan, the UK, the USA, France, Australia and Canada adopted monetary targets in the mid-1970s. In the 1980s, financial market innovations reduced the need for financial intermediation by the banking system and in turn began to impart volatility to the behaviour of monetary aggregates. The consequent weakening of the stable relationship among money, output and prices made many advanced country central banks to move towards signaling monetary policy stance through setting of interest rates. Monetary targeting, however, continued in some form in many bank-based economies in continental Europe such as Germany, France and Switzerland where it was possible to establish money demand stability with redefinition of monetary aggregates.

Given the under-developed nature of financial markets coupled with the quantity-based credit channel of monetary transmission, money target was considered suitable in case of developing countries. In the 1980s, monetary targeting was adopted in many developing countries such as Brazil, China, Indonesia, Korea, Malaysia, Peru, Philippines, Russia and Venezuela. As financial innovations spread to developing countries and they became more open to external capital flows, monetary targeting proved less effective.

Activity A:

1 Compare the monetary policy mechanisam and tools in Canada, China and USA.

13.6 Evolution of Monetary Policy Framework in India

In India also, monetary policy framework has undergone significant transformation over time. In the 1960s, as inflation was considered to be structural and inflation volatility was mainly caused by agricultural failures, there was greater reliance on selective credit controls. The aim was to regulate bank advances to sensitive commodities to influence production outlays, on the one hand and to limit possibilities of speculation, on the other.

In the 1970s, there was a surge in inflation on account of monetary expansion induced by expansionary fiscal policies besides the oil price shocks. By the early 1980s, there was a broad agreement on the primary causes of inflation. It was argued that while fluctuations in agricultural prices and oil price shocks did affect prices, sustained inflation since the early 1960s could not have occurred unless it was supported by the continuous excessive monetary expansion generated by the large-scale monetization of the fiscal deficit.

13.7 Types and Uses of Monetary Policy

1. The uses of Monetary Policy

- Monetary policy cannot change long-term trend growth.
- There is no long-term tradeoff between growth and inflation. (High inflation can only hurt growth).
- When inflationary pressures build up: raise the short-term interest rate (the policy rate)
- Which raises real rates across the economy which squeezes consumption and investment.
- The pain is not concentrated at a few points, as is the case with government interventions in commodity markets.

2. Types of Monetary Policies

In practice, all types of monetary policy involve modifying the amount of base currency (M0) in circulation. This process of changing the liquidity of base currency through the open sales and purchases of (government-issued) debt and credit instruments is called open market operations. Constant market transactions by the monetary authority modify the supply of currency and this impacts other market variables such as short term interest rates and the exchange rate. The distinction between the various types of monetary policy lies primarily with the set of instruments and target variables that are used by the monetary authority to achieve their goals.

The different types of policy are also called **monetary regimes**, in parallel to exchange rate regimes. Targeting inflation, the price level or other monetary aggregates implies floating exchange rate unless the management of the relevant foreign currencies is tracking the exact same variables (such as a harmonized consumer price index).

Types of Monetary Policies

Monetary Policy	Target Market Variable	Long term objective
Inflation Targeting	Interest rate on overnight debt	A given rate of change in the CPI
Price Level Targeting	Interest rate on overnight debt	A specific CPI number
Monetary Aggregates	The growth in money supply	A given rate of change in the CPI
Fixed Exchange Rate	The spot price of the currency	The spot price of the currency
Gold Standard	The spot price of gold	Low inflation as measured by the gold Price
Mixed Policy	Usually interest rates	Usually unemployment CPI change

13.8 Measures of Money Supply in India

The Reserve Bank announces the following policy measures:

Bank Rate

The Bank Rate has been retained at 6.0 per cent.

Repo Rate

It has been decided to increase the repo rate under the Liquidity Adjustment Facility (LAF) by 25 basis points from 5.0 per cent to 5.25 per cent with immediate effect.

Reverse Repo Rate

It has been decided to increase the reverse repo rate under the LAF by 25 basis points from 3.5 per cent to 3.75 per cent with immediate effect.

Cash Reserve Ratio

It has been decided to increase the cash reserve ratio (CRR) of scheduled banks by 25 basis points from 5.75 per cent to 6.0 per cent of their net demand and time liabilities (NDTL) effective the fortnight beginning April 24, 2010. As a result of the increase in the CRR, about Rs. 12,500 crore of excess liquidity will be absorbed from the system. The Reserve Bank will continue to monitor macroeconomic conditions, particularly the price situation, closely and take further action as warranted.

New Monetary Aggregates

MO	=	Currency in Circulation+ Bankers deposits with the RBI+ 'other deposits with the RBI'
M1	=	currency with the public+Demand deposits with the banking system+ 'other deposits with the RBI'
M2	=	M1+Time liabilities Portion of savings Deposits with the Banking system+ certificates of Deposit issued by Banks Term deposits of residents with a contractual maturity of up to and including one year with the banking system
M3	=	M2 + Term deposits of residents with a contractual maturity of over one year with the Banking system+ Call term borrowings from Non depository financial lcorpotation by the Banking system.

Activity B:

1. Do you think that Central bank autonomy will help the countries in their economic activities? Validate your points.

13.9 Factors Affecting Money Supply

There are five sources which contribute to the aggregate monetary resources in the country (M3)

- Net bank credit to the bank
- Bank credit to the commercial sector
- Net foreign exchange assets of the banking sector
- Government currency liabilities to the public
- Non monetary liabilities of the banking sector.

Activity C:

1. Is there any relationship between Money supply and inflation. Justify your answers.

13.10 Monetary Management and Functions Of RBI

It is the central bank of country that is responsible for the regulation of supply of money. In India it is the RBI which manages the supply of money.

Functions of the RBI

- Issue of Currency
- Banker to Government
- Banker's bank
- Controller of Credit
- Exchange Management and Control
- Collection and Publication of Data
- Supervisory Function

- Promoter of the Financial System
- Money Market
- Agriculture Sector
- Industrial Finance

13.11 Monetary Policy and Inflation

Inflation measurement is fundamental to the conduct of monetary policy. Price indices form the foundation of central bank policy frameworks around the world. They serve as guides to decision-making, as well as providing the primary mechanism for holding independent policymakers accountable.

Inflation expectations measurements and their use are as follows.

There are two basic sources of inflation expectations: surveys and financial markets. the first group encompasses surveys of households and businesses, professional forecasters and financial market participants. All of these have drawbacks. For example, household and business surveys are costly, which can influence coverage, frequency and quality. The survey population can be unrepresentative, with more informed than uninformed people in the sample. There is a clear tendency for household surveys to be biased, with inflation expectations systematically overestimating actual inflation experience.

Equally important is the fact that there is evidently no correlation over longer periods between money growth on the one hand and these two real variables on the other. Evidently, monetary policy can affect the real economy over short periods, but over longer periods the real economy returns to its normal stat.

What monetary policy can do over the long run is ensure low inflation, but bad monetary policy will ensure high inflation and recurrent recessions.

13.12 Monetary Policy and Business Cycle

It is difficult to talk about how monetary policy works without referring to business cycles. The direction that inflation is projected to take depends heavily on the position of the 'business cycle'. As the term suggests, this is the fluctuation of the economy between periods of faster or slower growth.

The way the business cycle works is as follows. If the overall demand for goods and services exceeds the ability of the economy to sustainably supply them, then there will be shortages of goods and services. Because of the principle of supply and demand, prices will tend to rise. This is known as a 'positive output gap'. The reverse occurs when there is more production than demand. In such circumstances, inflation can fall. Estimating the size and movement of the output gap helps the Reserve Bank identify where the economy is in the business cycle. The aim of monetary policy is to try and push demand closer to the economy's long-term capacity to supply. Because the output gap constantly changes, depending on the position of the business cycle, monetary policy settings require constant adjustment. The ultimate aim is to smooth out otherwise destructive boom-and-bust cycles.

Activity D:

1. Discuss how monetary policy can be effectively formulated in India in the 21st Century.

13.13 Fiscal Policy

Fiscal Policy is that part of Government policy which is concerned with raising revenue through taxation and other means and deciding on the level and patter of expenditure. The fiscal policy operates though budget. The budget is an estimate of Government expenditure and revenue for the ensuing financial year; presented to Parliament usually by the Finance minister.

In terms of financial crisis, interim budget may be introduced later in the year to increase taxation, expenditure etc. Sometimes there may be slight modifications in taxation and expenditure without the formality of a revised budget. Fiscal policy is the combined practices of government with respect to revenues, expenditures, and debt management. Fiscal planning, generally done within the context of the Public Services Program (PSP)/Operating Budget and the Capital Improvements Program (CIP)/Capital Budget, reflects and helps shape fiscal policy. The budget process not only reflects those fiscal policies currently in force, but is itself a major vehicle for determining and implementing such policies. The fiscal policy statements Presented on the following pages are not static. They evolve as the economy and fiscal environment change and as the County population and requirements for government programs and services change.

13.14 Objectives of Fiscal Policy

- Arrange an optimum utilization of resources
- To remove poverty and unemployment
- To attain the growth of public sector for attain the objective of a socialistic pattern of society
- To reduce regional disparities
- To reduce the degree of inequality in the distribution of income and wealth.
- To raise the rate of savings and investment for increasing the rate of capital information.

Following are the four important aspects of India's fiscal policy:

1) Taxation Policy

The main objective of Taxation policy in India includes following:

- Mobilization of resources for financing economic development Formation of capital by promoting saving and investment through time deposits, investment in government bonds, units, insurance and so on.
- Attainment of quality in the distribution of income and wealth through the imposition of progressive direct taxes.

2) Public Expenditure Policy

The following are some of the important features of the Public expenditure policy

- Development of infrastructure
- Development of public enterprises
- Support to private sector
- Social welfare and employment programmes

3) Public Debt Policy

The total public debt of the central government is made up of internal debt and external debt. Internal debt is the amount of loan raised form within the country by the government. External debt since the internal debt is insufficient for needs, the government also takes loans from external sources, that is from abroad in the form of foreign technical know how and capital goods.

4) Deficit Financing Policy

Deficit financing helps the country by providing necessary fund for meeting the requirement of economic growth but at the same time it also creates the problem of inflationary rise in prices.

Activity E:

1. Critically examine the tax reforms and recent development in the taxation policy Of the government of India

13.15 Economy and Fiscal Health

As expected, economic statements on GDP growth, deficits and tax measures were encouraging and reflected India's continuing economic recovery. The government estimated GDP growth for FY10 at 7.2% and indicated that it aimed to strengthen this growth to 9-10% in the medium term. In FY10, gross domestic savings and the rate of gross capital formation decreased, while per capita income rose by 5.3%. The government's roadmap for fiscal consolidation, its direct tax measures and lower than-expected borrowings were also seen as positive. The fiscal deficit for FY10, inclusive of oil and fertiliser subsidies, was estimated to be 6.9% of GDP. The government indicated its target fiscal deficit for FY11 to be 5.5% of GDP and said that it aims to reduce the deficit to 4.1% by FY13. However, there were no indications with regard to reform in key areas such as economic liberalisation and labour, although proceeds from disinvestment are proposed to be as much as Rupees. 400 billion in FY11.

13.16 Structure of Union Budget

- The constitution of India provides that
- No tax can be levied or collected except by authority of law.
- No expenditure can be incurred for public funds except in the manner provided in the constitution
- The executive authorities must spend public money only in the manner sanctioned by parliament in the case of the union and by the state legislature in the case of a state.

The Budget is divided vertically in to revenue and expenditure horizontally; it is divided in to revenue account and capital account. The receipts are thus broken up in to revenue receipts and capital receipts and disbursements are broken up into revenue expenditure and capital expenditure.

13.17 Fiscal Policy Frame Work

Legal Framework

Fiscal policy is developed and amended, as necessary, according to:

- Federal law and regulation;
- Maryland law and regulation;
- Montgomery County Charter; and
- Montgomery County law and regulation.

Fiscal Planning Projections and Assumptions

Various trends and economic indicators are projected and analyzed for their impacts on County programs and services and for their impact on fiscal policy as applied to annual Operating Budgets. Among these are Growth of population and jobs, which are principal indicators of requirements for new or expanded programs and services. Demographic change in the numbers or location within the County of specific age groups or other special groups, which provides an indication of the requirements and costs of various government services and programs. The assessable property tax base of the County which is the principal indicator of anticipated property tax collections, a major source of general revenues.

Generally Accepted Accounting Principles (GAAP)

The application of fiscal policy in the financial management of annual operating expenditures must be in conformity with GAAP standards.

Credit Markets and Credit Reviews

The County's ability to borrow cost-effectively depends upon its credit standing as assessed by the three major credit rating agencies: Moody's Investors Service, Inc., Standard and Poor's, and Fitch. While key aspects of maintaining the highest credit rating are related to the management of the County's Capital Improvements Program (CIP), others are directly applicable to the annual Operating Budgets: Maintenance of positive fund balances (reserves) to ensure continued County liquidity for debt repayment; and Assurances through County law and practice of an absolute commitment to timely repayment of debt and other obligations.

Intergovernmental Agreements

Fiscal policy for operating budgets must provide guidance for, and be applied within, the context of agreements made between the County and other jurisdictions or levels of government relative to program or service provision. Examples include agreements with:

- Incorporated municipalities or special tax districts for reimbursement of the costs of various services provided by those units for their residents which would otherwise have to be expended by the Country.

13.18 Highlights of the Union Budget 2010-11 Fiscal Policy Directions

a. The declared policy objective - 'to quickly revert to a high GDP growth'; 'harness economic growth to consolidate the recent gains in making development more inclusive' and making robust 'government systems, structures and institutions at different levels of governance'.
b. 9% target growth in short-run and double digit in the next couple of years.
c. Strengthening and improving the economic & regulatory framework of the country.
d. Budget focus on infrastructure and social sectors – rural development, education, healthcare and employment generation.
e. Direct Tax Code (DTC) and Goods and Service Tax (GST) to be introduced from April 2011.

Policies – Direct Tax

- Income Tax slabs have been relaxed further as under:
  - 10% of tax on income from Rs 1.6 lacs to Rs 5 lacs.
  - 20% of tax on income from Rs 5 lacs to Rs 8 lacs.
  - 30% of tax on income from Rs 8 lacs and above
  - in case of female assesses stands raised to Rs 1.9 lacs and for senior citizens stands raised to Rs 2.4 lacs.
- Additional deduction of Rs 20,000 under Section 80CCF in respect of subscription to long term infrastructure bonds
- Reduction in surcharge from 10% to 7.5% on Corporate tax
- MAT increased to 18% of book profits from the present rate of 15%
- Tax audit limits for Business increased from Rs 40 lacs to Rs 60 lacs and for Professionals from Rs 10 lacs to Rs 15 lacs
- Introduction of the Direct Tax Code (DTC) with effect from April 01, 2011

Policies – Indirect Tax

- Excise duty hike by 2%, signaling partial roll back of fiscal stimulus
- Introduction of the Goods & Service Tax (GST) with effect from April 01, 2011
- Indicative rate of GST to be @ 10%
- Excise duty hiked on certain categories of cigarettes
- Reduction in excise duties on water filters (except those made from RO technology), corrugated boxes & cartons, latex rubber thread, medicinal and toilet preparations etc.
- Customs duties lowered on certain medical equipment.

Policies – Service Tax

- Rate of tax on services retained at 10% to pave the way forward for GST
- Accredited news agencies that provide news feed online exempted from service tax
- 4 new services added to service tax
- Proposals relating to service tax are estimated to result in a net revenue gain of Rs 3,000 crore for the year.

Customs Duty

- No change in basic customs duty. All products listed under the IT Agreement of the WTO to continue to attract nil customs duty, however Peak rate of Customs duty continues to be 7.5%.
- Exemption of 4% Special Additional duty (SAD) on finished goods imported for trading, however,

SAD to continue on imported components.

- Exemption of Basic Customs Duty (BCD) and SAD on parts of mobile phones – battery chargers and hands-free until March 2011.

Service Tax

- Rate of Service tax continues at 10%.
- Pre-packaged IT software, with license for right to use, exempted from Service Tax.

Direct/Income Tax

- No change in rates of corporate taxation. Corporate tax to continue at 30 per cent.
- Surcharge on domestic companies reduced to 7.5% from 10%.
- Minimum Alternate Tax (MAT) increased to 18% from existing 15 %.
- Enhancement of weighted deduction to 200% from 150% for in-house R&D.

Activity G:

1. Do you think that introduction of VAT will help the Business Community in India? What are the advantages of VAT**?**

13.19 Merits of Fiscal Policy of India

The following are some of the important merits of the fiscal policy of government of India.

- Capital formation
- Mobilization of resources
- Incentives to savings
- Inducement of to private sector
- Reduction of inequality
- Export promotion

13.20 Fiscal Policy –An Assessment

- Economic crisis
- The India fiscal situation
- Financial repression
- Fiscal adjustment
- Financial development priorities
- Long term fiscal policy challenges

13.21 Summary

The Reserve Bank of India being primarily concerned with money matters, organizes currency and credit that it thinks is subservient to the broad economic objectives of the country. In the performance of this task RBI formulates and executes monetary policy with clear –cut goals and use various tools for execution. Fiscal policy is the use of government expenditure and revenue to influence the economy.

Monetary policy is contrasted with fiscal policy, which refers to government borrowing, spending, taxation and fiscal policy can also be contrasted with the other type of economic policy like monetary policy, which attempts to stabilize the economy by controlling interest rates and the supply of money.

Monetary policy is referred to as either being an expansionary policy or a contractionary policy, where an expansionary policy increases the total supply of money in the economy and a contractionary policy decrease the total money supply. The three possible states of fiscal policy are neutral, expansionary and contractionary.

There are two main instruments of fiscal policy - government expenditure & taxation and monetary theory provides insight that how to craft optimal monetary measures. Finally we can say that monetary policy is the process of the central bank or monetary authority of a country, which is used to control (i) the supply of money (ii) availability of money (iii) cost of money or rate of interest to attain a set of objectives which are oriented towards the growth and stability of the economy while fiscal policy refers to the over all effect of the budget outcome on economic activity.

13.22 Self Assessment Questions

1. Define monetary policy. What are its objectives?
2. What are credit control measures of the RBI? Explain each in brief.
3. Critically examine the working of monetary system.
4. What is fiscal policy? What are its objectives?
5. What is budget? Why is it so important?
6. Bring out the nature and operations of money market.
7. Explain fiscal policy framework in brief. Discuss merits of fiscal policy

13.23 Reference Books

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- Paul, Justin, (2006), *Business Environment: Text and Cases*, Tata McGraw Hill
- Saleem, Shaikh (2006), *Business Environment*, Pearson Education
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- Industrial Policy Resolution of Government of India.

Unit - 14 Industrial Financial Institutions

Structure of Unit:

14.0 Objectives

After completing this unit, you will be able to:

- Understand the term "finance" and its importance
- Describe the term "industrial financial institutions" and it importance
- Recognize different types of industrial financial institutions and their role in general
- Explain in detail functions, services, and future plans of various industrial financial institutions.

14.1 Introduction: Finance and Sources of Finance

Finance, the "life-blood" of any industry, is a pre-requisite for the mobilization of real resources to organize production and marketing. Depending upon the nature of activity to be financed, business requires short-term, medium-term and long-term finance.

a.) Short-term Finance: Short-term finance refers to the funds required for the period of less than one year. Short-term finance is usually required to meet variable, seasonal or temporary working capital requirements. Borrowing from banks is a very important source of short-term finance. Other important sources of short-term finance are trade credit, installment credit and customer advances.

b.) Medium-term Finance: The period of 1 year to 5 years may be regarded as a medium-term. Medium-term finance is usually required for permanent working capital, small expansions, replacements, modifications, etc. Medium-term finance may be raised by:

(i) Issue of shares
(ii) Issue of Debentures
(iii) Borrowing from banks and other financial institutions
(iv) Ploughing back of profits

Although medium term financial requirement may be met by issue of shares, these sources are of long term nature.

b.) Long-term Finance: Periods exceeding 5 years are usually regarded as long-terms. Long-term finance is required for procuring fixed assets, for the establishment of a new business, for substantial expansion of existing business, modernization, etc. The important sources of long-term finance are:

(i) Issue of shares
(ii) Issue of Debentures
(iii) Loans from financial institutions
(iv) Ploughing back of profit

14.2 Introduction: Industrial Financial Institutions

Finance is a prerequisite to mobilize real resources for organizing production. In a developing economy, however, lack of finance is not the only deterrent to economic development. Even when finance is available, other important factors like imperfections in the information flow and dearth of entrepreneurship may come in the way of industrial and economic development. Hence, it is necessary to make finance and other development assistances in a package to take the dormant and developing economies to the take-off stage. Many developing countries, in particular, therefore, set up Development Banks rather than institutions which merely provide finance. “A Development Bank is a multipurpose institution sharing entrepreneurial risk, suiting to the dynamic industrial climate and encourages new industrial projects with an objective speedy economic growth.

The concept of development banking is based on the assumption that mere provision of finance will not help to bring about entrepreneurial development. Successful entrepreneurial banking includes the discovery of investment projects, undertaking the preparation of the project reports, provision of technical advice and management services and finally assisting the management of industrial units.” After Independence, starting with the establishment of the Industrial Finance Corporation of India in 1948, a number of development banks have been set up at all-India and State levels for assisting the development of large, medium and small industries by providing financial and various other promotional assistances.

14.3 Types of Institutions

The most important all-India Development Financial Institutions (DFIs) are Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI) and Industrial Credit and Investment

Corporation of India (ICICI). The Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units was converted into the Industrial Reconstruction Corporation of India(IRCI) established in 1971 with the main objectives of revival and rehabilitation of viable sick units was concerted into the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers and this was again transformed to new institution called Industrial Investment Bank of India (IIBI).

Besides the above, the All India Financial Institutions (AIFIs) providing industrial finance also includes investment institutions like the Unit Trust of India (UTI), Life Insurance Corporation India (LIC), and the General Insurance Corporation of India (GIC) and its subsidiaries. Development banks have been established at the State level too. There is a State Financial Corporations (SFCs) and State Industrial Investment/ Development Corporation (SIICs/ SIDCs) in most of the states.

Financial assistance is provided, directly or indirectly, to the small scale sector also by National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs) and Khadi and Village Industries Commission (KVIC), although financing is only an ancillary function of these organizations.

The Small Industries Development Bank of India (SIDBI), a wholly owned subsidiary of the IDBI, is an apex institution for promotion, financing and development of industries in the small scale sector and or co-coordinating the functions of other institutions engaged in similar activities. The IDBI is the apex institution which co-ordinated the activities of various institutions. A very important source of industrial finance is commercial banks.

14.4 Types of Assistance

Provision of rupee and foreign currency loans, subscription to shares and debenture, underwriting of shares and debentures, guaranteeing of deferred payments and loans are the important types of financial assistance provided by most of these institutions.

Development activities of the DFIs includes identifying industrial potentials of different areas; development of entrepreneurship through training and motivation; assistance in project identification, feasibility studies and preparation of project reports; technical and managerial consultancy; seed/ risk capital assistance, etc.

Direct assistance from the all-India development banks are normally confined to large projects. Various state level institutions and certain specialized institutions like the National Small Industrial Corporation (NSIC, State Small Industries Development Corporations (SSIDCs), Khadi and Village Industries Commission (KVIC), SIDBI and banks assist small-scale (including khadi and village) units and medium scale units.

Projects involving very large investment are assisted by the all-India financial institutions through consortium financing (i.e., the project is jointly financed by a group of financial institutions.) In consortium financing, one of the institutions plays the lead role. The DFIs have sponsored a number of technical consultancy organizations (TCs) and some institutes for entrepreneurial/management development and imparting education/research in capital market.

14.5 Industrial Financial Corporation of India (IFCI)

This is the first term-financing institution. It was set up in July 1948 by the Government of India under the IFCI Act, 1948, with the objective of providing medium and long-term loans to large industrial concerns in the private sector. However, now the units form the co-operative, joint, and public sector also has been made eligible for its assistance. It provides direct rupee and foreign currency loans for setting up new industrial projects and for expansion, diversification, renovation and modernization of existing units. It also underwrites and directly subscribes to industrial securities, provides financial guarantees, merchant banking services, and lease finance. Its resources are in the form of, loans from the RBI; share capital; retained earnings; repayment of loans; issue of bonds; loans from the government; lines of credit from foreign lending agencies and commercial borrowings in international capital markets.

It has introduced a number of financial and promotional schemes on its own; the latter include eight consultancy fee subsidy schemes, four interest subsidy schemes and two entrepreneurship development schemes. IFCI has now set up a range of subsidiaries to diversify its activities. It has formed IFCI Financial Service Ltd., for merchant banking, stock broking, and allied services; IFCI Custodial Services; IFCI Investor Services for registrar and transfer services; it has also promoted the ICRA.

The constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Companies Act enabling to respond to the needs of rapidly changing financial system and to have an access to the capital market. With the effect from October 1999, its name has been changed to IFCI Limited. A restructuring package has been introduced, witnessing crisis in the early 2004. Its future plans covers asset financing, IPO management, loan syndication, project finance, receivables financing, mergers and acquisitions as well as corporate and project advisory services.

14.6 National Industrial Development Corporation (NIDC)

The NIDC was set up in October 1954 as a statutory corporation owned by the Government of India. It is a financial PSU, a wing of Ministry of Commerce and Industry, Government of India.

Its functions are:

a) To formulate and execute projects for setting up new industries.

b) To provide consultancy services

c) To finance the rehabilitation and modernization of certain industries, such as, cotton and jute textiles, and machine tools.

The spectrum of its services are as below:

a) Industrial planning and management

b) Project engineering

c) Project/construction management

d) Procurement, technical and quality audit,

e) Social and industrial infrastructure

f) Human resources management

g) Environmental engineering

h) Energy management

i) Software and IT development

14.7 Industrial Credit and Investment Corporation of India (ICICI)

It was founded on January 5, 1955 as a public limited company with government support and under the sponsorship of the World Bank, and representatives of the Indian Industry.

A.) The Features of ICICI are as Explained Below:

The type of assistance and scope of activities of the ICICI are similar to those of the IFCI. Its principal business was to provide medium and long-term project financing/leasing and other types of financial and advisory services to private industry in India. Until at which, it was the only institution which was providing foreign currency loans, and even now, its foreign currency loans business is much greater than that of other financial institutions, it has pioneered the development of the IFS in many ways. It was one of the earliest organizations to start merchant banking services in India through its merchant banking division; it has developed the field of lease finance and installment sale; it has played an important role in setting up institutions, such as Over-the-Counter Exchange, TDICI, SCICI, CRISIL, and venture capital funds, through which it provides a variety of financial services.

B.) The Resources of ICICI are in the form of:

a) Share capital
b) Initial interest-free loan by the Government of India
c) Advance in foreign currency by the World Bank
d) Rupee loans by IDBI borrowings from the RBI
a) Lines of credit from the World Bank
b) Bond issues in India and foreign capital markets
c) Issues of shares to Indian public
d) Reserves

C.) Diversification:

ICICI has diversified its own activities into several fee and commission-based services, including custodial services to cater the needs of the foreign and domestic institutional investors. It has diversified into a wide range of financial services till date, such as investment banking, commercial banking, and asset management; overstep services, and broking through the setting up of many specialized subsidiaries which includes:

a) ICICI Banking Corporation Ltd\
b) ICICI Securities and Finance Company Ltd.,
c) ICICI Asset Management Company Ltd.,
d) ICICI Trust Ltd.,
e) ICICI Investors' Services Ltd.,
f) ICICI Brokerage Services Ltd.,
g) ICICI Credit Corporation Ltd.,
h) SCICI Securities Ltd.,

It has 50 per cent shareholding in TDICI Ltd., which, therefore, belongs to the ICICI Group. SCICI Ltd. has been merged with the ICICI with effect form April 1, 1996.

D.) Recent Developments ICICI Bank:

The original ICICI has now ceased to exist as a separate or an independent entity. In May 2002, the merger of ICICI, ICICI PFS and ICICI Capital with ICICI bank was effected, creating what is now referred to simply as ICICI Bank. According to the ICICI's 2001-2002 annual report, the merger of ICICI and its subsidiaries with ICICI Bank has create a combined entity "with complementary strengths and products and similar processes and operating architecture.

The ICICI Bank would now be able to fully leverage the strong corporate relationships that ICICI has built, seamlessly providing the whole range of financial products and services to corporate clients. The merger has also resulted in the integration of the retail finance operations of ICICI, and its two merging subsidiaries, and ICICI bank into one equity, creating an optimal structure for the retail business and allowing the full range of asset and liability products to be offered to all retail customers." The organization structure of ICICI Bank is divided into five major principal groups:

a) Retail Banking
b) Wholesale Banking
c) Project finance & special assets management
d) International Business
e) Corporate Centre

E.) Services of ICICI Bank:

Today, ICICI Bank is the largest bank in the private sector in India with approximately 540 branches and over 1000 ATM Machines. It offers diversified financial services at both the corporate and retail level. In addition, it has specialized subsidiaries that offer non-life insurance, venture capital, asset management, investment and information technology services.

Since the mid - 1990s, the ICICI has been developing the necessary subsidiaries and growing the services that will allow it to be a 'universal bank'. ICICI has also moved away from the long-term lending associated with the DFIs, offering more short-term products and creating a selection of debt products for its clients. ICICI Bank is a company that has been recognized for a number of "firsts".

Notably, it was the first Indian company to list on the New York Stock Exchange (NYSE) is September, 1999. The firm's success is based on a strategy that focuses on technology, low-cost branches and strong management.

F.) Role of Technology:

Technology is very important aspect of ICICI Bank's innovations, as the firm has taken advantage of the affordability of technology to enhance its business. For offering innovative services, it has partnered with:

a) Orange and Airtal to provide WAP – based m-commerce (mobile/telephone banking),
b) Compaq to develop a payment gateway
c) Yahoo! To provide on-line financial information
d) Satyam Info way to offer retail financial products over the internet.

ICICI and its subsidiaries have portals that allow its customers to access accounts and products on-line, offering cutting-edge web-based tools. ICICI was the first of the Indian financial services firms to aggressively pursue an e-commerce strategy and has established a reputation as the leader in this area. The firm has invested in the development of its e-commerce group and has dedicated resources to utilize the technological advantage for better customer service and increased internal efficiencies. The company has the largest call-centre in the industry and it can be accessed by customer in over one hundred cities. The service integrates automated and customer service technician services, serving a complete range of products. ICICI uses the most advanced technology at the call centers, i.e., bleeding-edge voice-over Internet-protocol technology and the most advanced desktop applications, to cross-sell products from its various subsidiaries and to facilitate the customers' banking experiences. In addition, ICICI offers mobile banking services, allowing its customer to use mobile devices to perform some of their baking functions, e.g., checking balances, paying bills and ordering cheque books.

Retail banking is at the heart of ICICI Bank's growth strategy and one of the main reasons behind the firm's impressive growth and results. According to its 2001-2002 annual report, ICICI Bank' retail portfolio (including the portfolio of ICICI Home Finance Company Limited, its wholly-owned subsidiary), at March 31, 2002 was over Rs. 7600 crores. The firm's retail asset products include mortgages, automobile and two-wheeler loans, commercial vehicles and construction equipment financing, consumer durable loans, personal loans and credit cards.

Activity A:

1. Identify the Industrial Financial Institutions in your State, and prepare a report on the services offered by any one of such institute located in your city.

14.8 Industrial Development Bank of India (IDBI)

The IDBI was set up as a wholly-owned subsidiary of the RBI on July 1, 1964 under an Act of Parliament, and by merging the Industrial Refinance Corporation (IRC) which, in turn, was set up by the government earlier in June 1958. In February 1976, the IDBI was declined from the RBI and since then, it has become a separate and independent entity wholly owned by the government. It is now the central or apex institution in the field of industrial finance.

Its main objective is to provide credit, term finance and financial services for the establishment of new projects as well as expansion, diversification, modernization and technology up gradation of the existing industrial enterprises in order to bring about industrial development in the country. It also provides several diversified financial products of non-project nature such as equipment finance, asset credit and equipment leasing, merchant banking, debenture trusteeship and forex services to the corporates. It functions as a development financing agency in its own right, in addition to its work of coordinating, supplementing, and monitoring the operations of other term-lending institutions in the country. Apart form providing direct assistance of the types supplied by IFCI and ICICI, it provides indirect assistance in the form of discounting/ rediscounting long-term bills/promissory notes, refinancing of term loans given by SFCs, banks, and so on, and subscribing to resources of notified financial institutions such as SFCs, IFCI, ICICI, IRBI, and so on. There are more than 850 primary lending institutions which were eligible for refinancing facilities of the IDBI. It also takes up various promotional activities such as balanced development of regions, entrepreneurship development, technology development and so on. The resources of the IDI are more or less similar to those of the IFCI. I vis-à-vis IFCI, UTI, SFCs came to be vested in it. As per the amendment to the IDBI Act in 1994, it has now been allowed functional autonomy in respect of granting loans, accepting deposits, and having exposure to foreign currency borrowings. As a result of going public, its Board of Directors will now include representatives of the shareholders.

The IDBI can now have public ownership up to 49 per cent of its issued capital. The Government of India introduced the Industrial Development Bank (Transfer of Undertaking and Repeal) Bill 2002 in the Lok Sabha, which is aimed at converting IDBI into a company under the Companies Act and to enable it to undertake banking business.

The IDBI has helped to set up various institutions such as TCOs, EXIM Bank (EXIMB), Entrepreneurship Development Institute, CRISIL, SHCIL, SEBI, and NSE. Its subsidiaries include:

IDBI Bank Ltd.; IDBI Capital Market Services Ltd.; IDBI Mutual Fund, SIDBI and, IDBI Intech Limited.

The IDBI started borrowing in international financial markets to meet foreign currency needs of the industry since 1982. It made the first public of (unsecured) bonds in 1991. It has introduced new instruments such as floating rate bonds, flexibonds, fixed deposits, and term money bonds to raise resources. It went public when it made a public issue of equity in June 1995. It introduced for the first time in the country, in 1993, the proactive of charging variable interest rate linked to long-term prime lending rate.

It is a member of the Association of Development and Industrial banks in Asia (ADIBA), the main objective of which is to improve the economic relationship among the major Asian economies and to contribute to financial and economic development in Asia.

14.9 Export-Import Bank of India (EXIM Bank)

The EXIM Bank was set up in January 1982 as a statutory corporation wholly owned by the Central government. Its paid-up capital in 1988-89 was Rs. 220.5 crores. It grants direct loans in India and outside for the purpose of exports and imports, refinances loans of banks and other notified financial institutions for purposes of international trade, rediscounts usuance export bills for banks, provides overseas investment finance for Indian companies towards their equity participation in joint ventures abroad, and guarantees, along with banks, obligations on behalf of project exporters. It is also a co-coordinating agency in the field of international finance, and it undertakes development of merchant banking activities in relation to export-oriented industries. It thus provides fund-based as well as non-fund based assistance in the foreign trade sector. Specifically, its products and services include:

a) Post-shipment term finance
b) Post-shipment credit
c) Term loans form export-oriented units
d) Overseas investment finance
e) Finance for export marketing
f) Overseas buyer's credit lines of credit too foreign governments
g) Relending facility to banks abroad
h) Rediscounting of export bills refinance of export credit
i) Refinance of export credit
j) Bulk import finance
k) Research,, analysis, advisory and information services.

Its sources of funds come from share capital, reserves, repayment of loans, loans from the RBI and the government, bond issues in the domestic and foreign capital markets, loans form international financial institutions, and so on.

14.10 Industrial Reconstruction Bank of India (IRBI)

In April 1971, the IDBI set up, at the instance of the GOI, the Industrial Reconstruction Corporation of India (IRCI), as a joint-stock company, to provide reconstruction and rehabilitation assistance. The IFCI, ICICI, LIC, and public sector banks also had contributed to its share capital. The IRCI was reconstituted and renamed as IRBI in 1985 in terms of the IRBI Act. It functions as a principal credit and reconstruction agency for industrial revival, modernization, rehabilitation, expansion, reorganization, diversification and rationalization. It grants loans and advances: underwrites stocks, shares and bonds; guaranteed loans and deferred payments. It gives assistance for capital expenditure, in addition to balancing equipment, correcting imbalances in working capital of sick, weak, closed units and those facing imminent closure.

It also acts as a coordinating agency in the field of reconstruction. Its development activities includes providing infrastructural facilities, raw materials, consultancy, managerial and merchant banking services, lease finance, and hire-purchase credit. The units in public, private, co-operative and joint sectors are covered by its operation.

The Union budget 1996-97 proposed to transform the IRBI into a full-fledged all-purpose development finance institution. Accordingly, on March 27, 1997, IRBI was transformed into Industrial and Investment Bank if India Ltd. (IIBI), by registering it as a limited company under the Companies Act, 1956. The purpose of this change was to make this institution as a full-fledged development financial institution. IIBI offers variety of financial products such as project finance, short duration non-project asset-backed financing, working capital and other short-term loans to companies.

14.11 Shipping Credit and Investment Corporation of India (SCICI)

The SCICI was incorporated as a public limited company in 1986 and its issued capital of Rs. 50 Crores has been contributed by ICICI (20 per cent), IDBI, IFCI, LIC, UTI, GIC, SBI, and four other commercial banks. Its main objective is to act as a channel for providing development finance to oceanic shipping, deep sea finishing, oil exploration, ship repairing, and offshore, coastal, and intermediary water services. It has diversified into areas, such as food processing and transportation.

Apart form institutional subscriptions to its initial share capital it has recently raised capital (about Rs.16 crores) by issuing shares to the public. In addition, it has received about Rs. 92 crores as unsecured loans from the government, Rs. 225 crores from bond issues, and Rs. 257 crores in long-term foreign currency loans.

14.12 Infrastructure Leasing and Financial Services Ltd. (Il AND FS)

The IL and FS Ltd. was set up in May 1988 jointly by the Central Bank of India (CBI), UTI, HDFC, International Finance Corporation, ORIX Corporation from Japan, Credit Commercial de France, and SBI. It functions as a subsidiary of CBI. The areas of its assistance are:

a) Financing of large infrastructure projects like highways, bridges, and power plants;
b) Equipments leasing for infrastructure development
c) Pollution control, transportation and communication
d) Investment banking services including promotion of mutual funds and extension of venture capital
e) Participation as a member of stock exchanges with a focus on the development of secondary markets

It concentrates on fully pay-out financial leases, it has been admitted as a member of Delhi Stock Exchange and is awaiting clearance for the membership of Bombay Stock Exchange. Its operations in financial markets are focused on government securities, corporate debentures and bonds of public sector units. IL & FS is a leading participant in the financial services sector in India and operated in the areas such as project finance and syndication mergers and acquisitions, infrastructure financing, asset management, venture capital, securities, trading services, etc. It identifies, conceptualizes structures, develops, and deploys resources in a variety of projects. It assists agencies in positioning infrastructure projects for commercialization. It has advised stated governments on the legal and project framework to be adopted for transmission, hydro-electric & retrofitting projects, and developing non-conventional energy power projects in the role of a sponsor. It has developed institutional capability in commercialization of surface projects in the role of a sponsor. It has developed institutional capability in commercialization of surface transport and other transport systems, water supply, power and telecom.

14.13 Technology Development and Information Company of India Ltd. (TDICI)

The TDICI was incorporated under the Companies Act by ICICI and UTI in July 1988 with a view to promoting technology development through transfer and up-gradation of technology, and through providing technology information. Specifically, its aims are:

a) To develop indigenous technology
b) To develop technologists entrepreneurship
c) To support (commercial) R and D activities, and technological innovations
d) To spread technology information.

It provides assistance in the form of grants, conditional loans, equipment support, venture capital, techno-managerial guidance, and so on, for those purposes. It has also launched a Technology Information Service (TIS), to develop value-added technology and techno-consultancy commercial support tom various industries and institutions in India. It has access to the on-line and off-line data bases of DIALOG and National Technology Information Service (NTIS) in the US. It was the first venture capital finance company in India. It provides assistance assistance to small and medium industries conceived by technocrat entrepreneurs. The operations of TDICI have remained small in size. Up to March 1996, its cumulative sanctions and disbursements were Rs.272 crores and Rs. 234 crores, respectively.

14.14 Risk Capital and Technology Finance Corporation Ltd. (RCTFC)

The RCTFC is a venture capital fund. It was set up in January 1988 by IFCI by converting its Risk Capital Foundation (RCF), which was established in 1975. Apart form risk capital, it provides technology finance for encouraging innovative technology, products, processes for energy conservation, control of environmental pollution, meeting the expenditure of national and international consultants, and for sponsored commercial R &D programmes. It assists new entrepreneurs to enable them to meet the gap in promoter's equity in medium-scale projects. It gives conventional loans or interest-free loans on a profit and risk-sharing basis with the project promoters. Its activities have been Rs. 120 crores and Rs. 86 crores respectively.

14.15 Tourism Finance Corporation of India (TFCI)

The TFCI was set up on 1 February 1989 as a public limited company under the Companies Act by the IFCI, other all-India financial institutions and banks. Its paid-up capital is Rs. 50 crores. It is specialized all-India development financing institution, which provides assistance in the form of rupee loans, foreign currency loans, underwriting of and subscription to industrial securities, deferred payments. Foreign loans guarantees, supplier's credit, and equipment leasing. This form of assistance is utilized for the development of tourism and tourism-related activities, facilities, and services. These includes travel agents, highway facilities, ropeways, car rental services, ferries for inland water transport, airport facilities, hotels, restaurants, holiday resorts, amusement parks, transport and so on. It would also provide advisory and merchant banking services in this field. It is to co-ordinate activities, and formulates guidelines and policies relating to financing tourism projects.

The projects with capital cost of Rs. 1 crores or above are generally eligible for assistance from TFCI, although smaller projects could also be considered. It would provide assistance jointly with state financial institutions for projects with capital cost of Rs. 1 crores to Rs. 3 crores, and on a consortium basis with all-India financial institutions for bigger projects. Again, the volume of operations ofTFCI has remained small; its cumulative sanction and disbursements till March 1996 were Rs, 1026 crores and Rs. 543 crores respectively.

Activity B:

1. Identify and visit the company (Large/Medium or Small Scale) near your locality, and prepare detailed report on the various types of services availed by such company from various Industrial Financial Institutions.

14.16 Small Industries Development Bank of India (SIDBI)

The SIDBI was set up in October 1989 under the Act of Parliament as a wholly-owned subsidiary of the IDBI. Its authorized capital is Rs. 250 crores with an enabling provision to increase it to Rs. 1000 crores. It is the central or apex or principal institutions which overseas, co-ordinate and further strengthens various arrangements for providing financial and non-financial assistance to small-scale, tiny, andcottage industries. In pursuance of the SIDBI (Amendment) Act, 2000, 51.1 percent of the shares of the SIDBI help by IDBI have been transferred to selvt public sector banks, LIC, GIC, and other institutions owned and controlled by the Central Government.

Its objectives are:

a) To initiate steps for technological up gradation and modernization of existing units
b) To expand channels for marketing of SSI sector products in India and abroad.
c) To promote employment-oriented industries in semi-urban areas and to check migration of population to big cities.

It operates two funds:

1. Small Industries Development Fund
2. Small Industries Development Assistance Fund

The operation of the former and of national Equity Fund which was earlier looked after by the IDBI is now handled by the SIDBI. Its financial assistance is channeled through the existing credit delivery system comprising NSIC, SFCs, SIDCs, SSIDCs, commercial banks, co-operative banks, and RRBs. The total number of institutions eligible for assistance from SIDBI is 869. It soft loan assistance through National Equity Fund and through seed capital schemes of specialized lending Institutions; refinances loans; and provides services like factoring, leasing, and so on.

The Union Budget 1996-97 envisaged a number of measures to develop small-scale sector with the SIDBI as the focal point. They include:

a) SIDBI will now refinance the SFCs and commercial banks for modernization projects up to Rs. 50 lakhs from its unutilized corpus of about Rs. 175 crores;
b) SIDBI's refinance ceiling of Rs. 50 lakhs for the single window scheme of SFCs, etc, for composite

loans will be doubles to Rs. 100 lakhs;

c) SIDBI will participate in venture capital fund, provided such a fund is dedicated to the financing of small-scale industry;

a) SIDBI will provide refinance to lending institutions which are now permitted to lend to SSI units seeking ISO certification of quality.

Since its inception, SIDBI has provided assistance to the entire SSIs sector including tiny, village and cottage industries through suitable schemes tailored to meet the requirement of setting up of new projects, expansion, diversification, modernization, and rehabilitation. In about a decade after 1992, it introduced 26 new schemes to fill the gaps in the credit delivery system. It has provided equity capital, domestic and foreign currency term loans, working capital finance, etc. SIDBI has entered into MOUs with many banks, governmental agencies, international agencies, R & D institutions, and industry associations for developing SSIs. It has established lines of credit in favor of SFCs, SIDCs, SSIDCs, etc. As per the May 2001 issue of The Banker, London, SIDBI ranked 25th in terms of capital and assets among development banks of the world.

14.17 National Co-Operative Development Corporation (NCDC)

The NCDC was set up in March 1963 by the Act of Parliament as a development finance institutions for agriculture and co-operative sector.

Its functions are:

a) To implement various programmes in the co-operative sector

b) To provide financial assistance in the form of loans and subsidy to co-operatives under various schemes

c) To promote, strengthen, and develop farmer' co-operatives in order to increase production and productivity

d) To plan and promote programmes relating to production, processing, marketing, storage, export, and import of agricultural goods through co-operatives;

e) To help in the implementation of programmes meant for weaker sections of society

It handles programmes in the areas of poultry, and fisheries, minor forest product, handlooms, coir, sericulture, and dairy farming. It acts as an on-lending agency for implemented certain projects in the areas of storage, soyabean processing, oilseeds, cotton processing, mustard seeds, coconut development, and so on. It has started preparing schemes for integrated co-operative development in certain districts.

These schemes would bring about area development through co-operatives in agricultural, allied, and non-farm sectors. One of its special areas of work is to formulate and implement programmes for distribution of consumer articles in rural areas.

14.18 Warehousing Corporations (WCs)

The WCs is system of corporations comprising one Central Warehousing Corporation (CWC) and 16 State Warehousing Corporations (SWCs). While the former serves markets of all-India importance, the latter serve secondary markets and co-operatives in rural areas. The CWC was set up in 1957 with a view to help storage of foodgrains and inputs, and industrial warehousing. In 1989-90, the total number of warehouse owned/managed by CWC and SWCs was 483 and 1030 respectively.

Activity C:

1. Prepare a detailed report on list of the various documents required for availing the services from any of the Industrial Financial Institutions.

14.19 Rural Electrification Corporation (REC)

The REC was set up in 1969 with the objective of:

a) Rapid electrification of the rural and backward areas;

b) Promotion of decentralized distribution of power in rural areas on co-operative basis;

c) Full exploitation of irrigation potential through energisation of pumpsets.

It provides assistance for electrification through various schemes.

14.20 Biotechnology Consortium of India Limited (BCIL)

It is a new company set up by the IDBI, ICICI and other financial institutions to facilitate the setting up of technology parks and the rapid conversion of laboratory developments into commercial processes and products. The company has been set up with share capital of Rs. 5 crores. It promotes venture capital funds and arranges technology and financial resources for them.

More specifically, BCIL was set up in 1990 as a public limited company, with the objective of providing the linkages amongst research institutions, industry, government and funding institutions, to facilitate accelerated commercialization of biotechnology. Promoted by the Department of Biotechnology (DBT), Government of India, its core capital of Rs. 5.37 crores, has been contributed mainly by the All India Financial Institutions, IDBI, ICICI, IFCI, UTI and IFCI Venture Capital Funds Ltd. along with the corporate sector including Ranbaxy Laboratories, Cedilla Laboratories, Galax India, SPIC etc.

BCIL is engaged in technology development and transfer, project consultancy, fund syndication, information dissemination and manpower training and placement related to biotechnology. For technology transfer, BCIL acts as an interface between technology sources and technology seekers.

The main sources of technologies have been the universities and national laboratories where research and development projects have been funded by the DBT. Promising commercial leads are identified and developed into technology packages in close interaction with the scientists. The processes are then demonstrated to a select cross section of industries to ascertain their interest following which commercial negotiations for technology transfer are taken up and concluded. Subsequently, BCIL continues interaction with both the industries and the scientists so that any gaps in the technology are bridged effectively. The projects are monitored to ensure their timely implementation as per the terms of technology transfer agreements.

BCIL also organizes Entrepreneur's Meets to create large scale awareness about the commercial potential of the indigenously developed biotechnologies. Representatives from government and financial institutions are also invited in such meets to facilitate financial, regulatory and other support to the entrepreneurs for expeditious commercialization.

Whenever required, BCIL offers consultancy in the form of market assessment, preparation of business plans or detailed project reports to assist the industry and the entrepreneurs. As on date, BCIL has assisted over 150 clients including research institutions, industry, entrepreneurs, government, financial institutions and international agencies.

BCIL has assisted Punjab State Government in preparations of detailed project report for setting up a "Centre of Excellence" in Bio-technology for development and commercialization of state-of-the-art biotechnologies. BCIL is currently assisting the state governments of Uttar Pradesh, Kerala and Pondicherry for setting up biotechnology parks for catalyzing investments in the area of biotechnology.

Through its publications and the biotechnology club, BCIL disseminates information relevant to commercial biotechnology to industries, institutions, universities and entrepreneurs. It also operates a biotech industrial training and placement programme through which postgraduates in bio-technology with an aptitude in industrial activities are trained in the industry to orient them in commercial biotechnology.

14.21 Infrastructure Development Finance Company (IDFC)

The IDFC, a new financial institution, has been set for providing long-term finance for infrastructure development with an authorized share capital of Rs. 5000 crores to be contributed by the GOI, RBI, banks and FIs. The GOI has already made a budgetary provision of Rs. 500 crores during 1996-97 with a matching initial contribution by the RBI. The TDFC will act as a direct lender, as a refinancing institution to facilitate the flow of private finance to commercially viable infrastructure projects in the areas such as telecom, power, roads, ports, railways, urban infrastructure, environment friendly infrastructure food and agriculture related infrastructure, urban water and sanitation, etc. The IDFC provides debt and equity support advisory services. It helps promoters in raising resources from international markets by offering financial guarantees. Its initial paid-up is Rs, 1000 crores. The government and RBI have provided Rs. 650 crores as subordinated debt. Thus, the total capital of IDFC at present is Rs, 1650 crores.

14.22 North Eastern Development Finance Corporation Ltd. (NEDFC)

The NEDFC was incorporated on August 9, 1995, and has commenced operations on March 1, 1996. The GOI notified it as a public financial institutions under the Companies Act, 1956. It has an authorized capital of Rs. 500 crores and an initial subscribed capital of Rs, 100 which has been contributed by the promoters, viz., IDBI, SIDBI, IFCI, ICICI, UTI, LIC, GIC and SBI. The Union Budget 1996-97 granted a tax-free status to its income for 10 years commencing from 1995-96.

Its objective is to accelerate industrial and infrastructure development in the North-Eastern region. The primary focus of NEDFC initially will be on identifying and developing entrepreneurship, and financing the establishment of new industrial and infrastructure projects as well as expansion, diversification and modernization of existing industrial enterprises. It will provide venture capital, loans, working capital, and other usual types of assistance provided by the development banks.

Apart from the institutions discussed above, there are number of other institutions, HDFC, HUDCO, NHB, SHCIL, DFHI, DICGC, ECGC, and others., which have been set up since 1950 by the government and public financial institutions.

14.23 Discount and Finance House of India (DFHI)

The Reserve Bank of India, together with public sector banks and financial institutions, has recently set up a company called the Discount and Finance House of India Ltd. (DFHI), to deal in short-term assets in order to provide liquidity in the money market.

14.24 Industrial Investment Bank of India (IIBI)

In 1971, the Government of India established an institution, namely, Industrial Reconstruction of India (IRCI), with the main objective of reconstruction and rehabilitation of industrial units which were closed down or were facing the risk of closure but which could be made viable will suitable assistance.

The need for a more powerful institution to deal with the problem of industrial sickness was felt and on March 20, 1985, the Industrial Reconstruction Bank of India (IRBI) was established as per the provisions of the Industrial Reconstruction Bank of India Act, 1984, and the erstwhile Industrial Reconstruction Corporation of India was vested and transferred to the IRBI on that date.

In 1997, IRBI was converted into a company and transformed it into a full pledged financial institution known as Industrial Investment Bank of India Ltd. (IIBI). The Bank has moved in to business-oriented activities from simple revival of sick units.

14.25 The National Small Industries Corporation Ltd (NSIC)

The National Small Industries Corporation Ltd. (NSIC)., which is wholly owned by the Government of India and meant exclusively for the development of small-scale industries, was established in 1956. The NSCI with its head office at Delhi has regional/sub-offices in several places.

The main functions of the Corporation are the following:

a) Supply of machinery, both indigenous and imported, on hire purchase to help setting up of new small ancillary units and to modernize existing ones;

b) The Corporation's Prototype Development and Training Centres, the sub-centres and the demonstration-cum-training centre at different places develop prototypes which may be transferred along with know-how to manufacturing units for commercial production, and or renders training in various engineering trades;

c) Under the Raw Materials Assistance Scheme, small-scale units are supplied raw-materials — imported and scarce indigenous ones —— on a continuing basis, giving them also the benefit of bulk purchases;

d) NSIC helps the marketing of products of small-scale units under the Government Stores Purchase Programme as well as under its Internal Marketing Programme through consortia approach. In the Field of export marketing, the Corporation has adopted a 'Single Window' assistance programme;

e) Further, with a view to creating facilities for regular display of products of the small-scale sector. NSIC has up show rooms-cum-marketing development centres in a number of places in the country;

f) NSIC undertakes small industries projects on turn-key basis and provides total services from feasibility studies to installation and commissioning of plant.

14.26 The Khadi and Village Industries Commission (KVIC)

The Khadi and Village Industries Commission , establishes as a statutory organization under the Khadi and Village Industries Commission Act, 1956, provides various schemes of assistance which cover extension of finance right from the stage of procurement of raw materials , tools implements to the production of goods and their marketing.

14.27 Commercial Banks

Commercial Banks are a very important source of finance for the industry. The industrial sector is getting around 50 per cent of the total bank credit. Since the major banks nationalization of 1969, there has been a substantial expansion of the bank branch networks, and substantial growth of the bank deposits and credits. Commercial Banks in India had been following the orthodox British line of disfavouring the loans to industries. However, there has been a change in their attitude. In respect of the term finance, the commercial banks, besides providing term credit and subscribing to share and debentures, indirectly participate in term finance by subscribing to the share and debentures, of financial institutions. Commercial banks also do underwriting of share and debentures. Some of the banks have merchant banking divisions. Scheduled banks have been permitted to hold in their own investment portfolio shares and debentures of the private corporate sector devolving on them through their underwriting and merchant banking commitments.

The shift in favour of the 'priority sectors' led to a decline in the share of the industrial sector in the total bank credit. Today, the industrial sector accounts for about half of the total bank credit as compared to over two-thirds, prior to the nationalization in 1969. This decline in the share has been confined to the medium and large sectors. Small industry is a priority sector and there has been a very significant increase in the proportion of the credit flow to this sector.

Activity D:

1. Fill in the blanks:

1. ________________ was converted into a company and transformed it into a full pledged financial institution known as Industrial Investment Bank of India Ltd. (IIBI). (IRBI)
2. _____________is the first term-financing institution, set up in July 1948 by the Government of India. (IFCI)
3. _______________was the first of the Indian financial services firms to aggressively pursue an e-commerce strategy. (ICICI)
4. ________ has been set up to help railways to finance its plan investment.(IRFC)
5. ____________ is engaged in technology development & transfer, project consultancy, fund syndication, information dissemination and manpower training and placement related to biotechnology. (BCIL)
6. BCIL stands for ___________. (Biotechnology Consortium of India Limited)
7. _______________ was set up jointly by the Central Bank of India (CBI), UTI, HDFC, International Finance Corporation, ORIX Corporation from Japan, Credit Commercial de France, and SBI. (The IL and FS)

14.28 Summary

There are number of institutions at all-India and State levels for assisting the development of large, medium and small industries by providing financial and various other promotional assistances. The most important all-India Development Financial Institutions (DFIs) are Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of

India (ICICI) and Industrial Investment Bank of India (IIBI). The IDBI is the apex institution which co-ordinates the activities of various institutions. Besides the above, national level institutions providing industrial finance also include some investment institutions like the Unit Trust of India (UTI), Life Insurance Corporation India (LIC), and the General Insurance Corporation of India (GIC) and its subsidiaries.

Developments banks have been established at the State level too. There is a State Financial Corporations (SFCs) and Industrial Investment/Development Corporation (SIICs/SIDCs) in most of the States. The Small Industries Development Bank of India (SIDBI), a wholly-owned subsidiary of the IDBI, an apex institution for promotion, financing and development of industries in the small scale sector for co-ordinating the functions of other institutions engaged in similar activities. Financial assistance is provided directly/indirectly, to the small scale sector also by National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs) and Khadi and Village Industries Commission (KVIC), although financing is only an ancillary function of these organisations. A very important source of industrial financing is also Commercial banks.

Provision of rupee and foreign currency loans, subscription to shares and debentures, underwriting shares and debentures, guaranteeing of deferred payments and loans are the important types of financial assistance provided by these institutions.

Development activities of the DFIs includes identifying industrial potentials of different areas; development of entrepreneurship through training and motivation; assistance in project identification, feasibility studies and preparation of project reports; technical and managerial consultancy; seed/ risk capital assistance, etc. The DFIs have sponsored a number of technical consultancy organizations (TCs) and some institutes for entrepreneurial/management development and imparting education/research in capital market.

As a percentage of GDP, disbursements by financial institutions to industry rose from as low as 0.5 per cent in the first-half of the 'seventies to 1.4 percent in the first-half of 'eighties, to 2.9 per cent in the first-half of the 'nineties and further to 3.3 per cent in the second-half of the 'nineties.

14.29 Self Assessment Questions

1. Write a short note on subsidiaries of Industrial Credit and Investment Corporation of India.
2. Discuss objectives of Small Industries Development Bank of India.
3. Explain Functions of State Industrial Development Corporations.
4. Discuss the objectives of National Small Industries Corporation.
5. Discuss in detail the objectives of the various all-India Development Banks in India
6. Discuss the role of Commercial Banks in Industrial Financing.
7. Explain in detail the role of ICICI as the alterative of Industrial Financing.
8. Discuss in brief the following:
   - i. RCTFC
   - ii. KVIC
   - iii. DFHI
   - iv. IRFC

v. REC
vi. WCs
vii. TDICI
viii. IL AND FS
ix. TFCI
x. SCIC
xi. IRFCI

9. Explain in detail Biotechnology Consortium of India Limited (BCIL)

14.30 Reference Books

· Mishra S. K. & Puri V. K. (2004), Indian Economy: Its Development & Experience; Himalaya Publishing House; Mumbai

· Cherunillam F. (2006) Business Environment- Text & Cases; Himalaya Publishing House; Mumbai

· Bhole L. M. and Mahakud J., (2009) Financial Institutions and Markets: Structure Growth and Innovations; Tata McGraw Hill & CoDelhi.

Unit - 15 Privatization and Disinvestment

Structure of Unit:

15.0 Objectives

After completing this unit, you will be able to:

- Understand the meaning and essence of the term 'privatization';
- Learn the rationale for privatization;
- Get insight on the modalities of the how it is carried out, i.e., methods;
- Analyze the pros and cons of the privatization;
- Analyze the disinvestments scenario in India;
- Built an understanding for the issues and critically examine its consequences;

15.1 Privatization: An Introduction

The rapid economic change across the world has/is integrating and interlinking the economies of the world, and thus the ever-evolving 'global village' has become the reality of the present world.

During 1960s and 1970s, large number of countries of the world, regardless of whether socialist or market-oriented, witnessed an expansion of the public sector, and in particular an expansion of State-owned enterprises. In the 1960s, there was trend towards nationalization in Britain. The performance of

SOEs, in many countries was by and large, been far from satisfactory. Therefore, since the late 1970s, the trend was shifted towards privatization by selling State-owned enterprise (SOEs) which indeed became a universal trend. Since 1980, the reversal trend of the statist economic expansion has, thus, set the new wave of lesser government involvement in the business. The famous quote by John Moore, "the business of government is not to be in business" comments on the inefficiencies of the Government in managing the State-owned Enterprises, and thereby has led to the emerging trend of the privatization.

The Privatization schemes led by the Conservative Government in U.K in 1980s by MS Margaret Thatcher has acquired the legendary status and has proved to be as the inspiration for similar exercises being adopted the world over. Every business, whether private or public, utilizes the resources of nation and society. i.e., human, capital, land and machine, and adds value to these resources and return back to the society. In case, these businesses are unable to add value to these resources, then it becomes the burden on society as well as on the nation. Such losses, generally in PSUs, increases the fiscal deficit of the nation, leading to inflation, thus, totally deplete the resources of the nation, without any value addition in its utility. From the Indian context even, the performance of most PSUs was very pathetic, and thus the charge to the Indian taxpayer was proven to be unethical, as it was for the unproductive performance of the PSUs.

It is said rightly said about the management of any enterprises that, "It is better to give it to someone, who can run it in a better manner, instead of holding it and incurring losses" In this context, Acharya Vishnugupt (Chanakya) once out that the state should not indulge in business.

As Professor Samuel Paul points out, in country after country, unbridle state expansion has led to the following problems:

1. Variety of the production obstacles in the public sector, i.e., economic inefficiency, high costs of production, inability to innovate, and costly delays in delivery of the goods produced, has initiated the in-capabilities within these enterprises.
2. Problems related to the provision of goods and services, such as failure to meet intended objectives, diversion of benefits to elite groups, and political interference in the management of enterprises; has heightened the intensity of the ineffectiveness with reference to making the goods and services available.
3. These set up of State-owned Enterprises has also led to the expansion of the bureaucracy, which has strained the public budget and external debt severely, leading to the problems in labour relations within the public sector, in-efficiency in government, and adverse effects on the whole economy.
4. The public discontent against the public sector enterprises has even tremendously amplified, due to their inefficiency, indifferent, irresponsible and sometimes even arrogant attitude and lack of concern for the customer needs; and corruption, nepotism and squander associated with their organization and management led to the growing interest in privatization.

These problems have led many governments to undertake programmes of public sector reforms, pushed by a need to curb public expenditure, to re-evaluate the possibilities for shifting public managed activities into the private sector. Thus, Privatization is an inevitable historical reaction to the indiscriminate expansion of the State sector and the associated problems, and a vital measure of economic rejuvenation

15.2 Privatization: Definitions

According to the World Bank, Privatization "is the transfer of ownership of State-Owned

Enterprises (SOEs) to the private sector by sale (full or partial) of going concerns by sale of assets following their liquidation."

Barbara Lee and John Nellis (1990) describe it, "Privatization is the process of involving the private sector in the ownership of operation of state-owned enterprise. Thus the term refers to private purchase of all or part of a company. It covers the contracting out and privatization of management—through management contract, leases or franchise arrangement." In general, it connotes "private ownership (or even without change of ownership) the induction of private control and management in the PSUs".

Thus, the broad term Privatization, can be defined in the simplest form as, "the process of transferring assets or service delivery from the government to the private sector". Privatization means "transfer of ownership/management of an enterprise from the public sector to the private sector or withdrawal of the State from an industry or sector partially or fully, as well as opening up of an industry that has been reserved for the public sector to the private sector".

Privatization characterizes the change from dogmatism to pragmatism and amounts to a reversal of policy. Over the past few years, the Indian government has been working towards privatization of some state-owned enterprises in order to help the economic rejuvenation. However, this effort has been attracting criticism, particularly from the Left parties, who are against the economic reforms in the India, in terms of Privatization.

The dual measures of economic stabilization as well as structural reforms were adopted by the Government of India in the Economic Reforms introduced in the year 1991-1992 in India. Moreover, over the last decade, the Indian economy has also demonstrated flexibility and closer integration with the world economy. India has moved into the 21st century with a strong desire to become the competitive in global arena. Therefore, understanding about the Privatization, the benefits and costs involved and incurring has to be analyzed.

15.3 Forms of Privatization

There are different ways of achieving privatization. "Each country has its own attention-grabber. Different ways of Privatization which can be adopted by the country are discussed below:

a. Ownership Measures: The degree of privatization is judged by the extent of ownership transferred from the public enterprise to the private sector. It can take the following forms:

1. Total Denationalization: It is complete transfer of a public enterprise to the private sector. For example: BALCO acquired by Sterlite Industries and Modern Foods acquired by Hindustan Lever.
2. Joint Venture: This implies partial introduction of private ownership, wherein the range of private ownership can vary from 25 per cent to even 75 per cent or more. For example: In the case of Maruti Suzuki where before liberalization, majority of shares were with Maruti but after liberalization, Suzuki increased its stake and became the majority stake holder.
3. Liquidation: the assets are sold to someone who may use those assets for the same purpose or for any other purpose.
4. Workers Co-operative: In this type of ownership transfer, the ownership of the enterprise is transferred to workers who may form a co-operative to run the enterprise.
5. Divestiture: It is the privatization of ownership through the sale of equity. It entails selling stock to the public. For example: In India various public sector banks such as State Bank of India, Vijaya

bank etc., sold their stocks to the public through IPOs.

b. Organizational Measures: Various types of the Organizational Measures of Privatization conceiving to limit state control are as explained below:

1. A Holding Company Structure: This alternative emphasizes on the decentralized pattern of management. In this type of organizational measures of Privatization, the organization is decentralized and sufficient autonomy of decision making is given at the operative level but the government retains the control in decision-making at the apex level.
2. Leasing: The government transfers the use of assets to private bidders for a specific period. In the leasing agreement the bidder is required to be assured regarding profit sharing between the State and bidder. This is a kind of tenure ownership.
3. Restructuring: Restructuring can be classified in to two types: Financial and Basic Restructuring.

Financial restructuring means the writing off of accumulated losses and rationalization of capital composition in respect of debt-equity ratio. The main purpose of rationalization is to improve the financial health of the enterprise. While, Basic Restructuring occur when the public enterprise decides to share some of its activities to be taken up by the ancillaries or small units.

c. Operational Measures:

1. Grant of autonomy to public enterprise in decision-making.
2. Provision of incentives for workers and executives consistent with increase in efficiency and productivity.
3. Freedom to acquire certain inputs from the market.
4. Development of proper criteria for investment planning.
5. Permission to public enterprises to raise resources sent from the capital market to execute plans of diversification and expansion.

Activity A:

1. List out the PSUs' privatized in the country other than that stated in the study- material. Comment on the mode of privatization adopted.

15.4 Benefits of Privatization

Privatization benefits the society in several ways. The fact that privatization is an important strategy of economic rejuvenation of even the 'communist' nations is a testimony to the economic role of privatization. Countries like U.K. have shown how it could help solve the fiscal crisis of the State to usher in a new industrial democracy. The benefits of privatization may be listed down as follows.

1. It reduces the fiscal burden of the State by relieving it of the losses of the SOEs and reducing the size of bureaucracy.
2. Privatization of SOEs enable the government of mop up funds,
3. Privatization helps the state to trim the size of the administrative machinery.
4. It enables the government to concentrate more on the essential State functions.
5. Privatization helps accelerate the pace of economic development as it attracts more resources from the private sector for development.
6. It may result in better management of the enterprises.
7. Privatization may also encourage entrepreneurship.
8. Privatization may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance.

15.5 Arguments against Privatization

There is strong opposition to privatization from different corners, based on economic, political, social and management rational and on vested interests. Some of the important arguments against privatization are as follows:

1. The public sector has been developed with certain noble objectives and privatization means discarding them in one stroke.
2. Privatization will encourage concentration of economic power to the common detriment.
3. If privatization results in the substitution of the monopoly power of the public enterprises by the monopoly power of private enterprises it will be very dangerous. For example, the purchase of IPCL (Indian Petrochemical Corporation Ltd.) by Reliance, led to an almost total monopoly in some of the most critical inputs in the petroleum industry.
4. In case of privatization creating monopoly, the consumer may become the victims of the primary objective of the privatized companies of making profit rather than providing services, with all the possibility if lack of provision to the remote areas.
5. Privatization many a time results in the acquisition of national firms by foreign firms.
6. Privatization of profitable enterprises, including potentially profitable, means foregoing future streams of income for the government.
7. Privatization has/will weakened union power, influencing their bargaining power in the matters of package finalization, and thus will leave them unprotected from the possibility of dismissal and unemployment.
8. Firms in the Private sector are known for 'capital-intensive technology use', will further affect the state of unemployment in the country considerable, increasing the burden of the state towards those unemployed.
9. Privatization of strategic and vital sector is against national interests.
10. There are well managed and ill managed firms both in the public and private sectors. It is not the sector that matters, but the quality and commitment of the management.
11. Moreover, Private sector normally prefers to employ youngsters, thus, depriving the sector from the experience of the senior officials, as well as do not take initiative to protect their young personnel once they become aged.
12. The capital markets of developing countries are not developed enough for efficiently carrying out privatization.
13. Privatization in many instances is a half-hearted measures and therefore, it is not properly carried out, with the result that the expected results many be achieved.
14. In many instances, there are vested interests behind privatization and it amounts to deceiving the nation. The UNDP's report Human Development Report 1993 observes that in many countries privatization often has been a 'garage sale' to favored individuals and groups.

15.6 Sins and Pitfalls of Privatization

Privatization does not guarantee unconditional success. Privatization in many countries has been found to be often fraught with many sins and pitfalls. Dubious objectives, tainted privatization process, etc., may lead to failure of privatization.

The commonly observed flaws of privatization are the following:

1. Lack of proper strategy: An important reason for failure of privatization is absence of a proper

strategy or norms regarding the industries/ units to be privatized, the method of privatization, extent of divestment, selection of buyer/investor etc.

2. Ambiguity of Objectives: the real objective of privatization is another problem. Is it for raising revenue? Is it for making the enterprise competitive? If there are multiple objectives, what is the priority list?
3. Connivance: Sometimes politicians have hidden objective behind privatization. The UNDP Report cited above points out that in too many cases it has taken place for the wrong reason, under the wrong conditions and in the wrong way.
4. Wrong Timing: Many privatization schemes could not get a good price because of wrong timing. A good price can be obtained if privatization is done when the performance market capitalization and the industry prospects are good. It is pointed out the Marti could have got a good price had it been privatized when the goings were good.
5. Lack of Political Consensus: Privatization is a political process too. As there opposing views regarding privatization, there are likely to have some opposition to privatization. The privatization BALCO is a case in point. The government shall try to make clear the need and objectives of privatization and shall bring about as broad a consensus in possible.
6. Wrong Labour strategies: Most public enterprise has surplus labour, getting rid of which is essential for success of the enterprise. But, to overcome labour resistance to privatization often unrealistic promises are given that the labour will not be affected by privatization. A more open and realistic handling of the labour is needed for making privatization meaningful. Prospects of retraining and redeployment of the labour are yet to be properly explored in countries like India.
7. Union Power: One of the side effects of privatization is the large potential layoff of employees, in a bid to increase efficiency. The fear of massive lay-offs has led to strong demonstrations against privatization. There are instances of strikes organized by trade unions and political parties held across the country against the government's policy of liberalization and privatization.
8. Lack of Political Will: Privatization is not carried out in real earnest and properly because of lack of political will and or vested interests. For example, some ministers oppose privatizations of enterprises under their ministry and some politicians oppose privatization of undertakings in their Constituencies or States.
9. Poor Financial Strategies: Many privatizations are carried out with out a good financial strategy.
10. Wrong Environment: Mere transfer of ownership does not help improve the performance of an enterprise. Where the market functions poorly and enterprises are still vulnerable to arbitrary government edicts, transferring ownership to the private sector is unlikely to achieve much.
11. Prevalence of Monopoly Elements: If privatization result sin the conversion of a public sector monopoly to private sector monopoly, privatization may not produce much beneficial effects, it could even worsen the situation.
12. Corruption: privatization has been criticized stating that it has gone hand-in-hand with wide-spread corruption and insider dealings, particularly in cases of privatization through asset sales and vouchers. This is because asset sales are often not done in a non-transparent fashion, with poor publicity of any impending sale. The scope for discretionary behaviour is great and personal contacts can be a great advantage. Joseph Stiglitz once admitted that it was "difficult to prevent corruption and other problems in privatizing monopolies".
13. Problem of Cultural Change: Improvement of performance of an enterprise after the privatization will depend, inter alias, on bringing about a change in the work culture and the total enterprise culture. This is no easy task.

15.7 Conditions for Success of Privatization

Due to the production or provision of goods and services inefficiencies and in-effectiveness in the Public Sector Enterprises, Privatization of these enterprises was adopted as one of the alternative. Professor Samuel points out that to restore the effectiveness and efficiency of such units, by applying the alternative of Privatization can be successfully accomplished, with the existence of the following conducive conditions in this matter**:**

1. Privatization cannot be sustained unless the political leadership is committed to change or vowed to reverse the actions of its predecessors, as learnt from the success of Privatization implemented in the Chile and in the United Kingdom. Of the Governments facing severe economic crisis and massive budgetary deficits, some of them had turned to Privatization and Divestiture as a part of their Adjustment Strategy.
2. Privatization when implemented as a result of the shift in preferences of the public which has aroused out of dissatisfaction out of the performance of other alternatives will ensure success in the achievement of the objectives for which it has been adopted.
3. Freedom of entry of goods and services should be considered as an important criterion, while applying Privatization. Long term contract and franchises limits competition and consumers' choice. Moreover, freedom of entry is difficult to achieve for certain capital intensive services.
4. But, in the case of certain health services, the public can be better served by several competitive private suppliers as compared to that supplied by one agency monopolizing the market through a long-term contract.
5. Public services to be provided by the private sector must be specific or have measurable outcome. Physical construction or utility services, for example, can be measured, but most educational services and police protection cannot be easily quantified, even though their inputs can be measured. Lack of specificity makes it more difficult to control services provided by the private sector, especially, when the public served is illiterate, unorganized and unassertive. Service delivery by non-governmental organizational or local governments may be more appropriate under these conditions.
6. The consumers should be educated and relevant and timely information disseminated to the society, to enable them to link the benefits they receive from a service to the costs they pay for it. This will add essence of sensibility in their purchase and consumption of variety of services. Even, User charges can be levied in this matter.
7. Privately provided services should be less susceptible to fraud than government services it they are to be effective. Services provided through collective or co-operative action at the community level are probably the least susceptible to fraud.
8. Equity is an important consideration in the delivery of public services. Broadly speaking, the benefits of privatization can accrue to the capital owner who supplies the service; to the consumer, who receives a more efficient services; and to the public at larger, through a reduction in the public sector deficit, and hence in taxes or the rate of inflation, or both. Privatization will be counter-productive if the ability of the public to pay, determined by the prevailing income distribution, and becomes the sole guide for the delivery of services. And, if the benefits of privatization are likely to be reaped solely by local elites, expatriate groups, or multinational corporations, political resistance to reform is likely to increase.
9. Strong social institutions are needed to help those put out of jobs as a result of privatization.

Reforms in India have focused largely on the trade, fiscal and industrial problems. Little attention has been paid to developing institutions such a social welfare, education, health and so on.

Activity B:

1. Prepare a report and discuss the case on "Privatization of Airports and Airline Industry"

15.8 Disinvestment: Indian Scenario - Background

The state sector was built up in India after Independence because the government wanted to build socialism in India. Thus, the state took on the task on building the infrastructure and basic inputs. To ensure the demand for the products made in India did not dip, the state erected huge walls of protection around the Indian economy. Many sectors of the economy originally left to the stated sector can now be taken over by the private sector- it has the capacity to run them. The state can concentrate on jobs that the state alone can do, such as governance. This is the essential logic of privatization.

15.9 Privatization and Disinvestment

Privatization process leads to change in management with change in ownership. Change in management is not a necessary condition in the process of Disinvestment. Disinvestment refers to dilution of the stake of the government to a level where there is no change in control that results in the transfer of management.

15.10 Rationale for Disinvestment

Because of the current revenue expenditure on items such as interest payments, wages and salaries of government employee and subsidiaries, the government is left with hardly any surplus for capital expenditure on social and physical infrastructure. On the other hand, the government should be spending on basic education, primary health and family welfare. At the same time, huge amounts of resources are blocked in several non-strategic sectors.

Not only this, the continued existence of the PSUs is forcing the government to commit further resources for the sustenance of many non-viable units. To top it all, there is a huge amount of debt which needs to be serviced and reduced. This makes disinvestment of the government stake in the PSUs absolutely imperative.

The performance of the public sector was far from satisfactory. Diseconomies of scale crept into in the public sector. The nine high-performing public-sector enterprises (Navratnas) account for nearly 75 per cent of profits of all public sector enterprises. Most of the others are running in losses. The profitability and ROI of profit-making units too is very low compared to industry standards. Of the various factors responsible for low profits in public sector undertakings, the following are particularly important:

- Price Policy of public sector undertaking
- Under-utilization of capacity
- Problems related to planning and construction of projects
- Problems of labour, personnel and management
- Lack of autonomy

In order to alleviate to these problems the government decided to disinvest its stake in PSU.

Disinvestment connote reducing government stake in the public sector. Disinvestment involves the conversion of money claims or securities into money or cash. They may or may not lead to privatization, i.e., transfer of control in private hands. As in the case of Maruti Suzuki and BALCO, disinvestments led to the transfer of control into private hands, but the in case of public sector banks and most of the oil companies, disinvestments resulted in the issue of shares through the IPO route to general public and financial instititutions, and therefore majority of stake and control remained with the government.

The disinvestment programme was started in 1991-92. The total realization to the government from various rounds of disinvestments till 1998-99 was Rs. 16, 809 crores.

15.11 Objectives of Disinvestment

The following are the main objective of the disinvestment policy:

- To reduce the financial burden on government
- To improve public finances
- To introduce competition and market discipline
- To improve growth
- To encourage wider share of ownership
- To de-politicize essential services

Arun Shourie, former Disinvestment Minister, on December 9, 2002, stated the following objectives of Disinvestment:

- The main objective of disinvestment is to put national resources and assets to optimal use and in particular, to unleash the productive potential inherent in public sector enterprises.

The policy of disinvestment specifically aims at:

- Modernization and upgradation of public sector enterprises;
- Creation of new assets;
- Generating of Employment;
- Retiring of Public Debt;

The government would continue to ensure that disinvestment does not result in alienations of national assets, which, through the process of disinvestment, remain where they are. It will also ensure that disinvestment does not result in private monopolies.

In order to provide complete visibility to the government's continued commitment of utilization of disinvestment proceeds for social and infrastructure sectors, the government would set up a Disinvestment Proceeds Fund. This fund will be used for financing fresh employment opportunities and investment and for retirement of public debt.

15.12 Benefits of Disinvestment

The Benefits expected to be achieved through disinvestment are:

1) Disinvestment would expose the privatized companies to market discipline, Thereby forcing them to become more efficient and survive on their own financial strength. They would be able to be responding to market forces much faster and cater to their business needs in a more professional manner. It would also facilitate in freeing the PSUs form government control and introduction of corporate governance norms in the privatized companies.

2) Disinvestment would result in wider distribution of wealth through offering of shares of privatized companies to small investors and employees.
3) Disinvestment would result in wider distribution of wealth through offering of shared of privatized companies to small investors and employees.
4) Disinvestment would have a beneficial effect on the capital market. The increase in floating stock would give the market more depth and liquidity.
5) In many areas, e.g., the telecom and insurance sectors, the end of public sector monopoly would bring relief to consumers by way of more choices, and cheaper and better quality of products and services – as has already started happening.

15.13 Disinvestment Transactions and Realizations

Disinvestment transactions undertaken can be classified into five main categories:

(a) Transactions involving the sale of minority shareholding of the Government, Subject to the residual equity of the Government remaining at least 51 per cent.
(b) Sale of majority shareholding in one CPSE to another CPSE.
(c) Sale of a large block of shares in a CPSE (including subsidiary of a CPSE) along With transfer of management control to a strategic partner identified through process of competitive bidding. This was termed as strategic sale. After the strategic sale, the CPSE ceased to be a Government Company as defined in Section 617 of the Companies Act, 1956.
(d) Slump sale of 2 hotel units of HCI and other related transactions during 1999-00 to 2005-06.
(e) Sale of all or part of Government's residual shareholding in disinvested CPSEs/ companies either through a public offering or private placement – viz. CMC, IBP, IPCL, MUL and ICI.

15.14 Methods of Disinvestment in India

There are three methods adopted by the government for the valuation of shares for disinvestment, which are as explained below:

1. Net Asset Method: This will indicate the net asset of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It does not reflect position of profitability.
2. Profit earning capacity value method: the profit earning capacity is generally based on the profits actually earned or anticipated.
3. Discounted Cash Flow Method: In this method the future incremental cash flows are fore-casted and discounted into present value by applying cost of capital rate. The method indicated the intrinsic value of the firm.

15.15 Strategic and Non-Strategic Classification

On March 16, 1999, the government classified public sector enterprises into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the strategic public sector enterprises would be those in the areas of:

· Arm and ammunitions and the allied items of defense equipment, defense aircraft and warships;
· Atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radioisotopes to agriculture, medicine and non-strategic industries);
· Railway Transport;

All other public sector enterprises were to be considered non-strategic. For non-strategic enterprises it was decided that the reduction of government stake to 26% would not be automatic and the manner and pace of doing so would be worked out on a case-to-case basis. A decision in regard to the percentage of disinvestment, i.e., government stake going down to less than 51 per cent or to 26 per cent, would be taken on the following considerations:

- Whether the industrial sector requires the presence of the public sector as a countervailing force to prevent concentration of power in the private hands, and ;
- Whether the industrial sector requires a proper regulatory mechanism to protect the consumer interests before public sector enterprises are privatized.

15.16 Evolution of Disinvestment Policy of India

The policy of disinvestment has largely evolved through the policy statements of Finance Ministers in their Budget Speeches. The policy as evolved is enumerated below:

1. In the Interim budget 1991-92, it was announced that Government would divest upto 20% of its equity in selected PSU's in favour of mutual funds, financial and institutional investors in public sector.
2. In the budget speech of 1992-93, the cap of 20% was reinstated and the list of eligible investor was enlarged to include FII's, employees and OCB's.
3. In April, 1993, Rangrajan committee recommended to divest upto 49% of PSE's equity for industries explicitly reserved for the public sector and over 74% in other industries. But Government did not take any decision on recommendations.
4. In 1996, as per the Common Minimum Programme, the Budget Speech 1996-97 announced the setting up of Disinvestment Commission for 3 years. CMP also emphasized to add more transparency to disinvestment process and examine the non core areas of public sector.
5. In the Budget Speech of 1998-99, it was announced that Government shareholding in CPSEs should be brought down to 26% on case to case basis, excluding strategic CPSEs where Government would retain majority shareholding. The interest of workers is to be protected in all cases. For this purpose on 16th March, 1999, the Government classified the PSE's into strategic and non strategic areas.
6. In 1999-2000 Budget Speech it was announced that Government will continue to strengthen the strategic units and "privatizing" the non-strategic ones through gradual disinvestment or strategic sale and devise viable rehabilitation strategies for weak units.
7. The 2000-01 Budget Speech focused on restructure and revival of viable CPSEs; close down PSEs which cannot be revived; bring down Government shareholdings in non-strategic CPSEs to 26% or lower, if necessary; and protection of the interest of workers. The receipts from disinvestment will be used for social sectors, restructuring of CPSEs and for retirement of public debt.
8. The suo-motu statement 2002, specific aim was given to the disinvestment policy: modernization and upgradation of PSEs, creation of new assets, generation of employment and retiring of public debt.
9. In the Budget Speech for 2003-04, Government announced details regarding the setting up of Disinvestment Fund and Asset Management Company to hold, manage and dispose the residual holdings of Government.
10. In 2004 with the change in the Government, there was a change in the outlook of Disinvestment policy.

In May, 2004, Government adopted National Common Minimum Programme, which outlines the policy of Government with respect to Public sector. "The UPA Government pledged to devolve full managerial control and commercial autonomy to successful, profit-making companies operating in competitive environment; they won't be privatized 'Navratna' companies can raise resources from the capital market.

Efforts will be made to modernize and restructure sick Public sector companies. It favoured sale of small proportions of Government equity through IPO/FPO without changing the character of PSE's. In regard to this, it approved listing of unlisted profitable CPSE's subject to residual equity of the Government remaining at least 51% and Government retaining the control of management.

It also constituted the formation of 'National Investment Fund'. The proceeds from disinvestment of CPSE's will be channelized into NIF. 75% of annual income of NIF will be used to finance selected social sector schemes- education, health, employment and the rest 25% to meet the capital investment requirements of profitable and revivable CPSE's.

On 27th January, 2005 the Government, Approved in Principle:

a. listing of currently unlisted profitable CPSEs each with a Net Worth in excess of Rs.200 crores, through an Initial Public Offering (IPO), either in conjunction with a fresh equity issue by the CPSE concerned or independently by the Government, on a case by case basis, subject to the residual equity of the Government remaining at least 51 per cent and the Government retaining management control of the CPSE.

b. the sale of minority shareholding of the Government in listed, profitable CPSEs either in conjunction with a Public Issue of fresh equity by the CPSE concerned or independently by the Government subject to the residual equity of the Government remaining at least 51 per cent and the Government retaining management control of the CPSE; and

c. Constitution of a "National Investment Fund": On 25th November, 2005, Government decided, in principle, to list large, profitable CPSEs on domestic stock exchanges and to selectively sell small portions of equity in listed, profitable CPSEs (other than the Navratna).

15.17 Current Policy on Disinvestment

The policy on disinvestment has been articulated in paragraph 34 of President's Address to Joint Session of Parliament on 4th June, 2009 and reads as under:

"Our fellow citizens have every right to own part of the shares of public sector companies while the Government retains majority shareholding and control. My Government will develop a roadmap for listing and people-ownership of public sector undertakings while ensuring that Government equity does not fall below 51 %."

The above policy was reaffirmed by the Finance Minister in paragraph 37 of his Budget Speech on 6th July, 2009. Paragraph 37 of FM's Budget Speech reads as:

"The Public Sector Undertakings are the wealth of the nation, and part of this wealth should rest in the hands of the people. While retaining at least 51 per cent Government equity in our enterprises, I propose to encourage people's participation in our disinvestment programme. Here, I must state clearly that public sector enterprises such as banks and insurance companies will remain in the public sector and will be given all support, including capital infusion, to grow and remain competitive.

The Government, on 5th November 2009 has Approved the Following Action Plan for Disinvesting Government Equity in Profit Making CPSEs:

i) Already listed profitable CPSUs, not meeting the mandatory public shareholding of 10%, are to be made compliant;

ii) All CPSUs having positive net worth, no accumulated losses and having earned net profit for the three preceding consecutive years are to be listed through Public Offerings, out of Government shareholding or issue of Fresh Equity by the company or a combination of both; and

iii) The proceeds from disinvestment would be channelized into National Investment Fund and during April, 2009 to March, 2012 would be available in full for meeting the capital expenditure requirements of selected social sector programmes decided by the Planning Commission / Department of Expenditure. The status quo ante will be restored from April, 2012.

Activity C:

1. Visit the site of Disinvestment Commission, and review the types of Disinvestments made till date by Government of India.

15.18 Disinvestment Procedure

From 1991-92, when it started and till 1996-97, disinvestment was handled by the Department of Public Enterprises (Ministry of Heavy Industries) and subsequently, from 1st April, 1997 till 9th December, 1999, by the Department of Economic Affairs (Ministry of Finance). The Department of Disinvestment (DoD) was set up as a separate department on 10th December, 1999 and was subsequently renamed as Ministry of Disinvestment (MODI) from 6th September, 2001. From 27th May, 2004, the Department of Disinvestment is one of the Departments under the Ministry of Finance.

The procedures followed for disinvestment have evolved over a period of time. These were based on decision- making through inter- ministerial consultations and involvement of professionals and experts, in view of the technical and complex nature of transactions and the need for transparency and fair play. The decision making process, the bidding procedure and the methods used for valuation of equity of CPSE sold are described below for the different modes of sales. The procedure for carrying out the disinvestment, according to the rules laid down by the Govt. of India, is as follows:

Proposals for disinvestment in any PSU are placed for consideration of the Cabinet Committee on Disinvestment (CCD). An Advisor is appointed to invite Expressions of interest (EOI) from parties. The prospective bidders undertake due diligence of the PSU. Concurrently, the task of valuation of the PSU is undertaken. There are four methods used to arrive at the reserve price of a PSU. These are discounter cash flow method, balance sheet method and asset valuation method. The share purchase agreement and shareholders' agreement are sent to the prospective bidders for inviting the final binding bids (Technical and Financial). The bids received are place before the CCD for the final approval. The CCD then approves the final buyer. After the transaction is completed, all papers and documents relating to it are turned over to the Controller and Auditor General of India (CAG), to enable the CAG to undertake an evaluation of the disinvestment, for placing it in Parliament and releasing it to the public.

15.19 Disinvestment Commission

In pursuance of the Common Minimum Programme of the United Front, Government of India constituted a Public Sector Disinvestment Commission on 23rd August 1996, with the following broad terms of reference:

1. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
2. To determine the extent of disinvestment (total/partial) indicating percentage) in each of the PSU.
3. To prioritize the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
4. To recommend the preferred mode(s) of disinvestment (domestic capital market/international markets/ auction/private sale to identified investor/any other) for each of the identified PSUs. Also, to suggest an appropriate mix of the various alternatives taking into account the market conditions.
5. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
6. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.
7. To select the financial advisers for the specified PSUs to facilitate the disinvestment process
8. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
9. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
10. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
11. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and
12. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required so as to ensure enhanced realization through disinvestment.

The Disinvestment Commission is an advisory body and its role and function would be to advise the Government on Disinvestment in those public sector units that are referred to it by the Government. The Commission shall also advise the Government on any other matter relating to disinvestment as may be specifically referred to it by the Government, and also carry out any other activities relating to disinvestment as may be assigned to it by the Government. In making its recommendations, the Commission is also required to take into consideration the interests of workers, employees and other stake holders, in the public sector unit(s). The final decision on the recommendation of the Disinvestment Commission vests with the Government.

The Commission has recommended disinvestment at varying levels for a number of PSUs., for example- GAIL, MTNL, CONCOR, PHL, ET&T, HVOC, HCIL, RICIL, R-Ashok and U-Ashok and NALCO

Strategic sales in various proportions have been recommended for many enterprises, like BALCO, HTL, KIOTC, ITDC, BRPL, MFL, HCL, SCI, EIL, EPIL, HPL, IBP, NEPA, HZL, PPCL, FACT, HLL, NFL and SAIL.

For several enterprises, namely, ONGC, MOIL, OIL, RITES, PGCL NTPC, NLC and NHPC, the commission has advocated no disinvestment for the present.

Activity D:

1. Visit the site of Disinvestment Commission, reviewing the structure of the disinvestment commission and the procedure of disinvestment, perform a role play.

15.19.1 Disinvestment from Public sector in India

Table 15.1
Disinvestment from Public Sector
(1991-92 to 2009-2010)

Year	Number of companies in which equity sold	Target Receipt for the year	Actual Receipts
1991-92	43 (31 in one tranche & 16 in other) 35 (in 3 tranches)	2,500	3,038
1992-93		2,500	1,913
1993-94	13	3,500	Nil
1994-95	5	4,000	4,843
1995-96	1	7,000	862
1996-97	1	5,000	380
1997-98	1	4,800	902
1998-99	2	5,000	5,371
1999-00	4	10,000	1,829
2000-01	10	10,000	1,870
2001-02	6	12,000	5,632#
2002-03	-	12,000	3,348
2003-04	-	14,5000	15,547
2004-05	-	4,000	2,765
2005-06	-	-	1,570
2006-07	-	3,8040	534
2007-08	-	41651	38,793
2008-09		10165	2,567
2009-10		1120	-

15.20 Disinvestment Proposals Under Implementation During 2009-2010

i) **NTPC Limited:-** Government on 19th October 2009, approved disinvestment of 5% equity of the company out of Government shareholding through Public Offering in the domestic market. This issue was closed on 5th February 2010.

ii) **SJVN Limited (Satluj Jal Vidyut Nigam Limited)** - Government on 19th October 2009 approved disinvestment of 10% equity of the company out of Government Shareholding through Public Offering in the domestic market.

iii) **Rural Electrification Corporation Limited (REC)** - Government on 29th October 2009, approved disinvestment of 5% equity of the company out of Government shareholding in conjunction with the, issue of fresh equity of 15% by the company. This issue was closed on 23rd February 2010.

iv) **NMDC Limited** - Government on 3rd December 2009, approved disinvestment of 8.38% paid up equity of NMDC Ltd. out of Government shareholding through Public offering in domestic market.

15.21 Summary

Privatization is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. Privatization can take three forms, i.e., Ownership Measures, Organizational Measures and Operational Measures. The New Industrial Policy has reduced the number of industries reserved for the public sector from 17 to 8 (further reduced to 4 and then to 2) and the introduction of selective competition in the reserved area. In 1991 public sector units have also been brought within the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR). The concept of MOU is to reduce the quantity of control and increase the quality of accountability.

The disinvestment programmes started in 1991-92 connote reducing the government stake in the public sector. Disinvestment may or may not lead to privatization, i.e., transfer of control in private hands. The government may only dilute its equity and raise resources to meet the social needs of the people. For the Navratnas PSUs, the government followed the policy of giving them more autonomy and increased their productivity through restructuring. The National Common Minimum Programme of the new government contains clear policy guidelines regarding disinvestment in PSEs. But it does not have a liberal policy regarding disinvestments.

15.22 Self Assessment Questions

1. What is Privatization? Discuss the various forms of Privatization.
2. What are the positive and negative consequences of Privatization?
3. Discuss the conditions for the success of Privatization/
4. 'Private Sector is preferable to Public Sector'. Yes/No. Justify.
5. What is Disinvestment? What is the difference between privatization and Disinvestment? What are the objectives of disinvestment?
6. Discuss various methods of Disinvestment
7. Write a short note on Disinvestment Commission
8. Discuss in detail evolution of disinvestment policy of India.
9. Profit-making PSUs should not be disinvested? Discuss the Statement.
10. Discuss the procedure of Disinvestment in detail.
11. Discuss the policy of the present government regarding disinvestment.
12. What are the problems with privatization in India?

15.23 Reference Books

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Unit - 16 International Business Environment

Structure of Unit:

16.0 Objectives

After completing this unit, you will be able to:

- To Understand the concept of the international business and international business environment;
- To explore the components of international business environment;
- To get insight on the economic environment and the economic indicators, influencing the economic environment;
- To Explore the demographic environment of the countries of the world and its overall impact on the international business;
- To understand the concept of culture and cultural adaptation and how it affects the international business environment around the globe;

- To explore the various elements forming culture of any society;
- To explore how the political environment of the world affects the international business;
- To understand various kinds of Government and the way countries are being ruled and Governed internationally;
- To analyze the political risks involved in the international business;
- To know how a firm can assess vulnerability to political environment across the world and take preventive measures to avert it;
- To understand how the legal system of the world affect the international business;
- To conceptualize the basics to understand the international technological environment and diffusion of the technological innovations;
- To understand the international business, in terms of the trading blocs, regions and international organizations;
- To explore and understand various other global issues, on the international business.

16.1 Introduction to the International Business Environment

The "Business Environment" refers to the external environment, with which it interacts and transacts, which further determines success or failure of a business. It refers to the factors outside the firm, influencing the scope and direction of the business activities by imposing several constraints as well as offering innumerable opportunities, having very little control over its environment. The most important external environmental factors are economic, demographic, political, legal, technological, socio-cultural and political factors. The basic job of any business enterprise, operating domestically or internationally, is to identify these environments, and formulate the policies accordingly. International business refers to all those business activities which involves cross border transactions of goods, services, resources between two or more nations. Transaction of economic resources include capital, skills, people etc. for international production of physical goods and services such as finance, banking, insurance, construction etc.

There are 195 countries in the world, each offering an independent yet interdependent market to manufacturers, service providers and knowledge- and skill based marketing operators. The world economy is opening up which imposes competition on the domestic markets not only from within but even from all remote corners of the world, by the very steep and high standards of the multinational and transnational firms. Peter F. Drucker describes this situation in "Management Challenges of 21st century", wherein he states "No institution whether a business, a university, or hospital can hope to survive let alone to succeed unless it measures up to the standards setup by leaders in its field any place in the world".

The Indian economy witnessed this when leading multinationals and mega-billion dollar corporations like Samsung, LG, Panasonic, Whirlpool, Bridgestone and other automobile manufacturers like Hyundai, General motors, Toyota, etc. Goods imported from China have been responsible for the closure of many small-scale manufacturers in the dry cell battery, kitchenware, cosmetics and toy industries.

Foreign trade has become the mainstay of many emerging economies and bolstered their GDP growth. Indian manufacturers too, have geared up in the process of internationalization. The pharmaceuticals industry witnessed a manifold increase in its production levels ever since companies like Ranbaxy led the industry in setting up their plants abroad. Today, many Indian manufacturers are adopting the strategy of offering counter competition to multinationals in various markets. The 1990s and the new millennium is witnessing rapid internationalization and globalization, as it is passing at dramatic pace through a transition period.

16.2 Reasons for/Motives of Internationalization

Many companies have established a strong global presence, by their world wide functions, generating major share of the revenue, thereby transforming into a multinational company. There are several answers to the question 'why firms go international?' The factors which motivate or provoke the business enterprises to go international may be broadly classified into, the pull and push factors. The pull factors, generally are the proactive reasons, are the forces of attraction to the foreign markets and the push factors are the reactive reasons, as discussed below:

Important reasons for going international are described below:

a. **Reducing the Cost of Production:** Business enterprises many times in order to take advantage of the cheap labour, optimum utilization of the capacity installed for business operations, specialization of the production parts and such others, contributing positively to reduce the cost of production to the firm, the business enterprise may opt to enter in to the international markets by appropriate means of entry, in the prospective markets. The figure below depicts the advantage of one of the aforementioned reasons:

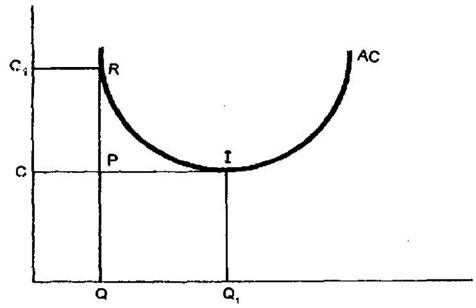


Fig. 1.1: Impact of exports on average unit cost.

The technological advances have increased the size of the optimum scale of operation substantially in many industries making it necessary to have foreign market, in addition to the domestic market, to take advantage of the scale economies. Domestic business units have installed the machineries with sound-advanced technology, having the optimum capacity of production of Q_1 units at cost C. But, as per the domestic market demand, the business enterprise utilizes the efficiency of the machine only to produce Q units, resulting into underutilization of the efficiency installed, increasing the cost of production per unit, and total cost at C_1. But, as mentioned, in case the firm produces the Q_1 units, reducing the cost of production, only for domestic market, the remaining produces will not find the market, unless it is sold in the foreign markets.

Thus, the domestic firms select to enter into the foreign market. It is the thrust given to exports that enabled certain countries like South Korea to set up economic size plants.

b. **Growth Opportunities:** The enormous growth potential of many foreign markets, with the increasing rate of economic growth and development, are worth becoming centre of attraction for foreign companies. The demographic trends complementing economic trends, offer prospective markets for various products and services, in developing countries. For instance, the newly industrializing countries (NICs) and the Peoples' Republic of China in particular, have been growing much faster than even the developed countries.

c. **Domestic Market Constraints:** Domestic demand constraints, compels many companies expand their markets internationally, to survive. In most of the advanced countries of the world the markets for number of products are getting saturated or declining. In the United States, for instance, the stock of several consumer durables like cars, TV sets etc. exceed the total number of households. Estimates are that in the first quarter of the 21st century, while the population in some of the advanced economies would saturate or would grow very negligibly, in some others there would be a decline, having very adverse effects on certain lines of business.

d. **Competition:** A protected market does not normally motivate companies to seek business outside the home market. Until the liberalizations which started in July 1991, the Indian economy was a highly protected market, not only in terms of the protection of domestic players from foreign competition but also domestic competition was restricted by several policy induced entry barriers by imposing the measures like industrial licensing and the MRTP regulations. The economic liberalization ushered in India since 1991, has increased competition from foreign firms as well as changed the scene within the country.

e. **Government Policies and Regulations:** Government policies and regulations also motivate internationalization. Many governments give a number of incentives and other positive support to domestic companies to export and to invest in foreign countries while other gives lot of importance to import development and foreign investment. Some companies also move to foreign countries because of certain regulations, like the environmental laws in advanced countries. Government policies which limit the scope of business in the home country may also provoke companies to move to other countries.

f. **Monopoly Power**: Monopoly power may arise from the factors, such as, monopolization of certain resources, patent rights, technological advantage, product differentiation, etc.

g. **Spin-off Benefits:** International business has certain spin-off benefits too. International business may help the company to improve its domestic business; international business helps improve the image of the company. Further, the foreign exchange earnings may enable a company to import capital goods, technology, etc. which may not otherwise be possible in countries like India.

h. **Strategic Vision:** The systematic and growing internationalization of many companies is essentially a part of their business policy or strategic management. The ignition-fuel for internationalization comes from the urge to grow, the need to become more competitive, the need to diversify and to gain strategic advantages of internationalization. Many companies in India, like several pharmaceutical firms, have realized that a major part of their future growth will be in the foreign markets.

16.3 Trends in the World Trade and Economic Growth

The international trading system, has, for long time, continued to suffer from gross inequalities and imbalances among the different strata's of economies. The global economic environment characterized by intermittent recessions during the last two decades, has further widened the disparities in the world trading system.

Mounting debt burdens, balance of payment (BoP) problems and deteriorating terms of trade of developing countries, formation of powerful, economic trade blocs, rollback from multilateralism, growing protectionism, and restricted market access in the developed countries are a few manifestations of the unjust international commercial order. These negative features constitute a mammoth destabilizing force, and their alarming dimensions threaten the collapse of a multilateral economic cooperation. Notwithstanding these constraints and limitations, a large number of developing countries have started opening up their economies, exposing them to international competition, in their efforts to integrate with the global economy. The developing countries, whose share in the international business today is very low, are expected to play a greater role in the future.

However, the projections are that in the next decade, the developing countries will increase their share in the world income and trade. In fact, their GDP and exports have grown faster than those of the developed countries for some time now. According to a World Bank (WB) Staff Report, during 1995-04 the real GDP of the world has grown at an annual rate of 2.8 per cent, for the high-income economies, and 4.9 per cent, for the developing economies. During the year 2005-2008, the high-income economies had grown more than 2.8 per cent and developing economies more than 6 per cent. Although the estimated average annual rate for the developing countries is nearly 5 per cent, East Asia and South Asia in the developing world would grow at an annual rate of 7.7 per cent and 5.4 per cent, respectively, but the performance of Sub Saharan Africa, North Africa, the Middle East, and several countries of the former Soviet Union may be very poor. The fall in global output during the year 2009 (—2.3 per cent) was the first of its kind since the Great Depression in the 1920s and 30s, prompting strong fiscal and monetary policy responses from governments around the world, has brought the downward spiral in the world economy. However, after the sharpest decline in more than 70 years, world trade and output are currently in a recovery phase, and have set to rebound in the year 2010. The world exports in volume terms are estimated to grow by 9.5 per cent in the year 2010, with developed economies' exports by 7.5 per cent and of about 11 per cent growth of the developing economies and the Commonwealth of Independent States, although inadequate.

16.4 International Economic Environment

Business organizations are the economic units of operation. Economic environment of the country is very imperative for the business organizations as well non-business organizations, as the measurement of the organizational performance is in the form of financial terms. The economic environment offers the various resources, in the form of economic factors. Thus, International economic environment consists of all those factors which give shape and form to the development of economic activities and may include factors like nature of economic system, general economic conditions, various economic policies, and various production factors as discussed below in detail:

Economic System: The extent to which the organizations have to face different constraints and controls imposed by the economic factors is determined by the economic system of the country. Economies of countries can be classified based on parameters such as ownership of means of production and levels of economic development. Based on the ownership of the means of production, economies can be classified into capitalist economy, socialist economy, and mixed economy.

National Income and its Distribution: The money value of economic activities of a country during a particular period, normally one year is defined as the National income of the country, which determines the purchasing power of people thereby the demand for various products and services. The World Bank relies on income levels to classify countries into these two categories. GDP is the value of the total final output of all goods and services produced in a single year within a country's boundaries.

The countries of the world are classified in three categories on the basis of gross national income (GNI) per capita. Low-income countries include those with the GNI per capita US $ 975 or less in the year 2008, Middle-income countries with GNI per capita at US $ 976 to US $ 11,905 and High-income countries includes those countries with GNI per capita at US $ 11,906 or more. A further division at GNI per capita US $ 3,855 is also made between lower-middle-income and upper-middle-income economies, as per the World Development Report 2009.

Economic Policies and Trade Policies: Various policies framed by the government, determines the resource utilization capability of a business enterprise, affecting the business units' production and revenue efficiencies, as whole influencing the success of economic development of the country. Therefore, the international business enterprise, while internationalization process have also to screen various economic and trade policies of various countries, thereafter, may opt to operate in the particular country. In India, for instance, the Monetary policy regulates the economic growth through the expansion or contraction of money supply and Fiscal policy deals with the tax structure and governmental expenditure, affecting the operations of the business enterprise, domestic as well as international, along with the other units. The announcements of the RTAs (Regional Trade Agreements), FTAs (Free Trade Areas), SEZs (Special Economic Zones), EXIM policy, rules and regulations under FERA and FEMA ACT, etc., Economic Agreements and other Trading Groups, Export Promotion Schemes, EPCG Schemes, by the government of India, from time to time., are the base of forecasting the operations and the probability of success of the large number of international players.

Economic Conditions: Also the economic conditions in terms of the inflation or deflation; Boom or Depression; Compositions of the major economic sectors, namely, Industrial; Agriculture and Services; Money supply in the Market; Balance of Payment; Foreign Exchange Reserves; State of Deficit Financing; the flows of the Imports and Exports; Trade relations with the other countries; the state of the funds availed from domestic and international financial institutions, etc, prevailing in the country influences the favourability of the economic environment of the country to the international business players.

Natural Resources and Natural Climatic Conditions: The availability of natural resources and favourable climatic conditions, like., land, minerals, fuel, vegetation, water, wind and wind velocity, atmospheric pressure, sun light, etc. form an integral part of the strategic planning for the business organizations, as, generally, locational patterns of the units are decided on the basis of availability of these factors.

Infrastructural Facilities. Infrastructure provides the various supporting elements for the efficient functioning of the organizations. These may include transportation, communication, banking services, financial services, insurance, and so on.

Moreover, the optimum utilization of the various economic factors as discussed above, is reflected in the trends of the financial and capital markets of the country, and the economic development, as a whole of the country. Thus, for understanding and analyzing the international economic environment, to the business enterprise intending to enter in a particular business sector, following questions are basic:

1. Does the economic system entry in the business sector identified?
2. What is the stage of economic growth and what is the rate of growth?
3. What is the level of income-national and per capita?
4. What are the incidents of taxes, both direct and indirect, in general and on specific products?

What are the infrastructural facilities available and the bottlenecks?

1. Are critical raw materials and components available and at what costs?
2. What are the sources of financial resources and what are their costs?
3. Is adequate manpower-managerial, technical and workers-available and what are their salary and wage structure? What is the level of their productivity?

Activity A:

1. Refer the World Development Report 2010, and review the trends of the various indicators of the economic growth of the countries and region of the world.

16.5 International Demographic Environment

Demographic refers to the statistical socio-economic characteristics or variables of a population, such as age, sex, race, education level, income level, marital status, occupation, disabilities, religion, birth rate, death rate, average size of a family, average age at marriage, etc. A census is a collection of the demographic factors associated with every member of a population. It refers to the characteristics of a human population as used in government, marketing or opinion research, or the demographic profiles used in such research. Distributions of values within a demographic variable, and across households, are both of interest, as well as trends over time. Demographics are frequently used in economic and marketing research. Demographic environment refers to that consists of above variables.

Different countries differ in their composition of the various demographic factors, thus, offering business opportunities, differently. For any business player, reviewing the present, estimating and forecasting the future trend of these different demographic factors is the primary exercise. For the business enterprise, with international orientation, it becomes all the more, very crucial, which also guide the international player in terms of which market company will select to enter; how many markets company will select to operate; types of operations the international player will install in the various markets, and many such basic questions of doing the international business. Thus, the study of demographic environment for the international business players becomes inevitable. As per the estimates, the world population growth is anticipated to entirely concentrate in the world's poorer countries. In 2009, world population stood at 6.8 billion, up about 83 million from 2008. The world total is likely to reach 7 billion in the latter half of 2011, with the bulk of growth in the world's poorest nations. The less developed countries of Africa, Asia, and Latin America and the Caribbean are projected to increase by just under 50 percent in the 41 years between now and 2050, and the poorest of these are projected to double in population size over that period. But this scenario assumes that fertility in less developed countries will decline smoothly to the low levels observed in today's more developed countries: about 1.8 children per woman. For fertility to fall to those low levels, many factors are key, including significant increased in the use of family planning in many less developed countries.

Moreover, as per the estimates, the world's youth population, between the age 15 to 24 years, is expected to become concentrated in the countries of Africa and Asia. During the year 2050, the number of youths in the world is expected to rise to 1.2 billion, with about 9 out of 10 youths from developing countries, at the working age, demanding for gainful employment, adequate health care facilities and the ability to raise a family with an appropriate living standard, as choose for. Before those things can come about, they must have had access to sufficient education and training so that they can take part in building their country's society and economy. Most likely, tomorrow's youth will have moved to cities in larger numbers as opportunities in the rural areas diminish. The obvious question here, is whether the developing countries with the prevailing economic conditions will be able to generate the avenues for meeting the expectations of the rising population, and the future youth segment of the country. But will the economic conditions of their country be able to meet their rising expectations?

16.6 International Political Environment: An Introduction

No business, whether at home or abroad, can be set up without assessing the ramification of the prevailing political environment. Political environment of the country, consists of the political parties, the political systems, the economic policies framed by the ruling parties, the ideologies of both, the ruling parties and the opposition parties, the philosophies of doing business, as propagated and promoted by the political rulers of the country, reflected in the business and trade policies formulated, does affect the present and future of the players in the concerned trade, be it international or domestic business enterprises. To illustrate, international companies, namely, Coca-Cola and Pepsi faced, out of the blue, the effects of the political compulsions imposed by many state governments in the recent past in India, compelling the companies to ban their products in those states. Even in the history of the Indian politics, IBM and Coke also opted to move out of India in the early 1970s, when the ruling party during that period decided to oppose the multinationals operating in India. While in other countries, like, Rwanda, Uganda, Burundi and Bosnia, the effects of political pressures are worse, with the companies not only losing their business and markets but also have suffered loot and plundered of assets.

Multinational firms' as well as the domestic companies operations' are screened and subject to the representations from various parties, influencing enjoying political powers, directly or indirectly, such as leaders, environmentalists, non-governmental organizations and social activists. Therefore, the business enterprises also make deliberate efforts to stay in the good books of the opponents, acquiring the fore-most position among their favorites, which demand from the international/domestic firms to harbor and harness the political bosses and the influential parties in initiating new rule and regulations as well as amendments in the existing rules. To exemplify, when Pepsi and Coca Cola faced public rage through the disclosures by an activist of non-governmental organization in India about heavy doses of pesticides in their respective soft drinks, but as a result of the companies' strategy of catering to the few social activists lobbyists and political influencers the, it was successful in keeping aside the issue for a certain period and extracting a statement favour of the soft drink giants, from the Central Government representatives in the Parliament. Multinational companies face multi-political systems all over the world. The understanding of the political environment and various political factors influencing the political environment should be explored and analyzed by enterprises, irrespective of whether operating in the domestic or international environment.

16.7 Types of Government and Political Economic Systems

The constitutional (or unconstitutional/arbitrary) authority can be measured for any country on two dimensions discussed below. The first dimension is the degree to which they give importance to collectivism. The second dimension looks at their being democratic or totalitarian.

1. **Collectivism vs. Individualism:** From the political context, the term collectivism refers to a political system that stresses the primacy of the collective goal over individual goals and the needs. Aristotle, the Greek philosopher (384-322BC), had advanced the theory of Individualism, "that private ownership for society good is desirable". East India Company, discovery of America and the Portuguese traders' discovery of India were each the outcome of private and individual efforts to seek new pastures of trade around the global. The recent economic wave of opening up of

economies, is transforming these economies gradually into individualism, as countries become industrialized and individuals express their own identity".

2. **Socialism:** Traces of socialism can also be seen in Plato's philosophy. The Greek philosopher had argued in The Republic that "individual rights should be sacrificed for the good of the majority and that property should be owned in common".

   In the modern context, socialism has been advocated by Karl Marx, who propagated the view that "few benefit at the expense of many in a capitalist society, where individual freedoms are not restricted. Socialism, thus, is a system that advocates government ownership and control of industry considered critical to the welfare of the nation". Social democracy reached at the peak in the countries where social democratic parties have been ruling from a long period. However, the trend has been reversed in many of the nations by the late 1970s and early 1980s, emerging new breed of political parties in Great Britain and Germany, favouring free-market economy.

3. **Democracy**: In democratic states, the government is elected by the people and is administered and run by the representatives of the people or by the people themselves directly, as per the law enshrined in the constitution of the country. A true democracy will have a multi-party system. The typical protective and safety measurements guaranteed by the constitution, to be kept in mind by an international business person are as follows:

- A free media;
- Regular and periodical elections in which all eligible citizens are allowed to vote;
- Universal adult suffrage;
- Limited and fixed term for elected representatives;
- Fair-judicial system, which is independent of executive;
- Non-political state bureaucracy;
- Non-political law enforcement agencies and armed forces;
- Free access to information related to the government (for example, Right to the Information Act in India).

4. **Totalitarianism:** In totalitarian country, whether based on one philosophy, one tribe or one political party, denies its citizens all those guarantees on which democratic nations thrive and repressive measures are used to keep the citizens in check from revolting or expressing their opinion against those in power. There are three types of Totalitarianism, namely, Religious Totalitarianism, Tribal Totalitarianism and Right Wing Totalitarianism. The states where religion sanctions the power of the state through a single party, individual or group, which flows through the laws established by the majority religion of the land and day-to-day life is also governed by religious fundamentals, like, Islamic states of Pakistan, Iran and Saudi Arabia. Tribal Totalitarianism is the most repressive form, based on one tribe rule, irrespective of the fact whether the majority is with them or not, and thus, rule over, like in African countries of Zimbabwe, Tanzania, Uganda and Kenya. Right Wing Totalitarianism occurs when political freedom of the people is curtailed even though economic freedom is allowed. The rulers of fascist Germany, Italy, South Korea, Taiwan and Philippines, have all been governed by right-wing extremism through military dictatorship before they became truly democratic.

16.8 Political Risks in International Business: Indicators

Political Risk refers to, "the likelihood that political forces will cause drastic changes in a country's business environment, which may adversely affect the profit and other goals of a particular business enterprise". When an international firm crosses its home country borders, it exposes itself to many perceived, well assessed risks as well as unimagined, unknown risks of political ideologies, political loyalties and political affiliations of different countries, governments, tribes and authorities. International firms do get advance signals and can smell and sense the beginning of such risks but once the resources have been committed, it gets too late to pull out of their business.

Indicators of Political Risks:

The firm's public relations activities, business monitoring executives and liaisons agents handling dealing with host governments can predict if a country is getting too risky, simply, by keeping track of business reports in financial periodicals and newspapers published locally as well as abroad such as The Economist and Currency - Indicators, which can impending fall of economies. Besides, the firms can regularly monitor following elements of different countries to keep an eye on business activities and environmental changes.

a. Economic Performance of a country: A firm can assess how the country has been meeting its commitments in servicing foreign debts, internal loans, maintaining hard currency and balance of payments system.

b. Political Stability: Political ideologies bring out the vulnerability of international firms. It is not possible for a firm to take sides with any political pole yet, many times, politicians, who were in opposition till yesterday, immediately take out their wrath on the previous government's policy. The consistency in the economic policies, in spite of the change in the ruling political parties is the interest of the business enterprises.

For example, In India, with the change in Narsimha Rao's government, the policy of opening the economy initiated by it was virtually continued by the subsequent government of Shri Atal Behari Vajpayee.

In fact, an international firm must undertake a complete study of political integrity of the country it wants to operate in, otherwise, will have to suffer the losses in their operations within such countries. In African countries, tribal and ethnics continue fighting against each other, providing unstable business environment to the international firms.

c. Spirit of Nationalism: The world is opening up. Each country wants to become a part of the global expansion of business and employment opportunities, brought by the international firms. The country has to provide and promote an atmosphere of global citizenship to all those expatriates who come and join the workforce but at the same time retaining its pride in cultural heritage and history. It is seen that wherever nationalism has been strongly voiced, along with the 'sons of the soil' theory, foreign business has always suffered, leading to MNCs deciding to stay out of the country. The countries that believe that foreign goods can cause local businesses to shut down, adopt many repressive and detrimental measures against foreign companies by way of tariff impositions, quantity restrictions and other such barriers.

16.9 Types of Political Risks in International Business

It is assumed that any calculated business risk is managed by most of the firms. But any risk that is not necessarily induced by unfair competition, laws of demand and supply, substitution of elasticity of demand or natural disasters, is a risk that is brought upon the firms by man-made frontiers too, generally in the form of political risks, as discussed below:

1. **Risks Related to the Government's Trade Policies:** There are many ways in which the government of the host country can prevent business expansion plans of a foreign company or even jeopardize its existing business activities. The government can impose exchange control, prevent repatriation of funds to another country, suddenly impose restrictions on imports by way of quotas, tariff barriers or stipulate export conditions in return on international firms. Trade barriers, such as sanctions, economic boycott and suspension of diplomatic relations, can also be imposed by the home country of the firm, forcing the firms to close business in the country.

2. **Risks Pertaining to Economic Policy:** Undoubtedly, the economic policies of a country frame the rules and regulations for the business enterprises operating in the country. The economies of scale of an international firms is more than that of the local players, and in order to protect these local players it may happen that the burden of the local taxes on the local players is lessened by indirectly raising the same on the international firms, or international firms may have to even face extreme measures.

The instance of nationalization of about 60 per cent of the British companies in the 1960s by Milton Oboe; in Uganda, that of throwing out the Asian companies after confiscation of their assets, taken by Idi Amin, are not unknown to the international business players. Similarly, Coke too faced such a situation in India in 1978, when the international firm had been asked to transfer 60 percent of its equity holding to Indians and declare the contents and formula of Coke. The Coke management preferred leaving Indian shores for good'. Following are some of such measures taken by the government:

a. Confiscation of International Firm's Assets: An international firm dreads the situation where its property, assets and business are forcibly taken over and confiscated by the host country government.

b. Expropriation of Firm's Assets: Many times in the interest of the local people and industry, government takes decision of sizing the firm's investments in the host country and offers a nominal compensation for the same, and the expropriated assets, thereby are managed by the public sector agencies as nationalized units. During the year 1959-1967, private companies (largely U.S. owned), were expropriated in Cuba, after the Cuban revolution of 1959, offering basic compensation, which was rejected by the United States.

c. Nationalization of Business Assets: When the governments for the cause of social benefits decides to move the property and assets of business from private hands to government-sponsored public sector undertakings or agencies, it is called as Nationalization. Such national interest is not challenged even in the international courts, as long as a valid reason and an adequate compensation is handed over by the country. In the interest of national benefits, countries have nationalized electricity generation and distribution, telecommunication systems defense-related productions, road transport, oil production and distribution, banking sector and means of other transports like the railways and airlines.

d. Domestication: Domestication refers to the host country insisting on the following:

i. Using locally manufactured raw material for manufacturing products of international firms. For example: When Suzuki joined hands with Maruti to manufacture cars in India, the 100 percent "Indianization" of the car over a period was the stipulated condition in the collaboration contract and developing Indian vendors to provide indigenous parts had been the major responsibility of Maruti officials in 1984-1986.

ii. Even the European community has a local content requirement of 45 percent for all foreign-owned manufacturing firms in Europe. Such a policy may be laid to adversely affect the efficiency of the operations of the international firms, by forcing them to adopt substandard indigenized products at uncompetitive rates, to accommodate local interests.

iii. Gradual transfer of ownership and management of international firms to local managers.

iv. Not permitting repatriation of funds and profits above a certain limit and insisting on profits being deployed back in the local industry. India had FERA operative in the country, which restricted foreign exchange transactions in the country. It is only now, under FEMA, under the New Exim Policy, that full convertibility has been allowed.

e. Diplomatic Severances and Political Sanctions: It refers to the announcements made by the political authorities of a country to end complete or partial trade, or business relations with the another country, with the step of withdrawing such contracts, if any, jeopardizing the operations of the international enterprises, and rendering them uncertain-dark future. Pakistan and India, have on many cocaine suspended diplomatic relations with each other, and incidents of calling back of their high commissioners, and at times, even have closed embassies, high commissions and consulates in each other's countries. Obviously, such conditions put the international firms, operating in either of the country in "uncertain fate-like" situation, where only some "magic-charm" can rescue this business players.

3. Risks Pertaining to Non-Governmental Organizations and Social Activists:

The non-governmental organizations (NGOs), act as protectors of public conscience and public morality but, many times, they become the major stumbling blocks for the development of trade and industry.

Issues such as child labour, rehabilitation of the affected parties either because of setting up the industrial unit or adoption of the new technology, environmental protection, women's emancipation, wildlife protection and prevention of cruelty to animals, save tress save paper, non-use of non-recyclable plastic, have been raised frequently by the social activists to protest against international firms setting up business in foreign countries. In India, KFC and McDonald's had to face violent protests when it was alleged that animal tallow was being used to cook their products. Pepsi, Coke and many other bottlers of mineral and pure water had to shut shops in many states, when pesticides were found in soft drinks and the issue of purified mineral water was raised by NGOs in India.

Any international business enterprises in order to safeguard their business prospects and favourable environmental conditions needs to explore and analyze the existence and unity of this NGOs', the power enjoyed by various non-governmental groups on the various political authorities, ideologies of the non-governmental organizations, as well as the public support available to the agitation and representation made by NGOs', against an issue.

4. Risk Pertaining to Religious, Political Terrorism and Extremisms Religious fundamentalists, international extremists groups and separatists groups, target international firms to extract ransom money by kidnapping their employees and expatriates. They also pose threats to installations, machinery and property. Besides the lure of money, it is also done to embarrass their own governments and the governments of the countries to which these firms belong, and satisfy their self-ego, guided by the selfish motives. Most of the times reflected in the terrorist attacks, which have been increasing in their frequency after the September 11, 2001 attack on the World Trade Center in New York City, the indirect message of victory of terrorists' power against the supreme power of the world, and the American firms, especially KFC, McDonald's and Pepsi, becoming major targets, after the initiation of action of America against Afghanistan and Iraq. In this digital era, Internet, and linking of the business operations through the same is the necessity, where the incidents of cyber crimes, like, terrorism on the Net Websites hackers, floating duplicate and unauthorized websites, sabotaging and attacking international business operations are common. Thus, with each country ready with the plans to implement cyber crime prevention laws, it is expected from the international agencies to coordinate and implement these plans successfully.

Activity B:

1. Review the political history and the current political scenario in the following countries and discuss its implications on the international business.

16.10 International Legal Environment: An Introduction

The legal environment of a country comprises of the rules, laws and the constitutional provisions which regulates the behavior of the citizens, residents of the country and business and other entities, along with the process by which countries enforce the laws and provides redressed systems to all for their grievances. The legal system of the country is of crucial importance to not only local business organizations but also to the international business firms, as it regulate business practices, define the manner in which business transactions are to be executed and set down the rights and duties and obligations that each party to business must adhere to.

The legal environment of the countries is constructed and framed by the political systems prevailing in those countries. The world is divided into many countries each with its own right of sovereignty and independency (political systems). The firm doing business with different countries have to compulsorily follow rules, regulations, trade laws, taxation laws and local contractual obligations.

16.11 Legal Frameworks

International business gets affected by three main legal frameworks when it spreads into multi-country operations:

(a) **International Laws:** International bodies, with mutual consent of different country memberships, set up and regulate their rules and regulations, common to every one, requiring each member country to abide by the same. Such international laws refer to the agreements, treaties, conventions, understandings (for example, WTO) and resolutions agreed between the countries on trade, protection of physical and intellectual property, visiting each other's territory and other issues in the political and economic sphere. The international law enforcement bodies authorized by all member signatories adopt the redressed procedures established by such agreements.

(b) **Host Country Laws:** International marketing firms have to be abided by the laws of the country in which they operate, which may not be similar to the laws as the company is subjected to in its country of origin.

(c) **Home Country Laws:** The laws and rules and regulations laid down by each government in its own country become the home country laws for all companies and businesses originating from that country, binding all originating companies all over the world. For example, even though Pepsi and Coke have operations in many countries, for them the laws of their home country, the United States, are as important, and some times more important, than those of the host country, even though they may be registered for their other country operations externally.

16.12 Legal Systems

The world over, countries ascribe to three main legal systems, i.e. Common Laws, Civil Laws and Theocratic Laws.

a. **Common Law:** Common Law is based on traditions, precedents and customs followed for centuries in a country. Tradition refers to a country's legal history, precedent to the legal cases and the decisions given by the courts of law in the country in the past and the manners and ways in which laws have been applied to specific situations historically by the courts of law. Common law has its roots in the English common law. Common law "seeks interpretation through the past decisions of the higher courts which interpret the same statutes established and customary principles of law to a similar set of facts".

b. **Civil Law:** It is also known as code law, based on a very detailed set of laws that are organized into codes, specifying the legal behavior. It has its roots in the Roman law and more than 80 countries of the world, including Germany, France, Japan, Russia, China follow this civil law system. The judicial courts rely upon the detailed written legal codes rather than interpretation of tradition, precedent and customs. The courts under this system do not have much flexibility, as compared to the courts of common law system.

c. **Theocratic Law:** Islamic law is not necessarily confined to moral behavior. Its practices are applied to commercial and business dealings too, which can definitely affect an international firm's dealings in any Islamic country. For example, women must not interact with strangers (men) applied to business relations. Such practices can affect the operations of a firm in Islamic countries.

16.13 Contract Law and Its Application in Different Legal Systems

While marketing their products and services internationally, business enterprises frequently enter into contracts and agreements with various allies, partners, franchisees and other service providers all over the globe, for collaborations, technical consultancies and distribution of their products and services. Hence, these firms need to look at all contracts minutely and sensitively. The approach to contract law is widely different in common law and code (civil) law.

Under the common law in many countries, a firm may have to spell out the details in the contract, with all contingencies, clauses and penalties, etc., specific for non-compliance and non-enforcement, even though the judges under the common law system have greater flexibility in interpreting the dispute to the contract in the light of circumstantial evidence and prevailing situations. It is important for the international players to draw up the contract and seek redressed according to the law followed in the country of operations.

Jurisdiction: In the case of any occurrence of contractual disputes, the redressal of that country whose legal provisions are applicable in the matter can be seeked, as well as considering which court's law provides quick redressed, i.e. international law, home country law or host country law, as specified in the contract should be followed. for example, a French firm entering into contract with Indian partner may specify all disputes arising out of this contract will be subject to Paris jurisdiction. In that case, the signatories may file suits in a court in Paris, or in case of legal complaint registered in a third country, laws applicable for settling such a dispute in Paris will be resorted.

However, in the absence of any such stipulation, the question which law will govern the dispute is on the bases of, (1) where the contract was entered into? (2) Where the contract has been executed?

16.14 International Dispute Settlement Processes

Litigation in common or civil courts can cause antagonism between the parties in dispute because both, the buyers and sellers, ill afford to earn a bad name for themselves for non-compliance of contracts. Hence, companies will usually try to reach an amicable settlement through informal processes, be it informal conciliation or arbitration by involving a (uninterested to the cause) third party.

1. **Mediation:** This is commonly known as conciliation, and helps maintain the future business ties in international trade too. It involves a third party that tries to settle the dispute. Such compromises can be referred to or quoted in any court of law, if any of the parties not agree to the solution, these are preferred by Chinese businessmen.

2. **Arbitration:** In order to enter arbitration for dispute settlement, companies may agree to appoint a third party as a referee, or an arbitrator, whose decision will be acceptable to both the parties. The arbitration process involves referring to either domestic country-specific arbitration rules or to the rules of any agency involved in the international arbitration process. The International Court of Arbitration, under the aegis of International Chamber of Commerce in Paris, is quite active in such dispute settlements. It has standardized the rules and procedures to administer arbitration, which have been adopted by a majority of the independent countries and their arbitration courts. Besides the chambers of commerce, a few other active arbitration commissions and councils are, Inter-American Commercial Arbitration Commission, The Canadian-American Commercial Arbitration Commission, London Court of Arbitration, etc.

16.15 Other Legal Issues

Various legal issues to be considered by an international business enterprise, are Property Rights, Anti-Corruption Laws, Protection of Intellectual Property Rights and Anti-Trust Laws, as explained in detail below:

A. Property Rights: Legally, the term property means a resource over which an individual or firm or a business holds a legal title. Resources do not refer only to a building, land, machinery, equipment, capital and minerals, but, it also refers to inventions, trademarks, brands, ideas and a firm's registered name, which are all covered under intellectual property. Each individual or firm's property rights are upheld in different countries under the legal systems they operate within. The definition and the protection that laws provide may not be enforced in many countries. Hence, an international firm should be well aware of the legal definition of private as well as public property rights in each country they want to do business with and the protection provision offered by the laws of the land.

Property rights may get violated in two ways, through private action and by public action,

1. **Private Action:** This refers to theft, piracy, blackmail, encroachments, fraud, etc., by individuals or groups of offenders, occurring in any part of the world, including the home country of the firm. The law of different countries punishing or penalizing such crimes is of the concerned to the international enterprises. The action may be swift and quick in the U.S., Germany and England and many other European countries.

2. **Public Action:** This refers to the situation where law makers themselves, their agents and representatives, bureaucrats and members of public bodies, local members of legislative assemblies indulge in law-breaking activities, such as extortion, confiscation of legal property of others, encroachment and other resources gobbling activities. This is done by dangling the threats of action, citing government rules and action to the firms or by indulging in heavy taxation, introducing ceiling laws, bringing in licensing procedures, redistribution of wealth to the have-nots, etc. This is also done by appropriating the firm's property into state ownership without compensation or handing over the property to another owner without compensating the earlier owner. Again corruption, nepotism and demanding gratification, bribes, undue favours seep into every society, be it a democratic country, monarchy or dictatorship - the White House, the Royal Dutch family, Japanese politicians, Indian leaders, bureaucrats, Pakistani government and army officers, police departments, revenue departments, of all countries. What matters for the international firm is to understand the stand law takes in the event a firm approaches it for redressed. In many countries corruption is treated illegal and public vigilance departments take or initiate action, whereas in many others it becomes a way of life and the loot continues.

B. Anti Corruption Laws: These laws are instituted by countries to prevent business organizations from 'using unethical means to wield undue influence over those who control the flow of business activities in the country. Such authorities as government officers, public servants, elected representatives and law makers, who can decide the fate of government contracts, business deals, and civil and military policies of the country are susceptible to many undue favors in the shape of gifts, share holdings, hard cash within and outside their country from the business community of the world. Their decisions can alter the competitive advantage, favoring a company over its business rivals. To prevent such a situation, anti-corruption laws modulate the code of conduct of public servants in international deals and also for business within the country. Any violation is strictly dealt with in many nations.

C. The Protection of Intellectual Property:

Intellectual Property: It refers to the property that is the product of intellectual activity, for example, computer software, a literary work, a music score, an industrial invention, or a chemical formula for a drug, a formula for any other chemical invention, etc. Ownership over these intellectual properties is established by patents, copyrights and trademarks.

A Patent grants the inventor of a new product or new process exclusive rights for a defined period for manufacture, use or sale of that invention. **Copyrights** are the exclusive legal rights of authors, composers, playwrights, artists and publishers to publish and distribute their works as they deem fit. **Trademarks** are the designs, names and brands often officially registered by which merchants, manufacturers and the producers designate and differentiate their works and products from others, e.g. Rexona, Rayban, Eu de cologne perfume, etc.

In the high technology knowledge economy of 21st century, intellectual property contributes huge economic values to business as knowledge can now be converted into digital form and can be copied and distributed at a very low cost all over the globe. It is the most vulnerable property of firm to protect, as duplicity and counterfeiting of products; misuse of popular brands; undue advantage from the popularity of internationally well-accepted products by adopting similar sounding phony names, etc., are some ways that violators of intellectual property adopt all over the world to make billions of dollars, and making unworthy billions of dollars spent on research, with such small leakage in the pipeline of inventions by the company. Hence, international firms need to be aware of the intellectual property laws and regulations adopted by countries all over the world, in addition to the international institutional protection systems available to the firm in case of violation in either the host country or even a country in which it does not have any operations but still the business gets affected due to such pilferages and violations.

Many countries have very rigorous laws in case of the offences while in many other the will to enforce such laws is missing. Such is the case with many countries out of a list of 164 signatories who have signed the Paris Convention for the Protection of Industrial Property, a landmark international agreement to protect intellectual property. China and Thailand have been the worst offenders recently in Asia. Pirated versions of computer software are freely available in China. Piracy and forging are quite widespread in all parts of the world in music and entertainment industry. The International Federation of Pornographic Industry claims that one-third of all CDs and cassettes around the globe were illegally produced and sold in the year 2002, costing the industry over US $4.6 billion in terms of revenue. As per the Business Software Alliance, a software industry association, in 2002 some 40 percent of all software applications used in the world are pirated. The worst region was Eastern Europe, where the piracy was as high as 71 per cent and in China 92 per cent. Trade Related Aspects of Intellectual Property Rights (TRIPS) Protection from the infringements of copyrights can be granted only by the respective countries if they are alert and diligent in dealing with cases of violations of individual rights. International firms too will have to be vigilant about the counterfeits, poor copies and duplicates of their products and brand marks being marketed by impostors all across the world and take up the necessary steps at the highest levels of their own governments and also the governments. Such lobbying will have to be managed at all international forums to ensure that their intellectual property rights are safeguarded. It is due to lobbying by many international firms that, for the first time, the world trade agreement included intellectual property rights within the ambit of The General Agreement on Trade and Tariff in 1994. Under the new arrangement, a fresh agreement has been signed by the member countries of WTO, wherein a council of the World Trade Organization is overseeing enforcement of much stricter regulations concerning intellectual property rights. This new agreement is known as Trade Related Aspects of Intellectual Property Rights or TRIPs. The regulations under TRIPS make it mandatory for WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years. Advanced nations had to comply with the rules within the first year of having signed this agreement. Poor countries where the implementation of protection rights would have been a bit difficult had been given five years to enforce these laws and the backward nations had been given 10 years to ensure legislation of intellectual copyrights.

D. Anti-Trust Laws: Home and host countries, both, would like to prevent their industry from getting monopolistic and anti-competitive, as such anti-consumer association virtually acts as a blockade for fair competition and leads to undue exploitation of the general consumer. In order to ensure a fair competitive strategy, the countries legislates the anti-trust laws.

The United States was the first to legislate and implement its anti-trust laws. In India, the Monopoly and Restrictive Trade Practices Act (MRTP), prevents the formation of monopolies and cartels.

16.16 International Socio - Cultural Environment: An Introduction

The world economy is in the middle of globalization, with each country opening its doors to welcome the foreign multinational and corporate organizations from developed economies to set up their empires, simultaneously encouraging the domestic business firms, manufacturing units and trading corporations to explore the markets around the world. In international markets no two cultures from two adjoining and adjacent countries could be similar, which poses another challenges on the international enterprises, in terms of communicating with the consumers and users, variation in semiotics, values, ideas, attitudes, beliefs, assumptions and traditions, etc. Identifying the similarities and disparities in cultures across the world, becomes inevitable for the international companies for adapting in different countries depicts the importance of learning the culture. Therefore, the companies are inevitably required to nurture cultural sensitivity within the skill and management techniques, in order to not only build the brands, but also gain the acceptance of the countries in which they operates, not only from their geographical and historical background but also from their cultural background. The following part of the chapter, focus on understanding the culture, elements of culture and focus on different cultural influences that are exerted on consumer behavior and on a business firm's international ambitions.

The word culture is derived from the latin word "colere", which means to inhabit, to cultivate, or to honor. The theoretical orientations for understanding, or for valuing, human activity is reflected in the different definitions of 'culture', by different authors. The term 'culture' is often referred to, "the universal human capacity to classify, codify and communicate their experiences symbolically, by anthropologists". According to Sir Edward B. Tylor, as stated in 1871, "Culture or Civilization in the ethnographic sense, is the complex whole which includes knowledge, belief, art, morals, law, custom, and any other capabilities and habits acquired by man as a member of society", while according to the 2002 document from the United Nations agency UNESCO, "it is the set of distinctive spiritual, material, intellectual and emotional features of society or a social group and that it encompasses in addition to art and literature, lifestyles, ways of living together, value systems, traditions and beliefs". About more than 200 definitions of culture have been compiled by Alfred Kroeber and Clyde Kluckholn in 1952, in their book, "Culture: A Critical Review of Concepts and Definitions". Culture is defined as the "personality of society", "It is the continuously evolving totality of learned and shared experiences of life, giving meaning to rituals, norms, traditions, nuances, languages, symbols, and common values amongst the members of an organization and society", "It is the collective programming of the mind, which distinguishes the members of the one group or category from the other". Professor Geert Hofstede defines culture as, "the software of mind which provides a guide for humans on how to think and behave; culture is a problem solving tool". Culture in 20th century has also say the popularization of the idea of corporate culture, referring to the distinct and malleable within the context of employing organization or of a workplace.

16.17 Constituents of Culture/ Elements of Culture

Any culture is identifiable and differentiable by its constituents. The elements of culture are influenced by the various cultural aspects, namely, Non-material Culture and Material Culture; Low context and High Context Culture; Mono-chronic and Poly-chronic; Individualism and Collectivism; Masculinity and Femininity as well as trust, fatalism, and future orientations.

The various elements of culture are discussed below in detail:

1. **Ecology or Geography:** It refers to the pattern in which an individual accepts the process of ecological factors in a society, the flora and fauna, wildlife, climate, temperatures, topography, natural resources, rivers, mountains, plains, minerals and other such gifts of God. In other words, it is the way, the natural resources are preserved, utilized, developed, protected, for all the species on the earth, including human beings. International business enterprises are concerned about these ecological factors, as it affects the history, economy of nations, and the consumer behaviour in the words of Professor

Phillip Parker.

2. Heritage Historical facts have a very strong impact on technological developments, social institutes, cultural fabric, social norms, attitude towards new innovations and acceptance of the times in which these were developed. For instance, the industrial revolution of the 18th century affected the social fabrics of Great Britain. Indian culture is influenced by the Mughals and British rulers, in various aspects of the country like '*classical music*' and formation of '*gharanas*', literature, paintings, parliamentary system, education system, development of various tourist sites as well as construction and destruction of the buildings, temples, mosques, which forms an integral part of the Indian culture. Similar heritage factors have evolved culture of the societies across the world.

3. Social Fabre: It consists of religion, family, institutes of education, the social organizations, the thinking of philosophers, the ruling elite and the ruled multitudes. It refers to the society's behavioural pattern followed from generation to generation, the interpersonal and intrapersonal relations, formed from the casteism; love of family and neighborhood; tolerance of strangers; accommodation of others by selfless behavior; love and respect for one's own religion as well for others' faiths and beliefs. Such caste system interferes in the professional life, dividing the role and selection of the work by the people on the basis of the caste to which they belong. For example, in India, the work of sweeping is not performed by the individuals belonging to the higher caste and they are reluctant in performing such work, but the same individuals may not hesitate in performing the similar job in the western countries, as such division of the work is not prevailing there. An international marketer has to be fully aware of all such differences, generally governed by the religious and social associations, exaggerated by the politicians and pseudo-preachers, as well as the media many times, in the society.

4. Cultural Values: Values are defined as the, "cultural standards or judgments of what is right, good, or desirable personal freedom, egalitarianism (inequality)". Values are defined as "enduring beliefs about a specific mode of conduct or desirable end-state; they guide the selection or evaluation of behavior, are ordered by the importance in relation to one another to form a system of value priorities". It is imbibed from the parent culture (enculturation) and assimilation of the learned cultures through various media (acculturation).

5. Cultural Imperatives: Cultural imperatives are the set of norms ensuring that businesses are conducted in the same way that locals do, which demands detail understanding by the international companies. Imperatives also announce the behaviour one has to adopt while interacting and adhering to the government officials, authorities as well as the rules and regulations. For example, to respect the elders, the seniority, is the way of life in India, which is expected even from the foreign business partners. But in America every one can be addressed by their first names while addressing the business meets is common, unlike, in the European countries, addressing people with their last names.

6. Cultural Exclusives: It refers to the activities that only locals may perform, and which foreigners are not expected to follow. For example, to touch the feet of elders and seeking their blessings is a common practice in India, a devoted Muslims offering prayer five times a day and a devoted Hindu worshipping their deities, even at their place of work, which the foreigner is not expected to do, but expected to accept and respect.

7. Language: It is a system of patterned sounds, often with corresponding written symbols, used by the members of a society to communicate their thoughts and feelings to one another.

Diversity in these patterns increases complications for integrating the workforce of the companies and to market their products on a truly national level, as each dialect, nuance and complexity may differ from culture to culture. Common language facilitates spreading of culture. It is a unifying force in the face of diversity in many countries. International business enterprises will have to understand both the written and spoken language as well as the non-verbal language to communicate effectively with the targeted market of the foreign country. English is the most important language (apart from the primary language in a country) for use in international business. Indian markets with 20 languages and 200 dialects, with variations in the communicable languages of those in north and east to that in the west, European markets, where language changes within a short distance, demands the use of more than two or three languages by the international businesses.

Moreover, the silent and the Non-verbal languages, different meanings assigned to the different colors across the countries, as well as the body language or kinesics, are also to be studied by the international business enterprises. For example, Shaking hands to greet each other in business meetings in many countries regardless of gender differences, but, in Saudi Arabia and Oman, a woman may not shake hand with a man. In US, the customary distance for business discussion is 5 to 8 feet and for personal business it is 18 inches to 3 feet. Also, in Greek, Turk and Bulgarian "Yes" is indicated by a sideway movement of the head that resembles the negative headshake used in US and India. The popular incident is the court case and debate filed by some people in India against Hollywood film star Richard Green for kissing and hugging an Indian lady film star during a public function held in New Delhi in 2007.

8. Information processing: Business enterprises are very much affected by the information processing patterns across the countries, influenced by the differences in the cultures order and classification followed while interpreting the information. To exemplify, in U.S., telephone directories are classified as per the last name of a person, whereas in Iceland, as per their first, or given, names.

9. Religion: The meaning and sustenance to the society's existence is defined by the religion. The fear and belief of the supernatural frames the society's value system, attitudes and hopes. It also provides the reason to multitudes in this world to face the problems of life bravely and emerge together as groups, forming a distinct culture and civilization. Food habits, purchase patterns, value calculation, individualism, totalitarianism, social hierarchical systems, family affiliations, cultural values, family norms, the status of women, the status of the old and infirm, the institution of marriage, the judicial systems and even the jurisprudence and the criminal code of conduct and the penal codes, all find their origin in the religions of the world. To illustrate, the Hinduism" and "Buddhism" religion propagate a life of renunciation while "Judaism" propagates the emancipation of human soul through education and removal of ignorance. The illustration of how religion affects the food habits of the people, ignoring this fact initially, affected the entry of the McDonalds in Bangalore (India). Religion also defines the system of official working days, the calendar of week days, annual celebration of the festivals, holy days and the auspicious beginning of business contracts, often called as "Muhuratas" and "Kamuhuratas" are all governed by religious beliefs. The countries based on Christianity, follows holiday on Sunday and Friday being the Holy day of the Islam religion, the weekly holiday is generally on Friday, keeping all businesses and offices closed on that day. Thus, it is of crucial importance for the global business player to keep track of the religious festivals and events and national, regional and local cultural occasions while planning his business meetings, regular working of the show-rooms, shops and offices.

16.18 Cultural Dynamics and Cultural Shock

A. Cultural Dynamics:

Culture has also been defined as "the sum total of the values, rituals, beliefs and thought processes that are learned, shared by a group, of people and transmitted from generation to generation", as it is not static; like shifting sands of time, culture too evolves itself over different periods of time by imbibing values and beliefs, through the process of exposure or subjected, adaptation to the changing environments in the society and different culture through the process of socialization, ensuring its survival. To illustrate, the inroads made by the Internet, credit cards and the plastic money culture.

The cultural change resulting from the cultural adaptation may be the outcome of choice. Therefore, the fundamental source of conflict in this new world will not be primarily ideological or primarilyeconomic, but "culture" and "fight for cultural identity" will dominate the global politics. Moreover, the increasing migration of the people from one country to the another country, along with their cultural identities has been resulting in the formation of "black home", like "Mini- India, Mini-Pakistan and Mini China in Singapore, Dubai, USA and UK".

B. Cu;tural Shock:

The term was introduced for the first time in the year 1958. It refers to the anxiety produced, often expressed in the feeling of lack of understanding, appropriateness or inappropriateness, and confused state, when a person moves to a completely new environment, coming on the surface after first few weeks of coming into the new place. It can also be described as the physical and emotional discomfort one suffers when coming to live in another country or a place different from the place of origin. On the other side, it is the great opportunity for redefining one's life objectives by learning and acquiring new perspectives, enabling an individual to develop better understanding of one-self and stimulate personal creativity.

The symptoms of cultural shock are, sadness; loneliness; melancholy; preoccupation with health; aches, pains, and allergies; insomnia, desire to sleep too much or too little; changes in temperament, depression, feeling vulnerable, feeling powerless; anger, irritability, resentment, unwillingness to interact with others; identifying with the old culture or idealizing the old country; loss of identity; trying too hard to absorb everything in the new culture or country; unable to solve simple problems; lack of confidence; feelings of inadequacy or insecurity; developing stereotypes about the new culture; developing obsessions such as over-cleanliness; longing for family; feelings of being lost, overlooked, exploited or abused.

Stages of Culture Shock:

Culture shock is the result of the following stages. Each stage can be ongoing or appear only at certain times.

a. The first stage is the incubation stage or the "honeymoon" stage, as everything encountered is new and exciting.
b. The second a person may encounter some difficult times and crises in daily life, like, communication, resulting into the feelings of discontent, impatience, anger, sadness, and feeling incompetence. Transition between the old methods and those of the new country is a difficult process and takes time to complete.
c. The third stage is characterized by gaining some understanding of the new culture, with the new

feeling of pleasure and sense of humor may be experienced, gaining the psychological balance, initiating an evaluation of the old ways versus those of the new.

d. In the fourth stage, the person realizes that the new culture has good and bad things to offer, this integration of the culture processed is accompanied by more solid feeling of belonging, and the person starts to define him/herself and establish goals for living.

The fifth stage is called the "re-entry shock." This occurs when a return to the country of origin is made. One may find that things are no longer the same. For example, some of the newly acquired customs are not in use in the old culture.

e. Many factors contribute to the duration and effects of culture shock. For example, the individual's state of mental health, type of personality, previous experiences, socio-economic conditions, familiarity with the language, family and/or social support systems, and level of education.

How to Fight Culture Shock:

The majority of individuals and families that immigrate from other countries, have the ability to positively confront the obstacles of a new environment, and this ability of the individuals affects efficiency of the international businesses. Some ways to combat stress produced by culture shock are:

1. Develop a hobby ; Don't forget the good things you already have!; Be patient, the act of immigrating is a process of adaptation to new situations. It is going to take time.
2. Learn to be constructive. If you encounter an unfavorable environment, don't put yourself in that position again. Be easy on yourself; Don't try too hard;
3. Learn to include a regular form of physical activity in your routine, This will help combat the sadness and loneliness in a constructive manner;
4. Exercise, swim, take an aerobics class, Relaxation and meditation are proven to be very positive for people who are passing through periods of stress
5. Maintain contact with your ethnic group. This will give you a feeling of belonging and you will reduce your feelings of loneliness and alienation
6. Maintain contact with the new culture. Learn the language. Volunteer in community activities that allow you to practice the language that you are learning. This will help you feel less stress about language and useful at the same time.
7. Allow yourself to feel sad about the things that you have left behind: your family, your friends, etc.
8. Recognize the sorrow of leaving your old country. Accept the new country. Focus your power on getting through the transition. Pay attention to relationships with your family and at work. They will serve as support for you in difficult times.
9. Establish simple goals and evaluate your progress; Find ways to live with the things that don't satisfy you 100%; Maintain confidence in yourself. Follow your ambitions and continue your plans for the future.
10. If you feel stressed, look for help. There is always someone or some service available to help you. You may want to check out Information and Resources.

16.19 International Technological Environment: An Introduction

Technology refers to the knowledge or methods that are necessary to carry on or to improve the existing production and distribution of goods, services, products or processed, and also includes entrepreneurial expertise and profession know-how. It intends to solve practical problems. It consists of applied research with specific objectives; development resulting in workable prototypes; engineering defining the knowledge for commercial exploitation; commercialization including mass production, called as entrepreneurial expertise and professional know-how. Technology is both hard and soft-that is machine, as well as, way of thinking. Thus, technology includes the tools—both machines (hard technology) and ways of thinking (soft technology), available to solve problems and promote progress between, among and between societies". According to the UNCTAD's Draft TOT code, Technology should be described as "systematic knowledge for the manufacture of a product, for the application of a process or for the rendering, of a service and does not extend transaction involving mere sale or lease of goods". Technological environment is important for business as it affects the type of conversion process that it may adopt for its purpose. It is one of the most important driving forces of Post- II World War period in shaping up economies of various countries. The strategic implications of technological environment as analyzed by Petrov are as follows:

1. It can change relative competitive cost positions within a business;
2. It can create new markets and new business segments; and
3. It can collapse or merge previously independent businesses by reducing or eliminating their segment cost barriers.

Technology throughout the countries of the world can be classified as follows:

· An **Emerging Technology** is an innovative technology that currently is undergoing bench-scale testing, in which a small version of the technology is tested in a laboratory.

· An **Innovative Technology** is a technology that has been field-tested and applied to a hazardous waste problem at a site, but lacks a long history of full-scale use. Information about its cost and how well it works may be insufficient to support prediction of its performance under a wide variety of operating conditions.

· An **Established Technology** is a technology for which cost and performance information is readily available. Only after a technology has been used at many different sites and the results fully documented is that technology considered established.

The technological environment of India is changing tremendously with the import of technology from foreign countries as well as technology generated out of research and development within the country. Thus, as the business enterprises have to work in the environment, where the change in the technology is common, they have to be more conscious to take the advantages of such changes. In analyzing technological environment by the international business enterprise, following questions are the basic:

1. What is the level of technological development in the country as a whole and specific business sectors?
2. What is the pace of technological changes and technological obsolescence?
3. What are the sources from which technology can be acquired?
4. What are the restrictions and facilities for technology transfer and time taken for absorption of technology?

Thus, exploring and analyzing technological environment is vital for the international business player, because this is the environment which brings new products, processes and materials, as well as entrepreneurial competitive advantage. The type of technology in use, the level of technological developments, the speed with which new technologies are adopted and diffused, the type of technologies that are appropriate, the technology policy, etc. are important to business. Moreover, the changes in technology are so rapid that the business enterprises has to keep track of same and keep modernizing to remain competitive and in business.

16.20 Choice of Technology

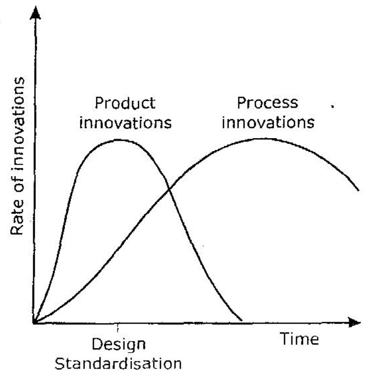
The choice of technology for a company must depend on the type of competitive advantage it seeks to develop as well as consistent with the firm's overall strategies, after thorough analysis of firms' available technologies, identifying the scope for cost minimization or product differentiation, thereby enabling the company to alter the rules of global trade and competition. Universities and firms are increasingly entering into collaboration to conduct joint research. Since the early 1980s, various inter-organizational alternatives such as licensing arrangements, acquisitions and joint ventures, are being replaced by R&D consortium. It is a group of firms linked together by cooperation agreements and to for conducting their R&D together. Organizational networks represent some geographical characteristics based on which we can classify them into industrial parks or industrial clusters. An industrial park is an area designed and zoned for manufacturing and associated activities. This is developed and managed as a single unit. Silicon Valley was not a result of any government policy. The government does however have an important role to play in nurturing clusters. Some basic understanding for taking decisions regarding the technological fronts by the international player is essential, which is provided further in the chapter.

16.21 Diffusion of Technological Innovation, Appropriate Technology and Technology Adaptation

1. **Technological Innovation:** Innovation is a very important factor that provides competitive advantage and, consequently determines the success. According to Joseph Schumpeter, a well know economist, 'significant advances in the economy occurs by disharmonious leaps and spurts as entirely new investment horizons are exploited". Our concern in this section of the chapter is technological innovation. In the business context, innovation may be defined as, "the technical, industrial and commercial steps which led to the marketing of new manufactured products and to commercial use of technical processes and equipment." Betz classifies the innovation in the following types, on the basis of the impact that technological change make on the applications:

- **Radical Innovation:** A basic technological innovation that establishes a new function. (steam engine or steam boat)
- **Incremental Innovation:** A change in an existing technology system that does not alter the functionality but incrementally improves performances, features, safety or quality or lower cost.
- **Next-generation Technology Innovation:** A change in an existing technology system that does not alter functionality but dramatically improves the performance, features, safety, quality or lowers cost and opens up new applications (substitution of jet propulsion for propellers on airplanes).Generally, the pattern of early innovations in a new-technology-based industry will be, first, product innovations (improving the performance and safety of the product); later, innovations shift to improving the production process, as mentioned by William Abernathy and James Utterback, and shown in the figure below. The rate of product innovations peaks about the time of introduction of a design standard for the new-technology product. Thereafter, the rate of innovations to improve the product decline and rate of innovations to improve production increases. This occurs because

until the product design has been standardized, the manufacturer cannot focus on improving the production processes that produces such a design.



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After the key technology of the industry mature, the market for the industry will eventually saturate. This level of the market for the industry will continue, unless the key technologies for the industry become obsolete by technology substitution. Then, the market volume of the industry based on the older key-technology product will decline to zero or to a market nicher.

2. diffusion of Technological Innovation, Appropriate Technology and Technology Adaptation

Time lags have been observed in terms of introduction or absorption of technologies in different countries, which is not only existing in terms of the differences in the developed and developing countries. In many developing countries, including India, television has arrived very late, that too in the early period there was only black and white telecast only, in spite of the color T.V. becoming quite common in the advanced and even in some developing countries. The cable T.V. came to India only by about the beginning of the 1990s. This late introduction and the slow expansion of the telecast affected not only the Television industry but also the Advertising industry, product promotion thereby.

In the international technological environment, simply diffusion of the technology will not solve the strategic questions, but it has to be accompanied by the wise analysis based on the appropriateness of the technology also, ensuring that the technology chosen is the most appropriate for the company/country. Due to the various factors such as natural factors like, topographical/ climatic/weather conditions and soil conditions, etc.; differences in income levels; scale of operations; demand conditions; use-facility characteristics; customers' characteristics; the technology suitable in a particular country may not be appropriate in another country or region. To illustrate, choice and purchase of appropriate technologies, by the body of competent scientists and engineers, employed by the government and worked in government laboratories, being at the core behind the success of Japan, and its industrial units, at the global level.

The concept of the most appropriate technology was made popular in the developing countries by the various writers, like Schumaher, more often implying the intermediate technology. Intermediate technology, refers to the technology that combines elements of traditional technology with elements of modern technology, generally gaining importance in the developing countries of the world. The increasingly dynamic technological environment is also witnessing the formation of the Innovation Networks which refers to the interconnections among organizations whose missions are widely different to achieve technological innovation by facilitating the flow of information, resources, personnel, and other inputs. The World Economic Forum considers technology as one of the factor to evaluate the global competitiveness of the countries. The state of technological readiness rankings, are of vital input for analyzing the international technological environment of the world countries. "Technology Readiness Level" is a measure used by some Unites States Government agencies and many of the world's major companies (and agencies) to assess the maturity of evolving technologies (materials, components, devices, etc.) prior to incorporating that technology into a system or subsystem. Any new technology can be incorporated into the system/sub-system, after it has been sufficiently proven by experimentation, refinement, and realistic testing. Various factors included for deriving the ranking of the countries in terms of the technological readiness are outlined below:

- Computer literacy and skilled computer programmers;
- Efficient and deep penetration of telecommunication like Land and cellular phone network with high bandwidth availability;
- Inventory of technically qualified persons in the country;
- Education and Training facilities;
- Innovation Culture;
- In-house R & D facilities with Companies;
- R&D support and Infrastructure by National and State Governments;
- A network of research Laboratories, training centers, Tool rooms and incubation centers for developing entrepreneurship;
- Strategic global alliances for research and application of technology which in many cases has prohibitive costs, like in Pharmaceuticals, Genetic Engineering, Space and nuclear research;
- Incentives for capital to flow into R&D in the country both internal and external investments;

Activity C:

1. Refer the Global Competitiveness Report 2009-2010, and comment on the technological readiness state of any two developed or developing countries.

16.22 Technological Leadership and Followership

Another important issue which the firm must consider while entering the international country, in regards to the technological decisions is whether the firm seeks technological leadership, i.e, "a firm seeks to be the first to introduce technological changes that support its generic strategy. Leadership can be established in technologies employed in any value activity". Technological followership refers to a conscious and active strategy in which a firm explicitly chooses not to be first on innovations." Porter points out that the choice of whether to be a technological leader or follower is based on the following three factors:

Sustainability of the Technological Lead: it refers to the degree to which it can sustain its lead over competitors in a technology.

· First Mover Advantage: The advantages a firm reaps from being the first, such as reputation, preemption a positioning, switching costs, unique access for a new product, proprietary learning curve, favourable access to facilities, inputs or other scarce raw materials; definition of standards; institutional barriers against limitations; and early profits.

· First Mover Disadvantages: The disadvantage firm faces by being the first rather than waiting for others. Such as pioneering costs (like costs of gaining regulatory approvals, achieving code compliance, educating buyers, high costs of early inputs because of scarcity of supply or small scale needs); demand uncertainty, changes in buyer needs, specificity of investments to early generations of factor costs; technological discontinuities and low cost imitation.

Activity D:

1. Review any five companies from the business sector of your choice, which have experienced either of the first mover advantage or first mover disadvantage.
2. Technological leadership can be sustained only if the competitors cannot duplicate the technology, or the firm innovates as fast or faster than competitors can catch up.

16.23 Technology Transfer

Technology transfer is a process that involves dissemination of commercial technology, involving communication of relevant knowledge between a transferor and a recipient, in the form of technology transfer transaction, which may or may not be a legally binding contract, but the communication by the transferor, of the relevant knowledge to the recipient. Foreign firms are the main source of new technology for developing countries such as India. Among the types of transfer transactions that may be used, the Draft TOT Code by UNCTAD has listed the followings:

· The assignment, sale and licensing of all forms of industrial property, except for trademarks, service marks and trade names when they are not part of transfer of technology transactions;
· The provision of know-how, and technical expertise in the form of feasibility studies, plans, diagrams, models, instructions, guides, formulae, basic or detailed engineering designs, specifications and equipment for training, services involving technical advisory and managerial personnel, and personnel training;
· The provision of technological knowledge necessary for the installation, operation and functioning or plant and equipment, and turnkey projects;
· The provision of technological know-how necessary to acquire, install and use machinery, equipment, intermediate goods and/or raw material which have been acquired by purchase, lease or other means;
· The provision of technological contents of industrial and technical cooperation arrangements;

The list of excludes non-commercial technology transfers, such as those found in international cooperation agreements between developed and developing states. Such agreements may relate to infrastructure or agricultural development, or to international; co-operation in the fields of research, education and employment or transport.

Technology transfer to host countries takes place in two ways, Internal transfer and External transfer. When a firm transfers technology to its affiliates under its ownership and control it is called as internal transfer of technology. It is said to be an external transfer when the recipient is a different firms.

The Technology transfer process consists of, namely, Technology Transfer; Technology Promotion; Technology Deployment; Technology Innovation; Technology Development; Technology Research Technology Assessment; Technology Information and communication; Technology Investment; Technology Collaboration and Technology Commercialization. Various factors that affects the technology transfer are Communication Factors, Financial Factors, External Factors, Human Factors, Corporate Factors and Technology Factors. There are four levels of Technology Transfer, namely, Operational level, Duplicate level, Adaptive level and Innovative level. Operative level is the bottom level, the simplest ones, generally needed for operating a given plant, involving basic manufacturing skills, as well as demanding troubleshooting, quality control, maintenance and procurement skills. Duplicate Level is the intermediate level, where duplicative skills are portrayed that includes the required investment capabilities for expanding capacity, to purchase as well as to integrate foreign technologies. Adaptive level is the technological self-reliance level, when imported technologies are adapted and improved, and design/skills for more complex engineering is acquired. Innovative Level is characterized by innovative skills, based on formal R&D, that are needed to keep pace with technological frontiers or to generate new technologies.

16.24 Intra-Regional, Inter-Regional Trade and the International Organizations

Another important trend in international business has been the growth of intra-regional trade, fostered by the economic integration schemes or the regional integration. There is a worldwide trend towards forming new regional arrangements and to strengthen the existing ones.

A brief account of the different forms of economic integration and the important integration schemes across the world are given below.

A. Forms of Economic Integration: Economic integration is a general term, covering several kinds of arrangements by which two or more countries agree to draw their economies closer together, having the one common feature, of announcements of tariffs, that discriminates against goods produced by countries, which are not parties to the agreement. All tariffs discriminate against foreign products. The key feature of the various agreements for integration is that tariffs are used to discriminate among different countries. This kind of discrimination is achieved by according preferential treatment to the goods produced by the other member countries. There are several degrees or levels of economic integration. The important forms of economic integration are outlined below:

1. **Free Trade Area:** A free trade area is group of countries bringing about free trade between/ among them. It abolishes all restrictions on trade among the members; but each member is free to determine its own commercial policy with non-members.
2. **Common Market:** The customs union is a more advanced level of economic integration than the free trade area. It not only eliminates all restrictions on trade among members but also adopts a uniform commercial policy against non-members.
3 **Customs Union:** A common market allows free movement of labor and capital within the common market, besides having the characteristics of the customs union, namely, free trade among members and a uniform tariff policy towards outsiders.
4. **Economic Union:** It is more advanced level of integration. Apart from satisfying the conditions of the common market mentioned above, the economic union achieves some degree of harmonization of economic policies such as monetary pole; fiscal policy, etc., which is also the main striving force of the European Community (EC).
5. **Economic Integration:** The ultimate form is full economic integration characterized by the completion of the removal of all barriers to intra-bloc movement of goods and factors, unification of social as well as economic policies and binding all the members by decisions of a super national authority consisting of executive, judicial and legislative branches.

B. European Union: The European Economic Community (EEC), known as European Common Market (ECM), European Community (EC), and European Union (EU), is the most successful among various regional economic integration schemes. It originally comprised of six nations, namely, Belgium, France, Federal Republic of Germany, Italy, Luxembourg and Netherlands, and formed on 1st January, 1958, by the Treaty of Rome, 1957. The Treaty of Rome required every member country to:

1. Eliminate tariffs, quotas and other barriers on intra-community trade;
2. Devise a common internal tariff on imports from the rest of the world;
3. Allow the free movement of factors of production within the community;
4. Harmonize taxation, monetary policies and social security policies;
5. Adopt a common policy on agriculture, transport, and competition in industry.

The EEC was expanded in 1973 with the inclusion of the United Kingdom, Denmark, and Ireland; Greece joined the Community in 1981; Spain and Portugal became members on January 1, 1986, raising the number of members to twelve. With Austria, Finland and Sweden joining the union in the early 1990s, the number rose to 15. With effect from May 1, 2004, the EU has 25 members. Several more countries are eager to join the EC. To qualify for membership in the EC, a country must be European and democratic.

EC-1992: By July, 1968, a Customs Union had been established among the original six members of the EEC as they abolished tariffs on trade among themselves and imposed a common tariff schedule on imports from other countries. The community members had also taken some noteworthy steps towards approximating their economic policies including adoption of Common Agricultural Policy (CAP) in 1962 and establishment of the European Monetary System in 1979. A detailed programmed for attaining a single integrated market was set forth by the EC Commission (the EC's executive body) in June 1985 in a White Paper entitled "Completing the Internal Market". The EC Council (the EC's supreme decision making body) promptly committed the EC to carry out White Paper's programmed by 1992, envisaging the unification of the economies of the member nations into a single market by removing all border barriers to trade and factor mobility and by unifying the economic policies and regulations came to be described as Europe 1992/EC-1992, listing 300 specific areas (subsequently reduced to 279) for action by the year 1992. The barriers targeted for removal pertained to the eight categories, namely, Border control; Limitations on the movement of people and their right of establishment; Differing internal taxation regimes; Lack of common legal framework for business; Controls on movement of capital; Heavy and differing regulation of services; Divergent product regulations and standards and Protectionist public procurement policies.

The Euro: Euro, the common currency of the European Union, was launched by 11 of the 15 members of the Union, on January 1, 1999. The exchange rates per euro determined at the time of the Euro launch were about US $ 1.17; British pound 0.70; Yen 133; and German mark 1.96. One euro was equivalent to about Rs. 49. The Maastricht Treaty of 1991, set the stage for the monetary union, laying eligibility criteria for member countries to join the EMU such as maintaining budget deficit, public debt, inflation, long term interest rates and exchange rate within defined limits.

The parties to the Euro were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Greece joined in January 2001. The monetary policy decisions for the Euro area are made by the European Central Bank (ECB), which along with the National Central Banks (NCBs) of all EU members comprise the European System of Central Banks (ESCB). Companies in the Euro land benefits from the ease of outsourcing, relocation of production bases, mergers and takeovers, transportation, procedures, marketing etc., besides the savings on hedging costs, improving their global competitiveness.

C. South Asian Association for Regional Cooperation (SAARC): South Asian Association for Regional Cooperation (SAARC) involving seven countries, namely, India, Bangladesh, Pakistan, Nepal, Bhutan, Sri Lanka and Maldives, was formally launched in December 1985. Mr. Rajiv Gandhi, the then Prime Minister of India, described the opening day of the SAARC summit in December 1985 as important day in the history of resurgent Asia, as seven neighbouring countries have come together in an act of faith. The participants of the summit affirmed that the birth of SAARC was a logical response to the problems facing the region. The fundamental goal of SAARC is, "to accelerate economic and social development through optimum utilization of their human and material resources".

According to Article I of the Charter of the SAARC, the objectives of the Association are:

1. To promote the welfare of the people of South Asia and to improve their quality of life;
2. To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potentials;
3. To promote and strengthen collective self-reliance among the countries of South Asia;
4. To contribute to mutual trust, understanding and appreciation of each other's problems;
5. To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
6. To strengthen co-operation with other developing countries;
7. To strengthen co-operation among themselves in international forums on matters of common interests; and
8. To cooperate with international and regional organizations with similar aims and purposes.

Article II of the Charter lays down the following principles:

- Co-operation within the framework of the Association shall be based on respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in the internal affairs of other States and mutual benefit;
- Such co-operation shall not be a substitute for bilateral co-operation but shall complement them;
- Such co-operation shall not be inconsistent with bilateral and multilateral obligations.

With about 1200 million inhabitants, the SAARC accounts for over one-fifth of the world population. The density of population in the SAARC countries, which have only about 3.3 per cent of the world's land area, is very high, nearly double when compared to the average density of the low income economies as a whole. A major share of the world's poor live in these countries. Generally, these are low economies. Intra-regional exports and imports of these countries have formed less than 10 per cent of world trade of each country. In general, there has also been a decline in the intra-regional trade of each country during the last decade or so, reflecting a more rapid expansion of trade with extra-regional countries — developed and developing. Some of the member countries are major exporters of certain commodities and, therefore, major competitors in the international market. For example, jute exports by India and Bangladesh and tea exports by Sri Lanka and India.

The member countries of SAARC have many common features and problems which are characteristic of the developing countries, providing number of areas that offers scope for development through mutual help and co-operation.

It is pointed out that there is a great scope for co-operation for water resource development. The position of Bangladesh in terms of hydrographic leverage with India is very similar to that of Nepal. In return, so is India's leverage with these two countries, as India is the only feasible and substantial buyer of the co-operation they can offer for the optimum utilization of the water flowing through them. Similarly, India and Pakistan still have, despite the Indus Valley treaty, valuable cooperation to offer or withhold from each other. The second summit of the SAARC held in Bangalore in November 1986 decided to set up its Secretariat at Kathmandu, Nepal. The Summit decided to expand and strengthen the co-operative programmes of the Association, with the following actions to be taken:

1. South-Asian broadcasting programmed covering both radio and television.
2. Concrete steps to develop tourism in the region, including facilities for limited convertibility of national currencies for tourists from SAARC countries.
3. Cooperation in educational, scientific, technical and research and development fields.

D. SAARC Preferential Trading Arrangement (SAPTA): The Sixth SAARC Summit held in Colombo in 1991 strongly mooted the idea of a SAARC Preferential Trading Arrangement (SAPTA) and the Foreign Ministers of all the member states (India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan and Maldives) signed the Agreement on 11 April, 1993 during the Seventh SAARC Summit in Dhaka. SAPTA became effective from 7 December 1995.The basic principles of SAPTA are as follows:

1. Overall reciprocity and mutuality of advantages.
2. Step-by-step negotiations and extension of preferential trade arrangement in stages.
3. Inclusion of all types of products — raw, semi-processed and processed.
4. Special and favorable treatment to Least Development Countries (LDCs).

The SAARC Preferential Trading Arrangement (SAPTA) is expected to play an important role in boosting the intra-regional trade. This preferential arrangement would benefit SAARC countries due to the following reasons:

1. The countries can substantially reduce the transport and transit cost because of geographical continuity among the members.
2. Capital goods produced within the region may be more compatible to the factor endowment of member states than those imported from developed countries;
3. The increasing competition among the member states would result in technical efficiency in existing industry as marginal firms might be forced to reduce their cost. Resources will be reallocated away from less efficient firms and monopolies protected by the tariff wall will no longer be in a sheltered position.
4. As economic ties get stronger and countries become committed to common economic goals, political problems will gradually recede, When economic benefits gain significance, amicable environment may evolve for dissolving political problems.
5. Regional co-operation may also pave the way for regional banks or corporation which might be influential in promoting regional investment in larger projects. It is it is intended to develop SAPTA into a South Asian Free Trade Area (SAFTA), The SAARC Council of Ministers which met in December 1995 reached an agreement to realize the objectives of SAFTA, preferably by the year 2000 but not later than the year 2005.

E. Indo-Lanka Free Trade Agreement: According to the Bilateral Free Trade Area Agreement signed by India and Sri Lanka on 28th December, 1998, a large number of items will be eligible for duty free trade. India has offered to permit as much as 1000 items on zero duty from Sri Lanka and Sri Lanka will allow duty free imports of 900 items from India. The main objectives of this Free Trade Agreement, according to its preamble, are the following:

1. To promote through the expansion of trade the harmonious development of the economic relations between India and Sri Lanka.
2. To provide fair conditions of competition for trade between India and Sri Lanka.
3. In the implementation of this agreement both the countries would pay due regard to the principle of reciprocity.
4. To contribute, in this way, by the removal of barriers to trade to the harmonious development and expansion of world trade.

The agreement also provides for safeguard measures under which if any product, which is the subject of preferential treatment, is imported into the territory of a contracting party in such a manner or in such quantities as to cause or threaten to cause serious injury in the importing country to the agreement, the importing country with prior consultations except in critical circumstances suspend provisionally without discrimination the preferential treatment accorded under the agreement. The contracting parties are also free to apply their domestic legislation to restrict imports in cases where prices are influenced by unfair trade practices like subsidies or dumping. This agreement would have long-term consequences as other members might try to "multi-lateralize" it within the SAARC region by demanding similar preferential treatment within the trading arrangement bloc.

It is feared that the India-Sri Lanka Free Trade Agreement would very adversely affect the farmers of India as several cash crops would enter India duty free from Sri Lanka depressing their domestic prices As India is a very large market, the Free Trade Agreement is likely to benefit Sri Lanka a lot and the benefits to India may not be much as Sri Lanka is a small market.

F. GATT/WTO and Trade Liberalisation: It is a well-known fact that protection has harmful effects on economic growth and consumer welfare. The desire of the nations to liberalize trade resulted in the establishment of the General Agreement on Tariffs and Trade (GATT). The Breton Woods Conference of 1944 which recommended the establishment of the IMF and World Bank had also recommended the establishment of an International Trade Organization (ITO). Although the IMF and World Bank were established in 1946, the proposal for the ITO did not materialize; instead the GATT, a less ambitious organization, was formed in 1948. It may be noted that as a result of the Uruguay Round the GATT was transformed into a World Trade Organization (WTO) with effect from January, 1995. Thus, after about five decades, the original proposal of an International Trade Organization has taken shape as the WTO. The WTO which will be a more powerful body than the GATT will have an enlarged role than the GATT. India is one of the founder members of the IMF, World Bank, GATT and the WTO.

The international trading system since 1948 was, at least in principle, guided by the rules and procedures agreed to by the signatories to the GATT which was an agreement signed by the member nations which were admitted on the basis of their willingness to accept the GATT disciplines. The primary objective of GATT was to expand international trade by liberalizing trade so as to bring about all-round economic prosperity. The Preamble to the GATT mentioned the following as its important objectives.

1. Raising standard of living.
2. Ensuring full employment and a large and steadily growing volume of real income and effective demand.

3. Developing full use of the resources of the world.
4. Expansion of production and international trade.
5. GATT embodied certain conventions and general principles governing international trade among countries that adhere to the agreement.

G. The Uruguary Round: The Eighth Round of the multilateral trade negotiations held under the auspice of the GATT is known as the Uruguay Round (UR) as it was launched in Punta d Este in Uruguay, a developing country, in September 1986. Because of the complexity of the issues involved and the conflicts of interests among the participating countries the Uruguay Round could not be concluded in December 1990 as was originally scheduled. When the negotiations dragged on, Arthur Dunkel, the then Director General of GATT, presented a Draft, popularly known as the Dunkel Draft.

This was replaced by an enlarged and modified final text which was approved by delegation from the member countries of the GATT on 15th December, 1993. This Final Act was signed by the ministers of 125 governments on 15th April, 1994. The results of the Uruguay Round were to be implemented within 10 years since 1995. Different time period were given for effecting the different agreements. At the beginning of September 2006, WTO had 149 members. Because of the inclusion of the new aspects in the GATT negotiations, developing countries had serious apprehensions.

H. GATT AND WTO: Following the UR Agreement, GATT was converted from a provisional agreement into a formal international organization called World Trade Organisation (WTO) with effect from 1st January, 1995, serving as a single institutional framework massing GATT and all the results of the Uruguay Round, directed by Ministerial Conference, meeting at least once every two years and its regular business overseen by a General Council.

Thus, under the old system, there were two aspects of GATTs: (I) GATT the Agreement — i.e.. the agreement between contracting parties (governments) setting out the rules for inducting international trade; (ii) GATT the Organisation—an international organization created to facilitate discussions and administration related to the Agreement (ad hoc, though, continued to exist until the establishment of the WTO). GATT the organization, ceased to exist with the establishment of WTO; GATT the agreement, which always dealt with (and still does) trade in goods, continues to exist, in an amended form, as part of the WTO alongside two new agreements, viz., General Agreement on Trade in Services (GATS) and General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). The old text is now called 'GATT 1947' and the updated version is called 'GATT 1994'. In short, the WTO is GATT' plus. The points of differences between GATT and WTO are summarized in the table below:

	GATT		**WTO**
1.	GATT was Ad hoc and provisional.	1.	WTO and its agreements are permanent.
2.	GATT had contracting parties.	2.	WTO has members.
3.	GATT system allowed existing domestic legislation to continue even if it violated a GATT agreement.	3.	WTO does not permit this.
4.	WTO is more powerful than GATT', settlement system was slow and less and efficient, its ruling easily blocked.	4.	GATT was less powerful, dispute dispute settlement mechanism is faster more efficient, very difficult could be to block the rulings.

Functions of WTO:

The WTO has the following five specific functions:

- The WTO shall facilitate the implementation, administration and operation and further the objectives of the Multilateral Trade Agreements and shall also provide the framework for the implementation, administration and operation of Plurilateral Trade Agreements.
- The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreements.
- The WTO shall administer the 'Understanding on Rules and Procedures Governing the settlement of Disputes.
- The WTO shall administer the 'Trade Review Mechanism.'
- With a view to achieving greater coherence in global economic policy make the WTO shall co-operate, as appropriate, with the IME and IBRD and affiliated agencies.

The WTO is a more powerful body with enlarged functions than the GATT and is envisaged to play a major role in the world economic affairs. To become a member of the WTO, a country must completely accept the results of the Uruguay Round.

I **United Nations Conference On Trade And Development (UNCTAD) :** The widening trade gap between the developed and the developing countries, the general dissatisfaction of the developing countries with GATT, and the need for a new organization for international economic cooperation in the field of trade and aid, which has been designed to reduce the trade gap of the developing countries, encouraged the establishment of the United Nations Conference on Trade and Development (UNCTAD), in 1964, as a permanent organ of the UN General Assembly. The UNCTAD was designed to serve as a forum in which the trade-related development issues could be discussed and analyzed, to lead to negotiations of international understanding on issues that were in dispute. The Conference, which is a plenary body of a large number of countries, meets normally at intervals of four years.

Functions of UNCTAD:

The principal functions of UNCTAD are as follows:

1. To promote international trade with a view to accelerate the economic development.
2. To formulate principles of and policies on international trade and related problems of economic development.
3. To negotiate multinational trade agreements.
4. To make proposals for putting its principles and policies into effect.
5. The major activities of UNCTAD include research and support of negotiations for commodity agreements, and technical elaboration of new trade activities designed to assist the developing countries in the areas of trade and capital.

Basic Principles of UNCTAD:

UNCTAD's action programme and priorities have been laid down in various recommendations adopted by the first conference in 1964, based on the following principles:

1. Every country has the sovereign right to freely dispose of its natural resources in the interest of the economic development and well-being of its own people and to freely trade with other countries;
2. Economic relations among countries, including trade relations, shall be based on respect for the principles of sovereign equality of states, self-determination of people, and non-interference in the

internal affairs of other countries; and

3. There shall be no discrimination on the basis of differences in the socio-economic systems, and the adoption of various trading methods and trading policies shall be consistent with this principle.

A Review of the Functioning of UNCTAD:

Given the important role of primary commodities and natural resources in the external sectors of the developing countries, the initial focus of UNCTAD was on commodity policy and efforts to stabilize and expand the export earnings of these countries. In the process, UNCTAD adopted a group approach to negotiate with OECD countries (i.e., the industrial economies), lining up together (Group B) the Centrally planned economies of Central and Eastern Europe and the Soviet Union plus a few similar economies forming their own grouping (Group D), and the developing countries coming together under the aegis of the Group 77 to coordinate their positions. China formed a separate group. Despite debates and disagreements over the years, UNCTAD played a key role in the emergence of:

1. The Generalized System of Preferences (GSP).
2. A maritime shipping code.
3. Special international programmes to help the LDCs.
4. International aid agencies.

J. United Nations Industrial Development Organization (UNIDO): The United Nations Industrial Development Organization (UNIDO), which was set up in January 1967, is an organ of the UN General Assembly. The primary function of UNIDO is to promote industrialization in the developing counties by encouraging the mobilization of national and international resources. Particular attention is given to manufacturing industries.

Unlike UNCTAD, UNIDO works directly with business firms, generally on an industry basis. The major activities of UNIDO fall into the following three categories:

1. Operational Activities: These include direct technical assistance to industries, at the request of the governments of the developing country and the in-plant training programmes, whereby groups of technicians and engineers from the developing countries, who are facing a common industrial problem, are brought together to consider how industry in the more advanced countries avoids or solves similar problems.
2. Research: In this area, UNIDO conducts feasibility studies on the requirements for a potential industry in the developing countries & Export-oriented industries are given a special attention.
3. Coordination: The coordinating activities of UNIDO include mostly the organization and sponsoring of inter-regional and international meetings, seminars, and symposia.

K. International Trade Centre (ITC): The International Trade Centre (ITC) is the focal point in the United Nations' system for technical cooperation with developing countries in trade promotion. ITC was created by the GATT in the year 1964 and since the year 1968, has been operated jointly by GATT (now WTO) and the UN, the latter acting through the UNCTAD. As an executing agency of the UNDP, ITC is directly responsible for implementing UNDP-financed projects that are related to trade promotion in the developing countries. Briefly, the ITC assists the developing countries by working with them, involving, Development of a national trade promotion strategy; Establishing appropriate government institutions and services, for the exporters in trade information, export financing, export quality control, export costing and pricing, export packaging, trade fairs and commercial publicity, legal aspects, international physical distribution of goods, trade promotion services for small- and medium-sized enterprises (SMSE), and commercial representation abroad; Finding market opportunities for current export products, both non-traditional items and elected primary commodities, and to promote them abroad; adapting the products to foreign-market requirements and developing new items; and promoting exports of technical consulting services; Training government trade officials, businessmen, and instructors in export marketing and trade promotion, and establishing a national framework for developing export training a long term; and Improving import operations and techniques to optimize scarce foreign exchange resources,

16.25 Some Issues in International Business

There are several important social issues in international business. Among them, four of the issues, namely, Business ethics, social responsibility, environmental factors and labour standards are discussed below.

A. Business Ethics: A very complex and controversial issue is that of ethics. The term business ethics refers to the system of moral principles and rules of conduct applied to business. The norms of ethics vary from country to country. What is ethically wrong or condemned in one nation may not be so in another. Bribery, pay offs or kickbacks are common in business in many countries, in varying extent and intensity. The position appears to be that "morality only exists within a culture and it is not for us to say what is moral in someone else's culture." The US Foreign Corrupt Practices Act of 1977 prohibits a firm from making or authorizing payments, offers, promises, or gifts for the purpose of corruptly influencing actions by governments or their officials in order to obtain or retain orders for a company. American businessmen complain that they are severely handicapped because of this legislation when they have to compete with those who are not so regulated. In countries like France and Germany, the money paid for bribes to secure business overseas is a legitimate tax write-off. Whatever may be the legal position regarding bribing, it is basically a question of the moral values and self regulation.

Another issue is whether it is ethical to sell products which are banned in some countries because of their harmful effects in other countries (often in developing countries). One issue is that if the government of a country permits the marketing of such a product, should a company give up the sale of the product on its own. If the harmful effects of a product outweigh the benefits, a company with sound ethics will not do business in that product even if there is no legal objection.

B. Social Responsibility of Business: Besides, being ethical in business, companies, particularly the large ones, have some social responsibilities. As the High-Powered Expert Committee on Companies and MRTP Acts (Sachar Committee) observes, "in the environment of modern economic development, the corporate sector no longer functions in isolation. The company must behave and function as a responsible member of society, like any other individual. It cannot shun moral values, nor can it ignore actual compulsions. The real need is for some focus of accountability on the part of the management which is not limited to shareholders alone. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community. In other words, the primary objectives of a socially responsible business should be to strengthen itself with due regard to the interests of the shareholders, employees and consumers. A responsible company has certain secondary objectives as well. The important among them are, To enhance labour welfare; To enhance customer service and goodwill; To assist in developing and promoting the amenities in the locality; To assist in developing the industry of which the firm is a member and to contribute to national goals. The marketing concept, which has gained tremendous popularity, indicates that the key to satisfying organizational goals is customer satisfaction. The societal marketing concept, which has been gaining popularity over the marketing concept, however, calls for generating customer satisfaction and long-run consume welfare as the key to attaining a long-run profitable volume.

C. Environmental Issues: Environmental issues have been engaging increasing discussion in the international business horizon. Some countries prohibit the import of goods which cause ecological damage. For example, US have banned the import of shrimp harvested without turtle excluder devise because of its concern for the endangered sea turtles. Developing countries are affected by the relocation of polluting industries from the developed to the developing ones. Similarly, several products which are banned in the developed nations are marketed in the underdeveloped world. The dumping of nuclear and hazardous wastes in developing countries and the shifting of polluting industries to the developing countries impose heavy social costs on them. The exploitation of the natural resources of the developing countries to satisfy the global demand also often causes ecological problems. When the multinationals employ in the developing nations polluting technologies which are not allowed in the developed countries or do not care for the ecology as much as they do in the developed nations, it is essentially a question of ethics. Another serious problem is that developed nations sometimes raise environmental issues as a trade barrier or a coercive measure rather than for genuine reasons. The debate has intensified in recent years on the links between trade and the environment, and the role the WTO should play in promoting environment-friendly trade.

On the other hand, it has also been pointed out that trade liberalization may improve the quality of the environment rather than promote degradation. International companies may also contribute to a cleaner environment by using the most modern and environmentally clean technology in all their operations. The solution lies instead in the use of appropriate environmental policies, whether they entail assigning property rights, taxing or subsidizing or applying regulatory remedies.

D. Labour Issues: One of the important social issues in the developed countries in respect of business with the developing countries pertains to ill-treatment of labour and children.

Child labour used in the manufacture of exports, from the developing countries is widely criticized by people in the developed countries and in the developing countries too. A similar issue is the sweat labour. The argument here is that goods are manufactured by labour working in inhuman/unhealthy working conditions not getting fair wages should be banned or boycotted. The frequent absence of minimal standards and poor labour-management relations have predictable outcomes, such as high labour turnover, absenteeism, stress and fatigue, low rates of productivity, excessive wastage of materials and labour unrest which are still too common. Another important issue is trade union rights. According to the WTO, the debate on the interaction between trade and labour standards is in many ways similar to the debate on trade and environmental standards. A concern expressed in some industrial countries is that excessively low standards in certain countries will impose downward pressure on standards, or give the low-standard countries an unwarranted competitive advantage. Developing countries, on the other hand, fear that this argument may be used as a surrogate form of protection. As with environmental standards, the WTO was not designed to set labour standards. This was made clear in the Singapore Ministerial Declaration of December 1996, which also acknowledged the competence of the International Labour Organization (ILO) in the matter of labour standards. If poor working conditions are the main reasons for a country’s competitiveness, then international competition will induce companies to relocate to countries with weak, non-existent or un enforced labour standards. Countries with higher labour standards may be forced to relax their own standards in a “race to the bottom”.

16.26 Summary

The “Business Environment” generally refers to the external environment, with which it interacts and transacts. International business refers to all those business activities which involves cross border transactions of goods, services, resources between two or more nations. Foreign trade has become the mainstay of many emerging economies and bolstered their GDP growth. The factors motivating the business enterprises for internationalization are classified into two groups, the pull factors and the push factors. The world trade and output are in a recovery phase, with the volume of world exports estimated to grow by 9.5 per cent in the year 2010. The most important international environments are economic, demographic, political, legal, technological and socio-cultural. International economic environment consists of the factors like nature of economic system, general economic conditions, various economic policies, and various production factors, that affects the international business. The countries of the world are classified in three categories on the basis of gross national income (GNI) per capita, into, Low-income countries, Middle-income countries and High-income countries. Apart from this, the per capita income level in the various country, the purchasing power of the citizens, the purchasing power parity, unemployment level, sectoral contribution rates, etc, also provides and overall understanding of the countrys's economic state and the prospects of the business. Another, important environment parallel to the economic environment is the demographic environment of the country. Different countries differ in their composition of the various demographic factors, thus, offering business opportunities, differently. For any business player, reviewing the present, estimating and forecasting the future trend of these different demographic factors is the primary exercise. On the other side, assessing the ramification of the prevailing political environment in the various countries also hold its own priority. Political environment of the country, consists of the political parties, the political systems, the economic policies framed by the ruling parties, the ideologies of both, the ruling parties and the opposition parties, the philosophies of doing business, as propagated and promoted by the political rulers of the country, reflected in the business and trade policies formulated, affecting the present and future of the players in the concerned trade, be it an international or domestic business enterprises.

The international business player has to continuously and cautiously screen the signs of political risk in the political environment and well-equipped, at times, to over come the adverse effects of the same. The international legal environment of a country comprises of the rules, laws and the constitutional provisions, regulating the behavior of the citizens, residents of the country and business and other entities, along with the process by which countries enforce the laws and provide redressed systems to all for their grievances. International business gets affected by three main legal frameworks, namely, International Laws, Host Country Laws and Home Country Laws. The world over, countries ascribe to three main legal systems, i.e. Common Laws, Civil Laws and Theocratic Laws. Various legal issues to be considered by the international business enterprises are Property Rights, Anti-Corruption Laws, Protection of Intellectual Property Rights and Anti-Trust Laws.

Moreover, in international markets, no two cultures from two adjoining and adjacent countries are similar. The elements of culture are influenced by the various cultural aspects, namely, Non-material Culture and Material Culture; Low context and High Context Culture; Mono-chronic and Poly-chronic; Individualism and Collectivism; Masculinity and Femininity as well as trust, fatalism, and future orientations. Various elements of the culture are ecology/geography, heritage, social-fabre, cultural values, cultural

imperative, cultural exclusives, language, information processing and religion. Cultural shock refers to the anxiety produced, often expressed in the feeling of lack of understanding, appropriateness or inappropriateness, and confused state, when a person moves to a completely new environment, coming on the surface after first few weeks of coming into the new place. There are various stages of cultural shock through which an individual passes. The international business enterprise has to also exercise their efforts in analyzing the positive and negative aspects of the culture on it business prospects and the human resources, highly vulnerable, and often prone to cultural shock.

Technology is the key to most of the problems in the present era of advanced technology. Technology throughout the countries of the world can be classified into, Emerging Technology, Innovative Technology and Established Technology. Technological environment is important for business as it affects the type of conversion process that it may adopt for its purpose. The choice of technology for a company depends on the type of competitive advantage it seeks to develop. According to the commonly observed pattern in the development of technologies, the rate of progress in a new technology follows an S shaped curve. The pattern of early innovations in a new-technology-based industry will be, first, product innovations (improving the performance and safety of the product); later, innovations shift to improving the production process. Moreover, in international technological environment, simply diffusion of the technology may not solve the strategic questions, but it has to be accompanied by the wise analysis based on the appropriateness of the technology also. The state of technological readiness rankings, are of vital input for analyzing the international technological environment of the world countries. Technology transfer is process involving dissemination of commercial technology, through communication of relevant knowledge between a transferor and a recipient. Various factors affecting the technology transfer (Internal and External), are, communication, financial, external, human, corporate and technology. Various issues involved in the transfer of technology, are, cost, appropriateness, dependence and obsolescence. Another important trend in international business has been the growth of intra-regional trade, fostered by the economic integration schemes or the regional integration. There is a worldwide trend towards forming new regional arrangements and to strengthen the existing ones. The important forms of economic integration are free trade area, common market, customs union, economic union and economic integration. The trading blocs/regions and organizations like, EU, SAARC, SAPTA, UNCTAD, UNIDO, ITC etc. affects the operations of the international enterprises considerably. The international trading system since 1948 was, at least in principle, guided by the rules and procedures agreed to by the signatories to the GATT which was an agreement signed by the member nations, with the primary objective to expand international trade by liberalizing, thereby all-round economic prosperity.

GATT was transformed into a World Trade Organization (WTO) with effect from January, 1995. The WTO, more powerful body than the GATT has an enlarged role than the GATT. India is one of the founder members of the IMF, World Bank, GATT and the WTO. However, the international business player scanning and exploring international environment has also to consider various other global issues pertaining to, the Business Ethics, Social Responsibility, Labour Issues, Environmental Issues, etc.

16.27 Self Assessment Questions

1. Define International Business Environment. Write a note on the motives to the business enterprise for internationalization.

2. Write a short note on the following:

a. International Economic Environment b. International Demographic Environment

3. Define and explain the following terms:

   (a) Expropriation (b) Domestication (c) Nationalism

4. Explain what kind of political risks an international marketing firm faces in the international political environment. How can an international firm safeguard its interests?

5. How can a firm assess vulnerability to political environments across the world and take preventive measures to avert it?

6. How does a government's trade policy affect the business of an international firm? Explain with the help of examples from your country.

7. Write a short note on the international dispute settlement process.

8. Discuss issues in the international legal environment.

9. Write a short note on the Intellectual Property Rights.

10. Explain the elements of culture.

11. Write a short note on Cultural Shock.

12. Discuss issues for technology transfer and measures for technology transfer in the international technological environment

13. Explain Technology 'S' Curve and discuss the relationship of the product and

    process oriented innovations.

14. Discuss the methods of technology transfer and factors affecting technology transfer in detail.

15. What is economic integration and briefly explain various forms of economic integration.

16. Discuss the formation of World Trade Organisation

17. Write short notes on: European Union, SAARC, UNCTAD, WTO

16.28 Reference Books

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· Shaikh S. (2010); Business Environment; Pearson; Delhi;

· Srinivasan R. (2002); International Marketing; (PHI) Eastern Economy Edition;

· Paul J. and Kapoor R. (2008); International Marketing-Text & Cases; Tata McGraw-Hill Publishing Company Limited; New Delhi;

- Prasad L. M. (2002); Principles and Practices of Management; Sultan Chand & Sons; New Delhi;

Unit - 17 International Trade

Structure of Unit:

17.0 Objectives

After completing this unit you will be able

- To give the overview of international trade.
- To give brief about India's foreign trade composition and direction.
- To elaborate on success elements required in an international trade.
- To explain the various risks involved in international trade and to discuss the importance of international trade to exporters.
- To discuss about the competition in international trade
- To explain the basic terms in international trade.
- To state the export cycle.
- To discuss the importance and various aspects of export documents
- To recognize the export documents in foreign trade
- To state the foreign trade policy highlights 2009-2014

17.1 Introduction

International trade is exchange of capital, goods, and services across international borders or territories. In most countries, it represents a significant share of gross domestic product (GDP). International trade is crucial to the continuance of globalization. Without international trade, nations would be limited to the goods and services produced within their own borders. International trade in principle is not different from domestic trade as the motivation and the behavior of parties involved in a trade do not change fundamentally ,whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

Another difference between domestic and international trade is that factors of production such as capital and labour are typically more mobile within a country than across countries.

International Trade refers to exchange of goods, services and ideas between two or more countries. The waves of liberalization, privatization globalization, and marketization (LPG & M) have opened up the Indian economy to global entrepreneurs, MNCs and investors for such exchange of goods, services and ideas. The LPG & M era has paved the ways for integration of India's economic, financial and non-financial systems with other economies regionally and globally, with the emergence of regionalism in the changed global economic context under WTO. Recent developments in international markets is that the developed world of Europe and North America is facing a financial crisis coupled with economic recession, has further driven the point that the future of the global economy lies in Asia, particularly in China and India. Indian entrepreneurs and MNCs are of the firm opinion that future lies in tapping global markets, particularly in Latin America, Africa, etc. Large domestic opportunities will certainly provide them an additional dividend in generating economies of scale, hedging risks and tapping India's demographic dividend in establishing Indian products, services and brands throughout the globe. They are particularly designing and devising their moves for international forays all around the globe through Greenfield investments, joint ventures, and acquisitions. All such trading, manufacturing and business activities that take place across national boundaries are referred to as International Business.

International Trade is crucial to India's economic health as it generates additional employment opportunities for the country through the exchange of goods; services and ideas and helps bring precious foreign exchange into the country. Greater international trade activity means more economic growth as the natural and physical resources of the country are effectively exploited, managed, used and traded, resulting in employment generation, foreign exchange accumulations, improved living standards, capacity enhancement in manufacturing and' in infrastructure and increased status of the country in global economic; political and social' issues.

Activity A:

1. List out the reasons, why International Trade, is crucial to India's economic health.

17.2 India's Foreign Trade: Composition and Direction

Export Composition: There was a substantial change in the composition of exports in 2008-09 and 2009-10(April-September) with the fall in share of petroleum, crude and products and primary products resulting in corresponding rise in share of manufactured goods.The share of petroleum, crude and products fell from 17.8 per cent in 2007-08 to 14.9 per cent in 2008-09 and 14.2 per cent in the first half of 2009-10, while the share of primary products fell from 15.5 per cent in 2007-08 to 13.3 per cent in 2008-09 and further to 12.7 per cent in the first half of 2009-10. The share of manufactured exports increased by 2.3 percentage points to 66.4 per cent in 2008-09 and further to 69.2 per cent in the first half of 2009-10 (Table 1).

India's moderate growth of 13.6 per cent in 2008-09 which was due to the high growth in the first half of the year prior to the setting in of global recession, was only due to manufactured exports as both primary products and petroleum, crude and products registered negative growths of (-)2.4 per cent and

(-)4.6 per cent respectively. Among manufactured products, the major drivers were gems and jewellery, engineering goods and chemicals and related products with export growths of 42.1 per cent, 18.7 per cent and 7.2 per cent respectively. The first half of 2009-10 when the global recession was in full swing, also saw an accentuation in the fall of India's export growth resulting in negative growth of (-) 29.7 per cent compared to the positive 48.1 per cent in the corresponding period of the previous year.

All the three sectors were badly affected during this period with petroleum, crude and products being the worst affected at (-)44 per cent export growth due to the low crude oil prices in the first half of 2009-10, which started declining from the high reached in the first half of 2008-09. Primary product exports also registered a decline of 32.4 per cent with fall in growth of both ores and minerals and agriculture and allied products. Manufactured goods registered negative export growth of (-)24.9 per cent, with the worst affected sectors being engineering goods at (-)34.6 per cent, followed by handicrafts including carpets at (-) 33.7 per cent and leather and leather manufactures at (-) 24.2 per cent. Examination of composition cum direction of exports in the Economic Survey 2007-08 had clearly shown the possible effect of the US slowdown on India's exports and the Economic Survey 2008-09 had shown the worsening effect of the US and global recession on India's exports.

A comparison of the commodity-wise growth of major exports to the United States, the European Union and 'Others' in 2008-09 and 2009-10 (April-September) shows that the fall in the shares of petroleum crude and products and primary products for the period was mainly in the 'Others' category. The consequent rise in share of manufactured goods during the above period was also in the case of 'Others'. Though the share of manufactures continues to be more important in the case of India's exports to the US market, there is a fall in the share in the first half of 2009-10 after a marginal rise in 2008-09. Exports of manufactured goods to the EU followed a similar pattern (Table 17.1).

Table 17.1 : Composition of Exports by major markets

Sr. No.		Percentage Share 2000-01 (Apr - Mar)	2007-08(Apr - Mar)	2008-09(Apr - Mar)	2008-09(Apr - Sep)	2009-10(Apr - Sep)	CAGR 2000-01 to 2006-07	Growth Rate 2007-08(Apr -Mar)	2008-09(Apr -Mar)	2008-09(Apr - Sep)	2009-10(Apr - Sep)
I	Primary Products										
	World	16.0	15.5	13.3	13.2	12.7	16.9	38.2	-2.4	44.5	-32.4
	USA	9.4	7.2	7.4	7.5	7.0	8.3	5.5	4.5	18.0	-30.7
	EU	13.1	9.4	8.3	8.5	9.0	11.5	20.0	-0.1	20.0	-26.3
	Others	19.8	19.1	16.2	15.5	14.8	19.5	44.7	-3.3	51.5	-33.2
(a)	Agree and Allied Products										
	World	14.0	9.9	9.1	9.1	9.0	10.4	43.0	4.4	53.7	-30.9
	USA	9.0	5.5	6.2	6.2	5.8	3.9	7.6	15.2	30.9	-29.9
	EU	11.9	7.4	6.9	7.0	7.3	8.7	22.8	4.4	30.8	-26.8
	Others	16.8	11.6	10.5	10.2	10.0	12.0	52.6	3.4	62.1	-31.8
(b)	Ores and Minerals										
	World	2.0	5.5	4.2	4.1	3.7	40.4	30.5	-14.6	27.2	-35.6
	USA	0.4	1.7	1.2	1.3	1.1	45.6	-0.6	-29.7	-19.6	-34.9
	EU	1..3	2.0	1.4	1.5	1.6	28.8	10.4	-17.1	-13.6	-23.7
	Others	3.0	7.5	5.7	5.3	4.8	42.1	34.1	-13.6	34.4	-35.7
II	Manufactured Goods										
	World	78.8	64.1	66.4	64.8	69.2	16.1	21.8	17.7	45.4	-24.9
	USA	90.6	82.1	82.9	82.4	78.9	10.9	8.2	2.2	22.2	-28.6
	EU	86.8	71.9	72.6	73.2	68.8	13.9	22.9	14.1	35.4	-34.5
	Others	70.9	58.3	63.0	59.7	67.7	19.2	25.6	23.3	56.0	-20.7
(a)	Taxttiles incl RMG										
	World	23.6	11.2	10.2	9.2	11.1	7.5	12.0	4.4	13.0	-14.7
	USA	27.2	19.8	18.6	17.1	18.6	8.5	-1.0	-4.8	0.2	-18.6
	EU	29.2	19.2	18.4	16.3	18.3	11.3	12.4	7.9	12.4	-21.7
	Others	19.8	6.9	6.5	5.8	7.7	4.1	20.3	6.2	20.5	-7.3
(b)	Gems and Jewellery										
	World	16.6	12.1	15.1	15.9	17.8	13.7	23.2	42.1	82.4	-21.7

	USA	29.3	24.0	21.9	24.2	24.7	9.7	4.6	-7.7	16.6	-23.6
	EU	11.5	7.5	8.3	9.8	7.1	8.7	28.5	24.8	72.6	-49.6
	Others	13.9	11.2	16.4	16.5	19.7	17.9	31.6	66.2	111.8	-16.4
(c)	Engineering Goods										
	World	15.7	20.7	21.6	21.3	19.8	24.9	27.2	18.7	48.8	-34.6
	USA	13.4	21.0	24.1	24.5	16.5	20.3	14.7	16.1	50.4	-49.7
	EU	14.0	23.1	25.7	27.6	22.8	26.3	31.8	25.7	56.1	-42.5
	Others	17.2	19.9	20.3	20.3	19.5	25.6	28.4	16.6	45.5	-28.2
(d)	Chemicals and Related products										
	World	10.4	13.0	12.3	11.5	13.1	24.6	22.2	7.2	29.0	-20.3
	USA	5.7	13.4	15.0	13.4	15.9	26.8	26.8	12.8	35.7	-11.2
	EU	9.7	13.8	13.2	12.4	12.8	23.8	28.1	7.4	24.4	-27.8
	Others	12.5	12.6	11.8	11.0	12.7	24.5	19.3	6.0	29.3	-19.6
(e)	Leather and Leather Mnfrs										
	World	4.4	2.1	1.9	1.9	2.0	7.5	16.1	1.5	17.6	-24.2
	USA	3.7	1.5	1.7	1.6	1.6	-1.5	-1.2	16.1	20.1	-27.4
	EU	11.4	6.6	5.9	5.9	6.7	7.8	20.2	1.0	17.6	-21.8
	Others	1.6	0.8	0.7	0.7	0.7	12.5	13.0	-2.1	16.6	-29.0
(f)	Handicrafts including Carpet handmade										
	World	2.8	0.9	0.6	0.6	0.5	1.5	7.2	-25.8	-12.2	-33.7
	USA	6.0	2.4	1.6	1.7	1.5	-1.2	-4.7	-30.6	-23.8	-35.0
	EU	4.4	1.5	1.1	1.1	1.1	3.4	-6.8	-18.0	-3.8	-33.2
	Others	0.8	0.4	0.2	0.2	0.2	3.4	65.8	-30.2	-6.9	-32.9
III	Petroleum,,crude products										
	World	4.3	17.8	14.9	17.8	14.2	46.3	53.6	-4.6	49.9	-44.0
	USA	0.0	3.2	0.7	1.3	1.8	230.3	136.0	-77.6	-64.5	1.4
	EU	0.0	11.5	10.7	10.3	12.8	883.9	99.3	5.4	65.8	-13.3
	Others	7.9	22.7	19.0	22.6	16.6	43.2	46.7	-4.2	52.4	-48.5
	Total Exports										
	World	100.0	100.0	100.0	100.0	100.0	19.0	29.0	13.6	48.1	-29.7
	USA	100.0	100.0	100.0	100.0	100.0	12.5	9.8	1.3	18.6	-25.4
	EU	100.0	100.0	100.0	100.0	100.0	16.6	28.7	13.0	38.1	-30.3
	Others	100.0	100.0	100.0	100.0	100.0	21.9	33.5	14.1	57.3	-30.0

Source :www.eximindiamart.com

The export growth performance of different categories of exports in 2008-09 shows that while primary products and petroleum products buckled under the pressure of world recession, despite a good growth in the first half of 2008-09, manufactured goods exports particularly to the EU and 'Others' were more resilient, though there was a moderation in growth. However, India's exports of manufactures to the US market grew by only 2.2 percent. This was due to the accentuation of the negative growth in textiles exports and the growth in gems & jewellery exports to the US turning negative. Textiles exports growth to the EU and 'Others', though low was positive, while growth of gems & jewellery exports to 'Others' was very robust at 66.2 per cent and was at 24.8 per cent to the EU market. In the first half of 2009-10, India's export growth of all items to almost all three destinations was negative with global recession in full swing. Among manufactured goods, textiles export growth was comparatively less negative mainly to 'Others', whose share also rose. India's gems & jewellery exports and chemicals & related products exports were more affected in the EU market, while the worst affected sector was engineering goods, especially in the US and EU markets with negative export growths of (-)49.7 per cent and (–)42.5 per cent, respectively. The performance of handicrafts (including carpets) exports which were badly affected even in 2008-09, worsened in all the three markets with a negative growth above30 per cent in all of them.

Import Composition: The composition of imports also underwent changes. Reflecting growing domestic concerns like inflation, the share of food and allied products imports which fell from 2.3 percent in 2007-08 to 2.1 per cent in 2008-09 increased to 3.5 per cent in the first half of 2009-10 with the increase in imports of edible oils and pulses (Table 17.2). The share of fuel imports fell from 34.2 per cent in 2007-08 to 33.4 percent in 2008-09 and 33.2 per cent in the first half of 2009- 10. Among fuel items, the share of POL, the major item, fell to 30.1 per cent in the first half of 2009-10 from 34.2 per cent in the corresponding period of 2008-09 reflecting the relatively lower oil prices. The share of fertilizers increased suddenly from 2 per cent in 2007-08 to 4.3 per cent in 2008-09 with growth in imports of nearly 250 per cent, but fell to 2.5 per cent in the first half of 2009-10. The most notable change is the fall in share of capital goods imports from 18.7 per cent to 15.5 per cent in 2008-09 and to 14.3 per cent in the first half of 2009-10. The commodity group 'Others' saw increase in share from 38.9 per cent in 2007-08 to 40.0 per cent in 2008-09 and 43.4 per cent in the first half of 2009-10. Even gold and silver and electronic goods increased their import shares in the first half of 2009-10 over the corresponding period in the previous year, despite high negative growths, as other items in the import basket had still higher negative growths.

Table 2: Commodity Composition of Imports Direction of Trade

	Commodity Group	Percentage Share				CAGR	Growth rate (Per Cent)			
		2001-01(Apr-Mar)	2008-09(Apr-Mar)	2008-09(Apr – Sep)	2009-10(Apr-Sep)	2000-01 to 2006-7	0207-08(Apr-Mar)	2008-09(Apr-Mar)	2008-09(Apr-Sep)	2007-08(Apr-Sep)
I	**Food and Allied Products of Which**	3.3	2.1	1.5	3.5	21.6	8.6	9.1	9.7	52.9
1	Cereals	0.0	0.0	0.0	0.0	112.4	-46.8	-93.3	32.6	-6.7
2	Pulses	0.2	0.4	0.3	0.6	41.1	55.2	-2.4	-10.3	40.0
3	Edible Oils	2.6	1.	0.8	2.0	8.3	21.4	34.4	4.7	67.6
II	**Fuel , of which**	**33.5**	**33.4**	**37.3**	**33.2**	**24.3**	**39.4**	**17.7**	**84.1**	**-40.3**
4	POL	31.3	30.1	34.2	30.1	24.1	39.4	14.7	82.8	-41.0
III	**Fertilizers**	**1.3**	**4.3**	**4.1**	**2.5**	**28.9**	**66.2**	**156.8**	**249.4**	**-59.4**
IV	**Capital Goods, of which**	**10.5**	**15.5**	**13.7**	**14.3**	**33.8**	**62.7**	**-3.9**	**71.7**	**- 30.2**
5	Machinery except Electrical & Machine Tools	5.9	7.8	7.3	8.2	31.8	43.9	7.7	46.6	-24.2
6	Electrical Machinery	1.0	1.2	1.2	1.2	26.4	46.5	27.7	82.3	-29.1
7	Transport Equipment	1.4	4.4	3.6	2.3	54.3	113.1	-34.3	134.9	-57.3
V	**Others, of which**	**46.3**	**40.0**	**40.8**	**43.4**	**22.9**	**22.7**	**23.8**	**46.5**	**-28.6**
8	Chemicals	5.9	5.0	5.1	5.8	21.9	25.8	23.0	59.0	-23.3
9	Pearls, Precious, Semi- precious Stones	9.6	5.5	5.7	4.4.	7.7.	6.5	107.7	122.2	-48.0
10	Gold & Silver	9.3	7.2	8.3	9.3	21.1	22.0	22.3	32.3	-24.9
11	Electronic Goods	7.0	7.7.	7.0	8.6	28.7	26.5	15.3	31.1	-17.7
	TOTAL IMPORTS	**100.0**	**100.0**	**100.0**	**100.0**	**24.5**	**35.5**	**20.7**	**55.1**	**-32.5**

Source: Calculated from DGCI&S data. Growth rate in US dollar terms.
www.eximindiamart.com

The directional pattern of India's trade has been changing constantly during the decade with the share of the top 15 trading partners increasing by 9.5 percentage points to 61.3 per cent in between 2004- 05 and 2008-09 (Table 17.3). In the first half of 2009-10, their share was 59.6 per cent. The major development in the direction of India's trade is that USA which was in the first position in 2007-08 has been relegated to the third position in 2008-09, with UAE becoming India's largest trading partner, followed by China. However, in the first half of 2009- 10, with oil prices moderating, China has gained a slight edge over the UAE to become India's major trading partner. According to the WTO's "International Trade Statistics 2009" the global recession reduced the trade imbalances of many countries. Japan's trade surplus fell from 2.1 per cent of the GDP before the crisis to 0.4 per cent in 2008, turning into a trade deficit of 0.02 per cent of the GDP during the first quarter of 2009. Germany's trade surplus of 8 per cent of the GDP until 2008 fell to 7 per cent in 2008 and United States' trade deficit of 6.8 per cent of the GDP in 2006 fell to 6.2 per cent in 2008 and further to 3.4 per cent in the first quarter of 2009. For the BRIC(Brazil, Russia, India and China) countries trade balances as a percentage of the GDP were more volatile due to trade in primary commodities, Russia and Brazil being specific examples. India has faced a structural deficit in merchandise trade that has grown especially from 2000 onwards. China's trade surplus of 7.6 per cent of the GDP in 2007 fell to 6.7 per cent in 2008 and 4.7 per cent in the first quarter of 2009, though initial monthly figures indicate that it is benefiting noticeably from the initial recovery of trade. Export Import ratios in Table 3 show that among its top 15 trading partners, India had bilateral trade surplus with five countries, namely the UAE, USA, Singapore, the UK and Hong Kong in 2008-09 and the first half of 2009-10. India's trade deficit with the USA and Singapore in 2007-08, turned into trade surplus thereafter. The export import ratio fell in 2008- 09 in the case of Hong Kong, though it recovered in the first half of 2009-10. The fall in export-import ratio from 0.8 in 2004-05 to the present 0.3 in the case of China needs special attention. Among the countries not in the top 15, Brazil is an interesting case. India's export-import ratio which had stabilized at above 2 till 2008-09 indicating a high trade surplus for India has suddenly turned into a trade deficit at 0.64 in the first half of 2009-10.

The disaggregated data for April-June 2009 indicate that this was probably due to the sudden fall in India's exports of refined POL to Brazil because of softening of crude oil prices and the sudden high rise in imports from Brazil of crude petroleum, besides sugar to meet domestic needs. High growth in imports of beverages, iron and steel, fats and oils from Brazil also seems to have contributed to the trade deficit. The UAE has displaced the USA as the topmost destination of India's exports in 2008-09 and 2009-10 (April-September) with an export share of 13.1 per cent and 14.4 per cent respectively. India's exports to all the top three export destinations—the UAE followed by the USA and China—registered negative growth of (-) 28.7, (-) 25.3 and (-) 21.9 per cent respectively. Region-wise, over half of India's exports (55 per cent) in the first half of 2009-10 were to Asia (including ASEAN), up from around 40 per cent in 2001-02. During 2009-10 (April-September), exports to Asia (including ASEAN) declined by 27.6 per cent and to Europe by 30.9 per cent. India's merchandise exports to South Asian countries declined by 30.4 per cent. In 2009-10 (April-September), Asia and ASEAN continued to be the major source of India's imports accounting for 61.3 per cent of the total. Country-wise, China remained the largest source with a share of 12 per cent in India's total imports followed by the USA (5.95 per cent), UAE (5.93 per cent) and Saudi Arabia (5.5 per cent). As a result of global recession, India's import growth from 14 of the top 15 trading partners was negative, Indonesia being the exception.

Table 17.3 India's Trade and export-import ratio with major trading partners

			Share in total trade				Export/Import Ratio				
		2004-05	2007-08	2008-09	2008-09 (Apr-Sep)	2009-10 (Apr-Sep)	2004-05	2007-08	2008-09	2008-09 (Apr-Sep)	2009-10 (Apr-Sep)
1	UAE	6.1	7.0	9.8	8.7	9.2	1.6	1.2	1.0	1.5	1.5
2	China	6.5	9.2	8.6	7.4	9.4	0.8	0.4	0.3	0.3	0.3
3	USA	10.6	10.1	8.2	6.9	8.1	2.0	1.0	1.1	1.4	1.2
4	Saudi Arabia	1.4	5.6	5.1	5.6	4.4	1.1	0.2	0.3	0.3	0.3
5	Germany	3.5	3.6	3.8	3.1	3.5	0.7	0.5	0.5	0.6	0.5
6	Singapore	3.4	3.7	3.3	3.3	3.2	1.5	0.9	1.1	1.4	1.1
7	Iran	0.8	3.1	3.0	3.2	3.3	3.0	0.2	0.2	0.2	0.2
8	Hong Kong	2.8	2.2	2.7	1.8	2.5	2.1	2.3	1.0	2.8	2.1
9	Korea RP	2.3	2.1	2.6	2.2	1.9	0.3	0.5	0.5	0.5	0.0
10	UK	3.7	2.8	2.6	2.2	2.4	1.0	1.4	1.1	1.3	1.3
11	Australia	2.3	2.2	2.6	2.5	2.9	0.2	0.1	0.1	0.1	0.1
12	Switzerland	3.3	2.5	2.5	3.1	2.8	0.1	0.1	0.1	0.0	0.0
13	Japan	2.7	2.5	2.2	2.0	2.3	0.7	0.6	0.4	0.4	0.5
14	Malaysia	1.7	2.1	2.2	1.9	1.9	0.5	0.4	0.5	0.4	0.7
15	Nigeria	0.4	2.1	2.1	2.3	1.9	13.3	0.1	0.2	0.1	0.2
	Total(1 to 15)	51.8	60.7	61.3	56.3	59.6	1.0	0.6	0.5	0.6	0.6
	Total Trade	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**

Source: Computed from DGCI&S data "A coefficient of export and import ratio between 0 and 1 implies that India's imports are greater than Exports and a coefficient greater than one, that India exports more than what it imports.
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Service Trade: Trade in services like transportation of goods is directly dependent on merchandise trade while in others like financial services it is complementary, with the advancement of telecommunications and computer technology, virtually all commercial services including health care and education have become tradable across borders without movement of natural persons. The trend towards globalization, reinforced by liberalization policies and the removal of regulatory obstacles, has fuelled steady growth of international investment and trade in services.The Global Economic Prospects 2010 report of the World Bank states that the global economic crisis also affected services trade which, was more resilient than merchandise trade. The term "Invisibles", which is generally used as a synonym for services, is most apt for this sector as regards recent data and information. Any analysis on the impact of the crisis on trade in services has to be made from the tit bits of information available from several widely spread out sources. Piecing these bits of information together shows that the global financial crisis which affected trade credit and also resulted in a slump in merchandise trade had both a direct and indirect bearing on trade in services. Some services like transport for which goods trade itself is a barometer of performance were severely hit.

India's Services Exports: India, which is moving towards services dominated GDP growth with a 9 per cent CAGR for services which is higher than the 5.8 per cent for non-services during 2000-01 to 2006-07, is also moving towards a services-dominated export growth with a CAGR of 28.7 per cent for services during 2000-01 to 2006-07 which is higher than the 19 percent for merchandise exports during the corresponding period. Services exports reached US$ 102 billion in 2008-09 with a moderate growth of 12.5 per cent over the previous year. Growth has been reasonably good in the miscellaneous services category which has increased its share by 16.1 percentage points to 76.4 per cent in 2008-09 compared to 2000-01. While the share of software services increased by 6.5 percentage points to 45.5per cent, the share of non-software services increased by 9.6 percentage points to 30.9 per cent. The CAGR of miscellaneous services was very high at 33.4 per cent during 2000-01 to 2006-07 followed by annual growth rates of 21.3 per cent and 15.9 per cent respectively in 2007-08 and 2008-09. While the high growth rate of the US $ 47 billion (2008-09) software services exports is well known, the high CAGR of non-software services during 2000-01 to 2006-07 is noteworthy. This was due to the high growth in communication services and business services exports, which, however, have fared very badly in both 2008-09 and the first half of 2009-10 with negative growth rates; and financial services which registered high CAGR during 2000-01 to 2006-07 and high growth in 2008-09.

The impact of global recession was visible on India's services exports, the growth of which declined to (-)21.4 per cent in the first half of 2009-10 compared to the high growth of 27.6 per cent in the corresponding period of the previous year . Except insurance, all the items witnessed a negative growth. While fall in transportation exports is a reflection of the fall in merchandise trade, fall in travel services is a reflection of the decline in tourist arrivals which declined by 1.8 per cent in the first quarter of 2009-10. In 2009, Foreign Tourist Arrivals (FTAs) at 5.11 million registered a negative growth of (-)3.3 percent as compared to the 4 percent positive growth in 2008.Foreign Exchange Earnings (FEE) from tourism which grew by 9.5 percent in 2008 fell to US $11.39 billion in 2009 with a negative growth of (-)3 per cent 7.61 Services exports are expected to grow in 2009-10, though at a relatively slower pace. While the lower merchandise trade affected transportation exports in the first half of the year, with pick up in global and India's trade, transportation exports are also expected to pick up. Software including BPO services after a negative export growth in the first half of 2009-10 has shown a recovery with an estimated positive but tepid growth of 5 percent in 2009-10 and a projected 13-15 per cent growth in 2010-11, according to NASSCOM. Receipts under business and professional services are also expected to be higher. According to the Ministry of Tourism, though foreign tourist arrivals declined in the first quarter of 2009-10, the growth rate has marginally improved during April-September 2009 as compared to the corresponding period of the previous year. In fact, both FTA and FEE have picked up in December with growth rates of 21 percent and 44.4 percent respectively over December 2008. Given the trend, travel receipts are also expected to improve in the remaining period of the year.

India's Services Imports: Imports of commercial services have become important in recent years reaching US$ 52.0 billion in 2008-09 though growth had decelerated to 1.1 percent due to global recession Business services are the most important category of services imports, followed by transportation and travel. Import growth of business services which declined by (-) 6.8 per cent in 2008-09 picked up by 16.9 per cent in the first half of 2009-10. Import growth of transportation and travel which decelerated in 2008-09 was negative in the first half of 2009-10 and particularly so in the case of transportation. Insurance, financial and communication services have registered positive growths.

Activity B:

1. Develop a bar diagram for India's Export and Import of services on the basis of data provided. Analyze the factors for its fluctuations.

17.3 Elements of Success In International Trade

Some important elements of success in International Trade are as follows:

1. **Coordination in Planning and Results of Firm:** Planning has been considered to be the key element of success in any business operations as it helps marketers to foresee the emerging challenges and problems and helps to devise the strategies to be implemented for handling such problems and challenges. Once marketers have identified and selected a particular export market, they must emphasize on having a deep understanding of various aspects of that market. The most important factor that the new exporters need to keep in mind is that they have to maintain control on high expectations in the beginning as international trade operations require a degree of patience.

2. **Understanding Foreign Cultures, Business Etiquettes and Practices**: Knowledge, understanding and sensitivity in target country cultures, business etiquettes, beliefs and practices are a must for an entrepreneur/Company. Something which is considered good in one country or culture may not be good for others. For example, green is favorite Colour of Muslims all around the world except in Malaysia it is considered as symbolic of ill will, poor health. Similarly white colour is considered bad in China, North Korea,South Korea and Japan but in Western countries, the bridal suit is usually of white colour.

3. **Hard work Dedication Devotion and Reliability:** Hard work (smart work) is an integral part of success. An international marketer must take necessary steps to win the trust and loyalty of importer through his actions and words. Good relationship between exporters and importers are essential for success in international trade. -Hard work, dedication, devotion and trust work are inbuilt advertising tools and help the exporter in bringing fruitful sales contract and order.

4. **Innovation and Product Adaptation:** Product specifications, standards and requirements vary from country to country due to various technical and regulatory reasons. For example, when

Toyota designed their car and tested it on Indian roads there was a high accident rate because the car was designed for Japanese roads, which are far broader and better paved than Indian roads. Subsequently, Toyota decreased the speed of their car to suit Indian customer requirements. Such reasons for innovation and product adaptation can be different due to any of the following factors:

(a) Specific Packing and Packaging requirements

(b) Labeling and Marking requirements

(c) Product Specifications and Standards

(d) Consumer Tastes and Preferences.

Therefore product adaptations and modifications are essential for any company entering foreign markets. Coca Cola has to sweeten its Thumps-Up as Indians consume more sugar than their counterparts in the US or elsewhere.

5. **Identifying Customer's Wants and Needs:** "Customer is a king" and, therefore, changes in his needs, choices and preferences is well expected as he wishes to be accepted with new products, design and styles continuously. To be successful the exporter/importer shall keep a continuous tab on changing market trends. It is essential to identify the needs and wants of customer in the beginning itself so that necessary adaptations or modifications can be made in the product.

6. **Planning Financial Resources:** "Finance is the life blood of an organization'. 'The exporter has to be particularly more careful as the gestation period of international transaction is larger. More importantly, international trade is prone to various risks such as exchange rate fluctuations, balance of payments crises, political risks, economic risks etc. It is important and essential to plan ones financial resources and crosscheck their turnover cycle effectively in the beginning itself to avoid any unforeseen situation during the course of business.

7. **Positive Attitude and Futuristic Thinking:** An international marketer must be of positive attitude and shall have futuristic thinking so as to take his organization ahead of the competition. Those organizations are successful that beat the competition in the markets and not only study the customers needs, but manage to surpass them. The making of Walkman by Sony Corporation is best example how futuristic thinking can be of help to an organization.

8. **Smartness Required:** International trade is to be viewed with long-term commitments and constant and growing business for the firm. It requires a leader (international marketer) who enjoys working with different people and winning new overseas customers in a systematic manner. International trade is a lengthy exercise and international trader has to be smart enough to manage the things in different markets, which are quite different ethnically.

9. **Documentation Knowledge Essential:** Being successful in international trade requires that the marketer master various trade documentation procedures and practices. He must be well-versed in using and understanding the role and importance of these trade documents as no international trade transactions can be completed without these documents.

17.4 Risks in International Trade

The international business is more risky as compared to domestic business. Some of the major risks in international business are as follows.

1. Financial Risk:

One of the most important worries of the exporter in international trade is to obtain their payments from the importer. The exporter not only has to check the creditworthiness of the importer but he also has to check the rules and regulations of foreign country buyers. The period of trade cycle in international trade is longer as well as the degree of risk is higher in financial matters. Legal work in international trade is a costly process hence the exporter must take prudent decision in choosing the method of receiving payments from the foreign buyers.

2. Foreign Exchange Fluctuation Risk:

If the exporter is carrying on trade in Indian rupees and sales proceeds as per government policy, the trader has to be immensely careful in taking note of depreciation or appreciation of the Indian rupee. The Reserve Bank of India has come out with various ways, to help exporters get hedged against such ex-change rate fluctuations risks.

3. Country and Customer Risk:

There are risks associated not only with the importer/importing company, but also with the country where he or his business is located.

(a) Target Country Risk:

(1) In case of economic crisis, there may be foreign exchange restriction that may prevent the outflow of funds from the importer's country or release of payments to the exporters.

(2) The country where the buyer is located may impose import restrictions after the contract between exporter and importer has been signed and such restrictions imposed may prevent the exporter to execute the contract due to such import restrictions.

(3) Another kind of target country risk is related to political and economic situation in the country, as business suffers mostly in case of breakdown in political and economic situation of any country.

(4) There may be collapse of banking systems of importer countries.

(5) There may be war, rebellion, battles, major terrorists or cyber attacks or civil unrest in the importer country breaking down the country financial and banking system.

(6) There may be natural disasters in importer country such as tsunamis, earthquakes, volcanic eruptions, droughts or floods etc.

(b) Customer (Importer) Risks:

(1) The solvency of the importer is major issue to be checked by the exporters. Some of the essential things to be checked are how long the importer has been into the business and what kind of business or businesses he has been doing in the past. Exporters shall check the relations of importer or the importing company with their -suppliers, banks and government.

(2) The creditworthiness of the importer is an important aspect to be checked by the exporter/ exporting company.

(3) Having checked the solvency and creditworthiness of the importer/importing company, the exporter/exporting company shall take necessary steps to cover risks through insurance covers from ECGC as sometimes the importer, although being sound in solvency and creditworthiness may be exposed to risks that are beyond his control. To cover the payments risk due to importer default or insolvency or country exchange restriction, it is advisable that the exporter gets his transactions covered by the Export Credit Guarantee Corporation.

Activity C:

1. Find out what kind of financial risk does the exporter in international trade face. Specify the recommendations you would make in order to avoide or minimize risk.

17.5 Importance of International Trade to Exporter

Business and industrial firms are also benefited from export trade as they have an opportunity to participate in international trade activities and can have several advantages to their business activities such as greater economies of scale. The benefits from exports to the exporters and exporting companies are as follows:

1. **Lack of Domestic Demand:** In case there is insufficient demand for the product or services offered by the exporter/exporting companies in domestic markets, they can take a decision to enter the foreign market so as to sell their commodity in international markets. India exports surplus goods and services such as mica, magnesium, jute, coffee, tea, natural rubber, textiles etc. In this way, it can synchronize its production and the demand.

2. **To Utilize Installed Capacity:** In case the exporter/exporting company has more installed capacity than the level of demand of the product in the domestic market, it can enter into international market and utilize its unutilized installed capacity for selling the goods and services in the international markets.

3. **Legal Restrictions:** The government can impose certain restriction on the growth and expansion of certain firms or the production and distribution of certain commodities in the domestic market in order to compel them to sell part of their produce in international markets, so that foreign currency can be availed.

4. **Relative Profitability:** Export trade is usually more attractive and profitable as exporter has better returns in overseas markets along with several exemptions/benefits from his own government. Exporters are encouraged for export through various schemes in production, processing, selling and financing the export transactions.

5. **Less Business Risk:** There may be ups and downs in any market but a diversified export business, scattered into many markets, helps the exporting firm in mitigating the risk of sharp fluctuations in the business activity of the firm.

6. **Increased Productivity:** Due to certain scientific and technological developments and greater economies of scale, exporters can have large-scale business and can have industrial great extent for overseas markets. Such large-scale production, therefore, will be higher but at a cheaper cost of production.

7. **Social Responsibility:** In order to meet social responsibilities, some business firms, especially those that are public enterprises, decide to contribute to the national exchequer by exporting their production. In India, many public sector enterprises such as Hindustan Zinc Ltd., Bharat Earth Movers Ltd., Hindustan Electronics, DRDO, RHEL, Hindustan and other organizations use to contribute foreign exchange to exchequer through exports.

8. **Technological Improvements:** In developing or underdeveloped economies, companies enter into alliances, joint ventures with foreign firms for the sake of technological transfer and

improvements. Such jointly-owned firms have a better understanding of local and overseas markets and can effectively utilize their experiences know-how and core strengths for penetrating new markets through their technological improvements and face competition in overseas markets successfully, as such firms can offer better quality products to end users.

9. **Product Obsolescence:** Exporter in international markets have the advantage of selling even obsolete products in the overseas markets as the product passes through various stages of its life cycle and even if this product has become obsolete in the domestic Market it may be in demand in over seas market.

10. **International Collaboration:** Exports provide an opportunity for international collaborations as developed as well as developing countries can join their efforts to sell their products in third country markets.

11. **Closer Cultural Relations:** International trade brings various countries closer culturally as better trade relations are established among the countries through various government and non-government trade commissions or trade representatives. Traders from one country' come into contact with foreign representatives and come to know their selling, marketing and production practices. The employees of various firms also come into contact with the persons of other countries and sometimes such contacts and relationships help the exporter to further expand his business.

17.6 Advantages and Disadvantages of International Trade

The comparative advantage in international production and trade is achieved when each trading partner has a product that will fetch a better price in another economy than it will in the home market. If each nation continues to specialize in producing the goods and services in which it has a comparative advantage, in such a situation, more goods will be produced, traded and sold among nations and the wealth of both the importing and the exporting nations and firms increases. The following are some of the specific advantages and disadvantages of export trade:

Advantages of International Trade are as Follows: The advantages of international trade are as follows :(1) Increase in domestic competitiveness. (2) Increase in sales and profits. (3) Increase in global market share. (4) Decrease in dependence on existing markets.(5)Better use of corporate technology and technical know-how. (6) Global sales potential of existing products. (7)Control on cyclical market fluctuations. (8)Better chances of corporate expansion.(9)Using excess production capacity effectively.(10) Better learning curve through information about foreign competition.

The fundamental advantages, of international trade offers several other advantages like increase in domestic competitiveness, lower cost of production, better products and effective management of cyclical trends in industry. International trade helps in more efficient and increased global production and allows nations and firms to consume a larger and more diverse bundle of goods and services. International trade is particularly more relevant and beneficial to smaller nations possessing limited natural resources as it enables them to participate in global buying and selling and makes them able to produce and consume more than it would have otherwise been possible.

Disadvantages of International Trade are as Follows: 1. Arranging new promotional material thereby increasing cost of sale.2. No short-term gain, long-term financial commitment required.3. Increase in administrative costs.4. Increase in human resource cost due to increase in travel. 5. Long gestation period of receiving payments.6. Modification in product packaging and labeling as per importer country requirements.7. High financial cost and delayed returns.8.Heavy administrative cost due to various export licenses, authorizations and Export documentation.

17.7 Competition in International Markets

Michael E.Porter has given a very simple way for assessing, analyzing and appraising the competitive strength of the firm keeping in mind its factors conditions, related industries, demand conditions and corporate strategy. The elaboration of various aspect of analysis and appraisal of Competition are as follows.

1. The Threat of Substitute Products:

According to Porter', if close substitutes of products exist in the market, it can increase the chances of customers switching over to the substitute products when the prices of the existing product will increase in response to high elasticity of demand in the market. This will happen due to any of these reasons which are as follows :(1) Importer's/buyer's intention to substitute the product or services is flexible and higher. (2)Competitors offer better price performance of substitute's product and services.(3)Importers/Buyers have lower switching cost to another product or services. (4)Importer/ Buyer keeps on changing as they have higher perception of level of product differentiation from one manufacturer to another.

2. The Threat of the Entry of New Competitors:

The new firms enter the market because of high returns, as profit is one of the driving forces for selecting a market in the LPG & M era. This will lead to rivalry/price wars among firms and as a result the profitability of the firm will decrease. Such kind of competition can be restrained if they can block the entry of new firms, or alternately, there are high entry and exit barriers making firms reluctant to enter new markets.. Firms can survive in such kind of competition if (1) Entrant competitors have greater opportunities product diversification, extension and modification as per importer/buyer's choice.(2)Entrant competitors have high reputation, prestige and brand equity in the target markets.(3)There are low entry and exit barriers for the firms' vis-à-vis patent s, rights, etc. (4)Switching costs or sunk costs are lower for players in the target segment.(5)There are lower requirement of capital for business in target segment.(6) Distribution channels and logistics are easy for the product and services, allowing various players to enter without any cost and risks involved.(7) Entrant competitors offer better product or services as it enjoys absolute cost advantages in target segment.(8) Entrant competitors have higher learning curve in this segment.(9)The segment is prone to possibility of price war.(10)Segment has favorable government policies vis-à-vis other segments.

3. The Intensity of Competitive Rivalry:

In the LPG & M era, the most important determinant of the competitiveness of any industry is the intensity of competitive rivalry. Rivals are supposed to compete aggressively and each firm will try to differentiate its offer from each other; and sometimes rivals compete with each other on the basis of non-price factors such as technological innovation, marketing, etc. such kind of competition will be marked by following features:(1) There will be greater number of competitors in market due to higher returns.(2)Market segments have higher growth rate of industry, economy and disposable income.(3)Market segments have intermittent industry overcapacity.(4)Market segment has lower exit barriers.(5)There will higher diversity of competitors as they come from different background.(6)Market segment is manifested with problem of informational complexity and asymmetry.(7)Competitors will try to maximize their share, as they will have fixed cost allocation per value added.(8)Market segment will require higher level of advertising expense.(9) Market segment has unsustainable economies of scale prompting others to jump in.

4. The Bargaining Power of Customers:

In the LPG & M era, the customer is a king and meeting his expectations is rightly described as the market of outputs. The customers demand new product and their ability of putting the firm under pressure is an essential factor of competition that the firms has to handle with unique products, better designs etc. Such bargaining power of the customer will also affect the customer's sensitivity to price changes. The other factors are as follows: (1) There is less buyer concentration than the firms' concentration in the market segment.(2)Importer will have a bargaining leverage, as industries will like to continue operations due to high fixed costs and minimize their losses in short run.(3)Importers/buyer buying volumes are higher.(4)Importer/buyer switching costs are lower in comparison to the firm's switching costs.(5)The buyer has easy cost free and prompts first-hand information on the market segment.(6)Due to his higher volume, the buyer can integrate backward with suppliers.(7)The buyer has choice; availability and affordability of substitute products from other sources. (8)Importer/buyer is sensitive to price of product or services.

5. The Bargaining Power of Suppliers:

In the LPG & M era, suppliers are acquiring critical factors in marketing success, as input has become a driving force in managing competition. Some of the factors are as follows (1) Supplier has lower switching costs in comparison to buyers.(2) The supplier's product is highly differentiated and unique from competitors.(3)There is absence of substitute inputs in market segment.(4) A supplier is uniquely positioned as market segment has few suppliers and large number of buyers. (5)Suppliers enjoy better space for forward integration than the buyers.

17.8 Basic Terms in International Trade

The International chamber of commerce has defined a set of international trade terms indicating the responsibilities or obligations of the buyer and seller.

The following are some of the frequently used terms in foreign trade which are as follows:

1. **Free Alongside Ship (FAS):** FAS means "Free alongside Ship". Under this term the seller's obligations are fulfilled when the goods have been placed alongside the ship on the quay or lighters. The buyer has to contact with the sea carrier for the carriage of the goods to the destination and pay the freight. The buyer has to bear all costs and risks of loss or damage to the goods thereafter. The seller must supply the goods in conformity with the contract of sale, together with the evidence of conformity as may be required by the contract, and also deliver the goods alongside the vessel at the 'loading birth named by the buyer at the named port of shipment in the manner customary at the port , within the period stipulated, and notify the buyer, without delay, that the goods have been delivered alongside the vessel . The Buyer must give the seller due notice of the name, loading birth of and delivery dates to the vessel. The buyer should also bear all the charges and risks of the goods from the time when they shall have been effectively delivered alongside the vessel at the named port of shipment at the date or within the period Stipulated, and pay the price provided as in the contract.

2. **Free on Board (FOB):** FOB means "Free on Board". The goods are placed on board a ship by the seller at a port of shipment as named in the sale contract. The risk of loss or damage to the goods is transferred from the seller to the buyer when the goods past the ships rail. The Seller must supply the goods in conformity with the contract of sale, together with evidence of conformity as may be required by the contract. The seller at his own risk obtains export license or other governmental authorization necessary for the export of the goods. The buyer must at his own expenses, charter a vessel or reserve the necessary space on board a vessel and give the seller due notice of loading birth of and delivery dates to the vessel, and the buyer bear all risks and costs of the goods from the time when they shall have effectively passed the ship's rail at the named port of shipment, and pay the price as provided in the contract.

3. **Cost and Freight (C&F):** C & F means "Cost and Freight". The seller must pay the cost and freight necessary to bring the goods to the named destination but the risk of loss or damage to the goods, as well as of any cost increase, is transferred from the seller to the buyer when the goods pass the ship's rail in the port of shipment. The seller must Supply the goods in conformity with the contract of sale, together with evidence of conformity as may be required by the contract .The seller at his own risk and expense obtain Export licence or other governmental authorization necessary for the Export of the goods. The Buyer must accept the documents when tendered by the seller, if they are in conformity with the contract of sale, and pay the price as provided in the contract and also bear all risks of the goods from the time when they shall have effectively passed the ship's rail at port of shipment.

4. **Cost Insurance Freight (CIF):** This term is basically same as C&F, but with the addition that seller has to obtain insurance at his cost against the risks of loss or damage to the goods during the carriage. The seller contracts with the insurer and pays the insurance premium. The buyer should note that under the present term, unlike the term "Freight/Carriage and insurance paid to "the seller is only required to cover insurance on minimum conditions (so-called FPA conditions). The Seller must supply the goods in conformity with the contract of sale, together with such evidence of conformity as may be required by the contract. The seller at his own risk and expense obtain any Export licence or other governmental authorization necessary for the Export of the goods. The Buyer must accept the documents when tendered by the seller, if they are inconformity with the contract of sale, and pay the price as provided in the contract, buyer must also bear all risks of the goods from the time when they shall have effectively passed the ship's rail at the port of shipment.

5. **Freight or Carriage Paid (DCP):** While C&F is used for goods which are to be carried by sea, the term "DCP" is used for land transport only, including national and international transport by road, rail and inland waterways. The seller have to contract for the carriage of the goods to the agreed destination named in the contract of the sale and pay freight. The seller's obligations are fulfilled when the goods are delivered to the first carrier and not beyond. In case the buyer desires seller to insure the goods till the destination, he would add 'including insurance' before the word 'paid in Freight' or 'Carriage Paid to'.

6. **Ex -Works:** This means seller's responsibility is to make the goods available at the factory.

7. **EX-Ship:** This is an arrival contract and means that seller makes the goods available to the buyer in the ship at the named port of destination as per sales contract. The sellers have to bear the full

cost and risk involved in bringing the goods. The seller's obligation is fulfilled before the customs border of the foreign country and it is for the buyer to obtain necessary import license at his own risk and expense.

8. **Free on Rail (FOR) and Free on Truck (FOT):** These terms are used when the goods are to be carried by rail, but they are also used for road transport. The seller's obligations are fulfilled when the goods are delivered to the carrier.

9. **EXQ/Ex-Quay:** Ex-Quay means that seller makes the goods available to the buyer at a named quay. As in the term 'Ex-Ship' the points of division of costs and risks coincide, but they have now been moved one step further from the ship into the quay or wharf i.e. after crossing the customs border at destination. Therefore, in addition to arranging for carriage and paying freight and insurance seller have to bear the cost of unloading the goods from the ship.

10. **Delivered at Frontier (DAF):** The term is primarily intended to be used when the goods are to be carried by rail or road. The seller's obligations are fulfilled when the goods have arrived at the frontier, but before the 'Customs border' of the country named in the sales contract.

11. **Delivery Duty Paid (DDP):** This term may be used irrespective of the type of transport involved and denotes seller's maximum obligation as opposed to 'Ex-Works'. If seller have not fulfilled his obligation till proper time then the goods are made available at his risk and cost to the buyer at his premises or any other named destination. In the latter case necessary documents (e.g. transport document or Warehouse Warrant) will have to be made available to the buyer to enable him to take delivery of goods. The term 'duty' includes taxes, fees and charges. Therefore, the obligation to pay VAT (Value Added Tax) levied upon importation will fall upon seller. It is, therefore, advisable to use 'exclusive of VAT' after the words 'duty paid'.

12. **Free Carrier (Named Point) FRC:** The term has been designed particularly to meet the requirements of modern transport like 'multi-modal' transport as container or 'roll-on-roll-off' traffic by trailers and ferries. The principle on which the term is based is same as applicable to FOB except that the seller or the exporter fulfills his obligations when he delivers the goods into the custody of the carrier at the named point.

13. **Freight Carriage and Insurance Paid (CIP):** The term is similar to 'Freight or Carriage Paid. In case of CIP the seller have additionally to procure transport insurance against the risk of loss or damage to the goods during the carriage. The seller contract with the insurer and pay the insurance premium.

14. **FAO/FOB Airport:** 'FOB Airport' is based on the same main principle as the ordinary FOB term. The seller fulfills his obligations by delivering the goods to the air carrier at the airport of departure, Without the buyer's approval delivery at a town terminal outside the airport is not sufficient, the seller's obligations with respect to costs and risks do not extend to the arrival of the goods at the destination.

17.9 Export Cycle (Export Procedure)

The exports procedures or export cycle refer to the essential steps involved in registering a firm for exports and imports with the offices of the Director General of Foreign Trade in India. No activity under the Exim Act for export or import can be undertaken by any individual or organization until and unless they have obtained an importer- exporter code from the required office.

Important Steps in Processing of an Export Order

1. **Inquiry and Offer**: The exporter may get an inquiry for exports through the trade promotion councils or a direct request from the prospective importer from another country. The enquiries will contain information on the details of products and goods required by the importers from abroad. The inquiry will also specify complete details of the goods e.g., the volume and the value, the grading. Catalogues, sizes , weights, the international standardizations certificates, the expected time of delivery and the mode of shipment along with the port of destination etc.The exporter can obtain more information on the intended importers through the trade promotional councils if required. He must immediately attend to the enquiry by responding through the email and provide details on products through literature and catalogues etc. At the outset, the exporter will have to make his offer to the importer in which he will have to submit his quotation on a proforma invoice and other relevant details like the products to be supplied, their rates, quantity. The quality, value, details regarding the freight, insurance and other charges. He will also have to quote the time of payment, the method of payment if letter of credit needed the conditions of sale, delivery period and other details on warranty/inspection, approval by the home authorities, certification by the international standardization authorities etc.

2. **Acceptance and Confirmation of Purchase Order:** Once the importer has accepted the offer made to him, he will have to place an order with the exporter. The negotiation if any will take place before placing of a confirmed order by the foreign buyer. The exporter on his part will have to confirm the acceptance of the order by immediately conveying his acceptance in writing. The seller will have to send a proforma invoice in triplicate to the buyer and ask him to return two copies duly acknowledged and signed by him so that out of these two signed copies, one copy can be signed by the exporter too and sent back to the importer buyer. This will signify the confirmation and acceptance of the order by the exporter too and an international contract for the export order will become binding between both the parties.

3. **Export Sales Contract:** The confirmation and the acceptance of the offer will result into formation of an export contract between the exporter and importer. This contract will carry details on the terms and conditions of the international deal. Although there are no specified rules by any competent authority on the export contracts, but a normal contract will carry details pertaining to details of goods, their quality and quantity, price per unit and the total value of the contract, validity of prices, delivery/ shipment periods, packing and forwarding instructions, inspection if needed, terms of payment, insurances and finally documents and certificates needed to fulfill the documentary requirements.

4. **Export Permissions and licenses:** There is freedom to export all items unless these items are banned or put on the restrictive list for which a license will be required from the competent authority. The exporter will have to check if he needs to get the license issued for the items for which he has received the export of order.

5. **Managing Finances for Exports:** There are various schemes and finances available for pre-shipment finances. The exporters can check with the banks and export promotion councils of their respective products as to how to avail these financial assistances.

6. **Managing Production/Procurement of Goods:** Once all formalities have been completed and the exporter has entered into a sales contract with the importer, the exporter has to now ensure that he manufactures or procures goods as per the specification given in the export contract.

7. **Reserving Shipping Berth:** Though the leading shipping companies announce their schedules in leading media papers and daily shipping intelligence news from time to time but generally the task of booking berth space for cargo is outsourced by shipping companies to the carrying and forwarding agents (C&F agents).

8. **Packing and Marking:** The importer will specify in the export contract about the standards and specifications to be followed for the packing and marking of the goods meant for exports. In the absence of any instructions the standard practices prevailing in the industry will have to be followed. The Bureau of Indian Standards have specified certain standards for packing of export items, the exporter can get these details from the bureau. Similarly Indian Institute of Packaging set up by the government of India in 1966 about the requisite know how on export packing standards and the institute have been advising the exporters on these developments at the international level. The international institutes e.g. the British Standard Institution and the standard institutions of many other countries have their own packing standards for different items. In addition the shipping companies will have their own specifications for the packing that can be accommodated on the shipping berths. The exporter will have to follow these instructions thoroughly in order to avoid facing rejections at a later stage.

   The standardized international markings will have to be followed in addition to the special marking instructions given by the importer. Generally these markings will include the private marking of the consigner, the shipping marking of the consignee, the port of destination, measurements, the country of origin and special handling instructions if any e.g, fragile, handle with care etc.

9. **Preshipment Inspection :**In order to ensure the exporters from India strictly adhere to the quality expectations and standards of international trade, the government of India had introduced the Export Quality Control and inspection Act in the Year 1963. As per this act certain items meant for exports have been put on compulsory pre-inspection list and these items can not be exported unless a certificate of pre-inspection have been obtained from the Export Inspection Council of India based in New Delhi or from any of their regional offices situated in Mumbai, Kolkata, Chennai, Kochi or Ahmedabad. But exemptions are given under some circumstances.

Export (Quality Control & Inspection) Act, 1963:

The Export Inspection Council is responsible for the operation of this Act. Under the Act, a large number of exportable commodities have been notified for compulsory pre-shipment inspection. The quality control and inspection of various export products is administered through a network of more than fifty offices located around major production centers and ports of shipment. In addition, organizations may be recognized as agencies for inspection and/or quality control.

Procedure for Pre-shipment Inspection:

Once the exporter has identified that he will have to undertake pre-inspection of the goods meant for export he will have to send intimation for inspection to the regional or local inspection office of the council along with the following information which are as follows: (1)Written intimation of inspection request in three copies.(2)Three copies of invoice.(3)Three copies of packing list which should carry package wise details, net weight of products in each package and the gross weight.(4) Specification of the product under export.(5)A copy of the export order from the importer buyer from abroad.(6)The requisite fee for inspection.

Types of Pre-shipment Inspection

Two kinds of pre-shipment inspections are as follows :

(1) The Consignment Shipment.

(2) Self Certification by the Exporter.

(1) The Consignment Shipment: In this arrangement every consignment ready for export has to be compulsorily inspected by the inspectors from the offices of the export inspection agencies and only after clearance from the EIA the consignment can be sent for shipment.

(2) Self Certification Scheme: Export houses with star status, public limited companies, large scale manufacturers, international organizations with manufacturing base in India.

Manufacturers who have set up their own research and development units along with the testing facilities are given the authority to self inspect their products and submit a self declaration certificate of having met the required quality standards. The export unit or the exporter will have to apply to the Directorate Inspection and Quality Control, New Delhi for the permission of self certificate scheme.

Excise and Custom Clearance

Excise Clearance: The exporter can export the products under (except for the products for which the exemption has been granted from excise duty) a bond submitted to excise authorities or he may pay full excise duty at the gate and then remove excisable goods from the factory. In a situation where he has paid full excise duty he may lodge a claim for the refund of excise duty later on with the excise authorities. However in case of goods cleared from the factory under a bond, sufficient surety and security will have to be provided to the excise authorities.

Customs Clearance: The exporter will be allowed to ship the export order only after he has obtained clearance from the port customs authority. Although there are Custom House Agents available at each port who specialize in documentations for customs clearance, it will be important to understand the procedure and the documentation involved in customs clearance. The exporter or the Custom House A gent will have to submit the following documents to the customs authorities at the port of clearance which are as follows: The shipping bill, Declaration regarding truthfulness of the statement made in the shipping bill,Invoice,GR/SDFform, Export License in case of restricted goods being exported, Quality control inspection certificate self declaration, Original contract for exports or the export order, Letter of credit if applicable, Packing list, ARE I form. The customs authorities after verification and scrutiny of all these documents will approve the cargo to be brought in inside the shed for exports at the port. The shipping bill so approved will have to be presented to the cargo in charge of the steamship company for allowing the goods meant for exports inside the cargo shed. The customs clearance can be arranged at the factory premises too by making an application to the Assistant Collector of the Customs of that particular industrial' area.

Handling Exchange Control Transactions for Exports

Reserve Bank acts as the controller and monitor of all foreign exchange reserves of the country in

India. An exporter who has undertaken an export transaction will have to satisfy the Reserve Bank of India about the inflow of foreign exchange into the county against the payment due from the export transaction. The exporter or customer house agent will have to submit the following forms prescribed by them which are as follows:

GR/SDF Form: This form contains the following information (1) Name and address of the exporter along with the description of goods. (2)Name and address of the authorized dealer (bank) through whom the proceeds against the export supplies will be realized or have been collected. (3)The details of the commissions and discounts, incentives to be paid to the foreign agent or buyers.(4)The complete breaks up of the full export value e.g. break up of the fob, freight, insurance, discount, commission etc.

Disposal of GR Form:(a)The exporter or his Custom House Agent will be submitting two copies of the GR form to the customs at the time of shipment. (b)The value and the particulars of the goods declared in this GR form will be verified by the customs. (c)Once the shipment has taken place the original GR form will be retained by the customs and the duplicate copy will be handed over to the exporter or his CHA. The original will be forwarded by the custom to the RBI. (d)The exporter on his part is under the obligation to submit the duplicate copy of the GR form within 21 days of the shipment to his authorized dealer (Bank).

There are other kinds of forms e.g. Statutory Declaration Form (used at the computerized points), the Softex Form (used in case of export of computers software etc) and the PP Form (used in case of post parcel exports) .

Insurance of the Export Consignment

In order to cover up the risks and to take preventive care of the goods being sent by the ship, the exporter will be required to get the marine insurance for the consignment under exports. The cost of such marine insurance will be borne by either party depending on the terms agreed to in the export contract.

Shipment of the Goods

Goods for export can be sent to the customers abroad by way of sea, air, post, land or river.

Shipping by Sea: The goods are sent to the port shed after they have been scrutinized by the customs authorities. The retention of the goods at the port-shed involves payment of various charges which are to be paid to the port commissioner before goods are allowed to be put on board in the vessel. Once the Preventive Officer of the Customs Department has given the permission for exports, he will issue a let ship order. Based on this slip of let ship, endorsement is carried by the preventive officer on the duplicate copy of the shipping bill. The shipping company or the commander of the ship will permit the loading of the cargo only on production of the shipping bill along with the let ship slip. The master of the ship will issue a Mate's Receipt containing information about the name of the vessel, berth, and date of shipment, description of packages, marks and number and the condition of the cargo at the time of loading. Based on the details given in the Mate's Receipt, two copies of the Bill of Lading will be prepared by the exporter or his agent. These two copies of the Bill of Lading along with the Mates Receipt will be submitted to the shipping company. The shipping company will be calculating freight on the basis of the measurements or weight etc given in the mates receipt. On payment of the freight by the exporter the shipping company will be issuing duly signed Bill of Lading to the exporter. This Bill of Lading duly signed by the authorized signatory of the shipping company, establishes the title to the export goods shipped on the vessel.

Shipping by Air: Shipping by air is advantageous in many cases where the goods are perishable in nature, or seasonal, are high in cost and less bulky in nature. The shipment by air can be fast, timely and pilferage and theft free.

Shipping by Post: The post parcel can be sent for commercial goods to a foreign buyer. The export of goods by parcel post either for gift purpose or for meeting the commercial export contract are governed by or regulated by the provisions of the postal notice no. 13, dated 3rd November 1973. The exports by post are also governed by the foreign trade and foreign trade regulations as in force in the country from time to time. It is for the exporter to satisfy the legal and statutory provisions of the export post parcel and the post office may not hold any responsibility even in the eventuality of having accepted a parcel for exports. Such parcel if rejected by the customs will be confiscated and the contents will not be returned.

Shipping by Land: The procedure for export by land routes are similar to the procedure adopted by the sea route. However the treatment of form ARE I will be slightly different. The excisable goods will have to be presented to the frontier customs officer once again and resealed and repacked in the presence of the frontier customs officers.

Presenting Documents to the Bankers for Collection: The last step pertains to the presentation of documents to the negotiating bank for encashment of the draft against the letter of credit. The exporter will be presenting the following documents to the bankers (1) Letter of credit. (2)Bill of lading. (3)Commercial invoice. (4)Packing slip. (5)GRJ/SDF form. (6)Certificate of origin. (7)Marine insurance policy. The negotiating bank will forward the set of shipping documents to the foreign bank of the importer for payment.

Activity D:

1. Find out any company involved in exporting of commodities and identify which mode for shipment of goods they are using. Specify the recommendations you would make in order improve the choice of mode, for shipment of goods in that organization.

17.10 Importance of Export Documents

Trade document is essential and an integral part of international trade operations due to various reasons. When exporter sells his goods in international markets he has to prepare various documents as transportation of cargo from one country to another is full of various regulatory and commercial requirements, so that he proves the delivery and title of goods. The various reasons for careful understanding of international trade documentation are as follows. Trade practices of a country, Legal requirement, Commercial requirements, and Creating superficial non-tariff barriers to restrict country trade. The important aspects of documentation can be elaborated as under.

(1) There are certain documents which are essentially required as they are needed as per the regulations of importing and exporting country and other international conventions for the transportation of goods from one country to another country and such essential documents in international trade are bill of lading, packing list, commercial invoice, import license, certificate of origin, inspection certificate, and insurance certificate etc.

(2) Countries maintain their data base of imports of various items and commodities so as to keep a vigil on avoidable imports to control the outflow of foreign exchange.

(3) Trade Documents provide the complete information about the goods and services such as

HS code, description of goods, price, quality and quantity of goods to be exported, mode of payments, incoterms and date of shipment etc. It help the importing countries customs department in easy cross-checking, duty assessment and clearance of goods to the importer.

(4) In certain cases, importing country demands certain documents so as to arrive on conclusion regarding the safeguard of public and animal health and to ensure that such commodities shall not be imported which may cause the spread of plant diseases. For example; Germany imposes restrictions on import of honey from Nepal as Nepalese Honey was considered to be having pesticides due to high use of pesticides, insecticides by farmers on their agricultural crop.

(5) Customs Official job is not only the evaluation, determination and collection of export or import duties on the cargo being exported/imported; but has a wider spectrum of functions such as looking after whether the goods are permitted for export/import or not.

(6) Exporter has to declare that these goods are meant for exports through trade documents and ensure that he may avail right insurance cover for the same as transportation of goods in international trade is full of risks.

(7) There are certain countries which, in order to control their imports and keep a check on them through sound information system; ask that the commercial invoice by the exporter has to be prepared on the forms of these countries. In international trade such forms are known as customs invoices. The countries demand the consular invoice along with the commercial invoice or legalization/visaed of commercial invoice so as to get the details of export shipments coming to their country.

(8) Certain documents such as short shipment certificate etc. are required so as to prove that only the part of goods has been shipped, provided it was either agreed in International sales and contractor mentioned in Letter of Credit. It can be said that the export documentation is an integral and essential part of international trade and no trade activity between two countries can be harmonious, sustainable and continuously growing until the exporters are not well trained and informed on trade documentation practices of the country.

17.11 Major Export Products of India

The major export products of India include leather, medical appliances, equipments, textiles which are as follows:

Leather Goods among Major Export Products of India: India has developed over the years to become a key player in the export of leather goods and accessories among the major export products of India. India exports numerous leather products for daily use like leather wallets, belts, key holders, folders, pouches, leather toys, handbags etc. Gift items made of leather such as Leather notebooks, decorated leather journals, key rings, rugs are quite popular in foreign countries.

Medical Appliances among Major Export Products of India: Indian medical appliances have made their mark in the foreign countries on account of superior quality and variety. Common medical appliances exported from India include absorbent gauze, sterile gloves, crepe bandages, gauze sponge, surgical face masks, surgical caps, and surgical disposables. Export of specialized medical appliances has also gained importance among major export products of India and appliances such as baby incubator, automatic vertical autoclave, and digital video, digital imaging software's.

Textile Goods Among Major Export Products of India: Textile goods have gained prominence among the export products of India; designer garments for ladies as well as gents manufactured by the big houses in India have created huge demand in the International garment industry. The popular ladies garment include knitted tops, embroidered salwar, sequin work blouses, sarongs, floral t-shirts, beaded garments, poplin embroidered kurta, viscose crape printed skirt.

Equipments Among Major Export Products of India: India caters to the need of varied equipments of the foreign countries, therefore the Indian equipment industry have grown in leaps and bounds and ranks high among the major export products of India like conveyor systems, hand pallet trucks, magnetic coolent cleaners, vibrating screens, industrial magnetic conveyors, cantilever racks, steel rolling mill plants, hydraulic stackers, heavy duty pallet rack.etc

Activity F:

6. List out the major commodities which are exported from India, and also suggest which commodities could be exported in abundance.

17.12 Various Aspects of Export Documents

The major concern of importing as well as exporting country parties in international trade is the accuracy of export documents as it helps the importer in making prompt duty payments which comes to doldrums if export documents are not correct or discrepant. Banks may not negotiate the documents for purchase or discount if exporter has submitted inaccurate trade documents. The exporting country also emphasizes that exporter shall submit the accurate documents to customs department with right description so that customs may take least time in assessing for duty if any and also for clearing the goods promptly. Documentation is of prime importance in the financing, transport, carriage and control of goods in international trade. It is only through documents that financing of shipments, transportation of cargo, and ensuring of payments is possible. Several aspects of export documentations which are as follows:

1. **It is an Easy Process:** Small and first time exporters are usually worried about the trade documentation practices as they find it very complicated process. But, it is very easy to understand and prepare export/import documents and trader himself can use his own expertise in preparing them provided he must go for a training program on trade documentation practices for a hand on knowledge on various aspects of trade documentation.

2. **Documentation is an Integral Part of International Trade:** The trade documentation is an important and integral part of export import business. Correct filing of documents and other regulatory procedures must be followed when an exporter export or import the goods and services to overseas market.

3. **Correct Documentation Essential:** A number of documents as specified under rules and regulations of a country must accompany each export shipment. They must be the correct, precise, non-discrepant documents and it is not easy to do so because the documentation differs from country to country product to product and region to region.

   In case the trade documents are found to be incorrect, incomplete and discrepant, importer can not get the custody of cargo from his port as and when they arrive. He may have to request for fresh and may have to pay certain charges.

4. **Helpful in Transportation:** Trade documents such as bill of lading/airway bill /transit challan bill are proof of transportation of goods from place of origin to place of destination. Bill of lading carries tide of goods as is a contract of affreightment of cargo. In case of loss/misplacement of cargo, these documents help in claiming the cargo insurance from the insurance company .These documents also help the exporter in claiming credit insurance from ECGC in case non-payment/ default by the importer.

5. **Provide Clarity in Exports Deals:** Trade documents provide clarity and transparency in international sales deals. One major purpose of the trade documentation is to provide a specific and complete description of the goods, to customs officials, shipping company, banks duty drawback directorate and importers.

17.13 Commercial Documents in Foreign Trade

The procedural and documentary formalities involved in the import and export marketing are diversely different from those required for the domestic marketing. In export marketing, the agencies involved are too many and the exporter or importer will have to raise documents to the satisfaction of each organization separately. The export documents can be classified into the following four categories based on the specific functions performed by each of them:

(1) **Commercial Documents:** These are the documents that are necessary to meet the customs and traditions of the export trade .These documents are essential to move the goods from one place to another and facilitate transfer of ownership from the seller to buyer after realization of sales proceeds. These documents include commercial invoices, bills of exchange bills of lading letters of credit, marine insurance policy and certificates of origin etc .These documents are the principle export documents. In addition, some of the other documents which are auxiliary to the export contract can be the proforma invoice, intimation for inspection, shipping Instructions, insurance declaration, shipping order and letters to the banks for collection / negotiation of the documents.

(2) **Regulatory Documents:** These are the documents which have been prescribed by the regulatory authorities of the exporting country. Most of these are pre-shipment documents, compliance of which is mandatory for fulfillment of an export contract. These documents include: 1. Excise gate pass I or II for clearance of goods as prescribed by central excise authorities. Earlier forms known as AR4/ AR4A have been replaced by ARE1 form.2. Shipping bill / (being treated as Bill of Export).3. Export application / dock challan as prescribed by port trust authorities.4. (GR/ SDF/ PP forms as prescribed by the Reserve Bank for monitoring foreign exchange flow and control.5. Insurance payment certificate, depending upon 'International Commerce Terms'.

(3) **Export Assistance Documents:** These documents are needed for claiming governmental assistance and subsidies offered by the government departments and other exports promoting bodies in the country. A certificate of origin is required to avail concessional duty by an importer wherever there is free trade agreement.

(4) **Documents as Prescribed by the Importers' Countries:** Any purchase from abroad or import transaction of the importer is governed by the laws and regulations of his country. The importer in

order to satisfy the statutory provisions of his country's government will insist on the submission of such documents. Such documents may refer to mandatory pre-inspection, quality approval, child labour norms, environment norms, consular invoice or certificate of origin of goods etc.

The export documentation can also be classified on the basis of function each document is purported to perform i.e the documents related to sales transaction of the goods documents related to transportation and shipment of goods , documents related to inspection of exportable goods, documents related to negotiation of documents and receipt of payments, documents related to collection control and conversion of foreign exchange proceeds and documents related to excise and other taxes as prescribed by the respective governments.

Proforma Invoice: It refers to the advance copy of the proforma of the invoice sent to the importer to understand how the bill will finally be prepared for the goods ordered by him.

Invoice: It is the basic document for an export transaction on the basis of which many other documents related to the exports of goods will be prepared .It is the sales bill of the goods ordered by the importer. It contains particulars related to the customer whom goods are being supplied, his name, address, his banker's details and import license numbers etc. It also relates the goods to be supplied e.g., the price per unit, the number of units being supplied by this bill, the total sales value of the invoice, the taxation description and calculation if any, the terms of sales, packing units, the packing specifications, identification and private markings of the packing, bill of lading numbers, name of the ship and the intended destination of the goods etc.

Packing List: The packing list refers to a consolidated statement of the contents packed in each large case and the numbers of such large cases meant for shipment. Such list will mention the packing date, the name and address of the exporter, the name and address of the importer, the export order number and date, the contents of the goods in terms of quality and quantity, weight, special handling instructions if any and finally the marking numbers to identify the consignment.

Certificate of Origin: The certificate of origin as the name suggests certifies the name of the country in which the goods produced for export. This certificate is sent by the exporter to the importer, as it will be needed by him to get the goods cleared by the customs authority of his country. The customs law of the country may have preferential duty rates for a particular country or the country may have put an embargo on the imports of specific goods from a particular country. In each such case, the submission of the certificate of origin will be required. The exporters can approach the chambers of commerce, the export promotion councils and other trade promotion associations, authorized by the government to issue such certificates of origin.

Generalized System of Preference (GSP Certificate): It refers to the situation wherein the imports from a particular country are given a preferential treatment by the importing country for levying of import duties etc. In such circumstances, the importing agency will prescribe and insist upon a special certificate from the exporter country, which can prove that the goods under export to the importer's country are genuinely manufactured within the country only. "In India the goods are certified to be manufactured in India only if the goods have been wholly manufactured or produced in India or have been produced from the imported raw material which have undergone sufficient working or processing in India to be regarded as originating there". In India such a certificate is issued by the following agencies:(1)Directorate general of foreign trade and all its regional offices(2)All development commissioners of special economic zones(3) Export promotion councils(4) Export inspection councils and agencies(5)

Commodity Boards and Export Authorities.

Transport Documents (Documents Related to Shipment of Goods)

Shipping Bill: Shipping bill is the principle document needed to obtain the permission of the customs to export the goods by sea or air. This document contains details regarding the exporter's name and address, particulars and description of goods under export, details of the packages of goods, total number of packages, total weight, fob prices, value as defined in the sea customs and act, the name of the vessel ,port of destination, and interim port if any before trans shipment to final destination.

Mate's Receipt: The cargo is handed over to the ship only after all formalities by the custom authorities and port authorities have been completed i.e. the examination of the goods by the custom's authorities, and the payment of port charges etc., have been paid by the exporter.

The captain of the ship issues this receipt which contains information regarding name of the vessel, berth, date of shipment, description of packages, identification marks and numbers, condition of the cargo at the time of loading into the ship etc. The mate's receipt forms the basic document for issuing the bill of lading and the mates receipt will be exchanged for the bill of lading.

Bill of Lading: The bill of lading pertains to the official receipt issued by the shipping company or their authorized agent for carrying the goods to its destination. This bill of lading also forms a shipping contract between the exporters and the shipping company, to deliver the goods in the condition in which these have been received at the port of loading. The bill of lading is a document that establishes the ownership title to the goods and as such is the most important document. The bill of lading is prepared on the prescribed form of the shipping company and contains the following information:

(1) The shipping company's name and address.
(2) Date and place of shipment.
(3) The name of the consignor.
(4) The name and destination of vessel.
(5) The description, quality, and destination of goods.
(6) The private markings and numbers.
(7) The invoice number and date of shipment.
(8) The gross weight and net weight of the consignment.
(9) The number of packages.
(10) Freight details.
(11) Signatures and seal of the shipping company's authorized agent.

Three original sets of bill of lading are issued by the shipping company. The non negotiable copies can also be obtained with clear markings of "non negotiable" for other necessary records etc. Different kinds of bill of lading can be issued by the shipping company depending on the conditions in which goods have been received such as Clean Bill of Lading,Claused Bill of Lading,Trans-shipment Bill of Lading, Freight Paid Bill of Lading, Freight Collect Bill of Lading, Airway Bill.

Financial Documents

Financial Documents in an export contract it includes Bill of Exchange, Letter of Contract to be opened by an importer, etc.

Bill of Exchange: Bill of exchange is the common system to collect payment in international trade. A bill of exchange is as good as any other negotiable instrument covered by the Section 5 of the Negotiable Instrument Act 1881. A bill of exchange is also known as draft, which is drawn by the exporter, calling upon the importer or the purchaser "to pay or accept obligation to pay a certain sum of money at a fixed future date. Once this bill of exchange has been accepted and the drawee (importer) has signed on the face of the bill of exchange, it becomes obligatory on the importer (drawee) to arrange for the payment within the specified period of time. The accepted bill of exchange becomes a tradable instrument like any other negotiable instrument and can be transferred to a third party too. The three types of bill of exchange are as follows :

(1) **Sight Bill of Exchange:** It refers to the situation when the drawer has asked the drawee to make payment against the draft bill of exchange immediately on receipt of the intimation about the document from the intermediary bank. The importer will be given the shipping documents for getting the delivery of the goods only after he has paid the sum drawn in the bill of exchange. This also means that the exporter has not allowed any credit period to the importer and has asked for payment against delivery.

2) **Usance Bill of Exchange:** When the export contract entered into by the signatories' parties has allowed a specific period of credit to the importer, the exporter will draw usance bill of exchange and accordingly the draft drawn will also mention the credit period allowed by him to the importer. The drawee importer will accept the obligation after putting his seal and signature on the face of bill of exchange drawn. The bank will present the documents for collection of payment to the drawee after stipulated period of credit and the proceeds will be remitted to the exporter by the bank as per the instructions sent along with the draft bill of exchange.

(3) **Documentary Bill of Exchange:** When the bill of exchange is accompanied by the shipping documents e.g. bill of lading, marine insurance policy, commercial invoice, inspection certificates, certificate of origin etc., (the documents that can establish title to the goods) it may be called Documentary bill of exchange.

Letter of Credit

International trade involves business transactions between exporters and importers who are from different countries spread across the boundaries of two different sovereign nations. Each of them will have to strictly adhere to the rules and regulations set by their respective countries. Such a situation makes it quite a risky business for the seller. He either has to collect his payment for the goods supplied in advance or he has to negotiate the documents through bank. The third option available to an exporter is to extend credit facilities to his customers abroad. The bankers all across the world present a fourth viable option to both the parties involved in the international business i.e. opening a letter of credit. The letter of credit arrangement offers an easy way out to handle the international payment system for the seller as well as the buyer from another country.

"A letter of credit is an undertaking by a bank to pay or to arrange to pay for the specified merchandise provided that certain stipulated conditions are met by the beneficiary" .The letter of credit has been defined by the international Chamber of Commerce as an arrangement however named or described whereby a bank (the issuing bank) acting on the request of and in accordance with the instructions of a customer (the applicant to the credit), to make payment to or to the order of a third party (the beneficiary),or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorize such payment to be made or such drafts to be paid, accepted or negotiated, by another bank, against stipulated documents and compliance with stipulated terms and conditions",

Basic Features of an Import Letter of Credit

The following basic features of a letter of credit are as follows:

(1) It is an undertaking given by a bank to honour a financial commitment.

(2) It is an undertaking given by the bank on behalf of its importer client.

(3) It is an undertaking given by the bank to an exporter who may not be a client of the bank.

(4) The undertaking will be honored subject to fulfillment of certain conditions by the exporter.

(5) There is another bank being involved for collection of the sum promised in the letter of credit. Parties to Letter of Credit are The Opener Applicant, The Issuing Bank, The Beneficiary Advising/ Notifying Bank, Confirming Bank and Negotiating Bank

17.14 Challenges for International Business

Globalization is a fact of life. Increasing globalization poses its own challenges to trading countries. There are five areas in which each country must excel in order to emerge as a strong global player which are as follows:

1. **Maintaining Competitiveness:** Many factors contribute to the competitiveness of a nation. It is being argued that labour costs, interest rates, exchange rates and economies of scale make a nation competitive. It has been demonstrated that the best way for companies to achieve competitive advantage is with innovation.

2. **Government and Trade Regulations:** The government of any country can influence its international business significantly. For example, govern-ment intervention for the purpose of protecting domestic industries usually results in less movement of goods and services across borders. The major role of government's in global business may stem from its being a world trade negotiator. The World Trade Organization (WTO) has been established to negotiate trade concessions among member countries. The members meet periodically and discuss the ways of minimizing trade barriers.

3. **Developing an International Perspective:** Firms operating in cross border markets need to develop an international perspective. Three areas need special attention they are experience, focus and attitude. (1)Experience: One way to acquire international perspective is to hire people with global exposure.(2) Focus: The second way to develop an international orientation is by emphasizing global orientation to human resource activities such as hiring, remunerating performance appraisal, promotions and the like. (3)Attitude: A third way to develop an international perspective is by changing the attitudes of managers towards their work.

4. **Managing Diversity:** Diversity is the outcome of globalization Workforce of any MNC comprises people from different countries of different culture. Managing such a workforce is a challenging task for any executive. Among the potential problems associated with diversity is the likely absence of cohesion among workers. While there are some potential problems associated with diversity, these are host of benefits gained. Culturally diverse groups can enhance creativity, lead to better decisions and result in mote effective and productive performance.

5. **Need to Maintain Good Corporate Citizenship:** An international business will be successful if only it creates and sustains the image of a good corporate citizenship-the two hall marks of which are honesty and social responsiveness.

17.15 Highlights of Foreign Trade Policy 2009-14

The short term objective of foreign trade policy is to arrest and reverse the declining trend of exports and to provide additional support ,to those sectors which have been hit badly by recession in the developed world. The policy objective was set in achieving an annual export growth of 15% with an annual export target of US$ 200 billion by March 2011. In the remaining years of Foreign Trade Policy i.e.upto 2014, the country should be able to come back on the high export growth path of around 25% per annum. By 2014, it could expect to double India's exports of goods and services. The long term policy objective for the Government is to double India's share in global trade by 2020. 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 and diversification of export markets. Improvement in infrastructure related to exports; bringing down transaction costs, and providing full refund of all indirect taxes and levies, would be the three pillars, which would be helpful in achieving this target. To provide a stable policy environment DEPB Scheme could be continued upto December 2010 and income tax benefits under Section 10(A) for IT industry and under Section 10(B) for 100% export oriented units for one additional year till 31st March 2011. Enhanced insurance coverage and exposure for exports through ECGC Schemes has been ensured till 31st March 2010.

Highlights of foreign trade policy 2009-14 are as follows:

1. **Higher Support for Market and Product Diversification:**
   (1) Incentive schemes have been expanded by way of addition of new products and markets.
   (2) 26 new markets have been added under Focus Market Scheme. These include 16 new markets in Latin America and 10 in Asia-Oceania.
   (3) The incentive available under Focus Market Scheme(FMS) has been raised from 2.5% to 3%.
   (4) The incentive available under Focus Product Scheme (FPS) has been raised from 1.25% to 2%.
   (5) A large number of products from various sectors have been included for benefits under FPS. These include, Engineering products (agricultural machinery, parts of trailers, sewing machines, hand tools, garden tools, musical instruments, clocks and watches, railway locomotives etc.), Plastic (value added products), Jute and Sisal products, Technical Textiles, Green Technology products (wind mills, wind turbines, electric operated vehicles etc.), Project goods, vegetable textiles and certain Electronic items.
   (6) Market Linked Focus Product Scheme (MLFPS) has been greatly expanded by inclusion of products classified under as many as 153 ITC(HS) Codes at 4 digit level. Some major products include; Pharmaceuticals, Synthetic textile fabrics, value added rubber products, value added plastic goods, textile made-up, knitted and crocheted fabrics, glass products, certain iron and steel products and certain articles of aluminium among others. Benefits to these products will be provided, if exports are made to 13 i dentified markets (Algeria, Egypt, Kenya, Nigeria, South Africa, Tanzania, Brazil, Mexico, Ukraine, Vietnam, Cambodia, Australia and New Zealand).
   (7) MLFPS benefits are also extended for export to additional new markets for certain

products. These products include auto components, motor cars, bicycle and its parts, and apparels among others.

(8) A common simplified application form has been introduced for taking benefits under FPS, FMS, MLFPS and VKGUY.(9)Higher allocation for Market Development Assistance (MDA) and Market Access Initiative (MAI) schemes is being provided.

2. Technological Up Gradation:

(1) To aid technological up gradation of export sector, EPCG Scheme at Zero Duty has been introduced. This Scheme will be available for engineering & electronic products, basic chemicals & pharmaceuticals, apparels & textiles, plastics, handicrafts, chemicals & allied products and leather & leather products (subject to exclusions of current beneficiaries under Technological Up gradation Fund Schemes administered by Ministry of Textiles and beneficiaries of Status Holder Incentive Scheme in that particular year). The scheme is till 31.3.2011.

(2) Jaipur, Srinagar Anantnag, Kanpur, Dewas, Ambur and Malihabad have been recognized as 'Towns of Export Excellence'.

3. EPCG Scheme Relaxations:

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

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

4. Support for Green Products and Products From North East:

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

5. Status Holders :

(1) To accelerate exports and encourage technological up gradation, additional Duty Credit Scrips shall be given to Status Holders @ 1% of the FOB value of past exports. The facility shall be available for sectors of leather (excluding finished leather), textiles and jute, handicrafts, engineering (excluding Iron & steel & non-ferrous metals in primary and intermediate form, automobiles & two wheelers, nuclear reactors & parts, and ships, boats and floating structures), plastics and basic chemicals (excluding pharma products) [subject to exclusions of current beneficiaries under Technological Up gradation Fund Schemes (TUFS)]. This facility shall be available upto 31.3.2011.(2)Transferability for the Duty Credit scrips being issued to Status Holders under paragraph 3.8.6 of FTP under VKGUY Scheme has been permitted. This is subject to the condition that transfer would be only to Status Holders and Scrips would be utilized for the procurement of Cold Chain equipment(s) only.

6. Stability/ Continuity of the Foreign Trade Policy:

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

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

(3) Income Tax exemption to 100% EOUs and to STPI units for the financial year 2010-11 in the Budget 2009-10.(4)The adjustment assistance scheme initiated in December,2008 to provide enhanced ECGC cover at 95%, to the adversely affected sectors, is continued till March, 2010.

7. **Marine Sector:**

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

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

8. **Gems & Jewellery Sector:**

(1) To neutralize duty incidence on gold Jewellery exports, it has been decided to allow Duty Drawback on such exports.

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

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

(4) To promote export of Gems & Jewellery products, the value limits of personal carriage have been increased from US$ 2 million to US$ 5 million in case of participation in overseas exhibitions. The limit is increased from US$ 0.1 million to US$ 1 million.

9. **Agriculture Sector:**

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

10. **Leather Sector:**

(1) Leather sector shall be allowed re-export of unsold imported raw hides and skins and semi finished leather from public bonded ware houses, subject to payment of50% of the applicable export duty.

(2) Enhancement of FPS rate to 2% would also significantly benefit the leather sector.

11. **Tea:**

(1) Minimum value addition under advance authorization scheme for export of tea has been reduced from the existing 100% to 50%.(2)DTA sale limit of instant tea by EOU units has been increased from the existing 30% to 50%.(3)Export of tea has been covered under VKGUY Scheme benefits.

12. **Pharmaceutical Sector:**

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

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

13. Handloom Sector:

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

14. EOUs:

(1) EOUs have been allowed to sell products manufactured by them in DTA up to a limit of 90% instead of existing 75%, without changing the criteria of 'similar goods', within the overall entitlement of 50% for DTA sale.

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

(3) EOUs will now be allowed to procure finished goods for consolidation along with their manufactured goods, subject to certain safeguards.(4)During this period of downturn, Board of Approvals (BOA) to consider, extension of block period by one year for calculation of Net Foreign Exchange earning of EOUs.(5)EOUs will be allowed CENVAT Credit facility for the component of SAD and Education Cess on DTA sale.

14. Thrust to Value Added Manufacturing:

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

(2) Coverage of Project Exports and a large number of manufactured goods under FPS and MLFPS.

15. DEPB:

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

16. Flexibility Provided to Exporters:

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

(2) Import of restricted items, as replenishment, shall now be allowed against transferred DFIAs, in line with the erstwhile DFRC scheme.

(3) Time limit of 60 days for re-import of exported gems and jewellery items, for participation in exhibitions has been extended to 90 days in case of USA.

(4) Transit loss claims received from private approved insurance companies in India will now be allowed for the purpose of EO fulfillment under Export Promotion schemes. At present, the facility has been limited to public sector general insurance companies only.

17. Waiver of Incentives Recovery, On RBI Specific Write Off:

(1) In cases, where RBI specifically writes off the export proceeds realization, the incentives under the FTP shall now not be recovered from the exporters subject to certain conditions.

18. Simplification of Procedures:

(1) To facilitate duty free import of samples by exporters, number of samples/pieces has been increased from the existing 15 to 50.

(2) To allow exemption for up to two stages from payment of excise duty in lieu of refund, in

case of supply to an advance authorization holder (against invalidation letter) by the domestic intermediate manufacturer.

It would allow exemption for supplies made to a manufacturer, if such manufacturer in turn supplies the products to an ultimate exporter.

(3) Greater flexibility has been permitted to allow conversion of Shipping Bills from one Export Promotion scheme to other scheme. Customs shall now permit this conversion within three months, instead of the present limited period of only one month.

(4) To reduce transaction costs, dispatch of imported goods directly from the Port to the site has been allowed under Advance Authorization scheme for deemed supplies. At present, the duty free imported goods could be taken only to the manufacturing unit of the authorization holder or its supporting manufacturer.

(5) Disposal of manufacturing wastes / scrap will now be allowed after payment of applicable excise duty, even before fulfillment of export obligation under Advance Authorization and EPCG Scheme.

(6) Regional Authorities have now been authorized to issue licenses for import of sports weapons by 'renowned shooters', on the basis of NOC from the Ministry of Sports & Youth Affairs. Now there will be no need to approach DGFT (Hqrs.) in such cases.

(7) The procedure for issue of Free Sale Certificate has been simplified and the validity of the Certificate has been increased from 1 year to 2 years. This will solve the problems faced by the medical devices industry.

(8) Automobile industry, having their own R&D establishment, would be allowed free import of reference fuels (petrol and diesel), upto a maximum of 5 KL per annum, which are not manufactured in India.(9)Acceding to the demand of trade & industry, the application and redemption forms under EPCG scheme have been simplified.

19. Reduction of Transaction Costs :

(1) No fee shall now be charged for grant of incentives under the Schemes of FTP..

(2) To further EDI initiatives, Export Promotion Councils/Commodity Boards have been advised to issue RCMC through a web based online system.

(3) Electronic Message Exchange between Customs and DGFT in respect of incentive schemes will become operational by 31.12.2009.

(4) For EDI ports, double verification of shipping bills by customs for any of the DGFT schemes shall be dispensed with.

(5) In cases, where the earlier authorization has been cancelled and a new authorization has been issued in lieu of the earlier authorization, application fee paid already for the cancelled authorization will now be adjusted against the application fee for the new authorization subject to payment of minimum fee of Rs. 200.

(6) An Inter Ministerial Committee will be formed to redress/ resolve problems/issues of exporters.

(7) An updated compilation of Standard Input Output Norms (SION) and ITC (HS) Classification of Export and Import Items has been published.

20 Directorate of Trade Remedy Measures:

(1) To enable support to Indian industry and exporters, especially the MSMEs, in

availing their rights through trade remedy instruments, a Directorate of Trade Remedy Measures shall be set up.

Activity G:

1. Prepare a chart describing the major changes in the foreign trade policy 2009-2014.

17.16 Summary

International Trade refers to exchange of goods, services and ideas between two or more countries. The waves of liberalization, privatization globalization, and marketization (LPG & M) have opened up the Indian economy to global entrepreneurs, MNCs and investors for such exchange of goods, services and ideas. International Trade is crucial to India's economic health as it generates additional employment opportunities for the country through the exchange of goods; services and ideas and helps bring precious foreign exchange into the country.

India's moderate growth of 13.6 per cent in 2008-09 which was due to the high growth in the first half of the year prior to the setting in of global recession, was only due to manufactured exports as both primary products and petroleum, crude and products registered negative growths of (-)2.4 per cent and (-)4.6 per cent respectively.

Among manufactured products, the major drivers were gems and jewellery, engineering goods and chemicals and related products with export growths of 42.1 per cent, 18.7 per cent and 7.2 per cent respectively. The composition of imports also underwent changes. Reflecting growing domestic concerns like inflation, the share of food and allied products imports which fell from 2.3 percent in 2007-08 to 2.1 per cent in 2008-09 increased to 3.5 per cent in the first half of 2009-10 with the increase in imports of edible oils and pulses. Success is a mantra that each firm wishes to chant, but to become successful it requires lot of planning and controlling of activities keeping in mind the competitor's strategy. Some important elements of success in International Trade are coordination in planning and results of firm, understanding foreign cultures, business etiquettes and Practices, hard work dedication devotion and re1iability, innovation and product adaptation, identifying customer's wants and needs, planning financial resources etc.International business is risky as compared to domestic business because of different types of risk such as financial risk, foreign exchange fluctuation risk, country and customer risk. Business and industrial firms are also benefited from export trade, as they have an opportunity to participate in international trade activities and can have several advantages to their business activities such as greater economies of scale. There are some benefits from exports to the exporters and exporting companies such as lack of domestic demand, increased productivity, relative profitability, International collaboration etc. The International chamber of commerce has defined a set of international trade terms indicating the responsibilities or obligations of the buyer and seller such as Free Alongside Ship, Free on Board, Cost and Freight, Cost Insurance Freight, Ex –Works, EXQ/Ex-Quay etc. The exports procedures or export cycle refer to the essential steps involved in registering a firm for exports and imports with the offices of the Director General of Foreign Trade in India. The major export products of India include leather, medical appliances, equipments; textiles. The major concern of importing as well as exporting country parties in international trade is the accuracy of export documents as it helps the importer in making prompt duty payments which comes to doldrums if export documents are not correct or discrepant. Documentation is of prime importance in the financing, transport, carriage and control of goods in

international trade. The export documents can be classified into the following four categories based on the specific functions performed by each of them: Commercial Documents, Regulatory Documents, Export Assistance Documents, and Documents as Prescribed by the Importers' Countries. Globalization is a fact of life. Increasing globalization poses its own challenges to trading countries. The short term objective of foreign trade policy is to arrest and reverse the declining trend of exports and to provide additional support ,to those sectors which have been hit badly by recession in the developed world.

17.17 Self Assessment Questions

1. Why do companies go international?
2. Briefly explain composition of India's import and export of services?
3. The directional pattern of India's trade has been changing constantly-give reasons.
4. Explain the success element needed in International Market?
5. Elaborate the various risks involved in International trade.
6. Discuss the advantages and disadvantages of International Trade for an exporter.
7. Explain documents related to sales transaction of good in detail.
8. Write short note on:
   a) Shipping Bill.
   b) Mate's Receipt.
   c) Certificate of origin
   d) Bill of Lading
9. What do you mean by financial document .Explain Documentary bill of exchange?
10. Explain important steps in processing of an export order.
11. Write short note on
    a) Procedure for pre-shipment inspection
    b) Shipment of the goods.
12. What are the various sources of competition in International Market? Discuss each one of them in detail.

17.18 Reference Books

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Unit - 18 Foreign Exchange Management Act

Structure of Unit

18.0 Objectives

After Completing this unit, you will be able to:

- Know the operations of MNCS in India
- Discuss the regulations of foreign exchange transactions.
- Know the objectives of FERA
- Explain the change of FERA into FEMA
- Evaluate the foreign exchange management Act.

18.1 Introduction

After India's independence, the Government of India enacted the Foreign Exchange Regulation Act, 1947 (FERA) to regulate the operation of foreign controlled companies in India. The Act was amended comprehen-sively in 1973. The major objectives of new FERA, 1973 were (a) the conservation of India's precious foreign exchange resources, and (b) the issue of guidelines to the foreign investors to invest in India's core sectors which employ sophisticated foreign technology.

FERA, 1973 was enacted at a time when India had less than a billion dollars in foreign exchange reserves and when almost all spheres of the economy were sought to be controlled and regulated by the Government. Under FERA, all transactions in foreign exchange and all transactions with non-residents (whether in foreign exchange or in rupees) were absolutely prohibited, except where specific relaxations were made. Similarly, non-residents were also not permitted to have any dealings in India. However, the practical and day-to-day provisions were contained not in the Act, but in the guidelines issued by the Government of India. These guidelines related to foreign business in India, as for instance, the necessity of all branches and all subsidiaries of foreign companies (except airlines and shipping companies) to have minimum Indian equity participation of 26 per cent. These guidelines were revised substantially in 1976.

FERA (1973) came under severe criticism particularly for the section which stipulated that whenever a person was prosecuted or proceeded against for contravention of any provision, rule, regulation, directive or any order under the Act, the onus of proving that he had the requisite permission was on him. This often led to unnecessary harassment of bona fide persons and companies with show cause notices and prosecution for alleged violations of FERA on narrow technical grounds. At the same time, however, thousands of crooks, both individuals and companies, managed to evade and avoid the draconian provisions of FERA and got away scot free.

The Foreign Exchange Management Act (FEMA) was introduced in July 1998 in the Parliament to repeal FERA, 1973 and to consolidate and simplify the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

18.2 Appraisal of MNC Operations on Indian Economy

The operations of MNCs open up the possibilities of interference in the industrial (and other) activities of the recipient country and are thus resented by the 'nationalist' thinkers. Their arguments against the operations of MNCs can be summed up as follows:

1. **Payment of Dividends and Royalty.** A large sum of money flows out of the country in terms of payment of dividends, profits, royalties, technical fees and interest to the foreign investors.
2. **Distortion of Economic Structure.** MNCs can inflict heavy damage on the host country in various forms such as suppression of domestic entrepreneurship, exten-sion of oligopolistic practices.
3. **Political Interference.** Because of their immense financial and technical power, the MNCs have gained the necessary strength to influence the decision making pro-cesses in underdeveloped countries. Though they do help in transferring technology to underdeveloped countries, it has been often found that models and patterns of industrial development and technologies transferred are not in har-mony with the interests of the host countries.
4. **Technology Transfer Not Necessarily Conducive to Development.** As far as transfer of technology to under-developed countries is concerned, the behaviour pattern of MNCs reveals that they do not engage in R and D activities within the underdeveloped countries. Their R and D efforts are concentrated in laboratories in the home country or in other industrialised countries.

18.3 Control Over Multinational Corporations

The responsibility of controlling the activities of mul-tinational corporations in India rests on different govern-ment agencies. These agencies are: (i) the Ministry of Company Affairs, (ii) the Reserve Bank of India, (iii) the Ministry of Industrial Development, and (iv) the Ministry of Finance. However, these agencies do not work in close cooperation with each other. As a result, there is no coor-dination in their functioning. Each case is discussed on its own merits by the authorities. There are no objective cri-teria for approving applications and the procedure resorted to by the various ministries is lengthy and cumbersome.

The Industrial Licensing Policy Inquiry Committee Report in 1968, the belief got strength-ened that imports of foreign technology were overpriced and were designed to perpetrate dependence. As a conse-quence, the government policy was progressively tightened in the following directions (1) Some industries were not allowed to import technology at all, the underlying prin-ciples of the policy being that (a) no 'inessential' article should be produced with fresh imports of technology (this gave the existing domestic and foreign producers automatic protection against fresh imports of technology) and (b) where domestic capacity was 'adequate' no technology should be imported; (2) Among industries where technology imports were allowed, the maximum rate of royalty was laid down; (3) In some designated industries, foreign 'investment was allowed in principle, but sanction in indi-vidual cases was a matter of administrative decision; (4) The normal permissible period of agreements was reduced from ten years to five, and renewals were generally frowned upon; (5) Exports and other marketing restrictions were generally not allowed, and often an obligation to export a certain proportion of the output was insisted upon; (6) A clause was often inserted in the agreements granting per-mission to the importer to sub-licence the technology; (7) The CSIR was allowed to look at applications for approval of technology imports, and if it expressed willingness to supply the technology, approval was withheld or at least delayed.

The most effective curb on the activities of foreign companies, especially MNCs, was supposed to come with the passing of the Foreign Exchange Regulation Act (FERA) in 1973.

18.4 Regulation of Foreign Exchange Transactions

Foreign exchange transactions were regulated in India by the Foreign Exchange Regulations Act (FERA), 1973. This Act also sought to regulate certain aspects of the conduct of business outside the country by Indian companies and in India by foreign companies. The FERA was widely described as a draconian and obnoxious law. Following the economic liberalization ushered in 1991, some amendments to the FERA were effected in 1993.

The main objective of FERA, framed against the background of severe foreign exchange problem and the controlled economic regime, was conservation and proper utilisation of the foreign exchange resources of the country.

There was a lot demand for a substantial modification of FERA in the light of the ongoing economic liberalization and improving foreign exchange reserves position. Accordingly, a new Act, the Foreign Exchange Management Act (FEMA), 1999, replaced the FERA.

Activity A:

1. List the Various MNCs who entred into Indian market after FERA.

18.5 Foreign Exchange Regulation Act (FERA), 1973

Foreign Exchange Regulation Act (FERA) was pro-mulgated in 1973 and it came into force on January 1, 1974. Section 29 of this Act referred directly to the operations of MNCs in India. According to the Section, all non-banking foreign branches and subsidiaries with foreign equity exceeding 40 per cent had to obtain permission to establish new undertakings, to purchase shares in existing companies, or to acquire wholly or partly any other com-pany. Guidelines for administering this Section of FERA were announced in 1973 and later amended in 1976.

According to these guidelines, the principal rule was that all branches of foreign companies operating in India should convert themselves into Indian companies with at least 60 per cent local equity participation. Furthermore, all subsidiaries of foreign companies should bring down the foreign equity share to 40 per cent or less. Exempted from these rules were, however, companies exporting a substan-tial part of their production, and companies engaged in core sectors and priority industries. In these cases, the guide-lines provided for higher levels of foreign equity.

Implementation of FERA. There were substantial delays in implementing FERA. According to Martinussen, by June 1979, only about half the companies directed to dilute the foreign holdings had carried out the process as stipulated. Most of the companies were in the process of diluting, but 64 companies had, at that time, yet to initiate the process. Not until 1982, i.e., eight years after FERA came into force, did the last group of 28 companies receive final directions pursuant to the Act. Moreover, upto the end of 1985, a total of 252 foreign controlled companies were exempted from the general rule stipulating a maximum of 40 per cent non-resident interest.

In regard to the companies that did not comply with FERA regulations, Martinussen observes a certain pattern. For instance, he found that almost all these companies belonged to only three groups. They were either engaged in tea plantation activities or in the manufacture of drugs and pharmaceuticals, or they were affiliated with particularly large TNCs. The special treatment to tea companies was due to the importance of tea in India's foreign trade. As far as the drugs and pharmaceuticals industry is concerned, India's heavy dependence on MNCs for bulk drugs came in the way of compliance of FERA regulations. As far as the third category of powerful MNCs in concerned, Martinussen gives in detail the experience with regard to Hindustan Lever Ltd. This company managed to secure concessions from the government on flimsy grounds. For instance, it succeeded in getting 60 per cent of its toiletries manufacturing classified by government as high technology activity as it helped in 'import substitution'.

18.6 Objectives of FERA

The principal objective of the Foreign Exchange Regulation Act (FERA) is to prevent the outflow of Indian currency and to see that the foreign exchange legitimately due to India should be received. In detail, the objectives of the Act are as follows:

- To regulate certain payments.
- To regulate dealings in foreign exchange and securities.
- To regulate the transactions indirectly affecting foreign exchange.
- To regulate import and export of currency and bullion.
- To conserve the foreign exchange resources of the country and to utilise the same in the inter-ests of the economic development of the country.
- To regulate holding of immovable property outside India.
- To regulate employment of foreign nationals.

- To regulate acquisition, holding, etc. of immovable property in India by non-residents.
- To regulate foreign companies.

The Act applies to the whole of India, to citizens of India outside India and to branches and Agencies outside India of companies or corporate bodies registered in India. The Act came into force with effect from 1st January, 1974.

18.7 Provisions of FERA

A. Regulation of Dealings in Foreign Exchange: Under the Act, the Reserve Bank of India (RBI) is the only authority to regulate foreign exchange trans-actions. Section 8 provides that except with the previous permission of the Reserve Bank, no person, other than an authorised dealer, shall conduct a foreign exchange business with any other person who is not an authorised dealer. However, the sale and purchase of foreign exchange between any person and a money-changer in India will not be hit by restrictions imposed in the section. The section further provides that except with the previous permission of the Reserve Bank, no person shall enter into any transaction which provides for the conversion of the Indian currency into foreign or wee versa at rates of exchange other than the rates authorised by the Reserve Bank.

B. Restrictions on Payments: Section 8 of the Act also lays down restrictions on certain payments. It provides that unless authorised by the Reserve Bank, no person in India or no person resident in India shall:

(a) make any payment to or for the credit of any person resident outside India;

(b) receive, otherwise than through an authorised dealer, any payment by order or on behalf of any person resident outside India;

(c) draw, issue or negotiate any bill of exchange or promissory note or acknowledge any debt so that a right, actual or contingent, to receive a payment is created or transferred in favour of a person resident outside India;

C. Restrictions Regarding Assets Held by Non Residents and import and Export of Certain Currency and Bullion: Restrictions on Import-Export of Currency: Section 13 provides that no person shall, except with the permission of the Reserve Bank, bring or send into India any gold, silver, foreign exchange or Indian currency. Similarly, no person shall, without the permission from the Reserve Bank, take or send out of India any gold, jewellery, precious stones, Indian currency or foreign exchange other than foreign exchange obtained by him from an authorised dealer or money-changer.

D. Duty of Persons Entitled to Receive Foreign Exchange and Payment for Exported Goods:

(i) Persons Entitled Receive Foreign Exchange: Section 1 6 lays down that no person who has a right to receive foreign exchange shall delay receipt of such foreign exchange without prior permission from the Reserve Bank.

(ii) Restrictions on Export of Goods: Section 18 lays down that the Central Government may, by notification, prohibit export of any goods unless the exporter furnishes to the prescribed authority particulars relating to the full export value of goods. The Central Government may also, by notifi-cation, specify that the goods shall not be sold at less than the declared value except with the permission of the Reserve Bank.

E. Restrictions on Appointment of Certain Persons and Companies as Agents or Technical or Management Advisers in India: Section 28 lays down that a person resident outside India, whether a citizen of India or not, or a person who is not a citizen of India but is resident in India or a company other than a banking company which is not incorporated under any law in force in India shall not, except with the general or special permission of the Reserve Bank,

F. Restriction on Establishment of Place of Business in India: Section 29 provides that a person resident outside India, whether a citizen of India or not or a person who is not a citizen of India but is resident in India or a company other than a banking company which is not incorporated under any law in force in India shall not, except with the general or special permission of the Reserve Bank,

- carry on in India or establish in India a branch office or other place of business for carrying on any activity of a trading, commercial or industrial nature other than an activity for the carrying on of which permission of the Reserve Bank has been obtained under the provisions of this section of the Act or
- acquire the whole or any part of any undertaking in India of any person or company carrying : on any trade, commerce or industry or purchase the shares in India of any such company.

G. Prior Permission of Reserve Bank Required for Taking up Employment in India by Nationals of Foreign State: Section 30 lays down that no national of a foreign state shall without the prior permission of the Reserve Bank, practice any profession or carry on any occupation, trade or business in India, in a case where such a foreign national desires to acquire any foreign exchange being intended for remittance outside India out of any money(s) received by him in India by reason of such employment or the practising of such profession or the carrying on of such occupation, trade or business, as the case may be.

H. Restrictions on Immovable Property: Property in India cannot be gifted to an unknown person because such a holding enables the holder to sell it and insist on taking away currency. However, partition and other transactions of existing rights are protected. It may be noticed that a foreigner can buy and hold any property in India but such an investment by non-residents of any nationality have to be approved by the Reserve Bank of India. The FERA is also a penal law, as it provides for the punishment for various offences of the Act, most of it for the misuse of foreign currency.

18.8 Concession for FERA Companies

FERA companies in November 1991 and January 1992. On January 8,1993 the government promulgated an Ordinance to amend FERA with immediate effect. The Ordinance removed a large number of restrictions on com-panies with more than 40 per cent non-resident equity, removed FERA controls on Indian firms setting up joint ventures abroad and allowed Indians to hold immovable property abroad, subject to certain conditions. Important concessions announced in November 1991, January 1992 and January 1993 were as follows:

(1) Companies with foreign shareholding were al-lowed to increase foreign equity to 51 per cent by remit-tances in foreign exchange in specified high priority indus-tries;

(2) Section 26, sub-section 7, which required the FERA companies to get Reserve Bank's

permission before raising working capital or accepting deposits was revoked;

(3) Sections 28 and 29 were revoked. This meant that FERA companies could now use their trademarks in India and could carry on in India any activity of a trading, commercial or industrial nature;

(4) Section 31 was re-voked. This allowed FERA companies to deal in immovable property in India;

(5) Section 27 which restricted Indian companies setting up joint ventures abroad and resident Indians associating themselves with or taking part in over-seas concerns was scrapped;

(6) Restrictions regarding assets held in India by non-residents were removed;

(7) Indians were allowed to keep foreign currency upto $ 500 or Rs. 15,000;

(8) Import and export in gold and silver was exempted from FERA implying that these commodities were now to be governed by Exim policy;

(9) Section 17 which conferred powers on the government to regulate uses of imported gold and silver was deleted;

(10) restric-tions on transfers of any security from a register in India to a register outside India were removed;

(11) Restrictions on transfers of shares by a non-resident to another non-resident were removed,

(12) The provision allowing the government to acquire foreign securities for purposes of strengthening foreign exchange position had never been invoked and was unlikely to be invoked. Since this provi-sion could cause avoidable apprehensions and fears in foreign investors, it was deleted;

(13) Foreign nationals were exempted from obtaining prior permission under FERA before taking up employment in India;

(14) A FERA provi-sion which provided that the Government could direct certain payments to be made by FERA companies in a special account, was deleted. Consequently the government of India adopted FEMA in 1999 under FEMA, the emphasis is on management rather than regulation.

(15). Opening up housing and real estate development activity to NRIs and OCBs.,

(17) Permitting NRIs to promote companies in India.

It may however be noted that no foreign investment is permitted in agricultural land or activity related thereto. NRI and OCB investment in the said line of business is not permitted. NRIs are also not permitted to own agricultural land, or plantations or form houses. Also Indian companies with more than 40% non-resident equity holding, cannot engage directly or indirectly in agricultural or plantation activity or purchase shares in companies engaged in such activity.

Activity B:

1. List the various foreign companies who could not Enter Indian market because of FERA but only after it became FEMA

18.9 From FERA to FEMA (1998)

On August 4, 1998, finance minister introduced the Foreign Exchange Management Bill (FEMA) in the Lok Sabha. FEMA seeks to repeal the Foreign Exchange Regulation Act, 1973 (FERA). The statement of objectives and reasons for FEMA states that FERA has outlived its utility on account of significant developments since 1993 such as substantial increase in foreign exchange resources, growth in foreign trade, rationalisation of tariffs, current account convertibility, liberalisation of Indian investments abroad, increased access to external commercial borrowings by Indian corporates and participation of foreign institutional investors in the stock markets. Keeping in view of the changed "environment, FEMA aims at simplifying, consolidating and amending the law relating to foreign exchange with the objective of facilitating external trade and payments, and for promoting the orderly development and maintenance of foreign exchange markets in India.

FEMA, in a radical departure from FERA, has not only simplified the definition of a person resident in India but has also delinked it from the citizenship aspect to denote a person residing in India for more than 182 days during the course of a period of 365 days immediately preceding the date on which such a period is reckoned; any person or body corporate registered or incorporated in India; an office, branch or agency in India owned or controlled by a person resident in India/outside India.

Seeks to establish a more liberal and orderly regulatory framework conducive to economic growth by limiting its ambit to:

(i) Current account transactions, such as payments due in connection with foreign trade, other current business, services and short-term banking and credit facilities in the ordinary course of business; payments due as interest on loans and as net income from investments; remittances for living expenses of parents, spouse and children residing abroad and expenses in connection with foreign travel, education and medical care of parents, spouse and children.
(ii) Capital account transactions, i.e., a transaction which alters the assets or liabilities, including contingent liabilities outside India, of persons resident in India or assets or liabilities in India of persons resident outside India,
(iii) Export of goods and services.
(iv) Realisation and repatriation of foreign exchange.
(v) Exemption from realisation and repatriation in cases like possession of foreign currency or foreign coins by any person upto such limit as the Reserve Bank of India (RBI) may specify; foreign currency account held or operated by such person or class of persons upto the limit the RBI may specify; foreign exchange acquired or received before 8 July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the RBI.

18.10 Foreign Exchange Management Act

The FEMA, which came into effect from January 1, 2000, extends to the whole of India an also applies to all branches, offices, and agencies outside India, owned or controlled by a person resident in India.

Objectives

The objectives of FEMA are:

- To facilitate external trade and payments
- To promote the orderly development and maintenance of foreign exchange market
- Dealing in Foreign Exchange etc.

Section 3 of FEMA imposes restrictions on dealings in foreign exchange and foreign security and payments to and receipts from any person outside India. Accordingly, except as provided in terms of the Act, or with the general or special permission of the Reserve Bank, no person shall—

(a) deal in any foreign exchange or foreign security with any person other than an authorised person;
(b) make any payment to or for the credit of any person resident outside India in any manner;
(c) receive otherwise through an authorised person, any payment by order or on behalf of any person resident outside India in any manner;
(d) enter in to any financial transaction in India as a consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Further, save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, posses or transfer any foreign exchange, foreign security or any immovable property situated outside India.

18.11 The FEMA Bill Became in ACT

The main objective of this Act is to consolidate and amend the law relating to foreign exchange with a view to facilitate external trade and payments and for promoting the orderly development and mainte-nance of the foreign exchange market in India.

The Act extends to the whole of India. The main provisions of the Act are as follows:

Section 3 Dealing in Foreign Exchange: No person shall deal in or transfer any foreign exchange or foreign security to any person; make any payment to or to the credit of any person resident outside India in any manner; receive any pay-ments by order or on behalf of any person resident outside India in any manner; and enter into any financial transaction in India as consideration for or in association with acquisition, creation or transfer of the right to acquire any asset outside India by any person, without permission from the Reserve Bank.

Section 4 Holding of Foreign Exchange: No person, resident in India, shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, without permission from the Reserve Bank.

Section 5 Current Account Transactions: Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.

Section 6 Capital Account Transaction: Any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction. The Reserve Bank may, in consultation with the Central Government, specify any class or classes of capital account transactions which are permissible and limit upto which foreign exchange shall be admissible for such transactions.

Section 7 Export of Goods and Services: Every exporter of goods or services shall furnish to the Reserve Bank details regarding the export value of such goods or services.

Section 8 Realisation and Repatriation of Foreign Exchange: Where any amount of foreign exchange is due or accrued to any person resident in India, such a person shall take steps to realise and repatriate to India, such foreign exchange within a specified period of time.

Section 9 Exemption from Realisation and Repatriation: The following are exempted from the operation of Section 4 and Section 8:

(a) possession of foreign currency or foreign coins by any person upto such limit as the Reserve Bank may specify;

(b) foreign currency account held or opted by such person or class of persons and the limit upto which the Reserve Bank may specify;

(c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;

(d) foreign exchange held by a person resident in India upto such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c) including any income arising therefrom;

(e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means upto such limits as the Reserve Bank may specify and

(f) such other receipts in foreign exchange as the Reserve Bank may specify.

18.12 The Salient Features of FERA

1. According to Section 3 of FEMA, 1998, no person shall deal in or transfer foreign exchange or foreign security to any unauthorised person.
2. Section 4 provides that no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, save as otherwise provided in this Act.
3. Section 5 provides that any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction, provided that the Central Government may, in public interest and in consultation with RBI, impose such reasonable restrictions for current account transactions as may be prescribed.
4. Section 6 states that any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction. RBI, in consultation with the Government of India may specify the class of capital account transactions which are permissible, the limit up to which foreign exchange shall be admissible for such transactions. RBI may prohibit, restrict or regulate following:

   (a) transfer or issue any foreign security by a person resident in India; by a person resident outside India, or by any branch, office or agency in India of a person resident outside India;

   (b) any borrowing or lending in foreign exchange in whatever form or by whatever name called;

   (c) any borrowing or lending in rupees between a person resident in India and person resident outside India;

   (d) deposits between persons resident in India; and persons resident outside India;

   (e) export, import or holding of currency notes:

   (f) transfer of immovable property outside India other than a lease not exceeding five years by a person resident in India; likewise, acquisition or transfer of immovable property in India, other than a lease not, exceeding five years, by a person resident outside India.

(g) giving a guarantee or surety in respect of any debt, obligation or other liability incurred by a person resident in India and owed to a person resident outside India.

5. Section 6, subsection 4 provides that a person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.
6. Section 6, subsection 5 applies to persons who reside outside India i.e., they may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India.
7. Under Subsection 6, RBI may, by regulation. prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.
8. Section 9 refers to certain exemptions from realisation and repatriation of foreign exchange in certain cases.
9. Contravention and Penalties. If any person contravenes any provision of FEMA, 1998 or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act or contravenes any condition subject to which authorisation is issued by RBI, he shall be liable to penalty up to twice the sum involved in such contravention. The Central Government shall establish an Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the adjudicating authorities under this Act. Appeal against the judgement of the Appellate Tribunal lies with the High Court. The Central Government shall establish a Directorate of Enforcement to enforce the provisions of this Act.
10. Section 40 of the Act gives power to the Central

Government to suspend or relax, either indefinitely or for a specific period the operation of all or any of the provisions of FEMA. The notification issued by the Central Government in this regard will have to be placed before the Parliament and got approved within a specified period.

Activity C:

1. Find out the items which can be exported & Imported after implementation of FEMA.

18.13 Evaluation of FEMA

As mentioned at the beginning, FEMA seeks to repeal FERA, 1973, because the conditions under which FERA 1973 was enacted and was implemented do not exist any more. For instance, India has now huge forex reserves. It is, however, true that the size of the economy in general and the external transactions in particular, have gone up substantially. Even then, none can deny the fact that the situation on the external front in recent times is a great deal more favourable than at any time in the past. Hence, there is no place for the fear complex that characterised regulatory efforts in the past. For another, with the culture of liberalisation that has come to be accepted as a framework of management of the economy, strict exchange control regime as visualised in FERA, 1973 had to be disbanded.

FEMA, 1998 attempts to simplify the provisions of FERA 1973. In fact, there are several major changes with immediate effect and relevance, particularly those relating to certain substantive matters and contraventions and punishments.

Besides, there is a major shift under FEMA, 1998. Under FERA 1973, all transactions in foreign exchange and all transactions with non-residents (in foreign currency or in rupees) were absolutely prohibited except where specific relaxations were made. Similarly, non-residents were also not permitted to have any dealings in India, Under FEMA 1998, however, the major focus is on transactions involving foreign exchange and foreign securities. Restrictions over dealings with non-residents and by non-residents in India have been substantially diluted, though not eliminated.

Another major change under FEMA is that only a monetary penalty will be slapped on the convicted, and there is no punishment by way of imprisonment for contravention of any of the provisions. The only circumstance under which imprisonment can be made is for non-payment of such penalty. Under FERA, however, the Enforcement Directorate had sweeping powers to arrest anyone suspected in indulging in forex violations. Naturally, individuals and particularly employees of companies would welcome the new provisions of FEMA. Cases under FEMA will also have to be referred by RBI.

Appeals against the' order of the Adjudicating Authorities. The Central Government shall also establish an Appellate Tribunal For Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals).

The FEMA provides for the establishment, by the Central Government, of a Director of Enforcement with a Director and such other officers or class of officers as it thinks fit for taking up for investigation the contraventions under this Act.

18.14 Comparison of FERA & FEMA

Important differences between FERA and FEMA have been summed up as follows.

1. In FEMA, only the specified acts relating to foreign exchange are regulated, while in FERA, anything and everything that has to do with foreign exchange was controlled. Also, the aim of FEMA is facilitating trade as against that of FERA, which was to prevent misuse. In other words, the theme of FERA was : 'everything that is specified is under control'. While the theme of FEMA is 'everything other than what is expressly covered is not controlled'. Thus there is a lot of deregulation.
2. FEMA is a much smaller enactment – only 49 sections as against 81 of FERA.
3. In the process of simplification, many of the "laid downs" of the erstwhile FERA have been withdrawn.
4. Many provisions of FERA like the ones relating to blocked accounts, Indians taking up employment abroad, employment of foreign technicians in India, contracts in evasion of the act, vexatious search, culpable mental state etc., have no appearance in FEMA.

18.15 Summary

The Foreign Exchange Management Act (FEMA), 1999, replaced the Foreign Exchange Regulations" Act (FERA), 1973, which regulated the foreign exchange transactions in India and which sought to control certain aspects of the conduct of business outside the country by Indian companies arid; in India by foreign companies.

The FEMA, which came in to effect from January 1, 2000, extends to the whole of India and also applies to all branches, offices, and agencies outside India, owned or controlled by a person resident in India.

The objectives of FEMA are to facilitate external trade and payments; and to promote the orderly development and maintenance of foreign exchange market.

The Reserve Bank of India is assigned an important role in the administration of this Act.

The FEMA empowers the Central Government to impose restrictions on dealings in foreign exchange and foreign security and payments to and receipts from any person outside India.

The Act imposes restrictions on persons resident in India on acquiring, holding or owning foreign exchange, foreign security and immovable property abroad and on transfer of foreign exchange or security abroad.

The FEMA lays down that all dealings in foreign exchange or foreign security and all payments from outside the country to India shall be made only through authorised persons, except with the general or special permission of the Reserve Bank. The Act also prohibits any payment outside India except with the general or special permission of the Reserve Bank.

The FEMA permits dealings in foreign exchange through authorised persons for current account transactions. However, the Central Government can impose reasonable restrictions in public interest.

Any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction permitted by the Reserve Bank. However, the Act empowers the RBI to impose a number of restrictions on capital account transactions.

The FEMA permits a person resident in India to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. Also, a person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

The Reserve Bank is empowered by this Act to prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business. However, the RBI shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

18.16 Self Assessment Questions

1 Critically evaluate the appraisal & control over MNCs.

2 Explain the objectives & Provisions of FERA

3 What do you mean by FEMA? Explain the main provisions of this act.

4 Discuss the salient features of FEMA.

5 Discuss the path through which FERA turns to FEMA.

6 Compare the FERA and FEMA.

7 Critically evaluate the Foreign exchange management act.

8 Case Study

Discuss the domestic or global environment that hinders the globalization of Indian business with the help of following information:-

The public sector Indian oil corporation (IOC), the major oil refining and marbling company which was also the canalizing agency for oil import, & the only Indian company in the fortune 500, in the terms of rules, planned to make a foray in to the foreign market by acquiring a substantial shape in the Balal Oil field in Iran of the Premier Oil. The project was estimated to have recoverable oil reserves of about 11 million tones and IOC was supposed to get nearly four million tones.

When IOC started talking to the Iranian company for the acquisition in October 1998, oil prices were at rock bottom ($ 11 per barrel) and most refining companies were closing shop due to falling margins. Indeed, a number of good oil properties in them iddle East were up for sale, using this opportunity, several developing countries "made a killing by acquiring oil equities abroad." IOC needed government's permission to invest abroad. Application by Indian company for investing abroad is to be scrutinized by special committee represented by the RBI and the finance & commerce ministries. By the time the government gave the clearance for the acquition in December 1999, the prices had bounced back to $ 24 per barrel. And the Elf of France had virtually took away the deal from under IOC's more by acquiring the premier oil.

The RBI, which gave IOC the approval for $15 million investment, took more than a year for clearing the deal because the structure investments were not in place, it was reported.

18.17 Reference Books

- Indian Economy : Mishra, Puri
- Business Environment : Aswathapa
- Business Environment : Cherunilim