LESSON -1

BUSINESS ENVIRONMENT - AN OVERVIEW

Objectives

After studying the unit you should be able to

* Define what you mean by Business and Business Environment.
* Classification of External and Internal Environmental factors.
* Analyze the various Internal Environmental factors
* Explain the impact of several Environmental factors

STRUCTURE

1.1 Introduction

Business is an important institution in society. Be it for the supply of goods and services; creation of employment opportunities; offer of better quality of life; or contribution to the economic growth of a country; the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much. Modern business is dynamic, changing, Vastness, diversified, globalised, Competitive and Informative.

The term business is used in different ways. In a functional sense it is used to refer to the functions or activities of an organization or an individual. Traditionally, the term business related to the commercial activities aimed at making profits or to organizations formed to make profit. But the modern outlook is very different. For many organisations Profit maximization is not the primary objective. There are many organisations both in Public and private which do not aim at maximizing their Profits.

The scope of business was interpreted by K.D Fernstorm and others given below;

1) Business which produce goods;
   a) Farms, dairies and other agricultural producers.
   b) Mines, Fisheries, lumbering enterprises and others which extract natural resources.
   c) Manufacturing enterprises producing machinery, materials or supplies and those producing goods for consumption.

2) Business which Produce Services:
   a) Railroads, bus and truck lines, Steam ship lines and other transportation enterprises
   b) Telephone and Telegraph Companies
   c) Producers of electric light and power
   d) Hotels, Restaurants and other producers of the services of food and shelter
   e) Laundries, dry cleaners and other enterprises furnishing household services
   f) Theatres, amusement parks and other enterprises furnishing amusement and recreation.

3) Business which distribute goods
   a) Wholesale merchants of various types
   b) Retail merchants of various types
   c) Importers and exporters

4) Business which facilitate distribution of goods;
   a) Warehouses, grain elevators and other storage business
   b) Auction houses, exchange and other enterprises which afford places of trade
   c) Advertising enterprises, including advertising agencies, bill board operators etc
   d) Finance Companies, Credit bureaus and similar enterprises

5) Business which deal in money and credit
   a) Commercial banks and other suppliers of short term credit
   b) Investment houses and other suppliers of long term credit

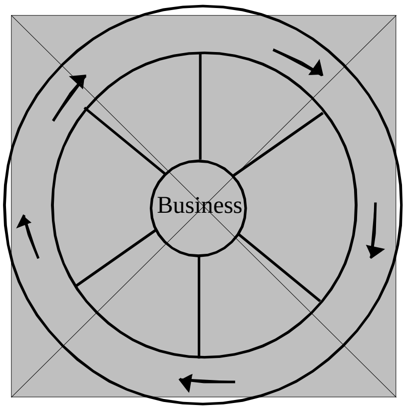
The concept of business confirming to commerce and private profit has undergone a lot of change. Nowadays we know Business as regarded as a social institution forming an integral part of the social system. According to Daves & Blomstorm Business is a "social institution, performing a social mission and having a broad influence on the way People live and work together" . Daves & Blomstorm says that Business is viewed as a subsystem of the total social system. Business cannot isolate itself from the rest of the society. Today the whole society is business environment. The three ideas that influence the business on society are values, viability and Public visibility.

1.2 Definition of Business Environment

Just as human beings live in a climate, business operates in a certain environment. This environment is complex, changing and not easily predictable. The business must look at the changes of the environment and adapt itself to revive and grow. William F.Glueck defined the term environmental analysis as "the process by which strategists monitor the economic/governmental / legal, market / competitive, suppliers/ technological, geographic and social settings to determine opportunities and threats to their firms."

Environmental diagnosis consists of managerial decisions made by analyzing the significance of data (opportunity and threats) of the environmental analysis

Exhibit - 1.1



Symbiotic relationship between Business and Environment.

1.3 Classification of external and internal environments:

Just as the life and success of any individual depends on his innate capabilities, including physiological factors, traits and skills, to cope up the environment, the survival and successes of a business firm depend on its innate strength the resourses at its command, including physical resources, skill and organisation and its adaptability to the environment. A total business system, thus, consists of two sets of factors - the internal and the external factors.

The internal factors are those within the control of the firm. The firm can alter or modify such factors like personnel, physical facilities, organizations and functional means, such as marketing mix, to suit the environment. The external factors, on the other hand, are, by and large, beyond the control of a company. The external environmental factors such as the economic factors, socio cultural factors, government and legal factors, demographic factors are generally regarded as uncontrollable factors. It is represented in Figure I-1.

1.4 Internal Environment:

There are a number of internal factors which influence the business decisions.

Value System: The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organisation, business polices and practices .It is widely acknowledged fact that the extent to which the value system is shared by all in the organization is an important factor contributing to success. The value system of JRD Tata and the acceptance of it by others, who matter were responsible for the voluntary incorporates in the Articles of Associations of TISCO its social and moral responsibilities to consumers, employers, shareholders and society.

Mission and Objectives: The business domain of the company, priorities, direction of development, business , Philosophy, business policy etc are guided by the mission and objectives of the company. Ranbaxy's thrust into the foreign marketing and development have been driven by its mission to become a research based international pharmaceutical companyî.

Management Structure and Nature: The organisational Structure, the Composition of the Board of Directors, extent of professionalisation of management etc are important factors influencing business decisions.

Some management structures and styles delay decision making while some others facilitate quick decision making.

Internal Power Relationship: - Factors like the amount of support the top management enjoys from different levels of employees, shareholders and Board of Directors have important influence on the decisions and their implementation

Human Resources: - The characteristics of the human resources like skill, quality, morale, commitment, attitude etc, should contribute to the strength and weakness of an organisation. Some organisations find difficult to carry out restructuring or modernisation because of resistance of employees whereas they are smoothly done in some others.

Company Image and Brand Equity: - 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.

1.5. External Environment: -

The external business environment consists of a macro environment and a micro environment The micro environment consists of the factors that effect the performance of the company. These include suppliers, marketing intermediaries, competitors, customers and the publics. The macro environmental consists of factors namely economic, political legal, technical, demographic and cultural forces, Let us analyze these different factors.

1.5.1 Micro-Environment: -

Suppliers : An important force in the micro environment of a company is the suppliers i.e those who supply the inputs like raw material and components to the company. The importance of reliable sources of supply to the smooth functioning of the business is obvious. Because of the sensitivity of the supply, many companies give high importance to vendor development. vertical integration where possible helps solve the supply problem. It is very risky to depend on a single supplier because a strike, lockout or any other production problem with that supplies may effect the company. Hence multiple sources of supply often help to reduce such risks.

Customers : The major task of a business is to create and sustain customers. A business exists only because of its customers. A company may have different categories of customers like individuals, household industries, other commercial establishments, government and other institutions. For example the customer of a type company may include individual automobile owners, automobile manufacturers. Public sector transport undertakings and other transport operations. Depending on a single customer is always riskyes because it may place the company in a poor bargaining position. The choice of the customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition.

Competitors : A firms competitions include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers. For example, the competition for a company’s television may come not only from other T.V manufacturers but also from two wheelers, refridgerators, cooking ranges, stereo sets and so on and from firms offering savings and investment schemes like banks, Unit Trust of India, companies accepting public deposits or issuing shares or debentures etc.

Market Intermediaries : The immediate environment of a company consist of a number of marketing intermediaries which are “firms that and the company in promoting, selling and distributing its goods to final buyers. The market intermediaries include middlemen such as agents and merchants who help the company to find customers or close sales with them:

Financiers: - Another important micro environmental facts is the financiers of the company. Besides the financing capabilities, their polices and strategies, attitudes, ability to provide non financial assistance etc are very important.

Publics: A Company may encounter certain publics in its environment. “A public is any group that has an actual or potential interest in or impact on an organisations ability to achieve its interestsî. Media publics, citizens action publics and local publics are some examples.

1.5.2 Macro Environment :

The macro environmental factors are more uncontrollable. Therefore the success of a business firm depend upon its adaptability to the enmroniment. Now let us discuss about these macro environmental factors.

i) Economic Environment : The economic conditions, economic polices and the economic system are important external Macro environmental factors that constitute the economic environment of business.

The economic conditions of the country like nature of the economy, stage of development of the economy, economic, resource level of income, distribution of income and assets are some of the important determinants of business strategies. Differences in the income levels between countries is a true reflection of the purchasing powers or living standards of people. In developing countries, the low income may be the reason for the very low demand for a product. The sale of the product with income - elastic demand will naturally increase with increase in income. But, a firm is unable to increase the purchasing power to generate more demand for its product. Hence, it may have to reduce the price of the product to increase the sales. Reduction in the cost of production may have to be effected to facilitate price reduction. It may also have to invent a new low cost product to suit low income. Thus the Colgate designed a simple, had driven inexpensive ($10) washing machine for low income buyers in less developed countries.

In countries were investment and income are steadily and rapidly rising business prospects are generally bright and further investments are encouraged. There are a number of economists and businessmen who feel that developed countries are no more worthwhile propositions for investments and these economies have reached more or less saturation levels in certain respects.

The economic policy of the government, needless to say, has a very great impact on the business. Important economic policy are Industrial policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology policy. Some types or categories of business are favourably affected by government policy, some adversely affected, while it is neutral in respect of others similarly an industry that falls within the priority sector in terms of government policies may get a number of incentives and other positive support from the government, whereas the industries which are regarded as inessential may have the odds against them.

The economic systems of the country also have a lot of impact on business. On one end there are the free market economies or capitalist economies and on the other end are the centrally planned economies or communist countries. In between these two are the mixed economies. Within the mixed economic systems there are wide variations.

ii) Political & legal Environment: - Political and legal environmental factors also influence the operations of business firms enormously. The influence of the political system of a country influences the business from multi angles, VIZ., deciding, promoting, fostering, encouraging, sheltering, directing and controlling the business activities. The success and growth of business depend upon the stable, dynamic, honest, people particpative, reared political system in a country. Countries with stable political system enjoyed the successful business operations. USA is a best example for political stability and dynamism. Hence people prefer to locate their business operation is U.S.A. According to John Kenneth Galbriath no country with a stable and government in addition to being stable should also be efficient. John Kenneth Galbriath argues that in all the advanced countries, "the early emphasis was not on capital investment but on political and then on cultural development. In USA, West Europe and more recently in Japan, a secure political context was stressed in both thought and action on economic development, it was considered the first requisite for economic progress".

In addition to the stable and dynamic governments, the political environment includes the polices and characteristics of political parties, the nature of the constitution and government system. In most of the countries apart from the laws that control the investment and related matters, there are a number of laws that regulate the conduct of the business. Such regulations cover matters such as standards in respect of product, packaging, promotion etc. In many countries, regulation with a view to protecting consumer interests have become stronger. Regulations to protect the purity of the environmental and ecological balance have also been assuming more importance.

Some governments specifies certain standards for the products to be marketed in the country. In a number of countries including India; advertisements of alcoholic liquor is prohibited. Advertisement including packaging of cigarettes, shall carry the statutory warning that "Cigarette smoking is injurious to health." Similarly, advertisements of baby foods shall inform that breast feeding is the best. In countries like Germany product comparison advertisement like better, best or excellent is not allowed. Similarly in drug & cosmetic industries the producer should disclose the long range side effects of the products usage.

There are a host of statutory controls on business in India. If the MRTP commission want to expand their business substantially, they have to convince the government that such expansion is in the public interest.

iii) Socio - cultural Environment: - Social and cultural factors in various countries effect the business These factors include attitude of the people to work, attitude to wealth, family, marriage, religion, education, ethics, human relations, social responsibilities etc.

For a business to be successful the business strategy should be the one appropriate for the socio - cultural environment. The marketing must will have to be so designed as best to suit the environmental chasacterstics of the market. In Thailand for example, He lene Curtis switched to black shampoo because Thai women feel it makes their hair look glossily.

The diffrences in language sometimes pose a serious problem. preett was perhaps, a good brand name in India but it did not suit for the overseas market and have it was appropriate to adopt prestige for the overseas market. In some languages, Pepsi-Cola's slogan 'come alive' translator as 'come out of the grave'.

The values and beliefs associated with colour varies between different countries. Blue is considered faminine and warm in Holland, is seen as masculine and cold in Sweden Green is the favorite colour in the Muslim world but in Malaysia it is associated with illness. White indicates death and mourning in China and

Korea but in some countries it expresses happiness and is the colour of the wedding dress of the brides. Red is a popular colour in the communist countries but many African countries have a national destaste for red colour.

Social inertia and associated factors come in the way of promoting certain products, services or ideas. We come across such stigmas in marketing of family planning ideas, use of bio-gas for cooking etc. While dealing with social environment we must also consider the societal Environment of business which encompasses the social responsibility of the business and the alertness or vigilance of the consumers and society at large.

iv) Technological Environment : Technological Environment has significant and direct influence on business,i.e. Technology is application of knowledge J.K Galbraith defines technology as “a systematic application of scientific or other organised knowledge to particular tasks.” Technology advanced phenomenally during the post 50 years. Technology changes at a faster rate. In fact, it brings change in the society economy and politics. Technology affects all walks of life, all countries and the entire globe. Technology flows from the advanced countries to the developing world through the Multinational corporations (MNCS), joint ventures, technological alliances, licensing and franchising. Technology influences the way we live, we cook (electric rice cooker) we drink even water (filtered and mineral water). communicate (telephone, fax, email video conferencing, e-mail chatting etc.) Preparing for a clear or a case of reading a news paper through internet marriage alliances through internet, computers aided design, production, selling (e-commerce) satellite networks electronic fund transfers, lasers, fibre optics, unmanned factories, miracle drugs, new diagnostic Methods.

v) Demographic Geographical and Ecological Environment : Demographic factors like the size, growth rate, age composition, sex composition etc of the population, family size, economic stratification of the population, educational levels, language, caste, religion etc are factors relevant to business. Geographical and ecological factors like natural resource endowments, weather and climatic conditions, topographical factors, locational aspects in the global context, port facilities etc are also relevant to business.

1.6 Meaning of Economic Environment: -

Economic environment refers to all those economic factors which have a learning on the functioning of a business Unit. Business depends on the economic environment for all the needed inputs .It also depends on the economic evironment to sell the finished goods. Naturally, the dependence of business on the economic environment is total and it is not surprising because as it rightly said, business is one unit of the total economy.

The importance of economic environment is reinforced by the fact that more and more economist are finding place in Industrial establishments. These changes are revolutionary after 1990. The results of these changes are emergence of global markets, establishment of world trade Organisation, emergence of global business and global competitors rather than local Competitors. The study of the economic environment may be taken up for firm, for many firms then has more direct impact. The economic systems, the economic planning and economic conditions of the country have direct impact on the economic environment of business.

1.7 Economic Systems:-

Economic system and organisation of institutions are established to satisfy human needs / wants. There are three types of economic systems, VIZ, Capitalism, Communism and mixed economic system. Economic systems are based on resource allocation in the system. They are market allocation in case of Capitalistic, command / central allocation in case of mixed economic system. In fact, there are no examples of pure Capitalistic or communistic economies. All actual systems are mixed economic systems of varied degrees of market allocation and command allocation.

i) Capitalistic Economic System:- The system of Capitalism stresses the Philosophy of individualism believing in private ownership of all agents of production, in private sharing of distribution. Processes that determine the functional rewards of each participant, and an individual expression of Consumer choice through a free market palace. In its Political manifestation, Capitalism may fall in a range between extreme individualism and no government and the acceptance of some state sanctions as mentioned by Adam smith and the later Philosphers of modern Capitalism.

We should mention about the Welfare State concept, which has developed in recent years. This is a modification of modern Capitalism that provides for on increase degree of state regulation when certain deficiencies appear in the economy. These limitations placed on the free market operations such as workmen's compensation law, provision for social security, laws regulating Industrial relations or direct State financial aid to housing and agriculture, medical, food, transportation, communication etc. USA, Japan and UK are the examples of Capitalistic countries. Most of the other countries like India, France, Italy and Malaysia have started shifting their economic systems towards this economic system.

ii) Communistic Economic System:- In this economic system, Private Property and Property rights to income are abolished. The State owns all the factors of Production and distribution, Communism is also called as Marxism. Lenin set up a communist State in Russia after the Great October Revolution of 1917. Later the idea spread to Czechoslovakia, China, Rumania, Yugoslavia, Poland and Sweden. Most of the East European Countries follow the Marxist idealogies. The major limitations of this system include.

1. It reduces individual freedom of choice due to restriction on items to be produced.
2. It fails to get total commitment of People to work and country's welfare.
3. It failed to achieve significant economic growth.
4. It could not achieve equality - the main plank of Marxism.
5. The rules of this system did not set fine examples for the executors to follows or implement.
6. It has been observed with rights of workers.

Communism to collapsed in the former USSR. Similrlary Communism collapsed in most of the African countries. This is mostly because of the changes towards privatication. The degree of command allocation has been declining even in China. Cuba is an example of the last remaining predominantly communistic country.

iii) Mixed economic system: - Under the economic system, the major factors of Production and distribution are owned, managed and controlled by the State. The purpose is to provide the benefits to the public more or less on equity basis. The others factors of mixed economic system are development of strong public sector, agrarian reforms, control over private wealth, regulation of private investment and national self reliance. This system does not distribute the existing wealth equally among the people, but advocates the egalitarian principle. It believes in full employment, suitable rewards for the workers efforts. There is no pure capitalistic system or Communistic system. The Exhibit I - 2. Presents Comparison of Capitalistic, Communistic and mixed economic systems.

Exhibit 1.2 Capitalism, Socialism and Communism Comparison

Characteristics	***Capitalism***	***Socialism***	***communism***
i) Economic Markets	Freedom to compete with the right to invest	Limited competition with State owned industries	absence of competition with State owned market and industries
ii) Individual insistences	Profits and wages in relation to one's ability and willingness to work.	Profits recognised wages fairly in section to efforts.	Profits not allowed workers argued to work for the glory of the state
iii) Capital sources	Capital invested by owners who may also borrow on credit, Capital may be re-inverted from projects depreciation is leagal	Obtained from owners and from state issued bonds for state owned industries. Depreciation permitted.	State provides all resources to start business owned by the state. No depreciation
iv) Labour	workers are free to select an employer and an occupation	workers allowed to select occupation state planning encourages employment.	the state determines one's employer and employment
v) Management	Managers are selected on the bases of ability. Manager have freedom to make decisions	Manager are state owned industries are answerable to the state. Non-monetory rewards emphasised	Key manager must be be party members. Absence of freedom to make decesions.
vi) Business ownership	Individuals have the right to own a business and to contract with others.	State owns the basic industries other business may exist.	state owns all productive capacity including community
vii) Risk Assumption	Losses assumed by owners may transfer business risks to others businesses through insurance	People assure risks of state owners industries Losses taken from taxes.	Economic production owned by the state. Risks assumed by the state. Losses reduce standard of living.

1.8 Economic planning: -

A mixed economy is necessarily a planned economy. It does not mean simply controlled economy in which, the government interferes in economic matters through fiscal and monetary polices, but it is an economy in which the government has a clear and definite economic plan. The public sector should have an economic plan. The public sector will have to operate according to certain priorities and to realise specific social and economic goals. At the same time, the government cannot leave the private sector to function in its own unorganized way.

The government has to prepare and implement a comprehensive economic planning integrating the private rector with the public sector. It is for these reasons that we have been having economic planning. Since

1951 when the First fine year plan war launched, we have had five decades of economic planning. We have completed nine five year plans. All the five year plans were designed to achieve four important long term objections, VIZ

a) Increase Production to the maximum possible extent so as to achieve a higher level of national and per captain income.

b) Achieve full employment.

c) Reduce inequalities of income and wealth and.

d) Set up a socialist society based on equality and justice and the absence of exploitation.

Massive investments were made in all the five year plans to realise these objectives. Table -I - 3 guess the allocation of the plans.

TABLE - 1.3

Pattern of Resource Allocation in Indian five year Plans

Needs of Development	I	II	III	IV	V	VI	VII	VIII
Agriculture	37.0	20.0	20.5	23.3	22.1	22.2	20.2	20.6
Irrigation	7.6	9.7	14.6	18.6	18.8	16.7	17.4	18.7
Power	4.9	24.1	22.9	19.7	24.3	26.5	23.7	18.8
Industry								
Transport & Communications	26.4	27.0	24.6	19.5	17.4	16.0	17.1	18.7
Social service	24.1	18.3	17.4	18.9	17.4	18.6	21.6	23.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(Source: Economic sources and planning commission Annual Report 1995-96).

Industry: - In the mid -1960s, India has a better industrial base and possessed more pre-requisites for industrial growth than South Korea, Malaysia, Taiwan, Thailand and Indonesia. Since then, the country has succeeded in creating a virtually autarkic economy, where all outputs and factor were subject to rigid price and quantity controls; where investment was strictly rationed; where there were multiple barriers to entry, investment, foreign trade and competition and where the objectives of the financial system was to supply subsidised development funds irrespective of returns.

Various administrative controls are industrial licensing, product reservation for public sectors, MRTP and asset classification of monopolies, product reservation for the small scale sector, Foreign exchange Regulation Act, Tariffs and quotes, the mini Plants, labour market rigidities, development finance and indigenous availability and essentiality.

National Income and per Capita Income: - Every sector of the economy employs natural, human and material resources and contributes to the aggregate flow of goods and services during a time period, usually specified as one year. This aggregate flow of goods and services represents the total income earned by factors of production employed during the years and is popularly called National income or National product. The rate of growth of the national income in an economy is an indication of the pace at which the economy has been growing. A high growth rate indicates that the economy is a developed one. Low growth rate signals that the economy is a developing or a poor one. Further more, a high national income indicates that the economy is developed and the overall environment is favorable for business growth.

Table- 1.4 gives details about national income and per Captain income since 1980.

Looking at the figures available Table 1.4, it may be stated that our performance compares favorably with that achieved by the currently high income countries when they were in their transformation phase. For examples our national income growth during 1950-1994 has been reported higher then that of the UK, France and Germany during the mid 19th to mid 20th countries, and about the same as the performance of the USA which was one of the most developed nations at that time.

TABLE - 1.4

National Income and Per capital **Income at** *Current Prices*

Year	***National Income***	***Per capita Income***
	Rs	Rs
1980-81	1,10,685	1,630
1990-91	4,18,074	4983
1991-92	4,79,612	5602
1992-93	5,45,434	6255
1993-94	6,26,957	7060
1994-95	7,44,663	8237
1995-96	8,56,663	9473
1996-97	9,85,162	10, 708.

However, it must be admitted that our growth rate have been less than the plan targets (see Table I-5) and below the required growth rate of about 10% per annum: Reason is abvious.

TABLE - 1.5

Targets & Actuals in National Income

Plan Period	***Target***	***Actuals***
1	2.1	3.6
II	4.5	4.0
III	5.6	2.4
IV	5.7	3.3
V	4.4	5.0
VI	5.2	5.4
VII	5.0	5.7
VIII	5.6	5.7

The primary reason for low growth levels in the national income is the deficiencies in investment. This is followed by high capital output ratio, low agricultural and industrial growth and population explosion. The last factor is mainly responsible for low Per Capita income, not withstanding satisfactory growth in the national income.

1.9 Economic Conditions

General economic conditions affects business. Economics pass through periods of boom and depression. A boom is characterised by high level of output, employment and rising demand and prices. A recession has the apposite of these characteristics.

If a region depends to a significant extent on any particular industry or sector, business in that region would be significantly affected by fortunes of that industry. The economic and business prospects in major oil exporting countries depend to a very great extent on the crude oil price. The economic conditions of a region may be linked to the prices of major crops of that region. For example, because of the fall in the prices, the coconut farmers of Kerala were estimated to have lost about Rs 10,000 Crores between 1997-200. Similarly, the rubber farmers lost an estimated Rs 1,500 Crore during the 5years period ended 2000. The Price of several other Commercials, crops also crashed. This situation has very adversely affected the general economic and business conditions of the State.

A Particular economic may be widespread international or national or may be confined to a region. For example, during 1997-98 when several South East economies under went a crisis, it affected the business of even firms in a number of other countries. The Indian steel exports to south East Asia, for example suffered a severel set back.

As we are aware that the US economy accounts for well over one fourth of the US global economy. This implies that growth trend of the US economy can affect the overall growth trend of the global economy by more than 25 percent. For example, in a year even if the rest of the global economy remains stagnant, on the whole, if the US economy grows by two percent, it will have the effect of the world economy growing by about half a percent. A recession in US economy will have an apposite impact. As the US economy is highly integrated globally, the economic condition the US can have repercussions in other economics.

The current account and balance of payments positions of a country, Exports and imports of a country are generally affected by a number of domestic and international economic conditions.

1.10 Economic Policies :

There are several economic Policies, which have a very great impact on business. Important Economic Policies are industrial Policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology Policy. Some types of categories of business are favorably affected by government policy, some adversely affected, while it is neutral in respect of others Similarly an industries that falls within the Priority sector in terms of the government policy may get a numbers of incentives and other positive support from the government, where as those industries which are regarded as inessential may have the odds, against them.

Industrial policy: -Industrial policy can define the scope and role of different sectors like private, public, joint and cooperative, or large, medium, small and tiny. It may influence the location of industrial undertakings, choice of technology, scale of operation, product mix and so on.

In India until liberalisation in 1991 the scope of private sectors was very limited. The development of 17 of the most important industries was reserved to the state. In the development of another 12 major industries the state was to play a dominant role. Further the production of a large number of items was reserved to small sector. Even in respect of industries which were open to private sector, entry and growth were regulated by licensing, MRTP Act so on. It was only in 1991 policy and after liberalisation business opportunities were enormously expanded.

Trade Policy: - The trade policy can significantly affect the fortunes of firms. For example a restrictive import policy or a policy of protecting the home industries, may greatly help the import competing industries, while a liberalisation of the import policy may create difficulties for such industries. Trade policy is often integrated with the industrial policy as part of the economic liberalisation and WTO compliance India has very substantially liberalised imports. Domestic firms now face increasing competition from imports. In other words they face growing international competition in the domestic market. This implies that in many cases Indian firms which do not come up to the international standards in quality, cost, marketing, after sales service will not be able to survive.

Foreign Exchange Policy: - Exchange rate Policy is the Policy in respect of cross border movement of capital are important for business. The liberalistion of exchange controls all round the world since the late 1970 has, encouraged cross-borders movement of capital.

Foreign Investment and Technology Policy: - Until the late 1980s, when the world wide trend towards liberalisation set in, foreign Capital and technology were under severe restrictions- in many developing and social Countries.

Restrictions on foreign capital and technology constrain not only the foreign firms but also the domestic firms because it may come in this way of acquiring the technology of their choice from the best source. Restriction on foreign capital may affect the growth plans of firms, including establishment of joint ventures. A liberal foreign investment and technology policy will increase domestic competition and would not put many domestic firms into problem. At the same time it would benefit many domestic firms.

Fiscal Policy: - Governments strategy in respect of public expenditure and revenue can have significant impact on the business The pattern of public expediture may effect the development of various regions, sectors or industries differently such is the case with the taxation policy. Government often use tax incentives to encourage or discourage certain activities. For example when industries suffers from recession a reduction of taxes like excise duty or sales tax may help improve the demand. A reduction of rates of direct taxes like personal income tax and carporate tax may help increase, because of the resultant increase in the disposable income, the spending in the economy leading to a increase in demand. Governments, central as well as provincial, of many countries offer different fiscal incentives to encourage industries.

Monetary Policy: - The central bank, by its policy towards the cost and availability of credit, can significantly influence the savings, investment and consumer spending in the economy. Depending on the conditions of the economy and the general economic policy of the government, the central bank may adopt an expansionary or contractionary or neutral monetary policy. For example, a one percentage point reduction in the Cash Reserve Ratio will significantly increase the loanable funds with the commercial banking system. Monetary policy may also be pressed into action to influence the exchange rate of the currency: You will be knowing about these policies in detail in the next chapters.

1.11 Conclusion: -

The business is influenced to a large extent on all these external and internal environmental factors. The success of a business depends to a large extent on adapting to the changing environmental factors. A business which can adapt itself very fast to the changing environmental factors can survive in the competitive market for a long time That is the reason we come across many companies which could not adapt to the environment changes and have collapsed. So the success of a business enterprise depends on its adapting to the changes.

Business fortunes and strategies are influenced, by economic characteristics, economic Policy dimensions such as the structures and nature of the economy, the stage of development of the economy, economic resource; the level of income, the distribution of income and assets, global economic linkages economic Policies etc. So a businessman should take into consideration all these different economic environmental factors that determine the success and survival of business.

1.12 Summary :

The Environment is a complex Phenomenon. The term environment consists of several subsets e.g., economic environment, Socio - cultural environment, Political-legal environment, technological environment etc., It thus represents the totality of all kinds of environments which have on impact on business. To a large extent, the environment is external to the firm. Business firms in general have little influence on external forces. Depending upon the nature and composition of several subjects of the environment, the business environment varies from country from one point of time to another. A number of problems are involved in the identification description, explanation and prediction of environmental factors. The environmental factors are dynamic. It is difficult to conceptualise and for quantity the proportion of change as well as the directions of change in environmental factors. The environment consists of all economic institutions, the structure of the economic system, market forces, Government's economic policies and plans. All modern economies have certain fundamental economic problems to deal with. There is a tendency towards the marketisation of economic institutions and opening up of economies.

Since the environment and the economic institutional framework affect business organisations, it is imperative on the part of the management to scan the environment before taking any decisions. The success of the business enterprise, in a large measure, would depend upon the proper understanding of the business environment.

1.13 Self Assessment Questions :

1. Discuss the concept of business and the classification of business enterprise?
2. Briefly describe "Business Environment" and the relationship of Business with Environment?
3. Explain about the internal and the external environmental factors that influence the business?
4. Discuss the Macro environmental factors? What is their influence on business?
5. What is economic environment? How is it important for business?
6. Describe the economic environment or it prevails today is our country?
7. Do you think the present economic environment is favourable to business? Discuss?
8. Why is economic Planning necessary? What has been our experience with Planning?
9. Bring out the salient features of the bare economic system?
10. What is the importance of economic polices?
11. Discuss the economic condition and their influence on environment?

1.14 Further Readings

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LESSON - 2

POLITICAL AND LEGAL ENVIRONMENT

Objectives :

After studying this lesson you should be able to

1. Understand the impact of Political and legal enveronment of business.
2. Understand the concept and components of democratic socialism in India.
3. Know the legal framework in India with special reference to socio-economic legeslation relevant to Industry, and
4. Identify the functioning of some economic administration bodies in India.

STRUCTURE

2.1 Introduction :

Business and politics are closely related to each other. Every business has to function within the political framework of the country. Business cannot survive and prosper without a clear understanding of the dynamics of politics and without the support of public opinion.

Political environment consists of th type of government, its stability, its actions and its control over the people. Political ideology of the government determines the role of business firms. Political stability improve the confidence of the investors in the business. Rules and regulations enforced by the government and the public reaction to them provide necessary direction to the growth of the business. Honesty in Government improves the morale of the people and prevents spreading of corruption in the society. Corrupt government corrupts the business and society.

A Political system which is stable, honest, efficient and dynamic and which ensures political participation of the people, assures personal security to the citizens, as a primary factor for economic development. The rich countries today owed their success mainly to the political systems they richly enjoyed. John Kenneth Galbraith comments, “no country with a stable and honest government that does not have or has not had a reasonably satisfactory state of economic progress”. He further argus that “In all these countries, the early emphasis was not on capital investment but on political and then on cultural development. In the United States, Western Europe, and more recently in Japan, a secure political context was stressed in both thought and action on economic development; It was considered the first requisite for economic progress”.

For instance, multinational companies like Coco Cola and IBM discontinued their activities in India in the late seventies because of the government policy of restricting the growth of multinational companies in the country. In 1989, the government allowed another multinational company, Pepsi Cola, to enter the Indian market to give boost to the food processing industry. Recently, the Coca Cola Company again entered the Indian market. Stability of the government is also an important factor from the point of view of growth of business. Businessmen prefer to start new units in those states where there is political stability and where rule of law prevails.

A business can succeed in the accomplishment of its goals only if it is able to properly foresee the changes in the polices and programmes of the government and adjust its activities. Accordingly long term changes reflect a basic shift in the attitudes and view points of the voters. Thus in a country like ours these are aimed at reduction in unemployment, industrial hazards, economic insecurity and to afford protection to the consumer. Frequent changes in the policies of the government may cause unforeseen factors such as outbreak of war, calamities like earth quake, drought etc., Cyclical changes in government Policies take place when the government is more responsive to popular opinion. Uncertainty regarding who may win the elections may cause instability and business houses may prefer to wait and watch the changes in new leadership. Regional factors will influence governmental polices such that a leadership with rural orientation may place greater emphasis on agriculture and industries based on agriculture.

2.2 Economic, Social and Secular Ideologies :

Business is a subsystem of the economic system of the country and it is composed of innumerable inter- locking sub-systems known as industrial and commercial firms. Each firm has further sub systems such as production, marketing, finance and personal. The economic system of the country exerts the most personal influence on the structure, organisation and operations of these firms. Therefore, the business system of a country cannot be studied without reference to the economic system of which it is a part. The economic system of the country provides economic enveronment of business. Business is infuenced by the overall economic, fiscal, commercial and industrial policies of the government etc.,

Under a capitalist economy, business is largely operated by enterepreneuers private profit. Decisions relating to production, distribution and consumption are made through market forces of demand and supply without much interference by the government. But in a communist or socialist economy, all business decesions are dictated and regulated by the Central agencies of the government. However, in a mixed economy like India, the businessman have freedom of choice and action in certain industries. Some industries are reserved exclusively for the public sector. The private sector business enterprises have to be guided by the governmental, budgetary, industrial and commercial policies.

2.3 Democratic Socialism in India

The classical basis of socialism was provided by Marx and Engles who belived that to end exploitation from the world it is necessary to abolish private ownership of the means of production. Marx and Engles considered private property to be the cause of all social levels. The tremendous progress achieved by the Soviet Union, which followed Marx and Engles model, has an impact on the capitalist countries of the world also. Although the Countries that followed capitalism did not lose faith in private property and individual freedom, yet they were convinced that the government could play an effective role for faster economic development.

Jawaharlal Nehru, the first Prime minister and the architect of Indian planning, greatly admired the achievements of Soviet Economic system. He borrowed the concept of socialism from socialist societies and democratic values of the capitalist societies to take advantage of the virtues of two extreme societies. This type of mixed economy followed by India is described as “democratic socialism”.

Under the directive principles of the Indian constitutions it has been laid down that the state should strive “to promote the welfare of the people by securing and protecting as effectively as it may be a social order in which justice, social, economic and political, shall inform all the institutions of national life.”

The mixed economic system practised in India during the last four decades has been able to create social and ecoomic infra structure. It provided industrial base by fostering the development of heavy and basic industries and enlarged educational oppurtunities. But it failed to increase the employment facilities as was expected. It also failed in eliminating poverty and reduction in concentration of income and wealth. Moreover the economy was over regulated leading to stagnation in many fields of economy.

2.4 Role of Government :

The Government plays an important role in almost every national economy of the world. Even in the capitalist economy a substantial share of the nation’s product goes to satisfy public wants. In a private enterprise economy, government interference is necessitated by the Socio-political ideological reasons. Market mechanism cannot perform all economic functions. Public policy is needed to guide, correct and supplement it in certain respects. Government normally play four important roles in an economy, VIZ regulation, promotion, enterpreneurship and planning.

2.4.1 Regulatory Role : Government regulation of the business may cover from the entry of the business to the final results of the business. The reservation of industries to small scale, public and co-operative sectors, licensing system etc regulate the entry. Regulations of product mix, Promotional activities etc amount to regulation of the conduct of business. Government regulations of the economy may be demanded into direct controls and indirect controls.

Indirect controls are usually through various fiscal and monetary incentives and desincentives or penalties. Certain activities may be encouraged or discouraged through monetary and fiscal incentives and disincentives. For example, a high import duty may discourage imports and fiscal and monetary incentives may encourage the development of export - oriented industries. The direct controls are more drastic and discretionary. They can be applied selectively from firm to firm and industry to industry, at the discretion of the state.

2.4.2 Promotional Role : The promotional role played by the government is very important in developed countries as well as in developing countries. In developing countries, where the infrastructural facilities are in adequate, the promotional role of the government has a lot of significance. The state will have the responsible to build up and strengthen the necessary development infrastructures such as power, transport, finance, marketing institutions for training and guidance and other promotional activities.

2.4.3 Entrepreneurial Role : In many economies the state also plays the role of an enterpreneur - secural factors such as socio political ideologes, dearth of private entrepreneurship; neglect of certain factors, absence of inadequate competition, exploitation of consumers etc. have contributed to the growth of state owned enterprises in many countries.

2.4.4 Planning Role : In developing countries the state plays a very important role as a planner, The importance of planning in less developed economies has been emphasized by Jawaharlal Nehru. He says, “Whatever it may be in other countries, in under developed countries like ours, which have to develop fairly rapidly, the time element is important and the questions is how to use our resources to the best advantage. If our resources are abundant it not matter how they are used. They will go into the common pool of development. But when one's resources are limited, one has to see that they are directed to the right purpose so as to help to build up what everyone is aiming at."

2.5 Political Institutions :

The political system in India under democratic socialism comprises three vital institutions.

2.5.1 Legislature : Legeslation exercises more influence on the business actvities and its impact is considerable. The legislature decides the types of business activites, growth; regulation and control of business, size of operation, employment and working conditions etc.,

2.5.2 Executive or Government : The Parlaiment /Assembly makes laws for the country, state and the executives enforces them. The executives includes the head of the state, ministers and all officers of the Government who are concerned with the execution of laws and running of administration.

2.5.3 Judiciary : Judiciary determines the manner in which the work of the excutive has been fulfilled. The main function of judiciary is to see that the authority of the executive conforms to the general rules laid down by the legislature.

As discussed above the intensity of the government business relationship depends upon the form of government, the ideology of the ruling party; the strength of the opposition parties; the role and responsibility of buroacracy; socio-economic legeslations, velocity of government polices, plans and programmes and the political stability. All these critical elements of political - legal environment will have heavy impact on the functioning and growth of business organisation.

2.6 Legal Environment :

Legal enveronment is an important offshoot of political environment but it reflects long term objectives of the public and the political leadership chosen by it. Thus, government may enact laws to regulate and control business activities and any violation of these laws may cause severe penalties and punishments. Important laws within the framework of which a business is required to operate in India are as follows.

a) The contract Act

b) The companies Act

c) The factories Act

d) The Industrial Disputes Act

e) The workmen's Compensation Act

f) The Essential Commodities Act

g) Two laws, dealing with excise and customs duties, Central and local sales - taxes, income tax, surtax and so on

h) Industrial (Development and Regulation) Act

i) Monopolies and Restrictive Trade Practices Act

j) The Foreign Exchange Regulation Act.

k) Securities Contract Regulation Act.

Let us discuss some of the important economic legislations in India having considerable impact on Industry.

2.7 Important Economic and Industrial Legislations :

Industries (Development and Regulation) Act, 1951 : The Industries (Development and Regulation) Act, 1951 is a very important piece of economic legeslation affecting the industrial sector. The Act came into force from May 8, 1951 and it extends to the whole of India. The Act seeks to secure planned industrial developement of the country regulating, controlling and developing industries that are included in the First schedule of the Act.

Objectives of the Policy : The following are the objectives of the Act.

1. to implement the industrial policy.
2. Regulation and development of important industries
3. Planning and developments of new undertakings.
4. Protection to some industries.
5. Improving working of industries.

The Act consists of two parts. Part -1 deals with development aspects and Part -II deals with regulatory aspects of scheduled industries.

The development of the scheduled industries is sought to be secured primarily through the agencies of central Advisory council and Development Councils as well as by offering certain special facilities.

Regulation of scheduled industries is sought to be down by means of a system of registration of existing undertakings, licensing of new undertakings for producing new articles or for substantial expansion or change of location of existing undertakings.

Control over the industries as sought to be exercised by causing investigation into the working of these industries and in appropriate cases taking over the direct management and control.

The Act, however empowers the central government to grant exemptions to any undertaking or a schedule industry or class of undertakings or scheduled industries from all or any of the provisons of the Act, Rules or Orders made thereunder. Exemptions are granted having regular to the smallness of, or the number of workers employed, or the amount invested in any industrial undertaking or the desirability of encouraging small understandings generally or the stage of development of any scheduled industry.

1. Registration of Undertakings : Every existing industrial undertaking was required to be registered after the Act came into force, provided it was included in the schedule to the Act. The central government shall register the scheduled industries and issue to the owner of the undertaking so registered a certificate of registration containing the production capacity of the industrial undertaking and other prescribed particulars.

2. Licensing of Undertakings: All new undertakings concered by the schedule must obtain a license from the central Government before being established. The license may contain conditions regulating the size, location, manufacturing programme, and expansion or addition of a new product.

3. Investigation : The central government enjoys wide powers of control by investigation into the scheduled insdustrial undertakings. The central government may order investigation to be made of any scheduled industry or industrial undertaking if it is of the opinion that in the case of such undertaking there has been substantial fall in the volume of production, or marked deterioration in the quality of any product, or any justifiable rise in price, or if the undertaking has been managed in a manner detrimental to the public interest.

4. Directions : On completion of the investigation, the Central government may issue directions regulating the production. It may require the industrial undertaking to stimulate development of industry, or prohibit the undertaking from reducing its production capacity or economic value or control the prices, or regulate the distribution of products. The Central government is also empowered to revoke the registration or license if it deems it necessary or justified in public interest.

5. Taking over of undertakings : If the central government is of the opinion that an industrial undertaking in respect of which directions were issued has failed to comply with such directions, or it has been managed in a manners highly detrimental to the scheduled industry concerned or to public interest. it may take over the management of such undertaking. It may also take over an industrial undertaking of the persons in charge of such undertaking have, by reckless investments, or creation of encumbrances on the assets, or by the diversion of funds brought about a situation which is likely to affect the production, or if it has been closed for a period of not less than three months.

Administration of the Act

The Act consists of three bodies. These bodies are

1. Central Advisory Council : The Act Consists of Central Advisory Council which Consists of representatives of industry, labours, Consumer etc., The main purpose of the council is to consider the general problems of industries and specific problem of registration and licensing to advise the Central government on regulation and development of schedules industries.

2. Development Councils : The Act contains Development Councils with each major industry group to suggest improvement in quality of service, management and productivity.

3. Licensing Committee : The Act sets up Licensing Committee to regulate industrial development. It grants licenses for setting up new enterprises in the private sector after considering their capital, location, Plant Capacity, foreign colloboration etc., This Committee follows the licensing procedure laid down by the government from time to time.

The Companies Act 1956 : A company may be understood as an association of indust..... united for some common purpose, permitted by laws to use a common name, and to change its members without winding up the association. Chief Justice John Marrhall of the U.S. Supreme Court defined a corporation as “an artificial being, invisible and existing only in contemplation of the law. The following are the essential features of the company form of ownership. These are :

a) Seperate Legal Entity : A company is legally seperate from its owners. A company is considered to be a legal ‘Person’ and can contiue to exist even though its ownership may change many times. Since it is a legal ‘Person’ a company can own property, take legal action and enter into contracts. A company has a domicle but is not regarded as a citizen either under. Act. 19 of the constitutions of Indian or under the citizenship Act.

b) Limited Liability : Another feature of the company is that the liability of its members is limited to the external of the nominal value of shares held by them. A member cannot be held personally liable for the debits of the company except when provided by the statutes e.g. when false representation is given courts can hold the members personally liable for debits arising out of such practices.

c) Transferability of Shares : The shares of company are transferable unless it is a private or a government company. If a member is unwilling to continue or is in need of money, he/she can transfer the shares for a consideration to others. Such transfer can be affected without taking consent of other members or without causing a closure of the company.

d) Continued Existence : A company enjoys relative permanence. If a shareholder sells his/her shares or the chairman of the company resigns, it will probably continue. It is the relatively stable existence that attracts the confidence of shareholders, goodwill of customers and layalty of employees.

Classification of Companies :

Companies are classified as below :

1. Public Company
2. Private Company
3. Foreign Company
4. Company with liability limited by guarantee
5. Government Company
6. Unlimited Company; and
7. Holding and Subsidiary Companies.

1. Public company : The meaning of a company as given earlier relates to a public company. In a public company members have the liberty to transfer their shares without affecting its continuity. The liability of the members is limited. This company is called public because it invites public to subscribe to its share capital.

2. Private Company : A private company is different from a public company. It is a company in which transferability of shares is not allowed and members are like a friends of a family and there will be no listing in stock exchanges and it will be called as ‘Private Limited’ Company.

3. Foreign Company : A foreign company is one which is registered outside India but has a place of business in India.

4. Companies Limited by Guarantee : Here members agree to pay a sum, in addition to the amount of shares held by them, if need arises, to pay off the creditors of the company. The additional amount to be paid is laid down in the memorandum or articles of association. A guaranteed Company may be with share capital or without share capital. If the company is without share capital, it raises the needed funds through entrance fees and subscription. Company limited by guarantee is generally formed to promote art, Science, religion or charity.

5. Government Company : An enterprise will be called a government enterprise if has most of the features of a private limited company. The whole of the capital or 61 per cent or over should be owned by the government. Majority of the directors are appointed by the government. It is created under the provisions of the companies Act. 1956.

6. Un Limited Companies : A company not having any limit on the liability of its members is called an unlimited company. The members of the unlimited company are like partners of a firm liable for its debts without any limit.

7. Holding and Subsideary Companies : Any Company that buys a sufficient number of shares in another in another is called a holding company and the acquired one is called subsidearing. Some holding companies own all the shares of their subsidiaries. A company is a parent company if it owns not less than half of the shares.

Company Formation :

Company formation is an eloborate, time consuming and expensive affair. The three stages involved in this are a) registration b) Capital raising and c) Commencement of business.

a) Registration : The registration of companies is the appropriate official to register companies. Before registration the promoters should submit a list of the names of the proposed company, memorandum of association, articles of association and list of the directors. The memorandum of association contains the name of the company, purpose, place, capital of the company and be affexied with Rs. 120 worth of stamps.

The articles of association contain the details of the amount of shares, procedure for conducting meetings, powers, duties rights and qualifications of directors, procedure for declaration of dividends, maintenence of accounts, audit etc. The Registrasr will scrutinise all documents submitted to him and will ensure that all the formalities are complied with. For registration, the registrar will charge a fee depending on the authorised capital of the company.

b) Raising of Capital : A public company raises capital by inviting public to subscribe to its share capital. In raising capital they should obtain SEBI clearance and enter into an agreement with the underwriter. They should also apply to the stock exchange for listing of its shares and then allot the shares.

c) Commencement of Business : A private company can commense its business immediately after it is incorporated. For a Public Company to commence it should get a certificate by submitting a declaration copy of the prospectus, a declaration of minimum subscription. Now the company is formed.

Objectives of the Act :

The main objectives of the companies Act are

1. Minimum standard of business integrity and conduct in promotion and management of companies.
2. Full and fair disclosure of all reasonable information related to the affairs of the company.
3. Effective participation and control by the share holders and the protection of their legitimate interests.
4. Enforcement of proper performance of their duties by company management and
5. Power of intervention and investigation into the affairs of the companies where they are managed in a manner prejudicial to the interest of shareholders or to the interest of public.

Company Law Administration :

The provisions of the companies Act are administered through a three layer administrative machinery. At the top is the company Law Board with the Powers like alterations in the memorandum of the company, power to authorise issue of shares at a discount, Power to order a general meeting and power to accord approval whereever required. Next to it are four Regional Directors at Calcutta, Bombay, Madras and Kanpur. They keep the Company Law Board informed on all relevant-matters. Below are the registrars. In each state capital there will be a registrar with the functions like collecting and preserving vital documents relating to all companies, ensure proper functioning of the company and scrutinising the contents of the returns to determine whether they have complied with the law.

MRTP Act 1969 : The act is aimed at prevention of Concentration of economic power which is aimed at the common detriment and prohibition of monopolistic, restrictive and unfair trade practices. The act also came into force that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment". The Act came into force from 1st June 1970 and has been amended in 1974, 1980, 1982, 1984, and 1991. The Act applies to the whole of India except the state of Jammu & Kashmir.

Objectives of the Act :

1. Prevention of concentration of economic power to the common detriment.
2. Control of Monopolies
3. Prohibition of monopolistic trade practices.

4. Prohibition of restructive trade practices.

After the 1991 amendment the objectives has been modified. Now the objectives are.

1) Control of monopolistic trade practices

2) Control of restructive and unfair trade practices.

Applicability of the Act

After the 1991 amendment the Act is applicable to all undertakings and financial institutions except the following.

1) Any trade unions formed for their own interest.

2) Any undertaking engaged in the production of aims & ammunations

3) All banking and insurance cmpanies.

Scheme of the Act : The Act deals with monopolistic trade practices indulged by any undertaking. It defined the concept of monopolistic trade practice as "Unreasonably preventing or lessening competition in the market, increasing prices, profits and limiting technical development of common detrement etc." The remedy for dealing with monoplies trade practice is an inquiring at the einstance of the Central Government by the MRTP Commission to prevent the mischief resulting from such practices. The Act also deals with matters relating to restrictive trade practices. Briefly a restrictive trade practice is one which prevents, distorts or restricts competition of goods and services in any manner. The Act provides for scheme of registration of certain agreements relating to restrictive trade practices.

The MRTP (Amendment) Act 1984 introduced new provisions relating to unfair trade practices with a view to promoting the interests of consumer. An unfair trade practice means a trade practice which for the purpose of promoting the sale, use or supply of any goods or for provision of any services adopts any unfair method or unfair or deseptive practices. The MRTP commision has been given full powers to regulate restrictive and unfair trade practices by making an enquiry and then pass the final order. The MRTP commision has the power to inquire into restrictive and unfair trade practices at the instance of the Central government, State government, Director General of investigation and registration, registered consumer associations, individual consumer and on its own.

MRTP Commission : The Commission has been set up by the Central government for the purpose of the MRTP Act. It consists of a chairman and not less than two and not more than eight members appointed by the Central governemnt. The powers and function of the commission are

1. Making enquiry and passing appropriate order in relation to restrictive trade practices and unfair trade practices.
2. Making enquiry into monopolist trade practice and submitting report to the Central government.
3. Making enquiry and submitting report to the Central government in matters relating to diversion and interconnection between undertakings, substantial expansion, establishment of new undertakings, merger, amalgamation and take over of undertakings.
4. The power of civil courts, for certain purpose.
5. The power of entry, search and seizure
6. Granting of temporary injunctions
7. Awarding of compensation for any loss or damage caused

8. The power to amend or revoke any order passed by it
9. Monitoring the enforcement of its orders etc.
10. Power to grant exemption.

Director General of Investigation and Registration

The Director General of investigation and Registration is an important wing for implementing the provisions of the MRTP Act. The Director - General is appointed by the Central government. The central government may also appoint as many additional, Joint, Deputy or Assistant Directors - General as necessary. The Director General acts independently of the MRTP Commission. The following are the important functions of Director General.

1) To conduct investigations

2) To maintain a register of agreements and

3) To perform other functions entrusted to him under the Act.

Consumer Protection Act 1986 : The consumer Protection Act 1986, provides for a system of for the protection of consumer rights and reduces consumer disputes. The act extends to the whole of India except the state of Jammu and Kashmir and it applies to all goods and services. The objective of the act is to provide for a better protection of the interests of consumers and for that purpose to make provision for the establishment of Consumer councils and authorities for the settlement of consumer disputes and for matters connected there with.

Consumer Protection Councils : The Act provides for the establishment of a Central Consumer protection Council by the Central Government and a state consumer protection Council in each state by the respective state governments. The central council shall consist of the minister in charge of consumer affairs in the Central government will be the chairman. The Council shall meet as and when necessary but minumum atleast they should meet once in every year. The state Council consists of members of the state government.

Objectives of the Act :

a. the right to be protected against marketing of goods and services which are hazardous to life and property.

b. the right to be informed about the quality, quantity, potency, purity, standard and price of goods and services so as to protect the consumer against unfair trade practices.

c. the right to be assured, wherever possible access to a variety of goods at competitive process.

d. the right to be heard and assured that consumer's interests will receive due consideration at appropriate forums.

e. the right to seek redressal against unfair trade practicess or exploitation of consumers and

f. the right to consumers education.

Consumer : As per the act consumer means a person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised or under any system of defered payment when such use is made with the approval of such person but does not include,

1) A person who obtains such goods for resale or for any commercial purpose or

2) hires any services for a consideration which has been paid or promised or partly paid and partly promised or

3) Under any system of deferred payment, when such services are availed of with the approval of the first mentioned person.

Consumer Disputes Redressel Agencies : The Act Provide a three tier Consumer disputes redressel system at the district, state and national levels. There are two agencies at the state level and one at the national level. The National Commission was established by the Central government in August 1988. It will consist of a person who is or who has been a judge of the supreme court, appointed by the central government and two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience relating to economics, law, commerce, accountancy, industry, Public affairs one of whom shall be a woman. Each state commision shall consist a person who has been judge of a High court appointed by the state government and two other members who shall be persons of ability, integrity and have adequate knowledge in dealing with problems relating to economics, law, commerce, accountancy, industry etc., one of whom will be a woman.

The District forum shall consist person who is or has been a District Judge nominated by the state government who will be called as president and a person who is eminent in the field of education, trade and commerce and a lady social worker.

A Complaint where the value of the goods less than five lakhs are dealt with the district Forum, if the value exceeds five lakhs but does not exceed twenty lakhs it will be dealt with the state commission and cases involving more than twenty lakhs by the National Commisson.

Consumer Complaints : A complaint in relation to any goods sold or delivered or any services provided may be filed with the redressel agency by

a) the consumer to whom such goods are sold or delivered or such service provided.

b) any recognised consumer association, whether the agrieved consumer is a member of such association or not.

c) One or more consumers, where there are numerous consumers having the same interests and

d) The Central or State government.

Remedial Action:

If the consumer disputes redressel agency is satisfied that the complant is true, it may order the opposite party to take one or more of the following things namely.

1. to remove the defect pointed out by the appropriate laboratory from the goods in question.
2. to replace the goods with new goods of similar description which shall be free from all defects.
3. to return to the Complainant the price, or, as the case may be the charges paid by the complainent.
4. to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party.
5. to remove the defects or deficiencies in the services in questions.
6. to discontinue the unfair trade practices and do not repeat them.
7. Not do offer hazardous goods for sale
8. to withdraw the hazardous goods from being offered for sale.
9. to promote for adequate costs to parties.

Penalties : If a person against whom a compaint is made and if he does not comply with redressal agences, he shall be punishable with imprisonment not exceeding three years or with a fine not exceeding ten thousand rupees or with both.

The Consumer protection Act was amended in 1993, which gave an important means to protect the consumer rights. However there were several problems for redressal agencies for their functioning. The posts of president was remaing vacant. Many redressal agencies are not adequately staffed. They suffer from financial problems. The consumer protection Act applies not only to private sector but also public sector.

Foreign Exchange Regulation Act 1973 : The FERA Act came into force from 1st January 1974 . The Act applies to the whole of India and applies to all citizens of India - outside India and to branches and agencies outside India of companies or bodies corporate regestered in India.

Objectives of the Act :

i) To regulate Certain Payments

ii) to regulate dealings in foreign exchange and securities

iii) to regulate the transaction indirectly affecting foreign exchange.

iv) to regulate import and export of curency and bullion

v) to conserve the foreign exchange resources of the country and to utilise the same in the interest of the economic development of the country.

vi) to regulate holding of immovable property outside India,

vii) To regulate employment of foreign national,

viii) to regulate aquisition, holding etc. of immovable property in India by non-residents,

ix) to regulate foreign companies.

The preamble to the FERA, 1973 as amended in 1993, states the objects of the Act as consolidating and amending the law regulating certain payments, dealings in foreign exchange and securites, transactions indirectly affecting foreign exchange and the import and export of currency for the conservation of the foreign exchange resources of the country and proper utilisation there of in the interests of the economic development of the country.

Administration of Exchange Control : Foreign exchange control is administered by the Reserve bank in accordance with the general policy laid down by the government in consultation with the Reserve Bank. Routine work is delegated to commercial banks. Before 1991 Industrial Policy 40 percent of the issued capital was allowed to be raised in respect of foreign colloborations with the approval of R.B.I. The new policy has announced certain liberal measures to attract foreign investment. Accordingly a list of high priority industries have been specified in which automatic approval would he granted for

a. Foreign technology agreements subject to certain conditions.

b. direct foreign investment upto 51% foreign equity subject to certain conditions,

c. direct foreign investment of more than 51% in listed forty industries subject approval by foreign investment promotion Board.

In case of other industries foreign equity participation would he allowed upto 40%. All other proposals will require specific approval under the general procedurs.

Transaction Regulated by Exchange Control :

The following are the transactions that are regulated under this act.

1. Purchase and sale and other dealings in Foreign exchange and maintanance of branches at foreign centres.
2. Procedure for realisation of proceeds of exports.
3. Payments to non-residents or to their accounts in India.
4. Transfer of securities between residents and non-residents and acquisition and holding of foreign securities.
5. Foreign travel with or without exchange.
6. Export and import of currency, cheques, drafts, travellers cheques and other financial instruments, securities, jewellary etc.,
7. Trading, commercial and industrial activities is India or foreign trades and companies and foreign nationals as well as acquisition of business undertakings and acquisition and holding of shares in Indian companies by such companies / firms and persons.
8. Investment, including portfolio investment in India by non-resident Indians.
9. Appointment of non-residents and foreign national and foreign companies as agents in India.
10. Occupation or profession undertaken in India by foreign nationals.
11. Acquisition, holding and disposal of immovable property in India by foreign nationals and foreign companies.
12. Acquisition, holding and disposal of immovable property outside India by person resident in India.

The Act ensures effective enforcement and implementation of the provisions. The scheme envisages appointemnt of enforcement officers, adjudication of levy of penalty by an adjudicating officer and prosecution proceedings for officers under the Act by the court. The act provides the central government to appoint a Director, Additional Directors, Deputy Director and Assistant Directors as it thinks fit.

The Securities Contracts (Regulation) Act 1956

The securities contracts (Regulation) Act 1956 is designed to regulate the functioning of stock exchanges in India and to prevent undesirable transactions in securities. The Act provides for -

i) recognition of stock exchanges subject to fulfilment of certain conditions relating to membership and rules and bye-laws.

ii) general control over trading methods and practices.

iii) regulation of contracts and options in securities and

iv) Procedures relating to listing of securities by public companies.

A stock exchange has been defined as a body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling, or dealing in securities. There are at present 21 recognised stock exchanges functioning at various places in the country while some stock exchanges may be recognised on a permanent basis, others may be on a temprary basis. The 21 stock exchanges are located at Bombay, Ahmedabad, Calcutta, Madras, Delhi, Hyderabad, Indore, Bangalore, Cochin, Kanpur, Pune, Ludhiana, Guwahati, Mangalore, Patna, Jaipur, Bhuvaneswar, Rajkot, Vadodara, Coimbatore and Meerut. In addition, a National Stock Exchange of India, with head quarters in Bombay has also been set up. The National stock exchange (NSE) has all India jurisdiction. After SEBI was established under SEBI Act 1992, certain powers exercised by the Central Government under the SCR Act have been transferred to SEBI.

Main Provisions

The securites contracts (Regulation) Act 1956, employers the central government to rule appropriate measures to achieve the objectives. The important provisions of the Act encompass the authority given to the central government, or, in certain cases the SEBI pertaining to

1. The grant of recognition or withdrawal of recognition to any stock exchange.
2. Approval of the bye-laws and rules of stock exchanges.
3. Power to direct the stock exchange to make or amend roles and bye-laws in certain cases.
4. Power to make or aimed by-laws or roles for stock exchanges.
5. Monitoring the activities and functioning of the stock exchanges by calling for periodic returns.
6. Power to respend business of stock exchanges.
7. Power to supersede governing body of any stock exchange on account of specifie reasons.
8. Regulation of listing of securities.

Recognition of Stock Exchanges :

After securities contracts (Regulation) Act 1956, came into existence only the recognised stock exchanges are granted recognition by the central government. If any stock exchange wants to get recognised it should apply to the central government in the prescribed manner with a copy of bye-laws. The central government if satisfied may grant recognition to the stock exchange. The central government will take into consideration the qualifications for membership of the stock exchange, the manner in which contracts shall be entered into and enforced between members and the representation of the central government on the stock exchange and its maintanence of accounts. The Act says that the central government shall not refuse grant of recognition to a stock exchange without giving an opportunity to be heard the reasons for the refusal shall be communicated to the stock exchange in writing. If the central government is of the opinion that the recognition granted to stock exchange should be withdrawn in the interest of the trade it may do so only after serving a notice to the governing body of the stock exchange and giving them an opportunity to hear in the matter.

Power of Recognised Stock Exchange to make Rules Restructing Voting Rights, etc. :

A recognised stock exchange may make rules or amend any rules made by it to regulate the voting rights. No such rules of a recognised stock exchange made or shall have effect until they have been approved by the central government and published by the government in the official gazette and in approving it the central government may make such modifications, the rules as provided by the central government shall be deemed to have been validly made. The Act also impowers the central government to make any rules, or demand any rules already made to the direct recognised stock exchanges or any recognised stock exchange in particular. If any recognised stock exchange fails or comply with any such order within the specified period, the central government may make rules or amend the rules.

Bye-laws of stock exchanges :

Any recognised stock exchange may subject to the previous approval of the SEBI, make bye-laws for the regulation and control of contracts. The SEBI can amend any bye-laws on the basis of the request from the governing body of the stock exchange where the governing body of any stock exchange objects to any bye-laws made or amended by the SEBI on its own motion may apply to the SEBI for a reversion within a specified period. After hearing the governing body, the SEBI may revise the bye-laws so made or amended.

Power to Obtain Information and to Conduct Inquiry :

Every recognised stock exchange shall furnish to the central government a copy of the annual report containing all the particulars prescribed. Every recognised stock exchange and every member of such stock exchange shall maintain and preserve for such periods not exceeding five years such books of account and other documents as the central government may prescribe. These books of accounts shall be available for inspection by the SEBI. The SEBI is also authorised to call up any recognised stock exchange or any member for any information the SEBI is also empowered to appoint one or more persons to make an enquiry in relation to the affairs of any members.

Power to Supersede Governing Body :

If the central government has sufficient reason to think that the governing body of any stock exchange should be superseded it may secure a written notice on the governing body, and give the governing body an opportunity to hear. When the governing body is supesseded the government may appoint any person to exercise and perform all the powers and duties of the governing body.

Power to Suspend Business of Stock Exchange :

The SCRA empowers the central government to suspend the business of any stock exchange under certain circumstances, for a period not exceeding seven days in the interest of trade or public interest. The period of suspension may be extended from time to time but after the governing body has been given an opportunity of being heard in the matter.

Listing of Securities :

Listing of securities refers to the sanction of the right to trade the securities on the stock exchange. Only listed securities are allowed to be traded on a stock exchange listing has some advantages.

1. Listing increases the market ability and liquidity of the security.
2. Listed securities have higher collateral value for purpose of bank credit.
3. Listing lends prestige to the security and dividends market.
4. Listed securities enjoy more public confidence
5. Listeing provides greater publicity of the company

   A public company desirous of getting its securities listed on a stock exchange shall apply to the stock exchange for this purpose with the documents such as memorandum and articles of association, copies of all prospectus or statements in lieu of prospectuses issued by the company at any time etc and the company shall abide by the conditions of the listing agreement with the stock exchange. Where any stock exchange refuses listing, the company shall be entitled to be purnished with the reasons for that the company shall appeal to the central government against the refusal.

2.7 Securities and Exchange Board of India (SEBI) :

The establishment of the securities and exchange Board of India (SEBI) was a land mark to monitor and regulate capital market activities and to promote healthy development of the market. The SEBI was consitituted in 1988 by the government of India and it was made a statutory body by the securities and exchange Board of India Act 1992.

The Board member of SEBI shall consist of a chairman, two members from among the officials of the ministers of the Central government dealing with Finance and Law, one member from officials of the Reserve bank of India. two other members appointed by the Central Government, professionals having special knowledge relating to securities market. The Act empowers the Central government to superside SEBI in on account of grave emergency. SEBI is unable to discharge the functions and duties under the provisons of this Act.

Objectives : The objectives of SEBI are to protect the interests of investors in Securities and to promote the development of and to regulate the securities market for matters connected therewith or incidental therewith.

Powers and Functions : The SEBI Act casts upon the SEBI the duty to protect the interest of investors in securities and to promote the development of and to regulate the securities market through appropriate measures. These measures promote for -

1. Regulating the business in stock exchange and any others securities market.
2. Registering and regulating the working of stock brokers, Sub brokers, share transfer agents, bankers to an issue, Trustees of trust deels, registrars to an issue, merchant bankers, under writers, port folio managers, investment advisers and such others intermediaries who may be associated with securities market in any manner.
3. Registering and regulating the working of collective investment schemes, including mutual funds.
4. Promoting and regulating self-regulatory organisations
5. Prohibiting fraudulent and unfair trade practices in securities market.
6. Promoting investor education and training of intermediaries in securities market.
7. Prohibiting insiders trading in securities.
8. Regulating substantial acquisition of shares and take over of companies.
9. Calling far information from, undertaking inspection, conducting enquiries and audits of the stock exchanges and intermediaries and self regulatory organisation in the securities market.
10. Performing such functions and exercising such powers under the provisions of the capital issues (Control) Act 1947, and the securities contract regulation Act 1956, as may be delegated to it by the Central government.
11. Levying fees or other charges for carrying out the purposes of section 11 of the Act.
12. Conducting research for the above purpose.
13. performing such other functions as may be prescribed by the government.

The following are some of the important areas on which SEBI engages.

1. Registration of brokers and sub brokers by stock exchanges.
2. Authorisation of Merchant Bankers
3. Control over Mutual funds
4. Issue of Insider Trading Regulations
5. Issue of Portfolio Managers Regulations.
6. Issue of guidelines for disclosure and investor protection.

Along with these areas SEBI can also extend to activities like inspection of stock exchanges. protection for debenture holders, stopping misuse of promoter's quota, free pricing for public issues, entry rules for foreign institutional investors, rules for securities of development financial institutions lead mangers. bankers to the issue, under writers and guidelines for flotation of public sector bonds, bonus shares and stock invests.

Guidelines for the Issue of Securities : The guidelines issued by SEBI promote for compulsory subscription by the promoters of companies. In case of new companies established by individual promoter and enterprenuer, the promoters contribution should be at least 25 or 20 percent of the total capital issued, as the case may be depending on the size of the issue. In case of new companies a minimum of 50 percent of total issued capital should be contributed by the promoters. There is a stock in period of 5 or 3 years of these contributions.

The Securities and Exchange Board of India modified by reserving 50 percent of the net public offer for allotment to individual investors applying for less than 1,000 shares. The remaing 50 percent of the offer to the public could be set apart for individual investors applying for more than 1,000 securities. In both the categories, the allotment would continue to be made on the basis of proportionate method of allocation repeatedly.

Evaluation of the working of SEBI : There was a lot of criticism on the functioning of SEBI. Inspite of all that SEBI started its activity with a firm note. Even the stock exchanges have come into conflict with SEBI regarding the discharging of powers regarding maintanence of accounts, approved bye -laws and discouraing of dealers in securities in certain areas. The powers of the Securities contract Regulation Act. 1956 are now transfered to SEBI through a new legislation. Thus if SEBI is to be successful in its role as regulator it needs to have more powers to prosecute the errant members of the system. As such SEBI in the future may require to play a crucial role in regulating, controlling and developing the stock market in India.

2.8 Summary :

The viability of business depends upon the ability with which it can meet the challenges arising out of political and legal environment. The political and legal environment of a country is influenced by political organisations. Political stability, Governments interaction with business constitutional provisions affecting business, foreign policy etc. A stable and dynamic political environment is necessary for growth. A successful manager is one who takes stock of the relevant politico-legal environment of his business and then capitalise on the oppurtunity available in that environment.

The political and legal environment of business consists of several critical elements, eg. the nature and form of government, the ideology of the ruling party, the strength of the opposition, the role and responsibility of the bureaucracy, political stability, the effectiveness of the government, its plans and programmes the socio-economic legislations, the political-legal institutions, etc.. In spite of all the policies of liberalisation followed by several countries, the need for some kind of government intervention in economic affairs will always be felt.

There are several legislations with which business firms are concerned. The companies Act is concerned with the regulation of corporate business enterprises. The securities conrtacts (Regulation) Act seeks to regulate the functioning of stock exchanges in India and prevent undesirable transactions in securities. The Foreign Exchange Regulation Act (FERA) is to regulate the dealings in foreign exchange and securities. The Monopolies and Restrictive Trade Practice Act (MRTP) was for preventing concentration of economic power to the common detriment and control of monopolies and to prevent monopolistic, restrictive and unfair trade practices. The consumers protection Act is meant to provide protection to consumers. Thus we find that a comprehensive, legislatives framework exists in India for protecting the interests of investors, consumers and society in general what is required is proper enforcement and effective implementate of these laws.

2.9 Self Assesment questions :

1. Discuss the concept of political environment and its impact on business?
2. Explain about Economic, Social and secular idealogies relating to political environment?
3. Discus about the economic role of the government?
4. What is the concept of Legal environment? Explain the industries development & regulation Act?
5. What do you mean by Monopolies Restrictive trade practices Act?
6. Explain about the consumer protection Act?
7. Elucidate the Foreign exchange regulation Act?
8. What are steps taken by SEBI for protecting stock exchange regulation Act?

2.10 Further Readings :

1. Subba Rao, A, International Business - Text & Cases, Himalaya Publishing House, 2001, Pg. 61-65.
2. William F. Glueck, Business Policy and Strategic Management, M.C. Graw Hill, 1980, P. 88.
3. Francis Cherunilam, Business Environment, Text & Cases, Himalaya Publishing House, 2002.

LESSON - 3

TECHNOLOGICAL ENVIORNMENT

Objectives

To know the meaning of technological environment and features of technology.

To analyze the impact of technology on society, economy and at plant level.

To examine the Restraints of technological growth

To analyze the transfer of technology concept.

STRUCTURE

3.1 Introduction

Among all the segments of macro -environment, technological environment influence the business to a large extent. we shall discuss the interface between business and technology. J.K. Galbraith defines technology as 'a systematic application of scientific or other organized knowledge to practical tasks.' During the last two years technology has developed very rapidly. Science and technology enabled man to conquer distances: control birth rate; save lives, generate, preserve and distribute energy; discover new materials and substitutes to the existing ones, introduce machines to do work of human beings, substitute mental work with computers; probe deep into the seas and space in search of new treasure; provide himself a lot of leisure and comfort.

Technology is the force that is shaping the destiny of all people over the world. Some of the technological inventions, the man feels are wonders, some others are horrors and yet others have mixed blessings. Automobiles and television for example have evoked mixed reactions. Hydrogen bomb, nerve gas and submarine gun have proved to be horrors. Pencillin, open heart surgery and birth control are wonders.

Features of technology

- Technology forces change on people whether they are prepared for it or not.
- Technology effects are widespread, reaching far beyond the impediate point of technological impact.
- Technology is self - reinforcing. As said by Alvin Toffler Technology feeds on itself. Technology make more technology possible.

3.2 Impact of technology

The impact of technology is discussed under three heads.

a) Technology and social change (b) Economic effects of technology and (c) Technology and plant level changes.

A) Technology and Society:-

The influence of technology is found on society. Let us discuss about the impact of technology on society.

1. Technology Reaches people through Business: Business is an institution through which man expects new discoveries to be converted into goods and services. New discoveries would remain mere ideas in mind, sketches on paper or mock models in laboratories but for business institutions, printing, housing , education and television are all dependent on business activities to make them work productively. Society depends on business to keep the stream of discovery flowing into useful through business. 50 percent of economic growth of USA, UK, Germany, France and Japan has achieved a lot of technical progress.

2. High Expectations of consumers: - Technology has contributed to the emergence of affluent societies. Affluent citizens want many things more than of same things. New varieties of products, superior in quality, free from pollution, more safe and more comfortable. High expectations, of consumers pose a challenge and an opportunity to the owners of business institution.

3. System Complexity : Technology has resulted in complexity. Modern machines work better but if they fail they need services of experts to repair. Failure of power supply for example will cause dry water taps, closed petrol bunks, suspended elevators between floor, dark streets, dark houses, dead TVS and so on .

4. Social Change : The role of technology on social change may be observed in many ways, First, there is the change in social life which results from a change in a technological process. An invention may destroy the economic basis of a city ; displace thousands of workers; yet the same inventions may result in the creation of a new city some where else and create more jobs than it originally destroys. Second, besides uprooting population, technology directly changes the patterns of their social life.

An invention may open new employment opportunities to women, radically change hours spent at work and in the family increase available leisure time, open jobs to youth and deny them to middle aged or old workers. Third, though social differences tend to be ignored out, status differences are likely to be created by technological advancement in developing countries. With vast resources multi national corporations (MNCS) have come and changed the life of people associated with them. Such people are paid better with higher incomes, the standard of living of these people is fairly high. Finally the way we cook, (electronic cooker) communicate (e-mail, fax) use media and work are affected by technology. Even the language we use changing.

B) Technology and Economy

1. Increased Productivity: Technology changes result in increased productivity in both quality and quantity. In a hospital the objective may be qualitative, such as maintaing life with electronic monitoring equipment regardless of costs. In a factory, the objective may be quantitative in terms of more productions at less cost. As productivity increased the real wages of employees increased and the benefits spread throughout the whole society.

2. Need to spend on R&D: Research & Development is very necessary for technolgy advances. Firms are required to take action of six issues.

1. We spend very less on R&D. Our total spending on R&D is less than one percent. In UK they spend two percent, in Japan 1.96 percent and U.S 2.3 percent.
2. The process of taking new technology from the laboratory to the market place is equally important.
3. Time factor in R&D. The time between innovation and commercialisation is being reduced .
4. When new technology come, the old technology needs to be abandoned.
5. The firm must decide on own R& D or to out source technology.
6. Decision on Product innovation or process innovation.

3. Job Tend to Become more Intellectual : After technology development jobs tend to become more intellectual. A job which was handled by an illiterate and unskilled worker now required the services of an educated and competent worker. A clerical post now demands the services of an expert in computers.

4. Problem of TECHNO Structure : Not only the jobs become more intellectual even the incumbents tend to become highly professionallised and knowledgeable. An organisation with latest technolgy is fresh with scienctists, engineers, college graduates and highly skilled workers on its pay roll. Motivation of such employees is a difficult task.

5. Need for Bio-Professional and Multi Professional Managers : Technocrats, who assume administration need to be qualified in management education in additon to the proficiency in the field they are specialized. Now-a-days business require Bio professional and Multi Professional mangers. A factory managers post can be filled with an M.B.A from a recognised institution. Technological advancement has made the business more complex and the managemt more demanding.

6. Increased Regulation and Stiff Opposition: Technological advancement increases regulation and stiff opposition. Government has the powers to investigate and ban products that are harmful or hurt the sentiments of a section of society. Import of animal tallow has been banned by the Government of India because the alleged mixture of tallow with Vanaspati oil hurt the feelings of Hindus. Technological advancement is imitating opposition from those who fear that new innovations are a threat to ecology, privacy, simplicity and even the human race. The public may be enlightened that technology does not always result in bad effects. It can be corrective as well as curative. Technolgy has created antibiotics which give rise to side effects. The same technolgy also shows the remedial measures for the side effects.

7. Insatiable Demand for Capital : Technology today necessiate massive investment of money, discovering new ideas and their adoption, educating, training and maintaining of manger. Todays technology is characterised by insatiable demand for capital. Business organisation should not only raise huge funds but employ them for gainful purposes. Qualified and competent people must be appointed to assume the responsibility for financial management.

C) Plant Level Implication:

1. Technology and Organization Structure :- Technology has considerable influence on organistaion structure, length of the line of command, and span of control of the chief executive. If companies use technology which is fast changing, matrix structures are more common. Other than technology, other factors which have their influence on organisation structure are history and background of a company and the personalties of the people etc..

2. Resistance to change : The resistance to change is purely psychological. Typical businessman oppose to new technology, because new technology is expensive and risky. If he is making enough money with existing technology why he must worry about new technology? For ex. Telco's trucks are still antiquated models only found in developing countries. But the turnover of Telco was Rs 1969 crores during 1989-90. Thus people are resistant to new changes.

3. Problem of Importing Technology : There are several problems for management who want to import technology like training of technicians and supervisors, testing facilities for raw materials, replacement parts etc. are not easily available. Import of technology is also not easy because developed countries are not willing to lend it . The technology which the developed countries are willing to lend is limited in scope and is mainly aimed at exploiting own dynamic competitive advantage in order to feed the markets they are interested in. Though companies are willing to transfer technology, there is the problem of choosing a right collaborators and obtaining clearance from government.

4. Inability to Absorb Technology: Ability to absorb western Technology is low in our firms "Bullet", Inidaís once prized 350cc motor cycle manufactured by Enfield for example, could not for a long time change the side of the foot brake - lever from left to right, thus putting the driver to considerable physical risk. The company could not adapt the design for relatively minor change to left hand driving system. Bajaj Scooters, which is second largest scooter manufacturer in the world took more than six months to introduce blinking indicators in their models.

5. Total Quality Management. TQM: TQM refers to deep commitment of an organisation to quality TQM replaces traditional belief's about quality with a set of principles like,

* High Quality costs more
* Quality can be improved by inspection
* Defects cannot be eliminated completely
* Quality in the job of the quality control personnel

The new principles of TQM are

* Meet the customers requirement on time, the first time and 100% of the time
* Strive to do error free work
* Manage by Prevention, not by correction
* Measure the cost of quality

6. Business process Reengineering (BPRE) : BPRE essentially involves how things would be done if the organisation were to start all over from scratch. Michael Hammer is the father of the process re-engineerging. TQM and BPRE seem to have identical objectives but they differ TQM seeks to improve essentially what is good but BPRE seeks to reject what is irrelevant and starting afresh. Another feature in TQM is essentially bottom-up approach where as BPRE is driven by top management. BPRE has several implications on the employees.

7. Flexible Manufacturing system FMS: FMS is another by-product of technology. Under this, machines are designed to produce batches of different products. The important feature of FMS is that by integrating computer aided design, engineering and manufacturing, they can produce low volume products for customers at a cost which has been previously posssible through mass production.

3.3 Restraints of Technological growth :

There are three factors which impede the growth of technology. The three factors are pollution, industrial resource base and social institutions.

Pollution: Industrial production leads to pollution. Smoke, smell, noise, effluents and dust are generated by industrial establishments. The bio-sphere of the land, air, water and natural condition on which all life on earth depends can absorb and break down many of these industrial pollutions without harm to people, animals or plants.

The industrial Resource Base : Industrial resources like minerals, different forms of energy, water supplier, skilled labour force and human knowledge are limited and this limitation checks advancement of technology.

Social Institutions : Social values and institutions are consistant with full productive potential that is present in technology. Technolgy must attend to the basic problems of food, clothing, health and housing of people. At the same time rapid industrial development through latest technology is necessary to catch up with the advanced countries, Many societies, perhaps those who adopt modern technology, have less dramatic problems is arriving at a fit between, their traditional social institutions and the new trends of technological development.

3.4 Sources of Technological Dynamics :

There are a number of factors which determine the technological dynamics of a company. The sources of technological change may be internal or external. Technological leaders in industries capture the best and have a superior ability to adopt externally developed technology to the Industry. The important factors which determine the technological dynamics of a company include the following.

Innovative Drive of the Company : Many companies view technology as a driving force of competitiveness and development and great importance to R&D. Recognizing the importance in R&D. Ranbaxy and Dr. Reddyís Laboratories have been investing on R&D and have benefited out of it.

Customer Needs / Expectations:- Technological orientation and R&D efforts of a company are influenced by customers needs and expectations. In many cases customer and supplier have a relationship to develop products and solution. If the consumers are highly demanding, companies are compelled to be innovative.

Demand Conditions: Besides customer needs and expectations there are certain demand related factors which influence the technology. For example, the size of demand influences the choice of technological Scale. Future trend is also important. For example, a fast growing trend of demand would encourage development of large scale technology. It will increase R&D efforts.

Suppliers Offerings: Many times technological changes are encouraged by the suppliers of a company like capital goods suppliers and other technology suppliers etc. For ex., the key source of technology is construction engineering firms that design production processes and build plants.

Competitive Dynamics: Competition compels the best use of technology and constant endures to innovate. Japanese companies have a high degree of technological orientation. That is the glory in Japan which are more makers of Civilian industrial products than in any other country including the United States. Absence of competition is the major reason for the technological backwardness.

Substitutes: Emergence of new Substitutes are an important reason for technological change. Substitution effects has a great impact on technology on industry. Technological changes create new products or substitutes of others such as fibreglass for plastic or wood, word processors for type writers and microwave ovens for Conventional ovens.

Social Forces: Certain social forces like protest against environmental Pollution or other ecological problems, demand for eco-friendly products, the need to tackle certain social problems etc. may effort to technological development. The technological environment has some social dimension too.

Research Organizations / Technical Facilities: The technological environmental is influenced by research organizations including research department of Universities which develop new technologies and proceed other technical inputs. Research establishments like Indian council for Social Research (ICSR), Central Food Technological Research Institute (CFTRI), Defence Food Research Laboratories etc, are well known in India.

Government Policy: Government policy is an important factor in the technological environment Government can contribute on development of technology by establishing own research organisations and funding R&D. Government may also encourage private R&D by various incentives like tax incentives, Subsidies etc. The technological policy of the government may favour or disfavour certain types of technologies. The restriction of foreign technology by some governments affected the comparative competitiveness of the firms. In countries like India the high emphasis on technology have led to high costs and distorted development. Further the reservation of certain products to small scale sector promoted several companies including multinational companies. The failure to absorb modern technology swiftly has adversely affected the exports of several import items like leather goods, textile items etc.

3.5 Transfer of Technology

Technology transfer is a process by which commercial technology is disseminated. This will take the form of a technology transfer transaction, which may or may not be a legally binding contract, but which will involve the communication, by the transferor, of the relevant knowledge to the recipient. The following are the types a technology transfers.

a) The assignment, sale and licensing of all forms of industrial property, except for trade marks, service marks and trade names when they are not part of transfer of technology transactions.

b) The provision of know-how and technical expertise in the form of feasibility studies, plans diagrams, models, instructions guides, formulae, specifications and equipment for training, services involving technical advisory and mangerial personel and personnel training.

c) The provision of technological knowledge necessary for the installation, operation and functioning of plant and equipment, and turnkey projects.

d) The provision of technological knowledge necessary to acquire, install and use machinery, equipment, intermediate goods and/ or raw materials which have been acquired by purchase lease or other means.

e) The provision of technological contents of industrial and technical cooperation arrangements.

Broadly there are two forms of T.T VIZ internalised and externalised forms of technology transfer. Internalised forms refer to investment associated TT, where control resides with the technology transfer. Externalised forms refer to all other forms, such as joint ventures with local control licensing strategic alliances and international subcontracting.

Level of TT : A simplified treatment of the subject would suggest forms level of TT

Operational Level: At the bottom level are the simplest one which are needed for operating a given plant that involve basic manufacturing skills, as well as some more demanding trouble shooting, quality control, maintenance chance and procurement skills.

Duplicative Level: At the intermediate level are duplicative skills which, include the investment capabilities needed to expand capacity to purchase and integrate foreign technologies.

Adaptive Level : At this Technological Self-reliance level, imported technologies are adapted and improved, and design skills for more complex engineering learned.

Innovative level: This level is characterised by innovative skills, based on formal R& D that are needed to keep pace with technological frontiers to generate new technologies.

Methods of Technology Transfer: Transfer of technology takes a variety of forms depending on the type, nature and extent of technological assisstance required. The following are the important methods of technology transfer.

1. Training or employment of technical Expert:- Simple and unpatented manufacturing techniques can be transferred by imparting the requisite training to suitable personnel . Alternatively, such technology can be acquired by employing foreign technical experts.

2. Contracts for supply of machinery and equipment : Contracts for supplying for machinery and equipment, which normally produce for the transfer of operational technology pertaining to such equipment is quite adequate for manufacturing purposes not only in small scale projects but also in a number of large scale industries.

3. **Licensing Agreements:** Licenssing greements, under which co licensor enter into an agreement with a license in another country to use technical expertise of the former is also a measure of transfer of technology.

4. Turnkey contracts : Transfer of Complex technology often takes place through turnkey projects which include the supply of such services as design commissioning or supervision of a system apart from the supply of goods.

Promotion and regulation : Because of the problems of foreign technology, if it is priorities regulated and promoted it can play a positive role. Therefore the government of India and a number of other countries have therefore taken a number of regulatary and promotional measures.

The Extent and term of Equity Participation: These are generally determined by the priorities of the technology using industry in the nations economy, supply conditions of the technology and its nature.

Phasing of Domestic Manufacturing: Countries like India insisted upon indigenisation on a phased manner. There should be adequate arrangement for research and development, engineering design, training of technical personnel and other measures for absorption, adaptation and development of imported technology.

The Appropriateness of Technology: The entrepreneurs should explore alternate sources of technology, evaluate them for a techno economic point of view and furnish reasons for preferring the particular technology and source of import.

Payment Terms and Foreign Exchange Out flow: Governments take measures to ensure that high payments are not paid for any technology. Restrictions were imposed on dividend payments and prices.

Restrictive Terms in the Agreement: According to the government policy there should be no restriction on free exports to all countries. There should be binding over with regard to procurement of capital goods, components, spares, raw materials, pricing policy and selling arrangements should be avoided.

3.6 Summary

The natural factors and available tehnology indicate, normally, the innate potential for development of business /economics of a nation/region. The extent to which this potential is really exploited depends on the economic, Social and demographic and political environments.

Technological developments have been revoluationizing the business scene. They facilitate not only the introduction of new products but also tremendous improvements in the operational efficiency and exciting changes in the modus operandi of business. It implies, inter alia, that even when goods demand exists for an old product, adoption of the state of the art technology. There are many factors which stimulate the innovative drine of a firm. These include the company's own strategies, demanding customers, competition, certain social forces, government policies etc., A company may also source technology externally, like from R&D organisation, other firms (including foreign firms) while sourcing foreign technology, the firm should ensure that the technology it chooses is the appropriate one and should be able to properly absorb the technology. Japanes technology is known for the choice of appropriate technology and improving on them after the absorption. Government policy is also very important technological environment. Restriction on foreign technology, scale of operation, type of technology etc. very adversely affected the Indian business in the post. The liberaligation has significantly improved the situation.

3.7 Self assessment questions

1. What is technology? What are its features?
2. Bring out the distinction between science and technology?
3. Explain the impact of technology on society?
4. Discuss the plant level impact of technology?
5. Discuss the sources of technological dynamics?
6. Explain the concept of Transfer of Technology?

3.8 Further Readings

1. Frederick Betiz J. Managing Technological Innovation, wiley and Sons, Inc, New York, 1998, P. 43.
2. Frances Cherunilam, Business Environment, Text & Cases, Himalaya Publishing House, March 2002, Pg. 99 & 100.
3. Aswathappa, K. Essentials of Business Environment, Himalaya Publishing House, May 1999, Pg. 103-124.

LESSON - 4

SOCIO CULTURAL ENVIRONMENT

Objective

In this chapter you will study about :-

Analysing the concepts of social and cultural environments.

Understand about the culture and factors that determine culture.

Describe about the social responsibility of business.

Analyze the arguments against and for social responsibility of business.

Discuss the barriers to social responsibility.

Explain the limitations of social responsibility.

STRUCTURE:

4.1 - Introduction

4.2 - Concept of Culture

4.3 - Social Responsibility of Business

4.4 - Summary

4.5 - Self Assessment Questions

4.6 - Further Readings

4.1 Introduction:

Business must have a social purpose. Business concerns must discharge social responsibility and social obligations and have social commitment. Otherwise, business cannot enjoy social sanction. These factors give form and content to several social movements. Successful business managers cannot afford to neglect these movements and their underlying ethos. No business can survive and grow without social harmony. Different countries attain social harmony in different forms through different ways and means. Thus the social environment differs over space, time and methods. Changes occur in the society and businessman must be ready to these changes. Culture reflects the ideas and shared values of the members of the society. Since these two are closely related to each other it is the socio cultural environment that is considered in the present chapter.

Social and cultural factors in various countries affect the business. These factors include attitude of the people to work attitude to wealth, family, marriage, religion, education, ethics, human relations, social responsibilities etc.

4.2 Concept of Culture:

According to Elbert W. Steward and James A. Glynn Culture is "the thought and behaviour patterns that members of a society learns through language and other forms of symbolic interaction in their customs, habits, beliefs and values, the common view points which bind together as a social entity. Culture change gradually picking up new ideas and dropping old ones, but many of the cultures of the past have been so persistent and self contained that the impact of such sudden change has torn them apart, uprooting their people psychologically". Thus culture has two phenomena. Shared values and passage of time. Culture of a society is shared by its members. Second cultural ethos are passed on from generation to generation. Culture is not confined to a particular period of time. The following factors bring about the changes between business and culture.

1) Culture creates people: Culture influence to a large extent because it determines the ethos of people. We have Indians, Japanese, Americans, Germans, Britishers and so on. All these people do not have the same culture. People have their own hereditory characteristics, cultural experience, sub cultural experience, family experience and personal experience. So when people of different cultural backgrounds promote, own and manage organisations, organisations have distinct cultures. Thus the culture of Tata group of companies differ from the companies owned by Birlas. Culture perform four functions:

a) Culture creates distinctions between one organisation and another.

b) Culture conveys a sense of identity for organization members

c) Culture facilitates the generation of commitment to something nobler that one's own self interest.

d) Culture enhances social system stability.

When organisation environment is dynamic and changing faster the culture may no longer be appropriate. So consistency of behaviour is an asset to the organisation when it faces stable environment. Ex: Telephone Companies.

2) Culture and Globalisation: As business nowadays is international, we have to understand the cultural differences across the countries. Work motivation, profit motivation, business goals, attitudes towards development of business relationships, greetings, body gestures, colours and numbers vary from country to country. When people move from one place to another, one country to another we have a lot of confusion, dis orientation which is called as culture shock. An executive who is transferred from India to Germany for example would have to make a lot of adjustments. Language differs, climate varies, food habits and socialisation pattern is new. Organisations, particularly M.N.C.S. must be prepared to cope with the culture shock.

3) Culture Determines Goods and Services:- Culture also determines the goods and services a business should produce. The type of food we eat, the clothes we wear, the beverages we drink, the building materials we use to construct houses vary from time to time within the same culture. Business should bring out the products taking into consideration these cultural differences. The fact that culture determines the types of goods and services is not as important as its manifestations. Culture is expressed through peopleís view of themselves, others, organisations, society, nature etc.

a) ***People's Views of Themselves:-*** People vary on the importance they give for self-gratification. This move was very strong during 1960s and 1970s. Some people are pleasure seekers giving more importance to fun, change and escape. Others are self realisation and join religious groups. People buy products, brands and services as a means of self expressions. Some people spent more time in health activities, jogging, tennis, others in arts and crafts. The leisure industry like camping, boating, arts and crafts, sports benefited by self-gratifiers.

b) ***People Views of Others:-*** People nowadays are towards "me society" than a "we society". People want long relations with others. Social support is promoted by health clubs, vacations and games. Nowadays the growing concept as television, home video games and computers also allow people who are alone to not feel so.

c) ***People's Views of Organisation:-*** People vary in their attitudes towards corporations, government agencies, trade unions and other organisations. The work ethic is eroding. Many people see work not as a source of satisfaction but as a necessary pursuit to earn the means to enjoy their non work hours. More companies are turning to social audits and to public relations to improve their image with their publics.

d) ***People's Views of Society:*** People's views towards society differ. People who defend it (Preservers) to those who run it (makers), to those who take what they can from it (takers), to those who want to change it (changers), to those who are looking for something deeper (seekers), those who want to leave it (escapers). Makers are high achievers who eat, dress and live well, while changers live more frugally by driving small cars, wearing simple clothes and so on. Escapers and seekers have major market for movies, music, surfing and camping.

e) ***People's Views of Nature:-*** Peopleís attitude towards nature also vary. Some feel subjugated, others feel harmony, and still others seek mastery over it. People have now realised that nature can be spoiled and destroyed by human activities. People's love towards nature is increasing tour operation for more tour packages, food producers to grow markets for "natural" products such as natural cereal, natural ice cream and health foods.

f) ***People's Views of the Universe:-*** People vary in their beliefes about the origin of the universe and their place in it. Most Americans are monotheistic, and church attendence has been also foolled steadily. As people lose their religious orientation they seek more of the good life on the earth.

4) People's Attitude to Business:- Attitude of the people towards business is largely determined by their culture. Business systems are a product of belongs, mores and customs of the society in which they exist. Businessmen should have some basic philosophies to guide their actions. Beliefs and valaue systems of what is right and what is wrong are basic to all business activity. Usually, these actions are judged by how well they contribute to the net social well being throughout the whole system.

5) Attitude to Work:- Attitude of the people to work depends on his culture. Motivation, morale and other related aspects of human resource management are based on the workers attitude to work. Attitude towards leisure also vary from country to country. Higher incomes produce more work or more spare time. Total detachment from work, the main plank of our culture should be reduced. The Japanese have achieved tremendous progress because of their commitment to work.

6) Collectivism and Individualism: The spirit of collectivism and individualism is related to such personnel aspects of employee morale, multiplicity of trade unions and inter and intra-union rivalries. Any charity or a good deed is having a motive of self rather than societyís welfare. This is the main reason for the low morale of our workers, multiple unions and rivalries among them. Collectivism is a hallmark of our society whether it is celebrated in a marriage, a social function, inauguration of a business unit or installing a CNC machine in a factory, we believe in people and crowds. We have factories which have thousands of employees and we have trade unions whose membership runs into lakhs.

7) Ambitious or Complacent: - An individual's ambition to grow or remain complacent depends on his cultural ethos. An ambitious individual is highly motivated, is wealth acquisitive, has a strong urge to excel, is prepared to change organisations and even take risks. Economy will be vibrant if a large proportion of population are ambitious people. Many of our people are complacent. An average citizen will be happy if he gets a government job, demands no initiative, no skills and no hard work. They don't prefer private sector because they demand hard work and high productivity. Complacency of people is one of the reasons for the backwardness of our economy. Our society is called ambition, particularly in wealth acquisition. Ours is the only society where we worship wealth in the form of Goddess Lakshmi unlike in the rest where wealth is only respected.

8) Education:- There is a close relationship between education and business. Centuries ago, a small intellectual elite maintained their domination in University halls, educating a few selected students to become intellectual and social leaders of the nation. It was felt that education was not for masses who laboures factories, fields and stores. University education had little interest in business and businessmen had little interest in education. Each lived in a different world. This seperation of business from education gradually changed as higher education expanded creating equal opportunities to all and the actual break through came with the rapid trend towards a knowledge - oriented society.

Industrial societies of today are knowledge - oriented and educated, and education as one of the social overheads that has been given priority in the developmental activities. But there are several variations. A society with too many constraints may spent more on teaching profession as a large part of the national income is spent on education.

In our traditional society, education was preserved to Brahmins and people of other castes were denied the facility. Our economy was premature and occupations were based on heredity. No education was needed for a cobbler to stitch footwear, for a barber to shave, for an agriculturist to sell land or for a goldsmith to make gold ornaments. All these were the crafts passed from the generations. Things have changed over passage of time. Economy turned towards industrialisation demanding technical education at all levels and to all castes. Educational institutions came up ever. We are having more number of primary schools than in U.S.S.R. and U.S.A. We have spent a lot of money on education in all the five year plans and in the tenth plan it is expected to spent more on education. There is no doubt that education benefits business. Business inturn responded and started supporting education. This encouraged Business to sponsor employee's for continuing education and bearing cost of employee's children education costs.

9) Family:- Family is referred to as a remarkable institution. Basically all types of social organisations in a family concerning with love, sexual relationship, marriage, reproduction, socialisation of the child are present. The family is the institution which is responsible for procreation and child rearing. In civilised societies the process of child socialisation have a tremendous significance. The importance of the childhood for personality and character formation have been recognised. It is the family which ultimately will plan the childís behavioural pattern than any environment factor. The family, through the husband-wife relationship, is also a recognised institution for the fulfilment of sexual needs. In many societies men and women have tended to socialise in same sex-groups. Nowadays women has been given equal status with men and husband-wife relationship has added meaning in terms of companionship, shared activities, satisfaction of emotional needs and other manifestations of primary group association.

The family is also important for a variety of other reasons, like relating to protection, inheritance, property rights, morality, care of the sick and the ages and the transmission of cultural values. The joint family system has flourished in our society for centuries. A joint family is understood as a group of people who generally live under one roof, who eat food cooked at one hearth, who hold property on common, and who participate in common family worship. The joint family has its own advantages. In times of distress a man could rely on other members, and the activities of the family members will be protected by one another. Secondly in the joint family affection as well as dependence is differed among so many relatives that a loss of an important member such as a parent is less critical than in a nuclear family it has a lot of impact. Thirdly safety and security needs of man, the second level needs as per Maslow's need hierarchy are met through the joint family system. Finally, enterpreneurial development is present in the joint family system. Joint family is a useful institution in capital accumulation. Birlas for example a joint family business, but they live seperately. The Mafatlals in Bombay live in the same building but the brothers are now seperated and the companies have been also divided.

The joint family system also have some problems. There was strain in the relationship among family members, life was not peaceful, women were generally forced to bear a large share of family strains. We come across the existence of joint family here and there. One example is a family with 217 strong living at Shimoga in Karnataka where all the family members meet once in a year and live together for a few days. Nuclear families have become very common nowadays where women enjoys equal status with men having their own earnings. As such people have money and spend more on childrenís education, household appliances and on vacation. All these developments in the family system are significant to business.

10) Authority:- The exercise of authority varies according to our management styles but different styles are likely to be present in different cultures. This is defined "as a measure of inter-personal power of influence between a boss and a subordinate, as perceived by the least powerful of the two, while the distance is seen as the extent to which either participant can influence the behaviour of the other. Traditionally, our society was known for authority and power being concentrated with the king. But the greatest merit of our society has been that the king or the boss is governed by the principle of Dharma, a concept which is unique to our culture."

11) The View of Scientific Method:- The followers of our religion feel that wealth, rainfall, demand, supply, mechanisation and all things of logic. We believe more in traditional things and not adaptive to modern things. Our Upanishads and Vedantas teached us so. Therefore traditional culture and modern science can go together as is proved in our country. Probably it is only in our country that a manager performs pooja before installing a new machine in his factory. Even our farmers after knowing about the possibilities and benefits of new varieties and methods they are turning to them.

12) Ethics in Business:- Ethics refers of the code of conduct that guides an individual in dealing with others. We can define ethics as that which deals with personal conduct and moral duty and concerns human relations with respect to right and wrong. Ethics concerns morals and philosophy. It deals with the behaviour of individuals and the standards governing the inter relationship between individuals. Ethics may be internal or external. A manager must be honest with oneself, since ones greatest asset is one's character. One should be honest and straight forward with others, treating them in the same manner in which one wishes to be treated. Fairness is necessary. Even for external the same suggestions should be followed. Every individual should not only be ethical for himself but make the group so. The following table represents the ranking of corruption. In different countries.

Fig. IV - I

New Zealand	9 . 5
Singapore	9 .26
United Kingdom	8 .57
Germany	8 .14
United States	7 .79
Hong Kong	7 .12
Japan	6 .72
South Korea	4 .29
Mexico	3 .18
India	2 .78
China	2 .16
Indonesia	1 .94

Corruption Index
10 = Free of corruption
0 Totally corruption

There are a number of frauds in public sector Banks. The following table reveals the number of frauds in Banks.

Fiqure - IV - 2

Frauds in Public Sector Banks

Bank wise frauds detected and amount involved in Rs. Lakh during the year 1995 and 1996 (upto March)

Bank	Number of Fraud cases	Amount Rs. Lakh.
State Bank of India	657	2119.16
Canara Bank	216	996.12
Bank of Maharastra	39	1935.38
Bank of Baroda	147	1325.08
Syndicate Bank	131	805.11
Oriental Bank of Commission	16	632.74
Bank of India	209	632.61
State Bank of Patiala	35	614.53
Andhra Bank	48	528.60
Punjab National Bank	83	403.75
U.C.O. Bank	82	401.01
Union Bank of India	77	383.24
Indian Overseas Bank	53	332.31
Others	357	1814.20

Ethics are important for the following reasons:

1. Ethics correspond to basic human needs.
2. Values create credibility with the public
3. Values give management credibility with employees
4. Values help better decision making
5. Ethics and profit
6. Law cannot protect society, ethics can.

A. Making Business Ethical:-

We can make business ethical by enacting some legislations and enforcing them rigidly. The following steps are involved.

a) Drawing up the code:- A code will be framed after discussions at all levels. Only after obtaianing consent and co-operation of all employees the code can be finalised. TISCO is an example.

b) Familiarising the employees:- The code framed should be familiarised to the employees. Thus printed copies should be distributed to old employees and also to new employees. They should be explained about this code in their regular training programme.

c) Implementing the code:- The code formulated should be implemented properly at three steps. The first step is that every employee should know that unethical behaviour would not be tolerated. The second step is to constitute an Ethics Committee. It shall monitor the ethical conduct of the employees at all levels. Finally social audit may be conducted to ensure that the code is implemented. We will discuss more about Business ethics in the next chapters.

B) Religion:

Religion refers to a specific and institutionalised set of beliefs and practices generally agreed upon by a number of persons. The major religions across the world are Hinduism, Christianity, Islam and Buddhism. Religion plays an important role in one's life. It makes an individual to lead a disciplined and orderly life. Religious practices relieve a person out of tention. When we visit any religious places we will be very relaxed. Every religion is subjected to stratification. Our society has been divided into four major castes viz. Brahmins, Kshatriyas, Vaishyas, Sudras, Christians and Islam.

Religion has a lot of influence on business. Work culture of employees, boss - subordinate relations, people's attitude towards business and other issues are governed by religious beliefes. The nature of business also depends on religions. Birlas being Jains did not enter into catering, hotelering and leather industries. For many Indian Business men business decisions are made not by management but by astrologers and fortune tellers. There are a number of examples where business people like Vinod Jain, R.P. Goenka, S.K. Birla, Sanjay Dalmea and the Ambanis take the key business decisions only after consulting personal astrologers.

The economy of a nation may be affected by religion. In a country like ours where people of several religious beliefs live, harmony among them is vital for business to flourish. Conflicts between religions will destroy business prospects as how communal clashes broke out after Dec. 6th 1992 i.e. Ayodhya incident.

13) Marriage:- Marriage had three objectives: the promotion of religion by the performance of household sacrifices; pregnancy and sexual pleasure while the three objectives are relevant even today, marriage as a social institution which results in multiplication of people, settled life, systematised and organised activities. A single marriage may spark off protest from women and approval from men. Marriage may even remain a recession hit economy.

14) Time Dimension:- Time dimension is another cultural aspect that will influence business. The dimension means peoples orientation towards past, present or future. In some societies people are oriented towards past. In others they focuss on present. Still some are futuristic employees are used and maintained as long as they are useful. The American society is an example for this

Japan is an example of futuristic society. They plan for a long term future, where they retain employer for a long time even for life. They spent lot of money to train them and this is mutual commitment on both sides. Our society is an example for past and future orientation.

15) Cultural Resources:- Cultural Resources or heritage makes the country distinctive. Our country has a vast cultural heritage. A look at our past is very pleasant. It makes an individual feel that he is an Indian. It certainly makes him to raise his head with confidence and hope. Ours is a beautiful country with vast, varied and rich minerals, varied animal life, beautiful rivers, huge mountain's, dense forests, splendid architecture, temples, mosques and great thinkers and seekers. It is on this land Adi Shankara Charya, Gautam Buddha, Swami Vivekananda and Mahatma Gandhi were born. We also have many practical blessings on the world like rice, sugarcane, spices, the game of chess etc. and sanskrit literature is one of the greatest contributions of culture of India.

Today, a number of Indians whereever they are proud of the country. We may face several problems politically and economically but we cannot predict the future. Our civilisation will retain its continuity. We have the Bhagavadgita to inspire us in action and the Upanishads for thought provoking. Most of the old cultures like widows to be burnt with their husbands, girls allowed to be married at childhood, caste system etc. are vanishing and we are towards a bright future with several cultural manifestations.

4.3 Social Responsibility of Business:-

Business depends on society for several inputs like money, men, skills and also for market where products may be sold to the buyers. Thus business depends on society for existence, sustenance and ecouragement. Once society ceases to have any use for business it has no place and reason to live. As such Business has definite responsibility towards society. This is called a social responsibility of business. Social responsibility means an obligation of decision makers to take actions to protect and improve the welfare of society as a whole along with their own interests. Every decision the businessman takes like diversification, expansion, opening of a new branch, closure of an existing branch or replacement of men by machines, society is affected in one way or other. Even the routine matters like overtime, night shifts, sub contracting and lay off of employees have a social impact. The business man should keep his social obligation in mind before contemplating any action. As business changes in terms of its form and organisation society also undergoes changes. Social values, social instiutions, social order, social contract, social conflict, social problems - everything changes along with a change in the business culture. In other words, business determines society as much as society determines business. Therefore business must be socially responsible.

Business Corporations of the world are not interested in making money. They want to be a great innovator more specifically a great public benefactor to serve the public. Each and every social group has definite expectations. The workers expect fair wages and bonus, the salaried managers expect a remunerative packet of pay and perks, the consumers expect a quality product and services at fair prices, the suppliers expect a prompt settlement of bills, the distributors expect prompt settlement of bills and the government expects to pay taxes and to be accountable for subsidies. In addition to all these the society expects some charitable donations for promoting education and culture, the ecologists wants to avoid totally pollution and upgrading of physical environment, the social workers want the overall development of backward areas. There is no end to the expectations of these social groups. The more you come up to their expectations the more they expect from you and your business.

Social Responsibility Models: - There are two approaches towards Corporate Social Responsibility. Some focus on micro level of analysis where individual companies show how they can be more socially responsive. Others deal with macro level where government should establish a countryís social goals. It is the micro analysis which is more significant.

Ackerman's Model:- Robert Ackerman suggested that Micro level theory should be the goal of a corporate social endeavour. Ackerman described three phases which companyís pass in developing a response to social issues.

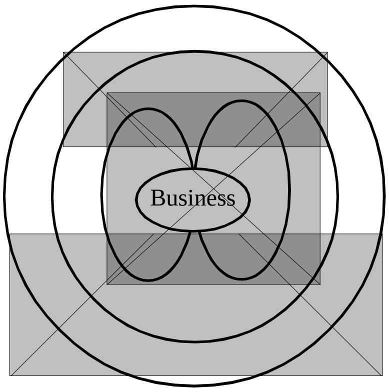
In Phase 1:- At this statge the corporation's top manager learn of an existing social problem. No one asks the company to deal with it. The chief executive only explains the problem of making a written or oral statement of the companyís policy towards it.

In Phase 2:- The company hires Staff specialists or outside consultants to studys the problem and suggest ways of dealing with it. The company has limited itself declaring its intentions and plan.

Phase 3:- Implementation. Now the company implements the operations. Implementation is done slowly. Ackerman advices that managers should "act early in the life cycle of any social issue in order to enjoy the largest amount of managerial discretion over the outcome.- Ackerman's point is that when many interests are involved the manager would lose control over this ability to handle the isse at their own discretion. Therefore big companies could make the best information available to their employees, encourage them to ask questions etc. Being responsive may well be the only responsible course of action.

Carroll's Four Part Model:- Archie B. Carroll, formulated a four - part model while discussing about the social responsibility. This model suggests that because a business firm is basically an economic entity its primary responsibility is economic. It must produce the goods what society wants and must sell them at profit. Firms should operate within the law. Ethical responsibility refer to the behaviour by the firm that is expected by society but not codified into law. Though they are not defined clearly, in specific situation they can be fairly clear. The four responsibilities are first a business unit earn profit in order to satisfy its economic responsibilities. Then the firm should fulfil the social responsibilities. Then it should strive to satisfy the ethical responsibilities. After satisfying these, the company should focus on discretionary responsibilities. Carroll suggests that if firms fail to satisfy discretionay or ethical responsibilities, society will assert and bring them under legal framework. The impact of business on all these responsibilities in the figure - IV-3. Therefore it is advisable for the companies to undertake ethical and discretionary activities voluntarily. 1.

IV-3 The Impact of Business on Responsibility



Arguments for Social Responsibility:-

There are many arguments in support of social responsibility. Let us discuss them:

1) ***Changes Public Expectations of Business:-*** Public expectations towards business have changed. Business exists only if it satisfies the valuable needs of society. Therefore if business wishes to remain for a long run, it must respond to society needs and give society what it wants.

2) ***Better Environment for Business:-*** Social Responsibility creates a better environment for business. The firm which improve the community quality of life will have a good environment. The labour recruiting will be easier and labour will be of higher quality. Turnover and absenteesm will be reduced. As a result of these social improvements, crime will decrease and less money will be spent to protect property and less taxes have to be paid to support police forces. Thus a better society produces a better environment for business.

3) ***Public Image:-*** Social Responsibility improves public image. Each firm seeks public image so that it can have more customers, better employees, more money markets and other benefits. A firm which seeks public image should support social goals.

4) ***Avoidance of Government Regulation:-*** Government seeks to regulate business with public interest. Government regulation is costly and denies more freedom in decision making. Before government stretches its arms, business should discharge its obligation to society.

5) ***Business has the Resources:-*** Business has a lot of resources in terms of men, talents, functional expertise and money. With all these resources business can work for better social goals.

6) ***Let Business Try:-*** Many institutions have failed in handling social problems, so why not turn to business. Many people an frustated with the failures of other institutions and they are turning to business.

7) ***Prevention is Better than Cure:-*** Prevention is always better than cure. If business delays in solving problems now, it may lead to serious social breakdown. So it is economical to deal with them at an early stage.

8) ***Moral Responsibility:-*** Business firms control many resources of the country so it is their moral responsibility to the overall betterment of the society. It is their responsibility to solve many serious social problems coming from large corporations.

9) ***Citizenship Argument: -*** Corporations are institutional members of society. If individuals have the obligation of improving society so the corporation also have their responsibility. Corporations are citizens and, cititzens have civic duties and responsibilities.

10) ***Duty of Gratitude: -*** Business Units benefit from society. On the common principle that one owes debts of gratitude towards those who benefit us, the corporation has certain debts that it owes to society.

Arguments Against Social Responsibility:-

Arguments against social responsibility are also equally strong. Some of them are as follows:

1) ***Profit Maximisation:-*** The basic objective of business is profit maximisation Business is operating in the world, of poverty and the economic efficiency of business should be given importance. Business's function is economic not social and economic values should be the only criteria to measure success. In this type of social system managers are the agents of stock holders who are interested to maximise profits while satisfying law and social system.

2) ***Society has to pay the cost:-*** There is another argument that society is responsible for its development and therefore it is their responsibility to bear them. Whether it can afford to do it or not is a different question.

3) ***Lack of Social Skills:-*** Business manager can manage business. But they are not good at solving social problem. Their outlook is also economical and their skills are same. They are not really good at social problems. Will these business people able to do better than government and other institutions?

4) ***Business has enough power:*** Business is already having social power therefore society should not take any steps which give it more power. Business is one of the two or three most powerful instiutions in society at the present time. Business influence is felt throughout the society. It is felt in education, in government, at home and in market place and it moulds many social values.

5) ***Social Overhead Costs:-*** Cost on social responsibility may not immediately affect business. Then the question is why to spend money on benefits which will realise only in future? It is the heavy social overhead costs which is one of the reasons for the dismal performance of some of our government. undertakings.

6) ***Lack of Accountability:-*** Businessmen do not have direct accountability to people, therefore, it is unwise to give businessmen the responsibility in areas in which they are not accountable. The society should develop direct lines of social accountability from business to the public.

7) ***Lack of Broad Support:-*** Business involvement in social groups lack support from all groups in society. Many persons desire business to become more socially involved, others oppose the idea. There is lack of agreement among the general public, among intellectuals, in government and even among business themselves.

8) ***Friedmen and Led Gttís Views:-*** Milton Friedman criticised on two principles one economic and the other legal. From the economic view, he asserted that if managers spend corporate funds on projects not intended to maximise profits the efficiency of the market mechanism will be undermined and the resources will be misallocated within the economy. On the legal side he said as managers are legal agents of the stock holders, their role duty is to maximise the financial return to the stock holder. Dhirubhai Ambani has also apposed to corporate responsibility.

Barriers to Social Responsibility:-

There are several barriers towards social responsibility. Let us discuss them:

The Individual Manager:- The individual manager is a person who is ultimately responsible for the social action programmes of any organisation. The manager can initiate, advocate, and put programmes into effect. The manager can also avoid prevent. Programmes from being planned or implemented. Most managers actions are always observed by the superiors. For this reason, most managers are cautious about proposing changes in the organisations behaviour.

The Organisation:- At the organisation level, the greatest barrier is focus on profits. Shareholder want dividends, Employees higher salaries and better working conditions. Under this situation social programmes have little chance.

The Industry:- There may not be any support from competitors in the same industry for social action programmes.

The Division:- A division must try to maintain itself as a profit centre. Any social responsibility decision that reduces the level of profit might threaten the divisionís viability. Thus, most divisions are slow in initiating socially responsible programmes until they receive clear instructions to do from top management.

Social Responsibility Strategies:-

Business response to social responsibility fall within four categories 1) social opposition 2) social obligation 3) social response and 4) social contribution. It has been clearly illustrated in figure IV-4 showing their positions ranging from low to high levels to socially responsible behaviour.

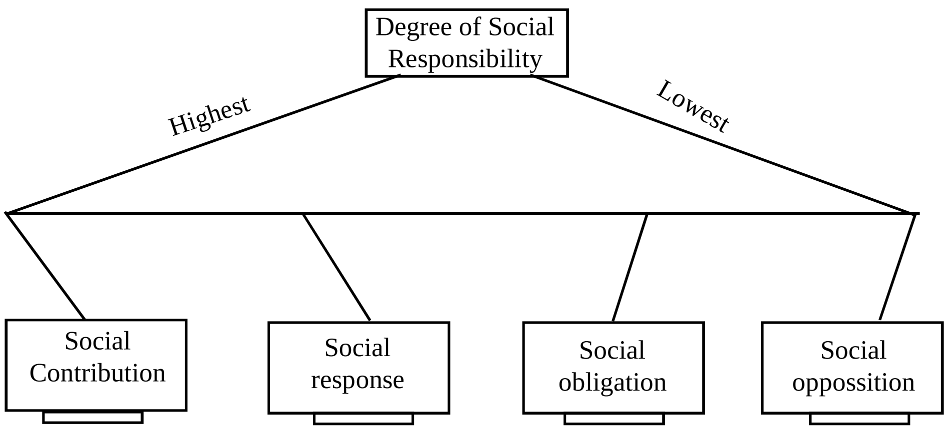


Fig - IV - 4 - Approaches to Social Responsibility

Social Opposition:- This view is taken by the businesses which feel that they have no obligation to society in which they operate. When they are caught for any offense, their immediate response is to try to cover it up while denying it.

Social Obligation:- This view is by the companies which feel that they have no obligation to obey the law. They feel that the only socially responsible behaviour is that prescribed by law. So such business people would. instal safety equipment that is required by law, that they will not spend additional money in order to instal better safety environment.

Social response:- Social response is the position taken by companies that meet their social responsibilities dictated by law and will go beyond the legal requirement. These units may participate in limited socially responsible efforts, but not until they are convinced that the benefits out weigh the costs.

Social Contribution: It is the view of the companies which believe that they have a deep obligation to serve the society. Such companies feel that they are responsible citizens in society and are eager to contribute for the improvement of the society.

Social Responsibility to different sections: - The social responsibility of business to different sections of the society is discussed here. The important generally accepted responsibility of the business is shareholders, employees, consumers and community are called as corporate accountability.

Responsibility towards Shareholders:- The responsibility of a business towards shareholders is a primary one. Shareholders are the persons making investment in the business so they should be adequately recognised. To protect their interests ì the primary business of a business is to stay in business.î Therefore it should develop and improve its business and build up financial independence. Adequate reserves should be maintained to declare reasonable dividends. By innovation and growth the company should consolidate and improve its position and help strengthen the share prices. The shareholders are not only interested in the protection of their investment but also on the image of the company. Therefore the company should increase public image. Such that the shareholders feel proud of their company. The shareholders should also offer wholehearted support and cooperation and they should appreciate the responsibility of the business to other sections of the society - to the workers, consumers and the community.

Responsibility towards Employees:- The success of a business depends on the morale of the employees and their cooperation. The following are the responsibilities towards employees.

1. The payment of fair wages
2. To provide best possible working conditions
3. To establish fair working standards and norms
4. The provision of labour welfare facilities
5. Arrangement for proper training and education of the workers
6. Reasonable choices for promotion
7. Proper recognition, appreciation and encouragement of skills and capablilities of the workers
8. An opportunity to participate in managerial decision.

TISCO Tata Iron and Steel Company is an example for them which was appreciated by the Social Audit Committee.

Responsibility towards Consumers:- Peter Drucker says the definition of business means ì to create a customer.î It has been recognised that customer satisfaction is the key to satisfy the organisational goals. The following are the responsibilities towards consumers.

1. To improve the efficiency of the functioning of the business, so as to increase productivity and reduce prices, improve quality and lessen the distribution channel.
2. To do research and development, to improve quality and introduce better and new products.
3. To supply goods at reasonable prices.
4. To provide the required after sales resources.
5. To ensure that the product supplied do not have adverse effects on the consumer.
6. To promote information about the products, including the adverse effects of using the product.
7. To avoid misleading the customers by improper advertisements.
8. To provide an opportunity of hearing genuine grievences.
9. To understand customer needs and take necessary measures to satisfy them.

Responsibility towards the Community:- A business has a lot of responsibility to the community and society. They are:

1. Taking appropriate steps to prevent environmental pollution and preserve ecological balance.
2. Asserting for the overall development of the locality.
3. Taking steps to conserve scarce resources.
4. Improving the efficiency of business operation.
5. Contributing to research and development.
6. Development of backward area.
7. Promotion of ancillories and small scale industries.
8. Contributing to the national effort to build a better society.

The limitations of Social Responsibility:- The social responsibility actions are limited by cost, efficiency, relevance and scope.

Cost: Social responsibility costs money. To do any social development like adopting a village, donating to a college or school building a hospital, maintaining a park everything involves cost.

Efficiency:- Social responsibility affects efficiency adversely. If a company runs its plant, even if it is incurring losses every year its efficiency goes down and its ability to compete is lost.

Relevance:- According to Friedman, ìThere is one and only one social responsibility of business: to use its resources and energy in activities designed to increase its profits so long as it stays within the rules of the game engages in open and free competition without deception and trent.î Therefore business should produce goods and services efficiently and leave solution of social problems to concerned individuals and government agency

S**cope and Complexity:** Society's Problems are too massive, too complex, and too deep seated to be solved by even the most socially acceptable company or even by all companies acting together several environmental pollution, acid Rain, ozone depletion, destruction of rain, forests, health problems - AIDS, drug and tobacco use, racial discrimination, sex discrimination, ethic and religious problems are some of the problems.

4.4 Summary

Business thus has its own limitations. It should deliver qualaity goods at low prices, earn profits for shareholders, pay taxes to the government and plan the strategies to stand in the competitive market. In such conditions how can it solve another complex problems of social responsibility?

The Socio cultural environment includes a host of factors like Social values, cultures, beliefs, traditions, social institution, class structure, social group pressures or social dynamics etc. the nature of social objectives and priorities along with the set of constraints give form and content to several social movements. The critical elements of the socio-cultural environment are social institutions and systems, social values and attitudes, education and culture, social groups and movements, the socio-economic order, social problems and prospects etc. Ever since the country became independent, India has been witnessing changes on several fronts of the socio cultural environment.

It is not merely the shareholders but several other groups who are interested in the running of a business enterprise. The management of the enterprise has therefore to strike a balance between the interests of all these groups or stake holders. The business has therefore to be run in a socially responsible manner. This is necessary if the business has to survive and grow in the long run.

4.5 Self - Assessment Questions:-

1. What is the concept of socio cultural environment? What are the factors influencing it?
2. Define culture? How does culture influence business?
3. What is business Ethics? What are ethical problem?
4. Define Social Responsibility of business?
5. Why is Social Responsibility important for business?
6. What are arguments against Social Responsibility?
7. What are the arguments favouring social responsibility?
8. Discuss the limitations of Social Responsibility?

4.6 Further Readings

1. Adhikary, M. 1997, Economic Environment of Business, Sultan Chand & Son, Delhi.
2. Aswathappa, K. 1999, Essentials of Business Environment. (Chapters 33 & 34) Himalaya Publishing House, Mumbai Kerith Davis and Robert L. Blomstorm, Business and Society, Environment and Responsibility.
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LESSON - 5

BUSINESS ETHICS AND CORPORATE GOVERNANCE

Objectives :

The main purpose of this unit is to help you to

* understand the concept of Business Ethics and Corporate Governance
* examine the factors influencing ethics and how managers face problems while decision making
* understand the significance of Corporate Governance and different committees on Corporate Governance
* analyse the different practices on Corporate Governance in other countries and in India.

STRUCTURE :

5.1 Introduction :

In the earlier lessons, the various factors which have a significant impact on the business are high lighted, In this lesson, business ethics and Corporate Governance are high lighted.

Business ethics and its impact on policy and decision making has been an issue of great concern to business men and scholars in the recent history. The last decade has seen a great awareness on the topic and the corporate managers are placing greater emphasis on ethical criteria in their strategic planning. If the business organizations follow good business ethics, there would be less government intervention. When the business sector doesn't maintain ethical standards, government makes legislations and so many rules will be imposed. The effect of these legislations and rules is that, they will affect each and every aspect of business activities. Another important need arises from the fact that business organizations should improve their image in the society. This requires that the business organisations should follow ethical standards in order to improve their image.

5.2. Business Ethics - Definition :

Ethics refers to a system of moral principles which involve right and wrong of actions and motives which are good and bad. Further, ethics also considers the consequences of such actions specifically business ethics refers to the application of ethics to business. The business sector is expected to possess the knowledge of ethics and apply the same in their regular practices.

Ethics may refer to the following :

1) Ethics are principles of personal and professional conduct
2) Ethics is broader than what is stated by law, customs and public opinion.
3) Ethical behaviour mady differ from society to society.
4) Ethical standards are ideals of human conduct. However, defining ethical standards is not an easy task.

Ethical considerations are important for managers for number of reasons. If the organisations fail to project a healthy image of itself in society in quality, service and customer satisfaction, their existence will be in danger. Ethical concerns are of vital important to individuals, organisations and society in general.

5.3. Need for Business Ethics :

Ethical practices in business are important to managers as individual's personal life and business life cannot be separated with respect to moral judgements. The need for business ethics can be summarised as under :

5.3.1 Ethics is related to basic human needs : It is an accepted fact that human beings tend to be ethical in their personal life as well as in their business situations. As a proprietor, manager, executive or an employee of any business organisation, the decisions taken by them will influence the lives of many employees directly and others in the society indirectly. As a part of the organisation, business executives are expected to play an honest and sincere role to be a model for other executives.

5.3.2 Ethical values improve the image : The organisations which follow ethical values are respected in the society. The products, services offered by such organisations will be honoured and accepted by the public and society. The organisations image will improve considerably as people believe that the company offers value for money. The organisations rating in the capital market will also be high.

5.3.3 Relationships between employers and employees improve : The employers will be able to provide good leadership to employees by following ethical values. The employees will be motivated to follow standards set by employers for achieving common goals, and objectives. The moral and ethical principles followed in the organisation will improve relations between employers and employees

5.3.4 Ethical values are the foundation for better decisions : The ethical values and principles followed by the management are the foundation for better decisions. The decisions taken by the management will provide positive results in the long run for the business organisations in terms of higher profits, returns and success.

5.4 Factors influening ethics:

Ethics is influenced by a number of factors or forces which may be explained as under :

5.4.1. Family, school and religion: The formations of ethics starts at an early life of every individual. As a child, one learns ethical principles from parents. Through rewarding good behaviour, parents inculcate ethical standards among childern. The education at school provides a strong foundation for ethical behaviour, Religions influences the ethical values in terms of honesty, sincerity, truthfulness and tolerance etc.,

5.4.2. Colleagues, and Superiors : The ethical standards of an individual are influenced by colleagues and superiors in the organisations. If the colleagues display unethical behaviour, the individiuals are also likely to accept the behaviour. The attitudes, beliefs and values of superiors will also shape the behaviour of subordinates.

5.4.3.Self Experiences : An individual's behaviour is always influenced by his/her own experiences in life. The experiences in the early childhood, young and middle ages will have a tremendous and continuous influence on the ethical behaviour. Individuals who display good behaviour are to be encouraged while a bad behaviour should always be condemned.

5.4.4. Different situtations : An individual behaviour is always influenced by the different situations. A threat to job, life and property wil change the behaviour of individual. Simalrly in organisations, employees in order to achieve the targets tend to behave unethically. The goals of the organisation take over the principles of morality and ethical value of of individuals. The managers at different levels compromise for the objectives of the organisation.

5.4.5. Legal framework : Any Government is normally interested in maintaining ethical standards in society. Laws relating to corruption, crimes, exploitation, unfair deals, harassessment etc., are made by Goverment to protect people from unethical practices. People in the society seek the intervention of the Government when their moral and ethical values are downgraded.

5.4.6. Industry codes : In many occassions, the industries provide specific guidelines to the executives. The acceptance and implementation of the codes of conduct are influenced by their individual qualities, objectives and purpose of the organisation.

5.4.7. Social Pressures : Social forces and pressures have considerable influence on ethics in business. Society in the recent past has demonstrated how severe actions are necessary for the prevention of use of pesticides in coladrinks. Such actions by dfferent groups may force management to alter certain decisions by taking a broader view of the environment and the needs of society.

5.5. Theories of Ethics :

There are two important theories which are contradictory in nature:

1) Theory of moral unity which states that business actions should be judged by the general ethical principles prevailing in the society. These ethical principles are universally applicable.

2) Theory of a morality which stresses that businessmen need not follow ethical standards as their objectives is to earn profits.

5.6 Sources of Business Ethics :

The ethical values related to business have emerged from different sources which are as under :

5.6.1 Religion : The ethical values, principles related to any society including business are drawn from religion. There are more than one lakh religions in the world. The prominent among them are Hinduism, Islam, Christianity, Buddhism, Jainism etc., The world's greatest religions are in favour of certain fundamental principles. The principles like mutual help, Co-operation, human values, dedication, sincerity, hardwork etc., are all accepted by all religious. These religions also stresses the need for an orderly social system to contribute to the welfare the Soceity.

5.6.2 Socio - Cutural values : Culture refers to a set of values, rules, and standards which are handed down from generation to generation. These rules and standards play an impartant role in influencing values of the individuals in the groups. The cultural values are also drawn from the different stages of human civilization. In the early stage of human civilization, ethics were developed according to conditions prevailing at that time. The basic needs of hunger, greed etc., have dominated and the strong people emerged as successful in the groups. Force and violence dominated trade ethics. In the agricultural stage, hardwork, thrift have contributed to the new values in the society. These values are helpful to managers for decision making even today. The cultural values have undergone rapid changes after industrial revolution. The industrial revolution has brought about structural changes in society and ethical values.

The emergence of Capitalists, number of factories, exploitation of workers, manual labour being replaced by machinery, etc., have created new problems in the society. This requires formulation of a code of conduct to business to protect working class and consumers in the society. Unwritten and oral ethical values have given place to written rules of conduct.

5.6.3 Legislative framework : The society expected that business would respond to ethical values. But inpractice, the earning of profits, amassing wealth have dominated the ethical values. Businessmen started corrupting officials, evaded taxes, and they did not pay attention to health hazards or industrial accidents of workers. The wages paid were highly inadequate, undue and long working hours with improper working conditions. Consumers suffered because of poor quality and high priced products. It is in this context, many legislations like ISI (Marks) Act, MRTP Act, weights & measures Act etc., were formulated. These laws are the rules of conduct formulated by legislatures to guide human behaviour in society. But law alone cannot help to promote ethics in business. The business promoters, managers, executives and employees have to evole certain ethical standards and should implement them in their decision making.

Ethical values is a mechinism through which individual behaviour is controlled in the society. These values always exercise superior power over the other systems of control like police, law etc. It is through implementation of ethical values, individuals can transform the shapes of the society.

5.7 Some Examples of unethical business practices :

The managers real world of deciding shades of difference between ethical and unethical behaviour is far more challenging and complex. Very often it may be difficult for the manager to free himself from bias and prejudice and look at the issues objectively. In spite of good intentions, he becomes involved in the situation and becomes identified with few points of view. It may not be possible for him to examine the decisions from purely ethical standands. However, the following may be stated as examples for unethical business practices :

1) providing false information about the organisation, activities or decisions.

2) doing insider trading to prevent outsiders

3) Overloading expense accounts
4) giving trade secrets to competetiors
5) bribing officials with money or gifts
6) cheating customers with high prices or low quality products
7) adopting unfair credit policies
8) misappropriating cash or stocks or any other assets
9) changing the documents
10) accepting money or gifts from middlemen
11) quitting a job without giving adequate notice
12) punishing employees without hearing their arguments
13) sending wrong reports to Goverment, sharcholders etc.,

The purpose of business ethics is to guide the efforts of managers in discharging their duties to the satsfaction of various stake holders like employees, owners, customers, suppliers and public. However, it is not an easier task to divide managerial actions into ethical and unethical behaviour because of a number of influencing variables.

5.8. Types of Ethics :

There are two types of ethics which are likely to emerge in any business organisation,

5.8.1 Human Relations ethics : The business ethics that is related to human relations in any business organisation is known as Human Relations ethics. The employees in the business organisation tend to develop human relations with outsiders. The relations with dealers, agents, officials, customers, politicians and media people influence the ethical practices in the business.

5.8.2 Policy Ethics : Any business organisation has to adopt ethical principles in its functional policies like production, finance, marketing, HRD, R&D etc., For ex : If capital is to be raised from financial institutions and public, the quality of information, reliability and transparency of financial statements are to be provided based on ethical principles. The efforts to sell in the markets should also concentrate on the ethical principles of selling.

The ethical burden of deciding policy issues are provided by top management. The managers and directors who are responsible for preparation and impementation policies have to incorporate ethical issues in the policies. The policies which contain ethical principles will have a strong influence on both internal and external groups. The policies are not only useful for decision making at present, but will also lay a strong base for future policies and decisions.

5.9. Problems of Decision making in Ethics :

The decision making related to ethics is not an easier task. The decisions in the areas of prodction, finance, marketing etc., can be easily made while the decisions to follow ethical principles cannot be made without the commitment of the total team of management. The following diffculties are however observed in the decision making related to ethics :

1) There is a phenomenal expansion of large scale company structures. In these type of organisations, decision making was undertaken by groups which are called committees. The issues that pose challenges are related to loyalty to organisations, general public and Government.

2) There has been a change in the ethical principles over time. For ex : donations to political parties were banned earlier in some countries, but now the same has been permitted through a law.

3) In business organisations and in Governments, the decisions which are likely to provide good to the largest groups are taken. These decisions are justified on the grounds of ethical principles.

4) Conflicting interests between different groups also poses a threat to ethical principles and practices.

5) Managers face dilemma between facts and values in ethical decisions. Facts are statements about what is and values are statements about what ought to be. for ex : a medicine should be priced high from the company point of view, but it may pose a problem from the patient point of view.

5.10 Management of Ethics :

Today many companies are using managerial techniques that are designed to encourage ethical behaviours. Some of the techniques which may be used to-manage ethics can be explained as under :

5.10.1 Role of top management : It is the top management that is expected to take imitiative in implementing ethical standards in the organisations. As far as practicable, the management should avoid implementation of those policies and strategies which will lead to mounting pressures on employees and other groups in respect of ethical standards.

5.10.2 Code of Ethics : Today many of the organisations have develped a code of ethics of their own. The different associations of industries have evolved different principles which are part of the code of ethics. Some of such principles can be stated as under :

a) To charge fair and reasonable prices and to communicate the same to the consumers

b) Not to withhold stocks of goods with a view to hoarding or black marketing

c) Not to adulterate goods supplied

d) To maintain accuracy in weights and measures of goods offered for sale

e) To provide after sales service wherever nessary

f) To discharge social responsibilities to protect the environment.

g) Not to involve in publication of misleading advertisements

h) To take steps to ensure that the agents or dealers do not charge prices more than fixed.

5.10.3 Committees on Ethics : In some companies, committees were constituted on ethical issues which consist of the board of directors, and CEO of the company. The committees collect information from employees and other groups to establish policies on ethical issues and to see that they are implemented.

5.10.4 Tranining Programmes : Some of the companies are providing training in ethics for their employees and managers. Sometimes cases based on actual events in the companies are used to provide principles of training to employees on the Job related issues. The training on ethics is very much essential as such training imparts philosophical issues related to Job.

5.10.5 Legislations : There are a number of legislations which are made to provide ethical guide lines to companies in India. Some of the legislations are :

a) The Essential commodities Act 1955

b) The Companies Act 1956

c) The MRTP Act 1969

d) The FERA Act 1973 (Now known as FEMA 2000)

e) The Consumer Protection Act 1986

f) The Environment Protection Act 1986.

5.1. Suggestions for making Ethical decisions :

The companies and managers face several problems and difficulties in making ethical decisions . The following measures may be taken to solve difficulties in decision-making :

1) A decision device in which an imaginary conversation may be organised in the form of a debate or discussion with few intelligent people and try to apply ethical principles for discussion.

2) Writing down the merits and demerits on a paper and an analysis of the merits and demerits may be undertaken to solve the ethical problems.

3) List out ethical priorities before the problems arise. Such priorities will help to ounderstand alternatives for an ethical decision making.

4) The managers may give publicity to the ethical principles so that the employees and other groups will try to understand the position in a clear way.

5) The manager should set an example to the other employees and outside groups as models. This will help in creating and uplifting work environment.

The ethical perfection is imaginary. There is no single method of making ethical decisions and no hard and fast rules are given. However, the use of ethical norms, standards and principles is highly subjective and relative to the various situations and challenges faced by the companies and individuals.

5.12 Corporate Governance :

The Concept of Corporate Governance has received the attention of policy makers, Academicians and corporate managers in the recent past. After 1990, the concept has become more popular. This concept is more related to holding the balance between economic and social goals and between communal and individual goals. The purpose of the corporate Governance is to encourage the efficient use of resources and equally to require accountability for the stewardship of these resources.

The concept corporate Governance can be understood as a formal system of accountability of managers to the shareholders. It can be defined as “the process where by people in power make decisions that create, destroy, or maintain social systems, structures and processes”. It can be implied that in the process of corporate Governance, people in power direct, monitor and lead corporations and there by either create, modify or destroy the structures and systems under which they operate. The issues involved in corporate Governance include complete transparency, integrity and accountability of the management. From the organisation point of view, Corporate Governance is maximisation of value to meet financial and other legal obligations. This point highlights the needs for board of directors to balance the interests of shareholders with those of other groups like employees, customers, society etc., From the public point of view, this concept is related to nurturing organisation while ensuring accountability in the exercise of power and patronage by firms.

5.13 Reasons for the growth of the concept :

The need for the concept has emerged from the following aspects :

1) Many companies in many countries tried to explicit the weakness in Accounting standards, in an attempt to show inflated profits and understate liabilities. The companies have gone up considerably in number, but the Accounting standards were inadequate. The standards covered few aspects and left many aspects.

2) In many companies, the roles of chairman and chief executive are combined in one person and this has led to make the matters undesirable.

3) There is a difference in the interests of those who have effective control over a firm and the interests of those who supply finance from external sources. This is a problem which has grown out of the seperation of ownership and control and of corporate outsiders and insiders.

4) Another significant reason is related to standards of financial reporting and accountability after the heavy losses sustained by investors and lenders. Investors lost because of management practices of the companies.

5) Many of the companies have not paid due attention to provide service to shareholders. For ex : in the matters of transfer of shares, despatch of dividend warrants etc., the companies failed to provide adequate information to the shareholders.

6) The foriegn investors have been pressing for transparency in respect of the functioning of the companies in India. The Indian public have become more educated on the different aspect of the functioning and management of companies and hence are looking for good practices in this regard.

5.14 Significance of Corporate Governance :

The significance of Corporate Governance can be understood as under :

1) The shape and quality of corporate Governance will assist in the growth of any capital market and economy. By applying the priniples of corporate Governance, the companies can attract investments for accelerating their growth. Hence the link between the management of the company, its board of directors and its financial reporting system has become critical.

2) The investors and markets are positively responding to the well managed practices of companies by giving higher valuations to them. In such companies the boards and management have the freedom to take decisions towards the progress of their companies.

3) A good corporate Governance is an important instrument for investor protection. It accounts for high transparent corporate disclosure and excellent financial reporting structure.

4) The concept of insider trading is to be avoided in companies and it is necessary that insiders should not take any unfair advantage relating to the information of the company. This requires the companies to adopt an internal procedure for adequate and timely reporting of information to various outsiders.

5) Good corporate Governance contributes to the efficiency of companies and help to create wealth for the companies and prosperity for the nation.

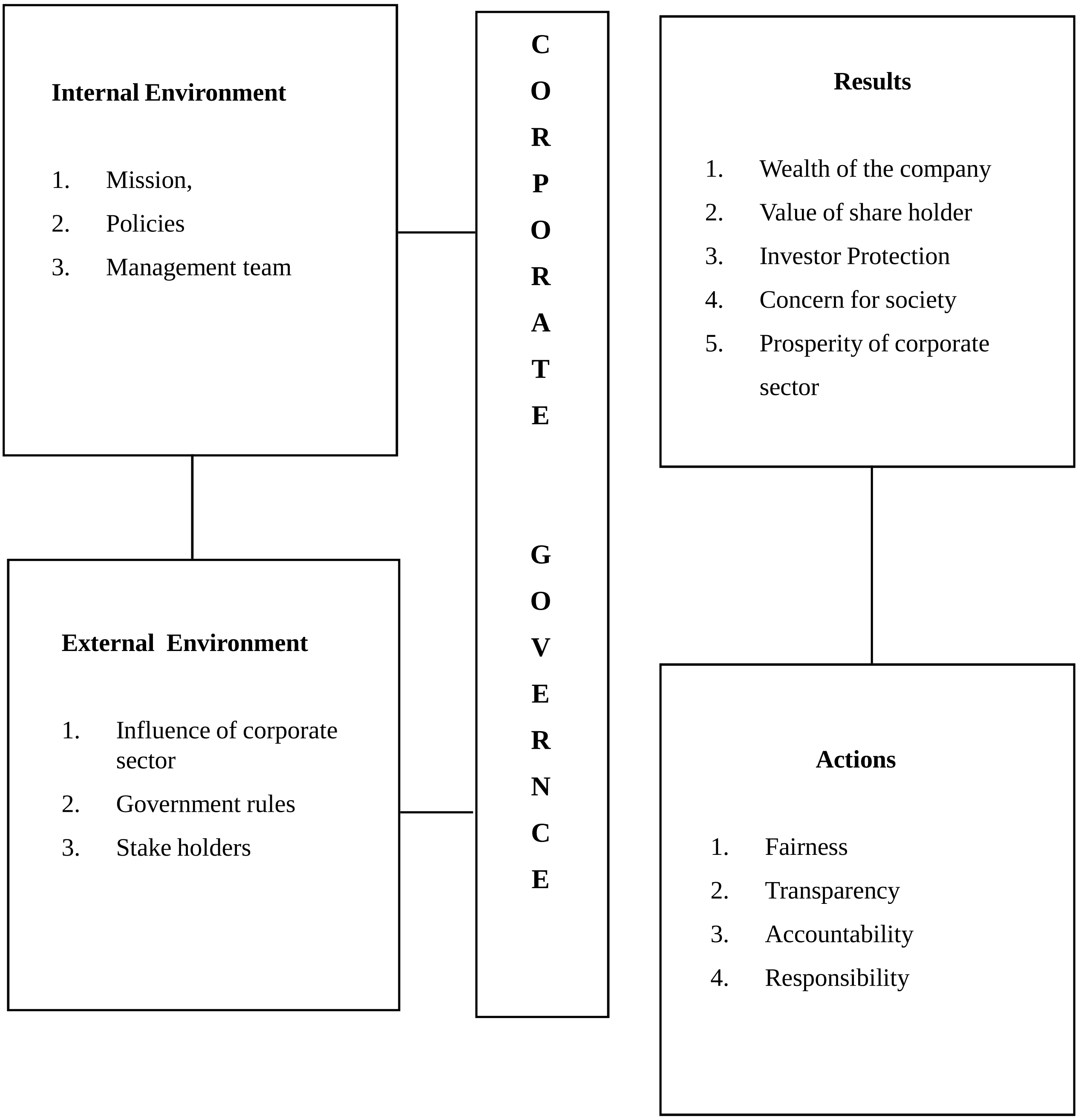


Fig : Modified version of fig given in p. 191 of Business Environment - text and cases by Francis Cherunilam,

6) In the era of globalisation, the corporate Governance enables firms to compete internationally and also help them to provide employment and to enhance social occeptance.

5.15. A Frame work of Corporate Governance :

A frame work of corporate governance can be shown in the following figure :

5.16 Evoluation of corporate Governance :

The evoluation of the concept of corporate Governance can be traced back to the early 18th and 19th Centuries. American corporations were chartered with the purpose of serving the public interest. Companies which supplied transport, water, banking and insurance facilities were incorporated by the State Legislatures. The courts have also recognised the need that the Board of directors should act in the best interests of the corporations and as well as of all internal and external shareholders. In the mid 19th century state legislatures in USA began passing laws of incorporation that were very general. Corporate promoters had the freedom to write their own corporate charters. The companies which have come into existence after world war - II did not work effectively as they were managed by managers with their self interests and ignored the interests of stake-holders. The corporations have witnessed a number of changes ...,

1) Flexible manufacturing processes
2) World wide markets
3) Corporate capitalism
4) Information technology

The Concept has gained momentum with the publication of the reports of various commities. The significant reports are :

1) Report of the Cadbury Committee
2) Report of the CII Committee
3) OECD Code of Corporate Governance
4) Kumara Mangalam Birla committee on corporate Governance

The above committees and reports are related to USA, and UK and India, The recommendations of the groups may be explaind as under :

5.16.1. Cadbury committee report

A committee was set up under the chairmanship of Adrian Cadbury in May 1991 by the Financial Reporting council, the London stock exchange and the Accountancy profession to took into the financial aspects of corporate governance. The committee submitted its report for public-scrutiny in May 1992. The major recommendation of the committee are as under :

1) Decision making power shoud not be vested in a single person.i.e. these should be separation of the roles of the Chairman and chief Executive.
2) Non-executive derectors should act independently while giving their Judgment on issues of strategy, performance and designing codes of conduct.
3) A remuneration committee made up wholly or largely to non-executive directors, should decide on the pay of the executive directors.
4) The interium company report should give the balance sheet information and to be audited by the auditor.
5) There should be a professional and objective relationship between the board and the executives.
6) Information regarding the audit fee should be made public and there should be regular rotation of auditors.
7) A majority of directors should be independant non-executive directors i.e., they should not have any financial interests in the compnay.

8) The term of a director should not exceed three years. This can be extended only with the prior approval of shareholders.

5.16.2 CII Report :-

The liberalisation of Indian economy and the growth of international competetion made Indian industry recognise the importance of corporate governance for enhancing its ability to compete in the global market place. In the context, the Confederation of Indian Indsutry (CII) setup a national task force in 1996 under the Chairmanship of Rahul Bajaj, ex-president of CII. The recommendations made by the committee are as under:

1) The full board should meet a minimum of six times in a year and each meeting should have agenda that require at least a half day discussion.

2) Any listed company with a turnover of Rs. 100 crores and more should have professonally competent, independant, non-executive directors.

3) No single person should hold directorship in more than ten companies. This ceiling excludes directorships in subsidiaries.

4) For non executive directors to play a significant role in coporate decision making, they need to become active participants on the board.

5) While re appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present for 50% or more meetings, this should be explicitly stated in the resolution that is put to vote.

6) Key information that must be reported and placed before the board must contain annual operating plans, and budgets, capital budgets, manpower ad overhead budgets, quarterly results of the company, internal audit reports, details of defaults, joint ventures, labour problems and their proposed solutions etc.,

5.16.3 OECD Report :

In a meeting held on 27-28 April 1998, OECD ministers asked the OECD (Organisation for Economic Co-operation and Development) to develop a set of Corporate governance principles that could be useful to members and non-member countries. In June 1998, the OECD adbhoc task force was formed with representatives from all member cuntires, important international organisations including the world bank. This task force had representatives from the private sectors and labour representatives. Even though the principles are primarily aimed at Governments, they also provide guidelines to stock exchanges, investors, private corporations as they deal with best practices, listing requirements and codes of conduct. The principles given by the OECD group fall into the following five broad areas.

1) The protection of rights of shareholders is the key for effective corporate governance.

2) The Corporate Governance frame work should recognise the rights of stakeholders in creating wealth, jobs and financially sound enterprises.

3) The Corporate governance frame work should ensure that timely and accurate disclosure is made on all material matters regarding the financial situation, performance, ownership and governance of the company.

4) The corporate Governance should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

5) The Corporate Governance should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redressal for violation of their rights.

5.16.4 Kumaramangalam Birla Committee Report :

Kumara Mangalam Birla headed the committee appointed by the SEBI on May 7, 1999. The committee was formed to promote and raise the standards of corporate governance. The recommendations made by the Kumara Mangalam Birla Committee are as follows :

a) The board should have an optimum combination of Executive and non-executive directors and at least 50% of the board should comprise of Non-executive directors.

b) A qualified and an independant "Audit Committee" should be set up by the board of the company.

c) The board should set up a "Remuneration Committee" to determine the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.

d) To expedite the process of share transfers, the Board should delegate the power of share transfer to an officer or a committee. The delegated authority should attend to share transfers at least once in a fortnight.

e) The Corporate Governance section of the annual report should make disclosures on remuneration paid to directors in all forms including salary, bonus, benefits etc.,

f) The Board meetings should be held at least four times in a year with a maximum time gap of four months between any two meetings.

g) As a part of the disclosure related to Management, Management Discussion and Analysis Report should form part of the annual report to shareholders.

h) There should be a seperate section on Corporate Governance in the Annual Report with details on the levels of compliance by the company.

i) The half yearly declaration of financial performance including summary of the significant events in the last six months should be sent to each household of shareholders.

5.17 Corporate Governance

The different models of Corporate Governanance can be enumerated as under :

5.17.1 Traditional Model : The traditional model of corporate governance, which is the prevalent model in USA holds that shareholders' property rights are very important. The management of the Company is run through the elected board of directors. Management is concerned with production and their own rewards. This model relies on the ability of CEO to manage the company more efficiently.

5.17.2 Co-determination Model : This is a two tired system in which there is a division between supervision and management. This model was originated in Germany and has spread to many European countires.

This model implies that both Capital and labour should be represented in the process of corporate governance. Representatives of both ownership and the employeees comprise the board of directors . One version of this model promotes a two tires structure, with a supervisory board and a management board.

5.17.3. Other Models : The other important models include the following :

a) In the stakeholder model of corporate governance, all components that have a direct stake in the performance of a corporation are represented in the governance process.

b) The American Law Institute has proposed another model in which an independant board of directors will be functioning. The board would focus on auditing functions, reviewing management, and to assess the competency of CEO etc.,

5.18 Corporate Governance in India :

In India, the companies (Amendment) Act 2000, contains provisions which have a signficant impact on the business performance of companies. In accordance with the Act, the board of directors of a company shall have an optimum combination of executive and non-executive directors. Not less than 50% of the directors shall be non-executive . The remuneration of the non-executive directors shall be decided in the board meetings. The board meetings are to be held at least four times in a year, with a maximum time gap of four months between any two meetings.

Corporate Governance is considered as an important instrument of investor protection and it is therefore a priority on SEBI's agenda. To further improve the level of Corporate Governance, need was felt for a comprehensive approach at this stage of the development of capital market. This would ensure that the Indian investors are in no way less informed and protected as compared to their counter parts in the world.

5.19 Future of Corporate Governance :

Globally, Shareholders require reforms in the information on how companies are being run, Big investors require international standards in the performance of the companies relating to accounting clarity and disclosure. Boards of directors have been sued and found guilty for their actions. Significant changes have been taking place in the corporate regulation in the world. The efforts towards the adoption of international accounting standards in many countries had its impact on corporate governance. Stock exchange listing rules are being extended and tightened. Increasing recognition is being drawn to the processes, perceptions and powers of Directors.

5.20 Summary

Business ethics and Corporate Governance are the two concepts which have a significant impact on busines sector today. The managers have to adopt ethical principles in their decision-making. The increase in the number of corporate frauds called for application of ethical principles in decision making. The failure of the board of directors to provide transparency in the annual reports necessitated the emergence of a new concept called Corporate Governance. The role of Board of Directors, shareholders, stockholders etc., are clearly stated by a number of committees which are set up in different countries. In India, Kumara Mangalam Birla Committee report laid down certain guidelines for Corporate Governance.

5.21 Self assessment questions

1) Define business ethics. What are the factors which influence ethical values of managers?
2) What are the problems in decision making in ethics?
3) What is Corporate Governance? What are the reasons for the growth of corporate Governance concept?
4) Examine the evolution of Corporate Governance with the help of reports of various committees.

5.22 Further Readings :

1) VSP Rao and V. Hari Krishna, Management - text and cases, Excel Books, New Delhi, 2002.
2) K. Aswathappa, "Essentials of Business Environment" Himalaya Pub. House, Mumbai, 2000
3) Francis Cherumilam" Business Environment - Text and cases Himalaya Pub. House, Mumbai, 2003.
4) VK Bhalla and S. Shiva Ramu "International Business Environment and Management" Anmol Publications Pvt., Ltd., New Delhi, 2001.

LESSON : 6

ECONOMIC PLANNING AND STRUCTURAL - SECTORAL DIMENSION OF INDIAN ECONOMY

Objectives :

The main purpose of this lesson is to help you to

understand the objectives and assesment of Five year plans in India.

* provide insights into the structural dimensions of Indian economy.
* analyse the growth and perfermance of public sector in India.
* asses the role of private sector, joint sector and co-operative sector in India.

STRUCTURE :

6.1 Introduction

6.2 Objectives of economic planning in India

6.3 Assesment of Five Year Plans

6.4 Structural dimensions of Indian economy

6.5 Structure of Indian Industry

6.6 Public Sector

6.7 Growth of public Sector enterprises

6.8 Objectives of Public Sector

6.9 Significance of Public Sector

6.10 Performance and Problems of Public Sector

6.11 Policy Changes in Public Sector

6.12 Role of Private Sector

6.13 Problems and limitations of Private Sector

6.14 Role of Joint Sector

6.15 Prospects for Joint Sector

6.16 Co-operative Sector

6.17 Problems of Co-operative Sector

6.18 Summary

6.19 Self assesment Questions

6.20 Further Readings

6.1 Introduction

In this lesson, the objectives of economic planning, assessment of various plans in India, the structural & sectoral dimensions of Indian economy with reference to savings, investment, contribution of public, private co-operative and joint sectors are highlighted.

6.2 Objectives of Economic Planning in India

Just after the attainment of Independance, the Government of India set up the planning commission in 1950 with Prime Minister as the Chairman, to asses the country's needs of material capital and human resources so as to formulate plans for their more balanced and effective utilisation. The first five year plan commenced in 1951 and it was followed by a series of Five year plans. The Government adopted planning as a means of fostering economic development. The planning commission set out the following four objectives of planning:

1) to increase production to the maximum possible extent so as to achieve higher level of natural and per capita income.
2) to achieve full employment
3) to reduce in equalities of income and wealth
4) to set up a socialistic society based on equality of justice and absence of exploitation.

Apart from the basic objectives, each Five year plan takes into account the new constraints and possibilities faced during the period and attempts to make the necessary directional changes and emphasis.

6.3 Assesment of Five Year Plans :

In this unit, the approach to each plan, and the assesment of each plan are discussed. At the time of first five year plan (1951 - 56) India was faced with three major problems Viz., inflow of refugees, severe food shortage, and mounting inflation. India had also to correct the disequilibrium in the economy caused by the Second World War (1939-1945) and the partition of the country. Accordingly, the first plan emphasised as its immediate objectives, the rehabilitation of refugees, rapid agricultural development so as to achieve food self sufficiency in the shortest possible time and control of inflation. Simulataneously, the first plan attempted a process of balanced regional development which would ensure a raise in national income and a steady imporovement in the living standards of people over a period of time. The first Five year plan was a great success as the production targets especially in the agricultural sector were more than fulfilled and the objectives were more or less realised. The Second five year plan (1956-61) was conceived in an atmosphere of economic stability. Since the targets fixed for the first five year plan were achieved, the basic philosophy of Second five year plan was therefore to give a big boost to the economy so that it enters the take off stage. The second plan aimed at rapid industrialisation with particular emphasis on the development of basic and heavy industries. The more ambitious second plan could not be implimented fully because of the acute shortage of foreign exchange. Besides, the country started experiencing rise in prices. Hence, the second five year plan was considered as moderately successful.

By the beginning of third five year plan (1961-66) the Indian planners felt that the economy had reached the take off stage. As a result, the third five year plan aimed at self reliant and self generating economy. However, because of India's conflicts with China in 1962 and with Pakistan in 1965, the approach of the third plan was later shifted from development to defence and development. The third five year plan was thorough failure as the country suffered one of the severest famines in hundred years during the last year of the plan. The failure of the third plan led to the postponerment of the fourth five year plan which is called plan Holiday. During 1966-69, three Annual plans were implemented. The Fourth plan (1969-74) set before itself two principal objectives “growth with stability” and “progressive achievement of self reliance”. The rapid rise in prices from the middle of 1972 completely upset the cost calculation of the fourth Plan development projects. Above all, the country had to cope up with huge influx of refugees from Bangladesh and Indo-Pakistan war of 1972. The fourth plan failed after the mid-term. The fifth five year plan (1974-79) was introduced to achieve two main objectives Viz., removal of poverty and attainment of self reliance. These are expected to be achieved through promotion of higher rate of growth and an increase in the domestic rate of saving. The fifth plan was terminated by the Janata party at the end of the fourth year of the plan. The fifth plan cost calculations based on 1971-72 prices proved to be completely wrong. Moreover, after the promulgation of emergency in 1975, the emphasis was shifted on the implementation of the Prime Minister’s 20 point programme.

There were two Sixth Five year plans. The first was introduced during 1978-83 and the objective was to increase employment opportunities in the agriculture and allied activities through a minimum needs programme. The second was introduced during 1980-85 by aiming at a direct attack on the problem of poverty by creating conditions of an expanding economy. During the sixth plan period, the economy achieved all round progress. The seventh five year plan (1985-90) sought to emphasise policies and programmes which would accelerate the growth in food grains production, increase employment opportunities and raise productivity. This plan was heralded as great success since the Indian economy recorded a growth rate of 6% against the target 5%. The decade of eighlites witnessed a creditable average annual rate of growth of 5.8% as against the average of 3.5% in the previous five year plans. The Indian economy is stated to have crossed the barrier of what was called as “The Hindu rate of growth” by Prof. Raj Krishna. The Eighth five year plan was delayed by two years and was finally introduced during 1992-97 was approved at a time when the country was going through a severe economic crisis caused by balance of payments, accumalating debt burden, mounting inflation and recession in the industry. The Government initiated economic reforms with a view to provide a dynamism to the economy. During this five year plan, India registered the highest annual rate of growth of 6.8% with the adoption of economic reforms, the importance of private sector has increased and the market showed movement towards market based economic system.

The ninth five year plan (1997-2002) had its focus on “Growth with Social Justice and Equality” It had four important dimensions Viz., improving quality of life, generation of productive employment, regional balance and self reliance. The assessment of the plan reveals that it was silent on price policy and has not aoutlined a framework for controlling prices, which is the main cause for the phenomenal rise in administrative and other expenditure of the Government. The tenth five year plan (2002-07) is targeted at achieving a 8% GDP growth for the period and aims at improving the social sectors of the economy like education, health, drinking water, roads, sanitation, employment and other infrastructure. The tenth plan stated its objectives to be growth, equity and sustainability. The Government has to tackle the various unsolved social problems which will lead to the attainment of econamic objectives. The priorities and outlays of the five year Plans are shown in the following table :

Table : Priorities and Outlays of Five Year Plans

Plan	*Priority*	*outlay (crores)*
I	Agriculture	3870
II	Industries	7900
III	Self reliance	11600
IV	Growth with Stability	24880
V	Poverty	53410
VI	Poverty	158710
VII	Food, work & productivity	322366
VIII	Employment	798000
IX	Social Sectors	875000
X	Improvement in quality of life	19,68,815

Source : Reports of the planning commission Government of India.

6.4 Structural dimensions of Indian economy :

Economic development - has brought out a structural change (change in sector shares of national income) in the economy. This is evident in the form of a shift in the sectoral composition of production, diversification of activities and a gradual transformation of the economy into a modern industrial economy. The composition of gross domestic product has changed steadily during the planning era. While the share of agriculture and allied activities fell from 54.91 percent during the first plan to 30 percent during Ninth Plan period, the share of manufacturing increased from 11.88 percent during the first five year plan to 30 percent during Ninth Plan period. The share of service sector has considerably gone up to 40 percent during the same period. The expansion of service sector has not only been conductive for employment generation but also for better efficiency of the system and better quality of life. It is normally observed that one of the structural changes that took place in the course of economic development is a progressive shift of labour from agriculture and allied activities to secondary and teritory sectors. The economic development of any country is also influenced by rate of capital formation which is influenced by rate of savings and domestic capital formation.

A serious concern for the Indian economy since the middle of the second five year plan period has been the upward trend in the price levels. The price trends are related to trends in money supply and budget deficits of Governments. The imbalance between the demand for and supply of wage goods, particularly food, ushered the rise in prices in early 1960's and several other factors have made inflation a persistent feature of the Indian economy. The money supply in the Indian economy has grown considerably. The money supply in the economy is denoted by RBI as under :

M1 = currency with public and demand deposits with banks and RBI

M2 = M1+Post office savings deposits

M3 = M1 + Time deposits with banks

M4 = M3 + total post office deposits

Another component of the structural doimension of Indian economy is related to demographlic trends and structure. The main problem in India is the high level of birth rates and falling death rates. The rate of growth of population which was about 1.3 percent per annum during 1941-50 increased to 2.2 percent by 2001-02. The fast rate of growth of population implies low per capita GNP growth rate. Age structure of the population is an important demongraphic dimension. Rapid population growth implies high dependancy ratio The people in the age group of 0-14 and above 60 will create pressure on the economy for their needs. Rural-urban composition of population has its impact on the structure of the economy. The composition of population in rural areas has been steadily decreasing and the population in urban areas has been increasing. The quality of population can be examined by factors like life expectancy, level of literacy and the level of technical training attained by people in a country. The literacy rate has gone up from 18.2 percent in 1951 to 56.2 percent in 2001. Life expectancy at birth has gone up from 41.2 percent in 1951 to 60.8 percent by 2001.

The structural features of Indian economy can be explained as under :

1) Agriculture continue to dominate the Indian economy. More than 30 percent of national income still comes from Agriculture.

2) In terms of employment, it is in Agriculture sector, more than 65% of the work force are employed.

3) Rapid population growth largely because of fast decline in death rate and a very slow decline in birth rate is another feature of Indian economy with adverse consequences.

4) The government has been depending more on deficit financing, is another important feature of Indian financial system.

5) A steady increase in non-developmental government expenditure has been a significant factor which is of serious concern.

6) The revenue from indirect taxes is very high to the extent of about 77 percent and the share of the direct taxes is only about 23 percent.

However, in respect of various indicators of development, India achieved significant progress although the country is still to go a long way in achieving the standards of more affluent countries.

6.5 Structure of Indian Industry

As industrial development has been taking place in the economy, several structural changes took place in the industrial sector. The industrial development in the Indian economy can be understood in the following stages :

1) In the first stage, industry was concerned with the processing of primary products like grains. extracting oil, spinning vegetable fibres, preparing timbers and smelting ores.

2) In the second stage, industrial development concentrated on products like footwear, cloth, furniture, and paper etc.,

3) In the third stage, manfacture of machinery and other equipment was undertaken.

The heavy industry strategy was implemented from the second five year plan assisted in creating a strong industrial base. Gradually importance has been given to basic and capital goods industries as a result, index of industrial production increased considerably from 23.3 percent in 1970's to 39 percent in 1990's. During the same period, the importance of basic and capital goods increased and that of consumer goods industries decreased. The size of an industrial unit is another dimension. This is measured by output, total assets, fixed capital and employment etc., Cmplete seperation of situations for large and small scale industries with respect to these criteria cannot be made. In the Indian industry, large scale and small scale production has been taken up simultaneously for ex : engineering cloth and shoe making etc.,

The ownership pattern in the industrial sector reveals that the industry consists of four types :

1) Public sector - includes enterprises of central, state and local governments.
2) Private sector - includes corporate enterprises, partnership, individual proprietor ships, etc.,
3) Joint sector - includes enterprises owned jointly by public and private sectors.
4) Co-operative sector - includes industries established under co-operative philosophy.

Regional distribution of industrial activity and industrial concentration are two more dimensions of the industrial sector in the country. Few states like Maharashtra, Tamil Nadu, Karnataka, Punjab, Uttar Pradesh registered a hight industrial growth while the remaining states are not industrially developed. Some of the industrial groups Tatas, Birla's, Scindia, Reliance etc., have dominated the Indian industry.

The process of industrialisation, initiated as conscious and deliberate policy under Industrial Policy Resolutions of 1948 and 1956 involved heavy investments in basic and heavy industries. The progress made in respect of industrial sector is clearly reflected in the commodity composition of India's foregin trade. The rapid progress in industrialisation has been accompanied by a corresponding growth in technological and managerial know-how for efficient operation of the most modern industries and also for planning, designing and construction of such industries.

6.6 Public Sector :

The industrial development in India is planned to be achieved with active participation of government in the form of public sector and private enterpreneurs in the form of private sector. The industrial policy resolution 1956 gave the public sector a strategic role in the Indian economy. The investment in big and heavy industries and provision of infrastructure facilities, was felt necessary. As these cannot be generated from private sector, it was assumed that the government intervention in a big planned way would accelerate agricultural and industrial production expand employment opportunities and reduce poverty etc., The public sector was thought of as the engine for self-reliant economic growth to develop a sound agricultural and industrial base, diversity the economy and overcome economic and social backwardness. In addition to these, the investment in strategically important sectors like Railways, Telecommunications and Nuclear Power, Defence etc., and to monitor the performance of the private sector were also found to be necessary for the intervention of the government.

6.7 Growth of public Sector Enterprises :

The public sector enterprises were started by central, state and local governments. At the central level, the central government owned industrial undertakings. At the state level, state governments and at local level, local governments owned industries. The central government owned industries are running in four different forms :

i)	Departmental undertakings	(Railways, Telecommunication)
ii)	Public corporations	(LIC, GIC, NTPC, ONGC)
iii)	Public limited companies	(BHEL, ECIL etc.)
iv)	Independant boards	(Coffee Board, Tea Board, Tobacco Board).

At the States level also, the same type of ownership pattern are found. According to the latest data available, the number of Central Public Sector enterprises are 240 in number with an investment of about Rs.

2,30,000 crores. At the states level, as per the information compiled by the Institute of public enterprises (IPE) there are about 1100 enterprises which are functioning in 24 states with an investment of about Rs. 50,000 croses. The growth of central public enterprises can be shown as under.

Table : Growth of public sector enterprises

As on March 31	No. of Units	Total investment
		Rs. in crores
1951	5	29
1961	47	950
1980	179	18150
1990	244	99330
1999	235	273700

Source : Public Enterprise survey, Burea of Public Enterprises, Government of India,

In order to encourage public sector, heavy investments were made in the public sector, so as to facilitate process of industrialisation in the country. The analysis across investments in different groups indicate the following :

Table : Investment in different groups

Group of Industries		*Investment (crores)*	*% of total*
1.	Construction	4,144	1.8
2.	Production and selling goods	1,57,776	68.6
3.	Producing services	68,220	29.6
	Total	**2,30,140**	**100.00**

Source : Public Enterprise survey, Burea of Public Enterprises, Government of India,

6.8 Objectives of Public Sector :

The objectives of establishing public sector and promotion of it in India includes the following :

a) to promote rapid economic development through creation and expansion of infrastructure

b) to promote exports and to substitute imports.

c) to accelerate balanced regional growth.

d) to generate financial resources for development

e) to redistribute income and wealth;

f) to improve employment opportunities.

6.9 Significance of public sector :

The contribution of public sector to the Indian economy can be presented as under :

a) National income : The public sector enterprises account for one fourth of GDP. During the forty years after independance, these enterprises have doubled their share to GDP. Measured at current prices, public sector accounted for 7.5% of NDP in 1950-51, had risen to 23.0% in 1996-97. This is largely due to a rapid expansion of the public sector enterprises. The government ownership in civil aviation, defence equipment, indigeneous crude oil production is 100%. Increasingly industries of strategic and national importance are being kept under state ownership. However, in agriculture and small scale industries the contribution of public sector is almost negligent.

b) Generation of employment : One of the major problems faced by Indian economy has been related to growing unemployment. The organised sector's contribution to employment generation is 90% out of which public sector alone contribute 78% and share of private sector is 22%. The average annual growth rate of employment in the public sector is about 4.3% where as it is 2% in private sector. The public sector has done well as a model employer. The role of public sector in providing employment to millions of people is highly commendable.

c) Capital formation : Another important role of public sector has been capital formation. A major part of the public sector investment is in the areas of roads, buildings, irrigation works, bridges, railways, iron, steel, power, oil exploration etc., These areas are capital intensive in nature. The projects in the public sector have long gestation periods. The share of the public Sector to gross capital formation increased from 3.5% in the first plan to 9.2% by the end of eighth plan.

d) Balanced Regional Development : Indian economy is characterised by vast regional differences in the areas of climate, resources, demography etc., These differences have resulted in the regional disparities. The public sector enterprises have a major role to play in setting up of large industries in the backward areas. The private sector does not consider the objective of balanced development of the country.

e) Industrialisation : Industrial development or growth is the parameter for economic development. The massive expansion of public sector enterprises had yielded positive effects on the economy in the aspects of increased export earnings, advanced technology, higher contribution to exchequer and an overall increase in the style and level of living of the people in India. The products produced by public sector include a wide range from air crafts, ships, railwagons, teleprinters, computers, telephone cables, industrial motors, oil, gas, petroleum products, and chemicals etc.,

f) Export promotion and import substituion : There are few public sector enterprises which have contributed to promote India's exports. The state trading corporation (STC) and the Minerals and Metals Trading corporation (MMTC) have promoted Indian exports to various countries in the East Europe. The foreign exchange earnings have gone up from Rs. 35 crores to Rs. 18,827 crores by 1998-99. Some public sector enterprises have started producing goods which are earlier imported. The Indian Drugs and pharamaceuticals Ltd., Oil and Natural Gas Commission, Bharat Electronics Ltd. have reduced the dependance of the country on imports.

6.10 Performance and Problems of Public Sector :

The performance of the public enterprises is difficult to assess as the public sector is functioning with multiple socio - economic objectives like profitability with employment generation. However, the financial performance of the public sector indicates that only 10 enterprises are making profits while the remaining 225 have been incurring consistent losses. The profit making enterprises include Indian oil corporation Ltd., oil, Hindusthan Petroleum corporation Ltd., Bharat Petroleum corporation Ltd., Steel Authority of India, Oil and

Natural Gas Corporation Ltd., Videsh Sanchar Nigam Ltd., Bharat Heavy Electricals Ltd., and Gas authority of India Ltd., etc. The reasons for the poor performance of public sector can be explained as under :

1) Accumalation of losses : A review of the working of the public enterprises reveals that they are making huge losses. Out of 235 central public enterprises, only 10 are making profits and the remaining are incurring losses. The performance of public enterprises in different states also reveals the same. State Electricity Boards, State Road Transport undertakings and state owned companies have accumalated huge losses. Out of 10 public sector enterprises which are making profits, majority of them are petroleum companies which are contributing to 65% of the profits. The Government should therefore make an analysis of the loss making enterprises and take necessary action in this regard.

2) Intervention by political parties : Majority of the decisions in the public sector are being influenced by political parties in the centre and states. The decisions relating to establishment of factories at different places which is prompted by political parties is contributing to increase in the project costs. This also leads to wastage of precious natural resources.

3) Delay and high costs : Most of the central and state public enterprises have been delayed for many reasons which has resulted in high costs. In a survey in Economic Times it was reported that 21 percent power projects costing more than Rs. 100 crores each with a total anticipated investment of Rs. 8865 crores had been delayed for reasons such as delay in the acquisition of land, supply of critical equipment and materials, law and order disturbances, forest clearance and difficult geological conditions. Besides the increase in project costs, the other consequences of delay are the costs of output and employment foregone during the period of delay, the cost of inter - sectoral inbalances, and the impact of inflation etc.,

4) In effeciency in Management : The Management of Central government enter prises are generally in effective. Some of the reasons for this sistuation are bureaucrats with no administrative experience are appointed in key positions, decisions are not allowed to be taken on pure commercial aspects, and delay in the appointment of executive together with uncertainity in the tenure.

5) Multiplicity of Trade unions : In many of the public sector enterprises, there are a number of trade unions which resulted in the inter and intra union rivalry. According to a report, in Singareni Colleries 19 trade unions were there. When they went on strike in 1993, the production loss was 15 lakhs tonnes and mandays lost were 14 lakh. The Union rivaries promote industrial disputes and have a negative effect on the performance of the company.

6) Idle capacity : Many public sector enterprises have excess plant capacities. The plants are operating at below capacities resulting in increase in overheads and wages. Out of public sector enterprises, nearly 60% of the units have recorded a capacity utilisation of more than 75%.

7) Other reasons : The other reasons for the poor performance of the public sector enterprises may be as under :

a) Wrong choice of locations of public sector enterprises has lead to the escalation in costs.

b) Poor quality products, raise in costs, higher social costs, corruption etc., have hampered the performance.

c) The atittude of employees is another contributing factor for the missmanagement of public enterprises.

6.11 Policy changes in public sector :

To improve the peformance of public sector enterprises, the government of India announced major policy changes in July 1991. These changes include the following :

a) A review of the port folio of public sector investments will be made with a view to focus the public sector on strategic, high tech and essential infrastructure.

b) The public sector enterprises which have become continuously sick will be referred to the BIFR (Board for Industrial and Financial Reconstruction). A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.

c) A part of the shareholding in the public sector would be diverted to mutual funds, financial institutions, general public and workers.

d) The boards of public sector companies would be made more professional and given greater powers.

e) The managements will be granted more autonomy and will be held accountable. A memorandum of understanding will be implemented to make the negotiation more effective.

A part from the above measures, the following steps are taken to improve the performance of public sector :

i) to remove excess employees in the public sector, a VRS (voluntary retirement scheme) was introduced and implemented.

ii) to divert shares of public sector, a committee was set up under the chairmanship of C. Rangarajan in November 1992 to suggest guidelines for disinvestment.

6.12 Role of private sector :

Private sector or private enterprises refer to all types of individual or corporate enterprises which are characterised by ownership and management in private hands with personal initiative and profit motive. In the early 18th and 19th centuries, private sector units were completely left out of government intervention. As the Government intervention in business has increased, the role of private sector is restricted. In India, the industrial policy resolutions 1948 and 1956 have clearly demarked the role of public and private sectors. The private sector was considered as the most suitable to industries which involved limited risk and short gestation periods. The growth of private sector in Indian economy may be explained with the help of the following table.

Table : Growth of Private sector in India

	1957	1971	1999
No. of non-Government companies	29283	30,008	5,10,821
Paidup capital			
(Rs. in crores)	1010	2440	1,40,257

Source : Rudradvtt & KPM Sundaram, Indian Economy P. 197, 2000 edition.

The private sector has been playing a significant role in the Indian economy which may be outlined as under :

1) Economic progress : Even prior to independance the economic progress in India was due to the private sector. Tatas, Birlas, Scindias, Mafatlal's have played a significant role in the industrial development of the country. These were many industries which started producing iron and steel, chemicals, paints, plastics, machine tools, metals and rubber etc., India has become self - sufficient in consumer goods.

2) Agricultural development : The agricultural sector in India is a primary sector which contribute nearly 30% to GNP and provides employment to nearly 70% of the population. The private sector in India in the field of agriculture and other allied activities such as dairying, animal husbandary and poultry etc., has contributed to the overall agricultural development in the country.

3) Trading Activities : The private sector has been making tremendous progress in the trading activities like wholesale and retail. However, in times of scarcity, the private traders have resorted to hoarding or black marketing. The government has attempted to control and regulate private trade through imposition of controls. Even in the international trade, the government made efforts to improve trade with institutions like STC, MMTC etc., The private sector in India still dominated the trading sector in the country.

4) Small Scale and cottage Industries : The small scale and cottage industries are in the private sector only. The small scale industries are providng employment opportunities and also are useful for utilisation of both human and physical capital. The government took various financial and non financial incentives for the promotion of small scale sector in India. The important fact that needs to be emphasized is that the small and cottage units would continue to remain and prosper in the private sector alone.

6.13 Problems and limitations of private sector :

The problems and limitations of private sector include the following :

1) The private corporate sector emphasises on non-priority sectors and profit making goods

2) The large expansion of private sector leads to concentration of economic power.

3) In the private sector, the industrial disputes are more and the industrial relations are poor.

4) Another common feature of private sector is growing industrial sickness.

5) Procedural delays are common in many developing countries in private sector because of heavy regulations of government.

6) Unrealistic controls are imposed by the government on private sector which will not give any in centive for additional production.

7) The private sector has been facing a problem of shortage of finance and the problem is more acute for small units.

The industrial policy of 1991 has liberalised the economy through which the role of public sector is regulated and controlled. The controls are removed in case of private sector. A greater role for private sector is envisaged by removing barrers and controls through a more liberalised approach.

6.14 Role of Joint Sector :

The concept of joint sector came into existence with the industrial policy resolution of 1956. After the industrial policy resolution of 1956, a number of companies were started by Government of India in collaboration with private sector by sharing ownership, management and control. for ex : Cochin Refiniries, Madras Fertilisers, Gujarath State fertilizer company etc., The share of the government of India is more than 50% in these companies. The industrial licencing policy Enquiry committee (also known as Dutt committee) recommended the creation of joint sector in India. Tata Memorandum on Industrial growth also hinted at joint sector with domination of private sector, Since the Dutt committee report was published in 1969, a number of State governments have obtained licenses for industrial projects with private participation in ownership and management. Many of them are medium sized enterprises and have been set up in collaboration with less known private firms. They have been encouraged by the idea of industrial growth.

6.15 Prospects for joint sector :

The prospects for joint sector can be enumerated as under :

i) The joint sector is expected to acquire an antmonopoly role and control the expansion of the leading large industrial houses. The sector can be used to promote socio economic objectives of the government.

ii) Both public and private sectors have shown certain limitations. The public sector was given exclusive responsibility in key sectors and private sector is known for initiative and enterprise. Hence a mix of the both sectors is necessary for speedy economic development.

iii) The sharing and control of management would control the power derived by the large industrial houses and enable the government to regulate the functioning of these enterprises.

iv) The concept of joint sector is a method of bringing about a balanced pattern of investment which will result in social orientation in the utilisation of private investible surpluses.

v) The joint sector can mobilise equities to about 50% as the share of the government and public financial institutions is 25% each.

vi) The joint sector as the industrial base of the economy can create a large pool of techno - managerial and organisational expertise in the process.

The concept of the joint sector is a compromise between the alternatives of total nationalisation and free enterprise economy. The implementation of the joint sector is an instrument to further the professed goals of social policy.

6.16 Co-operative Sector :

In India the co-operative sector has been assigned an important role in the development of many sectors. The first five year plan envisaged the co-operative sector to cover a number of important areas like agriculture, rural and small scale industry, retail distribution, housing etc., The important objectives of the development of the co-operative sector are prevention of concentration of economic power, wider dispersal of ownership of productive resources, active involvement of people in the development programmes, augmentation of the productive resources and speedier economic development liquidation of unemployment and poverty etc.,

The co-operatives took a concrete shape in India for the first time in 1904, when the co-operative credit Societies Act was passed. It was followed by the co-operative socities. Act in 1912 which provides for the registration of non-credit societies as well as federations of co-operatives. The primary agricultural credit societies cover about 96 percent of the rural areas. The national federation of industrial co-operatives was set up which assists in the marketing of the products of member societies. The Indian Farmers Fertiliser Co-operative Ltd., (IFFCO) is a unique venture of the co-operative movement in India in the field of large scale fertiliser companies besides these, a number of other co-operative institutions were set up for different purposes. These include :

1) The National co-operative development corporation which is responsible for planning, promotion and financing of the storage capacity of the co-operatives at various levels.

2) The National Agricultural co-operative marketing federation which represents the co-operative marketing societies promotes inter-state and export trade of farm products.

3) There are also a very large number of primary housing co-operatives in the country.

4) Other co-operative societies include National Agricultural Co-operative marketing Federation. All India State Co-operative Banks Federation, National Co-operative Dairy Federation and the National Federation of co-operative urban banks and credit societies which are functioning in the country.

6.17 Problems of Co-operatives :

The co-operative sector in India faces many problems which include :

1) There are wide regional disparities in the progress of co-operatives in India.

2) Many co-operative societies have become virtually non-functioning.

3) Financial, organisational and administrative problems also affected the working of co-operative sector in India.

4) The influence of political parties are co-operative societies adversely affected their functioning.

6.18 Summary

Ever since India achived Independance, the Government of India implemented Fiver year Plans for achieving economic and social objectives. Accordingly plan priorities are fixed, investments are made. The main components in the development of the economy are public, private, joint and co-operative sectors. The industrial policies of 1948 and 1956 have laid due emphasis on the development of these sectors. While the public sector showed rapid expansion, it has been burden on the exchequer with mounting losses. Hence the public sector is given a new direction since 1991. The private sector which has been controlled, and regulated by government has been given more freedom after 1991. The functioning of joint sector and co-operative sector have not been satisfactory.

6.19 Self Assesment Questions :

1) What are the objectives of economic planning in India? To what extent they are achieved?

2) Explain the structural dimensions of Indian economy?

3) Discuss the objectives and role of public sector in India?

4) Assess the performance of the public sector and identify the reasons for it?

5) Elaborate the role of private sector in the development of Indian economy?

6) How joint sector played an important role in the Indian economy?

6.20 Further Readings :

1) Francis Cherumilam “Business Environment - Text and cases” Himalaya Publishing House, Mumbai, 2003.

2) AN Agarwal “Indian Economy - Problems of Development and Planning” Wishwa Prakasam, New Delhi, 20th Edition.

3) K. Aswathappa “Essentrals of Business Environment” Himalaya Pub. House, Mumbai, 2000.

4) Ruddar Dutt and K.P.M. Sundaram “Indian Economy” Sultan Chand & Co. Ltd. New Delhi, 2000.

LESSON - 7

PRIVATISATION

Objectives:

The main purpose of this lesson is to help you to

- understand the concept, nature and objectives of privatisation
- study the trends of privatisation in the world and in India
- make an analysis of the benefits and consequences of privatisation
- provide arguments against privatisation and to present committees on privatisation in India.

STRUCTURE:

7.1 Introduction:

In view of the increasing globalisation and liberalisation, privatisation has become an agenda for Governments in many countries in the world including India. Though the process of privatisation may vary in different countries, it is important to study the implementation of various theoretical principles in the sphere of privatisation undertaken in India to find out the possible consequences of privatisation in the Indian economy with reference to restructuring public enterprises.

7.2 Meaning and Scope of Privatisation:

Privatisation refers to the induction of private ownership in publicly owned enterprises. It can be defined as “the process of involving the private sector in the ownership or operation of a state owned enterprise”. It covers three areas which include:

(a) ownership measures

(b) organisational measures

(c) operational measures

(a) The ownership measures includes transfer of ownership of public enterprises, fully or partially. This can be done in the following ways:

i) total denationalisation which implies a complete transfer of ownership of public enterprises to private sector

ii) joint venture through which partial introduction of private ownership

iii) liquidation which implies sale of assets to some one who may use it for the same purpose or different purpose.

iv) Management buyout which implies sale of assets to the employees

(b) Organisational measures are expected to take the following forms:

i) A holding company structure in which the Government limits its control to apex level decisions.

ii) Leasing strategy through which the public enterprise may lease out to a private bidder for a specific period for use.

iii) Restructuring which is normally done through financial restructuring, and basic restructuring. Under finanacial restructuring. the accumalated losses are written off and capital composition is rationalised. Under basic restructuring, the public sector enterprise may give some activities to be taken up by ancilliary or small scale Units.

(c) Operational measures are intended to improve the efficiency of the organisation. They include grant of autonomy to public enterprises in decision making, provision of incentives to employees, development of proper investment criteria, permitting the public enterprises to go to the capital markets etc.,

The above measures are related to transfer of ownership, managerial control of the public enterprises to private hands. Another form of privatisation which has been adopted by the Government of India is disinvestment of shares. The Central Government has been with drawing a part of its share from the public enterprises and facilitated the private sector to fill up the part with their share.

7 . 3 Privatisation in other countries:

The term Privatisation has been recently introduced in the economics. It was Peter F. Drucker who used the term in his book “The age of Discontinuity” in 1969. Nearly after a decade, the practical shape of Privatisation took place in Britain under the Prime Ministership of Mrs. Margaret Thatcher. The wave of economic reforms implemented in USSR under the term “Perestrokia” swept the economics of Eastern Europe. The much aggressive economy like China had to yield to economic reforms during 1980’s. Later many countries started their efforts to privatisation to revive their economies by encouraging private sector to improve efficiency and productivity of capital. Another significant aspect of privatisation is that the countries have to adopt measures towards privatisation as they were getting pressure from World Bank, IMF and other financial institutions. In a large number of Asian and African countries, the continuous losses of public enterprises forced Governments to move towards privatisation. Today, privatisation has become a key word which is used to explain the process of economic reforms in any country.

7 . 4 Nature and objectives:

Privatisation may be understood as the process whereby activities which are performed by Government and its employees are being performed by private individuals and sector. This process is done to yield better results in terms of cost and quality of service. Privatisation also provides results in terms of efficiency, quality and creativity in the distribution of goods and services. The purpose of privatisation is to replace the performance of public sector with private sector. There are a wide variety of techniques which are used in privatisation. The objectives of privatisation include the following:

(a) to improve the financial performance of public sector undertakings to reduce the burden on tax payers.

(b) To increase the size and dynamism of private sector in terms of distributing ownership more widely in the economy.

(c) To encourage and facilitate both domestic and foreign investments.

(d) To generate revenues for the state and to reduce administrative burden on the State.

(e) To transform the economy from public dominated to market dominated.

(f) To popularise the private sector in the economy.

7 . 5 Approaches to Privatisation:

The various approaches to privatisation can be explained as under:

1) Sale to outside parties: In this approach, the public enterprises are sold to outside parties which is also called disinvestment of shares. This approach can be beneficial as it provides adequate return to the firm and to the real owners who possess the expertise and incentives. The difficulties involved in this approach are lack of adequate domestic capital, resistance from managers and employees and difficulty of evaluating and negotiating deals etc.,

2) Buy out to employees: Buy out to employees is another alternative approach which has been practised in few countries. This approach may lead to better corporate governance as the employees have better access to information than outsiders. The limitations of this approach include the benefits are snot equally distributed and the employees in profit making firms get valuable assets and loss making firms get less value. Another limitation is that the insiders do not bring new capital or skills.

3) Voucher Privatisation: In this form of privatisation, Vouchers are distributed across population and attempts to allocate assets equally among Voucher holders. This type of programmes excel in speed and fairness. This approach does not provide any policy implications for the administration of the companies. Few countries implemented this approach.

4) Spontaneous Privatisation: This approach is relatively easy when compared to other approaches. This approach is normally adopted by small firms. The main advantage of this approach is that it has greater fairness in implementation. Russia implemented privatisation through this approach.

7. 6 Efforts of Privatisation in India:

Though the attempts towards privatisation were made in the 1980’s, they could not took a shape till Rajiv Gandhi assumed power in 1984 after the death of Smt. Indira Gandhi. Even during the reign of Rajiv Gandhi, none of the political parties were in favour of the privatisation. It was only the New Industrial Policy (1991) which translated the ideas of Rajiv Gandhi towards privatisation. Later, the efforts made by Government to privatise Scooters India Ltd., and UP State Cement Corporation failed because of the emergence of strong trade

Unions in India. Finally, the Government has been able to transfer the ownership of some public sector units to private sector. For ex: Allwyn Nissan, a public sector enterprise of AP Government has been handed over to Mahindra Maharashtra, scooters was handed over to Bajaj Auto. Recently the disinvestment in various public sector undertakings like GAIL, MTNL, CONCOR, ET&T, HCIL and NALCO was implemented. In case of some enterprises, strategic sales are recommended in case of BALCO, ITI, ITDC, HCL, SCI, HPL, IBP, FACT, IPCL, NFL and SAIL etc.,

7.7 Arguments against Privatisation:

There have been many criticisms levelled against privatisation, based on economic, social, political, managerial and rational aspects. The important arguments against privatisation can be as under:

1) The public sector has been developed to achieve certain economic and social objectives and privatisation dilutes them.
2) Concentration of economic power is possible through privatisation which is detrimental to the balanced economic growth of the country.
3) The role of foreign and multinational firms will increase in the economy which leads to domination of foreign companies in the economy.
4) Privatisation of profitable enterprises, including potentially profitable, means foregoing future streams of income for the Government.
5) There are well managed and ill managed firms both in the public and private sectors. It is based on the quality and commitment of management the undertakings are to be privatised.
6) The privatisation has only one objective i.e. to achieve maximum profits and the welfare of the society is ignored.
7) The privatisation of public sector undertakings results in loss of jobs and a threat for job security.
8) The capital markets in developing countries are not adequately developed so as to implement privatisation more effectively.
9) Privatisation of strategic and vital sectors will be against to the interests of the nation.

7 . 8 Benefits of Privatisation:

The benefits of privatisation may be listed below:

1) It helps to reduce the fiscal burden of the Government as the funds are mobilised from private sector.
2) It enables the Government to accumulate funds for the developmental activities of the economy.
3) Since the Government hands over the management of the industry to private sector, it helps to reduce the size of bureaucracy.
4) As major part of the industry is out of Government hands, the Central Government can concentrate on improving the centre - state relations and other developmental activities.
5) It helps to accelerate the pace of economic development as it attracts more resources from the private sector for development.
6) The growth of entrepreneurship is essential for any economic development of any economy. The potential entrepreneurship ccomes only from private sector.
7) As the management of the enterprises requires professional skill and qualities, these are obtained through involvement of private sector only.

8) Privatisation provides many benefits which include correct macro economic imbalances, increase competition and market discipline.

9) The society and the consumers are largely benefitted by privatisation as it provides qualitative products at competitive prices.

10) The decision making in private sector is quick and at proper time as bureaucratic procedures are avoided as in the case of public sector.

7.9 Problems in implementing Privatisation:

The general and specific problems in implementing privatisation can be stated as under:

1) In the absence of proper strategy for privatisation of industries / units, method of privatisation, extent of disinvestment, selection of buyers, the privatisation efforts may not yield proper results.

2) For the decision to implement privatisation, the objectives and timing should be clearly recognised. The ambiguity in objectives and wrong timing may lead to make the privatisation an ineffective exercise.

3) Lack of political will and consensus makes the privatisation a threat for development. For ex: Privatisation of BALCO.

4) Reduction in the excess staff of public sector is regarded as a common effect for privatisation in India. But in an economy of abundant human resources, privatisation will increase unemployment.

5) There is a need to change the work environment and work culture in the enterprises for effective implementation of privatisation. These can not be easily changed.

6) If privatisation results in conversion of a public sector monopoly to a private sector monopoly, privatisation does more harm to the economy than good.

7 . 10 Legislative measures of Government:

The legislative measures of Government towards privatisation and disinvestment in India are explained as under:

a) Rangarajan Committee on Privatisation: (1993) The Government appointed a committee under the chairmanship of Sri C. Rangarajan to study and recommend new measures to make privatisation more effective. The committee submitted its report in 1993 and the recommendations include the following:

1) Units to be disinvested need to be identified.

2) These is a need for the Government to retain majority holding in the equity of undertakings in the areas like Defence and Atomic energy.

3) The disinvestment process shall be in stages and the best possible price is to be obtained from bidders.

4) The process of disinvestment must be transparent.

5) The employees interests are to be protected.

6) An autonomous body needs to beet up to monitor the process of disinvestment.

7) Ten percent of the proceeds of the privatisation amy be set apart for lending to the public sector on concessional terms for meeting their expansion and rationalisation needs.

b) Disinvestment Commission: A five member Dis investment Commission was set up on August 7, 1996. Its majaor tasks are identified as under:

i) to prepare a long term disinvestment program.

ii) To determine the extent of disinvestment in each public sector undertaking.

iii) To decide on the aspects relating to instrument, pricing and time.

iv) To supervise the sales process.

v) To monitor disinvestment process.

This commission has so far submitted its reports on more than 50 public sector undertakings. The recommendations are related to strategic sales, disinvestment, etc., The commission works on a formula which is as under:

a) The board of directors of a public sector unit should be empowered to hive off a portion of its assets.

b) No permission is required for a public sector unit to form joint ventures with Indian or foreign companies.

c) The public sector units must have the power to fix salaries of top management.

d) Permission for investments in public sector units is to be abolished.

e) Performance assessments are to be carried out for introduction of accountability in public sector units.

7 . 11 Conditions for effective Privatisation:

The following conditions are essential for the successful implementation of privatisation according to prof. Samuel Paul.

1) Privatisation cannot be sustained unless the political leadership is committed to it and unless it reflects a shift in the preferences of the public arising out of dissatisfaction with the performance of other alternatives.

2) The replacement of public sector enterprise by private sector should provide a base for competition to provide better products and services to public.

3) Public services to be provided by private sector must be specific or have measurable out come. Physical, construction or utility services can be measured. Forex: the educational and police services cannot be measured though their inputs can be measured.

4) Long term contracts or franchises should not be made. These limit the competetion and the consumers choice. Hence the short term contracts are to be preferred.

5) Consumers could be able to link the benefits they receive from a service to the costs they pay for. Hence there is a need to educate consumers and provide information to the public to create more awareness.

6) The services provided by private sector should be less susceptible to fraud than services in Government sector. Services provided through collective or co-operative action at the community level are probably the least susceptible to fraud.

7 . 12 Summary:

Privatisation has opened new vistas of economic democracy in developing countries, particularly India so as to withstand competitive pressures and regulatory mechanism in public enterprises. Though the understanding of rationale for privatisation is lacking among people in India, it is however, important to come out with a solution to safeguard the interests of all the parties, workers, employers and the general public. The tenth five year plan (2002 - 07) has recognised that removal ofquantitative restrictions on imports would open up the economy to foreign competititon and the tariff levels ought to be lowered down. In the next five years, it is hoped to realise Rs. 78,000 crores through the process of disinvestment in public sector. VSNL has already been sold to Tatas, IPCL to Reliance, while NALCO is in the process of privatisation. This means the Government is on move to sell off public sector enterprises to general public and raise the level of Indian economy during the five year plan. This is a healthy signal for economic development.

7 . 13 Self assessment Questions:

1) Explain the concept, nature and objectives of privatisation ?
2) What are the benefits and limitations of privatisation ?
3) Discuss the privatisation efforts in India and abroad?
4) What are the arguments against privatisation of public enterprises?

7 . 14 Further Readings :

1) Francis Cheruinlam, “Business Environment - Text and Cases” Himalaya Pub. House, Mumbai, 2003.
2) K. Aswathappa ìEssentials of Business Environmentî Himalaya Pub. House, Mumbai, 2000.
3) Ruddar Dutt and KPM Sundaram “Indian economy” S. Chand & Company Ltd., New Delhi.

LESSON - 8

SMALL BUSINESS

Objectives:

The main purpose of this lesson is to help you to

* understand Role of Small Scale Industry in economic development
* analyse the institutional and policy frame work for Small Scale Industry
* discover the problems of SSI in India
* offer suggestions for the development SSI in India

STRUCTURE:

8 . 1 - Introduction
8 . 2 - Definition of Small Scale Industries
8 . 3 - Role of SSI in India
8 . 4 - Case for and against SSI
8 . 5 - Policies and measures of SSI
8 . 6 - Abid Hussain Committee report
8 . 7 - Problems of SSI
8 . 8 - Suggestions
8 . 9 - Summary
8 .10 - Self assessment Questions
8 .11 - Further readings

8.1 Introduction :

The small scale industry by whatever name it is called play a predominant role in the economic development of any country. Its contribution in terms of number of units, employment, production and exports are appreciable in any country. The special features of small scale industry in terms of

* requirement of low investment
* generation of employment
* less time required for setting up have resulted in the formulation and implementation of policies and programmes relating to small scale industry.

8.2 Definition of Small Scale Industry:

The definition of small enterprises varies from one country to another. In most of the countries, the criterion for defining a small enterprise is related to the size of employment. For ex: In USA, small business is one which has an employment of less than 500 people, in U.K. it is less than 20 skilled workers, in Germany less than 300 workers, in Sweden less than 50 workers and in Italy less than 500 workers. In some countries, both investment and employment are considered. In South Korea, investment limit is 2 lakh dollars and employment limit is 200 workers.

In India, the definition of small scale industry is an important aspect of Government policy as it identifies the target groups. The first official criterion for small scale industry dates back to the Second five year plan when it was in terms of investments in land, building, plant and machinery and the strength of the labour force. The term small scale industries has been defined in three ways:

1) The conventional definition includes cottage and handicraft industries which employ traditional labour intensive methods to produce traditional products largely in village households.

2) The operational definition for policy purposes includes all those undertakings having an investment in fixed assets in plant and machinery as prescribed by the Government.

3) The third definition relates to national income accounting. This includes all manufacturing and processing activities including maintenance and repair services undertaken by both household and non-household small scale manufacturing units, which are not registered under the Factories Act.

The Central Government increased the investment ceiling limits from time to time. When the small scale industry was introduced the investment limits are as under:

a) Small Scale Industry - Rs. 60 lakhs

b) Ancilliary undertakings - Rs. 75 lakhs

c) Tiny Unit - Rs. 5 lakhs

The present investment limits are as under:

a) Small Scale Industry and
Ancilliary undertakings - Rs. 1 crore

b) Tiny Units - Rs. 25 laksh

In India, the difinition of Small Scale Industry is based on investment criteria only. Upto 1960 employment of workers was also considered. Since 1960, the employment of workers was not considered as the criteria for defining small scale industry.

8 . 3 Role of Small Scale Industry in India:

The small scale industrial sector which plays an important role in the Indian economy can be summarised as under:

a) Employment: The small scale industries provide larger employment opportunities in an economy where the supply of labour has been increasing at a very rapid rate. Its present large capacity to absorb labour is obvious from the fact that the village and Small Scale Industries sector accounts for as much as 80% of total employment in the industrial sector of the country. The total employment in this sector as at the end of March 2002, is 19.22 million in the country. The handloom sector, sericulture and the food processing industry offers potential employment opportunities in this sector.

b) Production and exports: The production of small scale sector grew from Rs. 1553 billion in 1990 - 91 to Rs. 4785 billion by 2001 - 02. The Annual production growth rate of SSI sector at constant prices has been consistently above 8 . 0 per cent during the period 94 - 95 to 2000 - 01. The highest recorded rates were 11. 4% in 1995 - 96 and 11.3 % in 1996 - 97. In all these years, the performance of SSI sector has been consistently higher than the overall performance of industry and manufacturing sectors. The exports which stood at Rs. 96.64 billion in 1990 ñ 91 to Rs. 698.00 billion by 2000-01. On the export front, the performance of the sector has not been satisfactory in most of the years.

c) Inter- State dispersal: Inter - State dispersal of industries indicates the six states viz., Maharashtra, Tamil Nadu, West Bengal, U.P. Punjab and Gujarath account for 59% of the total units in the small sector. The states which have lagged behind in encouraging small scale industries are Rajasthan, Madhya Pradesh and Orissa. Some concentration was observed in the location of small scale units on account of specialisation by particular districts. 90% of the total woolen hoisery units were in Ludhiana, 80% of the cotton hosiery in Coimbaatore, Ludhiana, Calcutta and Delhi, 25% of iron and steel castings were located in Jalandhar.

d) Promotion of welfare: These industries are also useful for promotion of welfare. People with low incomes can organise these industries. This increases the income levels and quality of life. Further, these industries tend to promote an equitable distribution of income. Since these industries can be set up anywhere with the local resources, these help in the reduction of regional economic disparities. Some of the problems of unplanned urbanisation will be avoided by the establishment of small scale industries in the country.

e) Other benefits: The small scale industries tend to provide other benefits which include:

i) They are highly innovative and are suitable to tastes, fashions and personalised services.

ii) The employees who work in small scale sector are more happier when compared to employees who are working in large scale enterprises.

iii) The small scale industries which are locally situated can protect socio-cultural values and are perceived as symbols of national identity.

iv) "Small is beautiful" said E.F. Schumacher. He maintain's that man's current pursuit of profit and progress has resulted in the growth of large organisations which has lead to environmental pollution and in human working conditions. He emphasises on small working units, communal ownership and regional work places for utilising local labour and resources.

v) Small companies and new entrepreneurs were at the fore front of every business sector whether it was computers, TV sets, electronics, garments and diamond exports.

8 . 4 Case for and against SSI:

The case for SSI can be stated as under:

1) Large employment: The most important single argument in favour of these industries is that these provide an ample scope for employment on a large scale. This is of great significance for a country like India which is a labour surplus economy and where labour force is increasing at a very rapid rate. These industries have potential for large employment, as these require very low investment per Job.

2) Large production and exports: These industries also contribute a sizable amount to the industrial output of the country. Of the total output of the manufacturing sector, as much as 40% comes from these industries. Besides quite many goods, including several luxury items (like handloom cotton fabrics, silk fabrics, coir products, handcrafts, carpets, jewellary etc.,) go to swell the exports of the country. Their share in total products is as much as 40%.

3) Use of domestic resources: Another very strong argument in favour of these industries is that these use and develop resources which are available locally. The resources are family labour, Boarded wealth, artisan's skills, native entrepreneurship, material inputs etc., By using the local resources, these industries not only add to the national product, but also minimise their dependance on imported inputs and therefore cause no burden on the balance of payments of the country.

4) Quality of life: The small scale industries are of great significance for improving the quality of life the people in general. The freedom to work, self-reliance, self-confidence, can be built around the material activities performed in these industries. Many problems associated with machanical, monotonous life can be saved with the small scale industries.

The case against small scale industries can be explained as under:

1) **Output vs employment:** One important argument is that the emphasis on employment is irrelevant as the basic thing that is required for any economy is output. Since the productivity of these industries is low as compared to that of large industries, the small industries simply waste the capital which is very scarce. It is also argued that labour productivity in small scale industries is also less.

2) **Inefficient Production:** The cost of production in small scale industries is higher than in large industries because these industries suffer from several inefficiencies. The large scale industries obtain large scale economies to lower their costs.

3) **Impact on capital formation:** It is also contended that small industries have unfavourable consequences for saving and capital formation. They argue that the establishment of these industries will over a period of time reduce the availability of capital for large scale industries. As a result, a large part of their incomes will be used for consumption, resulting in a lower rate of saving and capital formation for the economy.

However several benefits and arguments which are stated, it is obvious that small industries are of great significance for the Indian economy.

8 . 5 Policies and measures of SSI:

The policies and measures initiated by Central Government for the smooth functioning of SSI in India can be stated as under:

a) Industrial Policy Resolutions & Five Year Plans
b) Import - Export Policy
c) The textile policy
d) Policy for Development of Handloom Industry
e) Policy for Khadi and Village Industries
f) Industrial Estates Programmes
g) Promotion of Ancilliary Industries

Measures taken by Central Government:

In accordance with the various policy measures which are referred to above, the following steps have been taken:

i) **Allocations in plans:** The financial resources devoted to the development of these industries have been on increase since the early years of planning. The allocation to this sector during the first plan was Rs. 42 crores, second plan Rs. 187 crores, third plan Rs. 241 crores, fourth plan Rs. 243 crores, fifth plan Rs. 592 crores, sixth plan Rs. 1945 crores, seventh plan Rs. 3249 crores, eigth plan Rs. 6334 crores and ninth plan was Rs. 4508 crores. Besides plan resources, quite a large investment has taken place on private account financed partly by Government financial institutions and partly from promoters own financial and non-financial resources.

ii) Institutional set-up: The various institutions that were set up to promote small scale industries are:

a) National Small Scale Industries Corporation

b) Small Scale Industries Development Organisation

c) District Industrial Centres

d) State Financial Corporations

e) All India Handloom and Handicrafts Board

f) The Central Silk Board

g) The Khadi and Village Industries Commission

h) The State Khadi and Village Industries Boards

Most of these organisations provide many types of support at various stages of the development of small scale industry.

iii) Concessions and reservations: The services rendered by various organisations include fiscal concessions, providing machinery on hire - purchase basis, allocation of land at cheaper rates, exemption from certain labour and factory laws, reservation of a larger number of products for exclusive production in the small scale sector.

iv) Credit flow: Government measures also bear upon the credit supplies to the small sector. Commercial banks, Co-operative banks, Regional Rural Banks, State Financial Corporations etc., fulfil this function under the direction of the Government. The small scale industries are included in the priority sector to which commercial banks provide 40% of the aggregate credit. The credit is provided for both short term and long term purposes.

v) Supply of raw materials: Arrangements have also been made to ensure the supply of raw materials. There have also been selective relaxation in the import policy in favour of the small scale sector for the import of certain raw materials. As for the supply of critical inputs, (like iron and steel etc.,) are concerned, efforts are made to see that the small scale sector does not suffer.

vi) Marketing Support: Marketing support has also been provided for the small scale sector. The strategy adoted includes such elements as diversification of markets and product-wise, introduction of modern marketing techniques, exploring new markets etc., Besides, Co-operatives are also promoted to undertake marketing of these products.

vii) Improving skill and technology: Government help is also available for skill formation and technological upgradation. The facilities are made available through training institutes, demonstration centres, mobile training units etc., Further, the Government utilises the expertise and facilities available with such institutions such as National Laboratories, Indian Institute of Technology, and other research oriented organisations.

The various efforts mentioned above are in the direction of "protection" and very little is done to improve the efficiency and competitiveness of the small scale sector.

8 . 6 Abid Hussain Committee Report:

The Government has appointed an expert committee under the chairmanship of Mr. Abid Hussain in Dec. 1995 and the committee submitted its report in Jan. 1997. The major recommendations of the committee are as under:

i) The concept of small scale industries should be widened to include small scale business and service enterprises.

ii) The policy of protection of small scale industry should be replaced by the policy of promotion with measures like adequate supply of credit, service, technology assistance, infrastructure and low transaction costs etc.,

iii) Increasing public and private partnerships in setting up support system for small scale enterprises is necessary.

iv) The role of central Government should be restricted to policy formulation, legal and institutional development and the State Governments have to play a key role in the development of small scale enterprises.

v) The reservation for small scale industries should be abolished. The committee observed that the items which were reserved for this sector were not at all manufactured by these units. Hence the reservation of items should be abolished.

vi) The investment ceiling limit for small scale industries should be enhanced to three crores and the limit for tiny units should be increased to Rs. 25 lakhs.

vii) The committee recommended that in the accounts of large companies, information is to be provided on a statutory basis on the extent of accounts payable to small enterprises.

8 . 7 Problems of Small Scale Industry:

The problems of small scale industry can be stated as under:

1) Several inefficiencies: These industries are beet with inefficient operations in several ways. One dismal aspect of their functioning is that a significant portion of their capacity remains unutilised. The units have become unviable because of very little research in important matters like location, financial viability, existence of markets etc., The result is high costs and shoddy goods in the case of large many units. Here it may be worth mentioning that this sector produces only a very small number of items reserved for this sector. The operations of these units have been far removed from sound commercial considerations.

2) Large Sickness: Another problem that points to its poor performance is the large sickness that permeates this sector. The number of sick units as at the end of year 2001 stood at 2,50,000 units. The bank credit outstanding against these units is Rs. 5,500 crores as at the end of the year 2001. The loss of sickness is not only confined to finance, but also extended to other areas like less production, less exports and less employment.

3) Inadequate dispersal: Most of the small scale units are located in few states only. Of the estimated number of small scale units (3.37 million in 2000 - 01) as many as 60% are located in 6 states. Thus the aim of reducing geographical disparities through an even spread of these industries has not been fulfilled.

4) Other problems: Other problems of small scale sector include the following:

a) The supply of credit has not been commensurate with their needs associated with fixed and working capital.

b) The marketing problems include lack of standardisation of products, inadequate market intelligence, competition from technically more efficient units have been faced by these units.

c) Raw materials are not available in sufficient quantity, required quality or at reasonable prices.

d) The methods of production which are employed by small and tiny enterprises are old and inefficient.

e) Another serious problem is severe competition from large scale industries. Large scale industries use modern technology and having access to many facilities which the small scale industries are not able to obtain from the market.

8 . 8 Suggestions:

To enable small and cottage industries to play their role well in the development of the country, it is necessary to remove their difficulties and make them healthy and sound. The suggestions for making small and cottage industries more viable include the following:

1) Selection of appropriate industries: The first and foremost requirement is to ensure that the small scale industries are to be selected which promise further growth. For ex: products which require for their production with traditional skill and include artistic handicrafts, carpets, jewellary etc., goods which are meant for industrial use include pressed cotton, vegetable oils, products which involve special operations like footwear, knit wear etc., Industries producing such products should be selected and helped accordingly.

2) Industrial Co-operatives: For the development of small scale and cottage industries, industrial co-operatives can render immense help. The industrial co-operatives can help in solving the problems in the areas of credit, marketing and raw materials etc.

3) Improvement in methods of production: For the development of these industries, it is essential that their production methods are to be modernised and that they use of better types of implements. Arrangements should also be made for repair and maintenance of these implements.

4) Provision for industrial education : Another essential step is to provide industrial education to people working in these industries. Adequate facilities for industrial training and education should be made available to them.

5) Improvement in marketing : Marketing of goods produced by these industries has to be improved. The marketing efforts to include assessment of local markets, domestic markets, national and international markets so as to improve the facilities of marketing.

6) Improve competitive strength: The efforts must be taken to improve the competitive strength. The concessions given to the small scale sector should be linked with performance and should be phased out over a period of time.

The measures will go a long way in improving the performance of small scale industry. The Central and State Governments have to take these measures and help small scale industry to play an important role in the process of economic development of the country.

8.9 Summary:

The small scale sector has been playing a predominant role in the economic development of the country. The Central Government has been initiating various measures through allocations in the five year plans, reservations and concessions etc., But the small scale industries have been facing several problems which require the attention of policy makers, banks and other insitutions.

8 . 10 Self - assessment Questions:

1) Explain the role of small scale industry in the economic development?

2) What was the policy and institutional support provided for small scale industries?

3) Elucidiate the problems of SSI and suggest meassures to overcome the problems?

8 . 11 Further Readings:

1) Agarwal, A. N. "Indian Economy - Problems of Developent and Planning". Wishwa Prakasam, New Delhi, 2003.

2) Francis Cherumilam "Business Environment - Text and Cases". Himalaya Pub. House, Mumbai, 2003.

3) Ruddra Dutt and KPM Sundaram "Indian Economy" S. Chand & Co., Ltd. New Delhi, 2000.

4) Vasant Desai "Small Industries and Entrepreneurship" Himalaya Pub. House, Mumbai, 2001.

5) K. Aswathappa "Essentials of Business Environment" Himalaya Pub. House, Mumbai, 2000.

LESSON - 9

ECONOMIC POLICIES

Objectives

After studying this lesson you should be able to:

* understand the different industrial policies beginning from 1948 and the ideologies behind each policy;
* appreciate the direction and pattern of industrial growth during the last 45 years as reflected in these policies;
* Examine the rationale behind the changes that are to follow particularly since 1991.

STRUCTURE :

9.1 Introduction

Industrial Development is the key factor for rapid economic development of any country. Rapid industrialisation results in increased production of both commerce and capital goods and rise in the levels of living. It requires huge accounts of social investment which may be beyond the capacity of the private sector. Hence it is inevitable for the Government to play an active role in the industrialisation of the country. So, it is necessary to study the Industrial Policy of the Government of India.

The term “industrial policy” refers to all those procedures, principles, policies, rules and regulations relating to industries, their establishments, functioning, growth and management. It incorporates fiscal and monetary policies, the tariff policy, labour policy and Government’s attitude towards assisting public and private sectors.

9.2 Industrial Policy Resolution – 1948:

Since independence, the Government of India had announced two important industrial policy resolutions - one in 1948 and the other in 1956. The Industrial Policy Resolution of 1948 was in force upto 1956, i.e., 8 years. Later in view of the circumstances prevailing, the Government announced its second Industrial Policy in 1956, which replaced the Industrial Policy Resolution of 1948.

Following were the main features of Industrial Policy Resolution issued by the Government of India on April 6:

1. **Acceptance of the importance of both Private and Public sector:** The industrial policy resolution accepted the importance of both public and private sectors in the industrial economy of India. It envisaged a major role for the Government to play.

2. **Categorisation of industrial sector:** The resolution divided industries into four categories. These categories were as under:

   a) **Industries where State had a monopoly:** In this category three fields of activity were specified-arms and ammunition, atomic energy and rail transit,

   b) **Mixed sector:** in this category, 6 industries were specified – coal, iron and steel, air – craft manufacture, ship- building, manufacture of telephone, telegraph and wireless apparatus and mineral oils. However, existing private undertakings in this field were allowed to continue for ten years after which the Government would review the situation and acquire any existing undertaking after paying compensation on a fair and equitable basis.

   c) **The field of Govt. Control**: The government did not undertake the responsibility of developing these industries but considered them of such importance that their regulation and direction was necessary. Some of the industries included were – automobiles, heavy chemicals, heavy machinery, machine tools, fertilizers, electrical engineering, sugar, paper, cements, and cotton and woollen textiles.

   d) **The field of Private enterprise**: All other industries which were not included in the above three categories were left open to the private sector.

3. **Role of Small and Cottage industries**: The 1948 Resolution accepted the importance of small and cottage industries in industrial development. These industries are particularly suited for the utilisation of local resources and for creation of employment opportunities.

4. **Other important features**: The role of foreign capital in industrial development of the economy was recognised but the need for regulating and controlling it according to the needs of the domestic economy was deemed essential. The resolution gave importance to relations between the management and labour since this was necessary for industrial development. Hence, the Resolution enumerated a policy of labour conditions wherein workers would be given fair wages and labour participation in management.

Appraisal: The basic idea of the industrial policy resolution was to control the capitalistic form of industrial organisation and introduce a form of institutional frame – work which is called mixed economy. This is a welcome feature from the viewpoint that the Government was allowed to take an active part in the industrialisation of the country rather than leaving the job entirely to the private sector. But there was criticism from the side of industrialists that the policy as prejudicial to them. The supporters of 'socialism' appreciated the policy as a good step towards establishment of democratic socialism.

9.3 Industrial Policy Resolution – 1956:

Since the adoption of 1948 resolution, significant developments took place in India. Planning had been proceeded on an organised basis and the first five year plan had been completed. Parliament had accepted the socialistic pattern of society, as the basic aim of social and economic policy. These important developments necessitated a fresh statement of industrial policy. A second Industrial Policy Resolution was announced on

30th April, 1956, replacing the resolution of 1948. Following were the important provisions of the 1956 Resolution:-

1) **New Classification of Industries**: - The resolution laid down three categories which bear a close resemblance to the earlier classification, but were more sharply defined and were broader in coverage as to the role of the State. These categories were

   a) **Schedule A:** Those which were to be an exclusive responsibility of the state;

   b) **Schedule B:** Those which were to be progressively state – owned and in which the state would generally set – up new enterprises, but in which private enterprise would be expected only to supplement the effort of the state; and

   c) **Schedule C:** All the remaining industries and their future development would be left to the private sector.

The first category included as many as 17 industries: arms and ammunition, atomic energy, iron and steel, heavy castings and forgings of iron and steel; heavy machinery required for iron and steel production, mining, machine tool etc., heavy electrical industries; coal; mineral oils, mining; iron are and other important minerals like copper, lead and zinc; aircraft; air transport, railway transport, shipbuilding; telephone, telegraph and wireless equipment; generation and distribution of electricity.

The second category included 12 industries; other mining industries, aluminum and other non ferrous metals not included in schedule A: Machine tools, Ferro – alloys and tool steels, the chemical industry ; antibiotics and other essential drugs; fertilizers; synthetic rubber, carbonisation of coal; chemical pulp; road transport and sea transport.

The third category industries which consisted of the rest had to fit into the frameswork of social and economic policy of the State and be subject to control in terms of the Industries (Development and Regulation) Act and other relevant regulations.

The division of industries into separate categories did not imply that they were being placed in water tight compartments. There could be overlapping between industries in the private and public sectors.

It would be open to the State to start any industry not included in schedule A and schedule B when the needs of planning so required or there were other reasons for it. Similarly, privately- owned units might be permitted to produce an item falling in Schedule A for meeting their own requirements or as by- products.

2. Encouragement to village and small – scale enterprises: This policy reiterated the govt's determination to provide all sorts of assistance for the rapid development of small and cottage industries in view of the distinct advantages they possess in respect of the generation of employment opportunities, wider dispersal of industries and the equitable distribution of income and wealth.

3. **Removing regional disparities:** The resolution stressed the necessity of reducing the regional disparities in levels of development in order that industrialisation may benefit the country as a whole. The resolution fully supported the idea of balanced regional development.

4. The need for the provision of amenities for Labour: - The Resolution stressed the need for improving the living and working conditions of workers. There should be joint consultation and the workers and technicians should be associated in management.

5. Attitude towards foreign capital: - The government recognized the need for securing the participation of foreign capital and enterprise particularly with regards to industrial technique and knowledge for speedy industrialisation of the Indian economy.

Appraisal: - The 1956 Industrial Policy Resolution came in for appreciation and criticism. The emphasis laid on certain socio – economic objectives was indeed laudable. The Policy stressed the need for balanced regional development of the economy, prevention of concentration of economic power, building up of a strong cooperative sector, expansion of oppurtionites for gainful employment and improvement of living standards and working conditions of people. The public sector was to be expended. The encouragement to the small – scale sector was to be intensified.

On the other side, the 1956 policy was vehemently criticised on the role assigned to the public sector. It was criticised that a public enterprise in an impersonal industrial venture and an impersonal attitude towards an enterprise is hardly conducive to its growth. Further, it was contended that the State was unduly straining its already overburdened and overstrained financial and administrative resources. Some critics went so far as to suggest that it would bring about State capitalism and that the government will be well-advised to reconsider its policy.

Merits and demerits apart, the 1956 policy continued to constitute the basic economic policy for a long time. This was proved in all the Five Year Plans.

9.4. Industrial Licensing Policy - 1951

Introduction : Industirial licensing is governed by the Industries (Development & Regulation) Act, 1951. Over the years the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalised from time to time.

Legislative frame work for licensing : The Industrial policy resolution 1948 was followed by Industrial (Development and Regulation) Act, 1951 to provide a statutory frame work to implement own industrial policies. The Indistrial (Development and Regulation) Act, 1951 came into effect in 1952.

Provisions of the Act : The Act provided for compulsory registration of all scheduled undertaking with the government within a specified period of time; that licences should be obtained from government by all new undertakings and by undertakings contemplating substantial expansion.

The Act provided five types of licences, namely, for (i) new undertaking; (ii) substantial expansion; (iii) the production of new articles; (iv) change in the location - either part or whole of the undertaking; and (v) carrying business.

The Act further provided for the establishment of the licensing committee, the central advisory council and the development councils, for consultation in regard to problems relating to the admnistration of the Act and other matters pertaining to the development of industry.

In July 1966, professor R.K. Hazari was appointed as Honorary Consultant to the planing commission to conduct a study of licensing under the Industries (Development and Regulation) Act, 1951, (i) to review the operation of licensing under the Act and (ii) to consider and suggest modifications to be made in the licensing policy. On the report of the Hazari Committee, a thorough discussion was initiated in Rajya Sabha in May 1967.

This was led to appoint a committee known as the Industrial licensing policy enquiry committee under the chairmanship of proffessor M.S. Thacker and the same was taken over by Sri S. Dutt in April 1968. The Committee was to go into the basic questions regarding the functioning of the licensing system and the advantages obtained by some of the large industrial houses. The committee submitted its report in July 1969.

The Dutt Committee recognised the fact that industrial licensing was a negative instrument and as such could only play a limited role for a license for setting up a new unit or expand this specific purpose. The committee also observed that the licensing system specifically meant to implement the Industrial policy of the Government failed to achieve the objective of planned economic development as well as of preventing concentration of economic power.

9.5 Industrial Licensing Policy - 1970

In February 1970, the Government aunounced its new industrial licensing policy. It accepted the recommendation of the Industrial Licensing policy inquiry Committee that there should be a list of core industries in the economy. The core sector would consist of the industries listed in schedule A of the Industrial policy resolution 1956 and this core sector would be reserved for the public sector. Larger industrial houses, foreign companies, subsidiaries or branches of foreign companies were allowed to participate in the remainings core and heavy investment sector leaving the core industries reserved for public sector.

The joint sector concept was accepted in the middle sector, involving investment ranging from Rs. 1 crore to Rs. 5 crores, licence applications of parties other than undertakings belonging to the large industrial houses were to be given special consideration. The existing policy relating to small scale sector was not only to be continued but also to be extended.

9.6 Industrial Policy Statement - 1973

A change in industrial policy in certain directions was indicated by the Industrial policy statement made by the central Government in 1973. The basic changes sponsored by this statement were as under :

1. Core sectors : The core industries and the core sectors were clearly determined as :

a. Those basic to national economic development.

b. Those having direct linkages with the core industries

c. Those with substantial potential for export.

2. Public sector : such industries from this sector as listed in Schedule A of the 1956 industrial policy Resolution were preserved for the public sector.

3. Dual coverage : In the rest of such core sectors, larger industrial houses (with not less than Rs 20 crores of assets each) could also apply for licensed capacity.

4. Small and medium sectors : Reservation were also made for the small and medium sectors. It was intended that encroachment in these sectors by large industrial houses would be resisted.

Cooperatives in these sectors were also to be encouraged particularly in the field of mass consumption goods.

5. Foreign companies : Foreign concerns, their subsidiaries and Indian branches of foreign companies were also made eligible to apply for licensed capacity.

6. Joint sector : The Central and State Governments would themeselves directly collaborate with the private sector in the promotion of an intermediate sector being called the joint sector.

This enunciation was made more or less as an Approach paper to the Fifth-Five-year plan. The statement by and large had raised the olive branch to the corporate sector, the monopoly houses and international resource capital disbursers mainly in the form of the multinational companies. The obvious intention of the Government has been to provide a thrust to the expansion of the industrial base by any or all means by mobilising resourses from as many ways as possible.

9.7. Industrial Licensing Policy - 1975

Late in 1975, in keeping with the latest policy changes, important relaxation were announced by the Government in the licensing policy.

These relaxations were :

1. Wide range : Delicensing and unlimited expausion were permitted for 21 industries, provided the products were absorbed in exports or in channels indicated by the government.

2. Big houses : This permission was given to big industrial houses including monopoly houses and multinationals.

3. Dispensation : Industrial licensing was dispensed with for small and medium intrepreneus not attracting the MRTP Act, upto Rs 1 Crore for new units and upto Rs 5 Crores for expausion.

4. Spill over : A 25 percent excess expausion over the licensed capacity was condoned.

A plethora of licenses were actually issued. Many of these licences were, however, not used or were used only partially, many of these being purchased or cornered by monopoly houses and multionals. The programme for industrialisation conceived by the Government through the issue of industrial licenses to a considerable extent went away. Either the licenses were not acted upon, or were acted upon only partially even it by parties other than the licensces themselves.

9.8 Industrial Policy Statement - 1977

With a change in Government at the centre, a new industrial policy was formulated in 1977.

This had the following characteristics :

1. Cottage and small-scale industries : An overhelming priority was given to the revival and growth of cottage and small scale industries.
2. Revised role for heavy and large-scale industries : The role of large - scale industry will be related to the programme for meeting the basc minimum needs of the population through wider dispersal of small scale and village indstries and strengthing of the agricultural sector.
3. Regularion of large business houses : Large and monopoly business houses would have to generate their own resources for expausion, and those would not be allowed to enter or expand even indirectly into areas earmarked for collage, small and medium sectors.
4. New-look public sector : The public setor would also function as a stabilising force as aslo a catalystic agent for development of the entire industrial field, the private and ancillary sectors inclusive.
5. external resources : Less reliance would be placed on foreign capital and technology , and more on indegenous mobilisation of resources and development of technology.

9.9. Industrial Policy Resolution - 1980

In July, 1980 the new Industrial policy was announced, with an emphasis on ‘modernisation, expansion and development of backward areas in relation to both small and large scale industries.

The 1980 policy was extensively clothed in economic philosophy and socio-economic objectives. The policy incorporated the concepts of optimisation of capacity usage, emphasis on productivity and generation of employment. It also intended to foster regional balance, revamp the public sector, and promote the rural sector as a support to agronomy.

This policy is in fact an updated version of the 1956 industrial policy Resolutin. As a sequal to the erunciation of revised Industrial policy in 1980, the Government enforced later in the year a few follow - up regulations :

1. Spill over : The permission to condone creation of 25 per cent additional capacity in excess of authorised capacity would be automatic.

2. Large houses : Such condonation in respect of FERA and MRTP companies, however would be considered on a selective basis.

3. Security of small sector : This would be rigidly observed, and no encroachment into this sector by large houses would either be permitted or condoned.

4. Automatic expansion : for full utilisation of installed capacity, a measure of automatic expansion would be permitted to a large number of industries listed in the first schedule of IDRA 1951.

5. Sick units : The insefficiently operated sick units would be rigidly disciplined, their merger with healthy units encouraged and their take-over by the government considered in special cases.

Serious anomalies have neverthless crept into our planning process, right upto the sixth five year plan, with huge arrears of unfulfilled targets on the one hand, and a runaway price spiral on the other.

9.10. Summary

In a period of about forty-five years since Independece, the industrial policy has grown towards making the country a socialistic state and all the supporting measures were also meant to strengthen the same trend. Probably, a saturation point was reached and governments role had to be reviewed since the outcomes were not satisfactory. This attempt is felt in the policy of 1991 and amost a total reversal of the first policy may be seen from the next year.

9.11. Self-Assessmet Questions

1. Describe the rationale and objectives behind the Industrial policy of 1956.
2. “The Constitution and the Directive Principles of State Policy remain the same but there is a world of difference in the Governments role when considered in 1956 and 1991”. Discuss.
3. Trace the changes in the official definition of small scale industry and tiny sector.
4. “Government’s tightening of its grip over the private sector only lead to the failure of the policy” – elucidate.

9.12 Further Readings

1. Ruddar Datt., KPN Sundaram, “Indian Economy”, S. Chand & Company Ltd., New Delhi, 2001
2. Sivayya K.V. and Das. V.B.M., “Indian Industrial Economy” S. Chand & Co Ltd., New Delhi, 1990.

LESSON - 10

NEW INDUSTRIAL POLICY- 1991

Objectives

After studying this lesson you should be able to:

* describe major policy issues and explain their rationale,
* explain Industrial policy, 1991 and describe its components,
* mention the merits of the Industrial Policy, 1991,
* make a critical evaluation on the Industrial Policy, 1991.

STRUCTURE

10.1 Introduction

In 24th July 1991, the government headed by Mr.P.V. Narasimha Rao announced a new industrial policy which sought to drastically alter the industrial scenario in our country. There are several departures in the new policy. The most important initiatives are with respect to the scraping of industrial licensing and registration policies, an end to the monopoly law and a more welcoming approach to foreign investments, apart from redefining the role of the public sector. These measures, long overdue, are welcome as they would free the industry from regulations, most of which have outlived their utility.

10.2 Objectives of New Industrial Policy 1991

The objectives of the New Industrial policy are:

i) Self - reliance to build on the many aided gains already made.

ii) Encouragement to Indian entrepreneurship, promotion of productivity and employment generation.

iii) Development of indegenous technology through greater investment in R&D and bringing in new technology to help Indian manufacturing units attain world standards.

iv) Removing the regulatory system and other weaknesses

v) Increasing the competitiveness of industries for the benefit of the common man.

vi) Incentives for the industrialisation of backward areas.

vii) Enhanced support to the small-scale sector.

viii) Ensure running of public sector undertakings on businesslines and cut their losses.

ix) Protect the interests of workers

x) Abolish the monopoly of any sector in any field of manufacture except on strategic or security grounds.

XI) To link Indian economy to the global market so that we acquire the ability to pay for imports, and to make us less dependent on aid.

In pursuit of the above objectives, the government has decided to take a series of initiatives in respect of the policies relating to the following areas.

Industrial Licensing policy

Foreign Investment

Foreign Technology Agreements.

Pubic sector policy.

MRTP ACT.

10.3. Industrial Licensing Policy

Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. In order to achieve the objectives of the strategy for the industrial sector for 1990 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 attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to respond to fast changing external conditions that have became characteristic of today's industrial world.

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 going into greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further inupetus must be provided to these changes which alone can push the country towards the attainment of its entrepenueral and industrial potential. This necessitates to remove restraints on capacity creation.

Therefore, Industrial Licensing will be abolished for all industries, except those specified, irrespective of the levels of investment. Those specified industries will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems relating to safety and environmental issues, manufacturing of products of dangerous nature.

The exemption from licensing will be helpful to many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. ultimately, the Indian economy will benefit by becoming more competitive, more efficient and modern.

10.4 Foreign Investment:-

While freeing the Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. The relationship between domestic and foreign industry need to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign investment would bring advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for the promotion of exports. 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. These industries have generally been known as the Appendix 1 industries and are areas in which FERA companies have already been allowed to invest on a discretionary basis. Such a framework will make it attractive for companies abroad to invest in India.

Government will encourage foreign Companies to assist us in our export activities. Attraction of substantial investment and access to high technology and to world markets, involve 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.

10.5. Foreign Technology Agreements.

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. With a view to injecting the desired level of technological dynamism in the Indian industry, the government will provide automatic approval for technological agreements related to high priority industries within specified parametres. Indian companies will be free to negotiate the terms to technology transfer with their foreign counterparts according to their own commercial judgement. This measure induces the Indian industry to develop indigenous competence for efficient absorption of foreign technology greater competitive pressure will also induce our industry to invest much more in research and development then 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.

10.6. Public Sector Policy

The public sector has been central to our philosophy of development. In the direction of achieving our development objectives, public ownership and control in critical sectors of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development

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. The key sectors of the economy are dominated by major 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 public sector entering the new areas of industrial and technical competence, a number of problems have begun crept themselves in many of the public enterprises serious problems are observed in the insufficient growth in productivity, poor project management, overmanoring lack of continuous technological up gradation and inadequate attention to R&D and human resource development. As far as rate of return on investment is concerned, public enterprises have proved to be inefficient. This resulted in their inability to regenerate new investments and technology development. Ultimately, 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 dilutions. The most striking example is the take over of sick units from the private sector. This accounts for almost one-third of the total losses of central public enterprises.

Therefore, the government shall adopt a new approach to public enterprises to make them more growth oriented and technically dynamic. There must be greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Units which are potentially viable must be restructured and given a new lease of life. The priority sectors for the growth of public enterprises will be as follows;

a) essential infrastructure goods and services,

b) exploration and exploitation of oil and mineral resources,

c) technology development and building of manufacturing capabilities in areas where long term development of the economy is crucial and where private investment is inadequate,

d) manufacture of products where strategic considerations predominate such as defence equipment.

In the changing conditions, government will not be barred form entering areas not specifically reserved for it. The government will review the existing portfolio of public investments with greater realism. The review will be in respect of industries based on low technology, small-scale and non-strategic areas, inefficient and unproductive areas, areas with a 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 the high priority areas or are generating good or reasonable profits. Competition will be induced in these areas by inviting private sector participation. In 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 is a need to be attended to the sick public enterprises incurring heavy losses.

10.7. Monopolies and Restrictive trade practices Act (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 the MRTP Act in investment decisions of large companies has become obstacle to India's industrial growth. The pre-entry of investment decisions by the MRTP Act will no longer be required, However, emphasis will be on controlling and regulating monopoly houses to obtain prior approval of the central government for expansion, establishments of new undertakings, mergers, amalgamation and take over, and the appointment of certain directors

The thrust of policy will be more on controlling unfair restrictive business practices.

The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and the establishment of new undertakings. The provisions relating to merger, amalgamation and takeover will also be repealed. Similarly, the provisions regarding restrictions on the acquisition and the transfer of shares will be appropriately incorporated in the Companies Act.

The 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 on suo-moto or complaints received from individual consumers or classes of consumers.

10.8 Related Measures

The industrial policy reforms have been supplemented and reinforced by reforms in related areas. Progressive integration of the Indian economy with the global economy has been acknowledged as one the objectives of the Exim Policy. The import policy has been made more liberal by drastically reducing the tariff levels and Quantitative restrictions and by procedural reforms. Another significant change has been the reform of the foreign exchange rate policy. The Rupee was made partially convertible on current and later it was made fully convertible. Measures have been initiated to move towards capital account convertibility. The Capital Issues Control Act and the office of the Controller of Capital Issues were scrapped and free pricing of Capital issues was introduced. Price controls have been gradually eased out. Several restrictions imposed in respect of foreign investment, like phased manufacturing programme, foreign exchange balancing etc., have been, by and large removed.

10.9. Merits and limitations of New Industrial Policy 1991

1. The Industrial policy 1991 is truly historic. Opening up the economy is an inviting step.

2. The changes proposed to be made aimed at making the Indian industry more competitive internally as well as internationally. Freeing the industry from needless controls is a welcoming step.

3. The delicensing and abolition of registration will free Indian entrepreneurs from the need to make endless trips to New -Delhi.

4. The scrapping of any asset threshhold or market share prescription for the definition of an MRTP Company and a dominant undertaking allows companies to go ahead with investment programmes without delay.

5. The liberalisation of the rules relating to direct foreign investment, permitting 51% equity in a wide range of industries, the easier facilitation of foreign technology agreements and other related measures go a long way in attracting foreign investment and technology.

6. Reforms relating to the public sector like privatisation and transfering sick units to BIFR will help improve the performance of the government undertakings.

7. Finally, the New Industrial Policy brings out market economy, i.e.; greater reliance on the market.

Limitations

1. Scraping of licensing leads to absence of mechanism to determine priorities and to develop backward areas.

2. The policy did not announced the altitude of government towards sick units.

3. Transfering of 20 percent of equity is profit making public sector to mutual funds revenue raising exercise than genuine attempt at privatisation.

4. Due to infrastructural deficiencies the foreign direct investment may not come as expected.

5. The Policy is drafted at the behest of IMF, which means virtual surrender of economic sovereignity of the country to a foreign agency.

10.10 An Evaluation of the New Industrial Policy 1991

The economic reforms ushered in since 1991 are revolutionary indeed in comparision with the policy and procedural reforms Litherto attempted in India. It is a bold step in the direction of freeing the Indian industry from the shackles of abortive and crippling controls. Although further policy changes and reforms are needed, changes already introduced, if implemented in real earnest, will certainly provide a considerable growth impetus. However, real debureaucratising is a challenging task. The bureaucracy has a tendency to attempt to defeat the measures aimed at deregulations.

A strong mandate and political will and bold administrative measures are essential for implementing several of the proposals. The government often shows signs of confusion and lack of boldness on the face of opposition from trade unions, politicians and bureaucrats. There will certainly be strong opposition from these groups to protect their vested interests. In the face of the strong opposition from trade unions, the government’s stand on privatisation has not been clear.

The policy environment now in India is much more conducive for both domestic and foreign investments than in the past. However, there are now a host of countries trying to woo foreign investment with much more conducive economic environment than in India. Further, cultural factors also tilt the balance in favour of other nations as far as foreign investment is concerned. Further, foreign business still regard the policy and procedural system in India is concerned. Further, foreign business still regard the policy and procedural system in India perplexing. Even many Indian entrepreneurs feel that the policy and development environments in countries like China are much superior to that in India and a number of them prefer to locate production bases abroad. The development of the infrastructural sector has been tardy in India, even after the liberalisation. Because of these factors one should not except wonders out of the belated measures.

However, for the first time the domestic industry has been given a considerable chance to prove its mettle. This dynamism coupled with an enhanced external collaboration and competition should be expected to provide a considerable momentum for development. At the same time, the government should strive to remove contraints and to implement the proposed reforms in letter and spirit.

Although the economic policy liberalisation of 1991 came in for severe criticism by the opposition parties, their anti-liberalisation stand was prominent. More interestingly, the short-lived BJP government and the United Front government that followed, not only endorsed the liberalisation policy ushered in by the congress government under Narasimha Rao, the then Prime Minister, but also carried farward the process of deregulation and decontrol to achieve faster economic growth. The economic policy of the United Front government expressed in the Common Minimum Programme (CMP) that further deregulation and decentral might be required in the agricultural, industrial and other sectors to accelerate economic growth and development. In short, India’s economic liberalisation is almost unanimously accepted by all political parties so that it is irreversible.

The Union Budget 2001-2002 was hailed for initiating the second generation reforms. Whichever political party comes to power in future, the difference will pertain to ethnic factors; will no more be related to economic policies or ideologies.

10.11. SUMMARY

The New Industrial Policy 1991 may be able to attract foreign investment and give a boost to domestic investment, but whether it will lead to more employment with higher output growth is doubtful. Besides excessive freedom to foreign capital may ultimately affect our economic sovereignity and as also push the country into a debt trap.

10.12 Self-Assessment Questions

1. Explain the objectives and major components of New Industrial Policy Resolution 1991.
2. Comment on Industrial Policy Resolution1991.

10.13 Further readings:-

1. Aswathappa. K., Essentials of Environment of Business. Himalayan Publishing House, Delhi, 2003.
2. Sengupta.N.K. Government and Business, Vikas Publishing House Pvt. Ltd. New, Delhi. 2001.

LESSON - 11

MONETARY AND FISCAL POLICIES

Objectives:

After reading this lession, you should be able to;

* define monetary policy, its objectives and nature.
* explain the instruments used by RBI for implementing monetary policy
* define the fiscal policy and its objectives in controlling the economy,
* analyse the Indian fiscal policy
* evaluate the monetary and fiscal policies of the RBI and Government of India

STRUCTURE

11.1 Introduction

The monetary and fiscal policies effect the financial sector and the economy in general. They can be used to influence specific sectors of industries or segments. These policies have important influence on the Gross National Product.

The Government and the Central Bank make use of various fiscal and monetary weapons respectively to achieve stability and growth by influencing and regulating the behaviour of the various classes of spenders as savers, consumers and investors. In other words, the fiscal and monetary policies are also important determinants of business prospects and investment decisions. They can help the overall economic situation and business prospects bright or check an unwarranted boom or unhealthy demand explosion. They can encourage investment and production in certain priority sectors and discourage them in the non-priority sectors. They are also capable of influencing technological choice and investment and production trends. In short, the fiscal and monetary policies influence the aggrigate supply and demand and the associated level of employment, wages, interest rates, rent, prices and profits.

11.2 Objectives of Monetary Policy:

Monetary policy is assuming greater relevance in the transition era of the economy from closed system to open system. The primary objectives of monetary policy are 1) to provide necessary finance to various investors through commercial banks and co-operative banks for economic development 2) to control the inflationary pressures generated in the economy, 3) to maintain full or nearfull employment. The ultimate objective of monetary policy is expansion and development of the economy. This does not mean that it is solely responsible for it. The government is the major responsible authority for stimulating the economy. Monetary policy and fiscal policy work together for the same set of objectives.

Monetary policy is the policy statement through which the Reserve Bank of India targets a key set of indicators to ensure price stability in the economy. Historically, the monetary policy has been announced twice a yea one for the slack season, i.e. April to September and one for the busy season, i.e. October to march from the financial year 1998-99, the RBI has decided that the policy would be released once in a year, since the share of the agricultural credit has come down.

The government can buildup excess demand in the economy by development expenditure and then regulate the supply through physical controls on price and distribution. On the other hand, it can act through monetary policy, which is designed to regulate demand through the use of monetary and fiscal instruments and then let the market forces determine commodity prices and their distribution and consumption pattern.

11.3 Monetary Policy and Money Supply :

Money supply comprises currency with the public and demand deposits. The budgetary operations of the government considerably affect the money supply. If the government meets its budgetary deficits by borrowing from the Reserve Bank, there will be an increase in money supply, both in currency and bank deposits. The RBI has no control over budgetary operations, though it has opportunities of tendering advice to government on this matter.

Another source of variation in money supply, over which the RBI's influence is restricted, is the country's international payments position. Demand deposits are a very important determinant of money supply. In many developing countries, the proportion of demand deposits in money supply has been increasing. This trend is association with economic development and banking habits of people.

Deposits with banks may originate in two ways - through passive creation or active creation. The former occurs when banks open deposit accounts for customers against the receipt of value either in cash or cheques drawn on other banks. The latter takes place when banks create deposits by extending credits. In the first case, the immediate effect is that there is no addition to the Quantum of money, though its distribution may undergo a change; but ultimately it enables the banks to extend credit and thus results in an increase in money. In the second instance, the supply of money is augmented immediately. When a bank extends credit, it would result partly in a rise in deposits either with itself or with other banking institutions. Under the fractional reserve system, the banks can create deposits by a multiple of the reserves, since the payments made with the proceeds of bank loans are eventually redeposited with banks, leading to additional reserve funds.

By varying the cost and availability of credit Central Bank produce desired changes in the assets pattern of credit institutions, mainly commercial banks. The item among bank's assets having special significance in this connection is the credit extended by banks to their constituents, which is the sum of what are usually called loans and discounts. The capacity of banks to provide credit depends on their cash reserves, comprising cash in hand and balances with the Reserve Bank. These increase through a rise in the deposit resources of banks, or by their borrowing from the reserve bank, or by sale of their investments. The regulation of credit by the Reserve Bank in essence means regulation of the quantum of the reserves of banks. If the bank desires to bring about an expansion in credit, it adopts measures to augment the bank's reserves of credit is to be restricted, it attempts to curtail the reserves.

11.3.2 Extent of Money :

Before initiating measures for the expansion or contraction of money supply the RBI generally measures the extent of money and credit available in the economy at a given time. The following indices are generally used for the prupose. M_1 represents money supply with the public. M_1 has two components; a) currency with the public and b) deposits of the public with banks. Currency with the public is sum total of notes in circulation and circulation of coins minus the cash on hand with the banks. Deposits of the public with banks is the sum total of demand deposits with banks and other deposits of the public with RBI.

M_2 represents the total M_1 plus post office savings and bank deposits.

M_3 is the sum total of M_2 and time deposits with banks.

M_4 represents M_1 plus total post office deposits.

M_1 is called "narrow money" and M_3 is called "broad money". M_3 represents the aggregate monetary resources or the money stock of the entire banking sector. The sources of M_3 are a) the net bank credit to the government, b) bank credit to the commercial sector, c) net foreign exchange assets of the banking sector and d) the governments currency liabilities to the public.

11.3.3 Expansion of Money :

Money is pumped into the economy through the issue of currency by the RBI, budgetary operations of the government and borrowings by the government from foreign countries. Expansion of money has always been on the increase. Expansion of money supply is not wrong, it is desirable, in a developing economy as money is needed to match the growth in the real national income. Actually, the growth in money supply must be higher than the growth in the real national income. This happens because of two reasons; a) as incomes grow, the demand for money as one of the components of savings tends to increase. b) an increase in money supply is also necessitated by the general reduction of the non-monetised sector of the economy. In our country, the rate of increase in money supply has been far in excess of the rate of growth in real national income. Hence the inflationary pressure is there on the economy.

11.3.4 Contraction of Money

Unlimited expansion of money and credit results in hyper-inflation, which hits all sections of society, particularly the poor. The Reserve bank has responsibility to ensure that money supply is within manageable limits and inflation is not too harsh. For this purpose, the Reserve Bank has been using different general credit control measures.

11.3.5 Structural Adjustments and Monetary Policy

In tune with the ongoing structural adjustment programme, objectives and instruments of the monetary policy have been redefined. The major considerations which underlie the monetary policy in recent years have been; a) bringing about a declaration in monetary expansion with a view to containing inflation without hampering the revival of the economy; b) reducing the monetised deficit, i.e., printing of new currency consistent with the government's objective of bringing down grass fiscal deficit and c) boosting exports in order to alleviate the problem of external payments deficit. To achieve these objectives, the following instruments of monetary policy have been employed.

1. The stipulation of minimum lending rate for advances of over Rs. 2 lakhs has been discontinued and banks would be free to fix their own prime rates.
2. Statutory Liquidity Ratio (SLR) has been reduced to 25 per cent, sharply shrinking the captive market for government securities.
3. State governments too would have to go to market for loans.
4. Automatic monetisation of the budget deficit would cease and has been replaced by a system of 'ways and means advances' under which temporary accommodation provided to the central government would have to be liquidated by the end of the financial year.
5. The RBI would endeavour to develop an active market in securities for which it would undertake to develop institutions and instruments as well as an appropriate structure of market - determined rates of interest on securities.
6. A close linkage would be established between monetary policy and exchange rate policy.
7. The RBI is prepared to accept that banks choice of asset holdings would be determined not by statutory prescriptions but by risk - reward perceptions.
8. Guidelines have been issued for the promotion of market - makers in major stock exchanges and for the grant of bank advances for the purpose, without any ceiling and without applying the 50 percent margin applicable to advances against shares.

11.4 Instruments of Monetary Policy :

The central bank acts as leader of the money market supervising, controlling and regulating the activities of the commercial banks and other financial institutions. It also controls the credit operations of the commercial banks and other financial institutions. It attempts to stabilize business conditions in a country. Various methods and instruments are available to the central bank for this purpose. Some are general and quantitative which control and adjust total quantity or size or the volume of the deposits created by the commercial banks. Other measures are selective or qualitative controls as they control only certain types of credits and not all. The former measures control the volume or stock of the money and credit while the later measures control the availability or flow of money and credit.

11.4.1 General or Quantitative Controls : Quantitative or general controls relate to the volume and cost of bank credit in general without regard to the particular field of enterprise or economic activity in which the credit is used. consists of a) bank rate or discount rate policy, b) open market cooperation's, and c) reserve ratio. The general or quantitative control.

a. Bank rate or discount rate: - Bank rate is the rate which the central bank charges for giving loans to commercial banks. When a commercial bank has low or no cash reserves above the legal requirements, it may obtain the additional cash reserves from the central bank at an 'interest rate' i.e., bank rate.

Suppose, the central bank believes that inflationary conditions are prevailing, it will raise the bank rate. In their turn commercials will increase their interest rates. The cost of credit to the public will increase. Contraction in business activity takes place leading to contraction of income and expenditure, reduction in the demand for goods, resulting in fall in the price level. The success of bank rate policy to control credit will depend upon the relationship bank rate, interest rate, cash reserves, security and effect of interest rate on borrower and investor.

b. Open market operations: - Direct buying and selling of Government securities and bills in the money market by the central bank of the country, with the objective of expansion and contraction of credit and economic activity in the economy is known as open market operations. If the securities are purchased then there will be an outflow of money from the capital market. This results in expansionary effect on income, employment, output and prices. Similarly the sale of securities will yield contractionary effect on the level of economic activity.

c. Reserve ratio : In view of safety and liquidity, the commercial banks are legally required to keep a part of their total demand and time deposits with the central bank. This is known as Statutory Liquidity Ratio. Changes in reserve requirements affect the amount of reserves that commercial banks must keep as deposits with the central bank and consequently the amount available for lending or investing. By raising the reserve ratio to be maintained by every bank, the central bank can reduce the volume of credit and by lowering the reserve ratio, it can expand the volume of bank credit. Hence, changes in reserve requirements are a powerful weapon for influencing the volume of bank deposits and money.

11.4.2 Selective or Qualitative Controls: -

In selective controls, the essential and non-essential uses of bank credits are distinguished and only the non-essential uses are brought under the scope of central bank control. It allows the expansion of bank credits to essential industries. This helps to raise the level of production and real income in the essential industries and curbs inflationary pressures that would have been created.

Several methods can be exercised to affect particular sectors of the economy and include such as :

a) insisting on minimum margins for lending against specific securities,

b) fixing a ceiling on the amounts of credit for certain purposes,

c) changing discriminatory rates of interest on certain types of advances,

d) moral suasion and

e) direct action

Among the above five measures, the first three are self-explanatory, the latter two need clarification.

Under moral suasion, the RBI addresses periodical letters to banks urging them to exercise control over credit in general, or advances against particular commodities or unsecured advances. Periodic discussions are also held by the Governor of the Reserve Bank with the authorities of commercial barks urging them to restrain from lending liberally.

Direct action may involve by the Reserve Bank to rediscount bills of a particular commercial bank which has failed to comply with the directives of the former. At the extreme, it may involve cancellation of license of an erring bank. Direct action is too severe and is there fore, rarely followed. Despite the priority of selective controls in underdeveloped economies characterised of sectoral shortages and surpluses, the qualitative techniques suffer from some limitations:

1) They have no control over non-banking institutions,

2) It may not always be possible for banks ensure that loans granted by them are spent for the purpose for which they were originally sanctioned,

3) The banks may sanction loan for forbidden uses

11.5 Evaluation of Monetary Policy: -

Monetary policy has become a target of severe criticism. The primary objective of monetary policy will be controlled expansion. It is said that the RBI has failed both in expansion and control of money and credit in our economy. With regard to the expansion of credit, major component of the increase in money supply was the reserve bank credit to the central government. The inability of the RBI to deny or regulate credit to the central government due to both legal and practical considerations has been interpreted by the committee as an important factor. Thus money supply has expanded.

It is further said that the monetary policy operated by the RBI did not play any effective role in curtailing inflation in the economy. The reasons for failure to formulate an effective monetary policy should be found elsewhere and not with the RBI.It was criticised that the central government has lived beyond its means and making central bank impotent in discharging its responsibility in maintaining the value of the currency, Another argument to prove the Rreserve Bank's helplessness is that the powers and weapons of the bank cover only the commercial banks. If the inflationary pressure is really brought about by deficit financing and shortage of goods, the RBI's control may not have any effect at all.

11.6 Fiscal Policy: -

Fiscal policy refers to the policy of the government regarding taxation, public expenditure and public debt. Fiscal policy generally believed to be the governmentís weapon to regulate their economic and business activities

11.7. Meaning of Fiscal Policy: -

Fiscal policy is commonly looked upon as comprising variations in government tax and expenditure programmes. Since changes in tax and expenditure policies often imply a change in the size of the national debt, variations in debt policy are often included under the general heading of fiscal policy. Many economists consider debt management policy to be an entirely separate and distinct policy question. Government tax and expenditure policies can influence the volume of money in circulation.

11.8 Objectives of Fiscal Policy: -

Conventionally, macro-economic policy goals are concerned with full-employment of the labour force, enhanced economic growth avoidance of inflation, maintenance of balance of payments equilibrium and international competitiveness and promotion of regional balance another important objective is the promotion of social justice. Governments all over the world have been using fiscal measures to regulate their economic and business activities in order to achieve such objectives as: 1) accelerating the rate of investment; 2) promoting socially desirable investment; 3) achieving rapid economic development; 4) achieving full employment, 5) promoting foreign trade; 6) reducing inequalities of income and 7) establishing a welfare state.

11.9 Importance of the Budget:-

There is no other government measure that affects the whole economy as the Budget. It in not exasirating saying that all sections of the people await the annual budget with mixed feelings of anxiety, fear and hope, The big task of a finance minister is to present the annual budget which gives maximum support to forces that can move the country forward on the path of growth with stability and social justice. The budget should set the stage for the acheivement of economic and social goals.

In India, about a half of the GDP is channeled into the government sector by the Union, State and UT budgets and disbursed by the Union, State and UT governments under various development and non-development heads. This indicates the development and distributive importance and implications of the budgetary operations.

There has been a steep increase in the government expenditures, both in absolute and relative terms. The total budgetary expenditures are about 50 percent of the Gross Domestic Product today. The central government expenditure alone account for one forth of the GDP. In a developing country like India, the budget policy has to serve the following purposes;

1) accelerate the pace of economic development by mobilizing resources for the public sector and their optimal allocation;
2) effect improvement in production in the private sector in accordance with the national priorities;
3) effect improvements in income distribution,
4) promote exports and encourage import substitution; and
5) achieve economic stabilisation.

To achieve the above purposes various fiscal incentives and disincentives are also employed by the budget. Certain sectors or industries may be significantly influenced by the budget proposals like tax proposals or budgetary allocations.

11.9.1 The Union Budget

An estimate of all anticipated revenue and expenditure of the Union Government of India for the ensuring financial year is laid before Parliament on the last working day of February every year. All receipts and disbursements of the Union Government are kept under two seperate headings, namely, the Consolidated Fund of India and the Public Account of India. All revenues received, loans raised and money received in repayment of loans by the Union government from the consolidated Fund. No money can be withdrawn from this Fund except under the authority of an Act of Parliament. All other receipts and disbursements, such as deposits, service funds and remittances go into the Public Account, which is not subject to the vote of parliament. To meet unforeseen needs not provided in the Annual Appropriation Act, a Contingency Fund of India has also been established under Article 267 (1) of the Constitution.

After the presentation of the Annual Financial Statement, a general discussion will be held on the Budget in both the house of Parliament. The estimates of expenditure from the consolidated Fund of India are then placed before the Lok Sabha in the form of Demands for Grants. Generally, a seperate demand is made for each Ministry. All withdrawals of money from the consolidated Fund are authorised by an Appropriation Act passed embodied in another Bill, which is passed as the Finance Act of the Year. The receipts and expenditure of the Central and State Governments are audited by the Comptroller and Auditor General who is independent of the executive, and his reports on the accounts are submitted to the president governer for having them laid before parliament / State legislature.

The Budget is divided vertically into revenue and expenditure. Horizontally, it is divided into revenue account and capital account. Thus, the receipts are divided into revenue receipts and capital Receipts. And the expenditure is broken up into Revenue Expenditure and capital expenditure. The revenue expenditure includes all current expenditure of the government on administration, and the capital expenditure includes all the capital transactions of the government. The revenue receipts include revenue from taxes, white capital receipts include market loans, external aid, income from repayments and other receipts, such as income from public undertakings.

11.9.2 State Budgets

Like the Union Government, State governments have their own budgets. Estimates of receipts and expenditure are presented by the State Governments to their legislatures before the beginning of the financial year and legislative sanction of expenditure is secured through similar procedure. The constitution has provided for the establishment of a Consolidated Fund, a Public Account and a Contingency Fund for each state as in the case of Union Government.

11.9.3 Sources of Finances of the Union and States

The Constitution of India has provided for the sources of revenue for the Union and the States seperately.

Sources of Revenue for the Union

The Union list in the Constitution includes the following revenue subjects.

1. Taxes on income other than agricultural income;
2. Duties and customs, including export duties;
3. Duties of excise on tobacco and other goods manufactured or produced in India, except alcoholic liquors for human consumption and opium, Indian hemp and other narcotic drugs and narcotics;
4. Corportation tax
5. Taxes on the Capital Value of assets, exclusive of agricultural land, of individual companies; taxes on the capital of companies.
6. Estate duty in respect of property other than agricultural land;
7. Duties in respect of succession to property other than agricultural land;
8. Terminal taxes on goods of Passengers carried by the railways, by sea, or air; taxes on railway fares and freight;
9. Taxes other than stamp duties on transactions on stock exchanges.
10. Rate of stamp duty on bills of exchange;
11. Taxes on the sale or purchase of newspapers and on advertisements published therein;
12. Fees in respect of any of the matters in the Union list, but not including fees taken in any court;
13. Any tax not mentioned in the state list or concurrent list.

Sources of Revenue for the State

The State List in the Constitution of India includes the following revenue subjects :

1. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights and alienation of revenue.
2. Taxes on agricultural income.
3. Duties in respect of succession to agricultural lands.
4. Estate duty in respect of agricultural land.
5. Taxes on lands and buildings.
6. Taxes an mineral rights, subject to any limitations imposed by parliament of law relating to mineral development.
7. Duties of excise on the following goods manufactured or produced elsewhere in India: a) alcoholic liquors for human consumption; b) opium, Indian hemp and other narcotic drugs and narcotics.
8. Taxes on the entry of goods into a local area for consumption, use and sale therein.

9. Taxes on the consumption and sale of electricity.
10. Taxes on the purchase and sale of goods (other than news papers)
11. Taxes on advertisements (other than those on newspapers).
12. Taxes on goods and passengers carried by road or inland water ways.
13. Taxes on animals and boats.
14. Taxes on vechicles, whether mechanically propelled or not, used on roads.
15. Tolls.
16. Taxes on profession, trades, callings and employment.
17. Capitation taxes.
18. Taxes on luxuries, including taxes on entertainment amusements, betting and gambling.
19. Rates of stamp duty in respect of documents other than those specified.
20. Fees in respect of any of the matters in this list but not including fees taken in any court.
21. Fisheries
22. Forests
23. Irrigation, water storage and water power.

11.9.4. Concurrent list

Following are the revenue items in the concurrent list under the constitution.

1. Stamp duties other than duties or collected by means of judicial stamps but including rates of stamp duty.
2. Fee in respect of any of the matters in this list but not including fees taken in any court.

Under the constitution of India, a Finance Commission is to be constituted every fifth year or at such earlier time as the president considers necessary to make recommendations to the president regarding (a) the distribution between the Union and States of the net proceeds of taxes which are to be or may be divided between the states of the respective shares of such proceeds, (b) the principles which should govern the grants-in-aid of the revenues of the state in need of such assistance out of the Consolidated Fund of India; and (c) any other matters referred to the commission by the President in the interest of sound finance. The recommendations of the Commission, together with an explanatory memorandum as to the action taken thereon, are laid before each House of Parliament.

11.10 The evaluation of Fiscal Policy: -

The effectiveness of fiscal policy can be assessed form three angles,

a) fiscal policy and savings and capital formation,

b) fiscal policy and economic inequalities and

c) fiscal policy and inflation control.

With reference to the effectiveness of fiscal policy and savings and capital formation, the policy failed to produce enough savings for public investment. Financial has become a standard excuse to avoid or postpone project implementation. With regard to the impact of public revenue and public expenditure on minimising income inequalities, the gap between the rich and the poor has widened. The tax system has failed to rob the rich and public expenditure has failed to pay labour. Our fiscal policy has totally failed to check the inflation.

11.11 Summary: -

The effectiveness of the economic policy depends on the formulation and implementation of the policy instruments. And also on the degree of coordination in the use of policy instruments. Likewise the effectiveness of any given policy depends upon the choice of objectives and the relative weight assigned to each one. Fiscal and monetary policies constitute indirect and direct controls and they effect the overall working of the economy. Monetary and fiscal policies may be combined to achieve simultaneously internal and external equilibrium. There is no absolute choice between monetary and fiscal policy, particularly when both work for more or less the same set of objectives.

11.12 Further readings: -

1. Adhikary. M., Economic Environment of Business, Sultan Chand & sons, New Delhi, 1991.
2. Francis Cherunilan Business Environment Text and cases, Himalaya Publishing House, Delhi, 2003.

11.13 Self-assessment test: -

1. Define monetary policy? What are its objectives?
2. Critically examine the operation of control measures adopted by RBI.
3. What is fiscal policy? What are its objectives?
4. What is a budget? Why is it so important?

LESSON - 12

FINANCIAL INSTITUTIONS AND REFORMS

Objectives:

* understand the meaning of financial instutions
* analyse its operations and functions in changing economic environment.
* make critical evaluation of the role played by financial institutions in the direction of financial reforms.

STRUCTURE:

12.1 Introduction
12.2 Scope and Significance of Fls
12.3 Functions of Fls
12.4 Establishment of Fls
12.5 IFCI
12.6 IDBI
12.7 ICICI
12.8 SFCs
12.9 IIBI
12.10 LIC
12.11 UTI
12.12 GIC
12.13 Summary
12.14 Further Readings
12.15 Self - Assessment test

12.1 Introduction:

Industrial development of a country, to a very large extent, depends on the supply of finance. In India like other countries, the big industrialists can always raise money for their industrial schemes. Before independence one major constraint for the development of industries was the absence of institutional agreements for providing industrial finance on any significant scale. Though the entrepreneurial skill is not lacking, the entrepreneurial class with adequate capital at their disposal is vanishing. As the same time, there was also a great need for modernisation and replacement of obsolete machinery in already established industries. The usual agencies meant to provide finance for large scale industries were either apathetic or were found inadequate and hence the Government of India came forward with a series of financial institutions to provide funds to the large industrial sector.

These financial institutions are not banking institutions in the conventional sense, but development banks which serve as development agencies not only carrying on lending operation, but also developmental activities including promoting projects and guiding and advising the clients in their problems and difficulties.

12.2 Scope and significance of FIs.

The establishment of financial institutions is a largely a post - war creation, first introduced in Europe and Japan, and has now come to be accepted by most developing countries. The primary function of a FI is to provide medium and long term capital for investments. Capital markets in most developing countries are comparatively underdeveloped. Underwriting facilities are generally absent. There is rarely an environment of confidence among investors. In many cases there is a marked absence of entrepreneurs and existing business displays a disinclination to venture into new areas and lacks the incentive to do so.

These financial institutions have been created in response to the particular needs of the country they were to serve and to the political, economic and social environment in which they were to function. Hence, there is considerable variety among these institutions both in the organisation structure and in the scope of the activity. Some are owned exclusively by the Government, others by private institutions and still others by combination of the two. Some are devoted to the promotion and financing of government enterprises, some others exclusively to private investment, and still others to both fields. Some have broad planning functions while some others can lend and take equities. Some can set up and manage enterprises on their own account. Some are concerned with the entire economy, others with a single sector. Some are regional, others national. Ownership, sources of finance, degree of dependence on Government, objectives and methods of operation, differ from one institution to the other.

12.3 Functions of financial institution :

The basic task of a financial institution is to mobilise resources and to deploy them for industrial growth. Now the role has come to mobilise resources and skills, and to channel them into approved sectors of industry consistent with the overall industrial policy of the country. Closely linked to its major role as a financial institution, it has two functions; to mobilise savings and to allocate them. A dynamic approach is required of a financial institution to induce and attract savings and to search for new and better and productive investments. The hard core of the activities is financing. This involves evaluation of investment projects in the light of the declared objectives of the industrial policy of the government. Second appraisal also requires that the institution goes through the same viability appriasal in the project that the entrepreneur himself goes through, asking much the same questions about product-mix, the scale of operatioins, the technology, the plant facilities, the financial structure, the marketing arrangements, the managerial arrangements, the financial results etc. The constructive institution finds itself in the posture of moulding, modifying and advising on the proposals, so as to minimise the risks of failure of the business. It brings to the entrepreneur its background of experience in projects, and forces his clients to re-examine their plans, to understand their implications more clearly, and particularly the available options. Because of its deep immersion in the daily operations of the firms it has an intimate knowledge of the market place.

12.4 Establishment of Financial Institutions in India

The Industrial Finance Corporation was the first all - India term lending institution set up under the Industrial Finance Corporation Act, 1948. This was followed by the establishment of complementary State level institutions known as State Financial Corporations under the State Financial Corporation Act, 1951. These two laws provide for the Central Government and the concerned State Government respectively guaranteeing 1) the share capital, 2) dividend at minimum rates on it, and 3) loans and debentures raised by these respective corporations. Though the State Financial Coirporations were placed under the administrative jurisdiction of the concerned State Governments, the Reserve Bank of India's Industrial Finance Department has been performing the coordinating function and has been advising them practically in all their operations.

In 1955, in order to handle large foreign exchange loans expected from the World Bank, the Government of India agreed to the promotion of another all - India term lending institution, namely, the Industrial Credit and Investment Corporation of India Limited, incorporated as a joint stock company. At about the same time, the National Small Industries Corporation Ltd. (NSIC) was established to assist small-scale industries through marketing, financing and other supporting activities.

In 1956, life insurance was nationalised and the Life Insurance Corporation of India was formed. The share capital of the Life Insurance Corporation of India is wholly held by the Central Government.

In 1958, in order to utilise the American counterpart funds for helping industry, the Refinance Corporation for Industry was incorporated as a limited company under the Companies Act. It share capital was subscribed by the Reserve Bank of India, Life Insurance Corporation of India and a few commercial banks. Its main function was refinancing Commercial Banks which gave them loans to industry.

In 1963, the Unit Trust of India was formed by an Act of Parliament with the help of development finance provided by the financial institutions. Its object was to attract small investors who want a regular return and yet do not want to take the risk of buying equity shares readily. It would raise resources by selling units to the public, investing its funds in the corporate sector through shares and bonds, and paying dividend to their unit holders out of its earnings.

In 1964, the need for coordinating agency was felt. It was also thought that such a coordinating agency should perfectly be kept under the Central Banking authority of the country on the model of the Canadian Development Bank. Accordingly, the Industrial Development Bank of India was established under the Industrial Development Bank of India Act, l964 as a wholly owned subsidiary of the Reserve Bank of India. The shares held by the Central Government and the Reserve Bank of India in the Industrial Finance Corporation were transferred to the Industrial Development Bank of India. And further shares were issued by the Industrial Finance Corporation to be wholly subscribed by IDBI so that the IDBI became a 40 percent shareholder in the IFC. The IDBI has been conceived not only as one more direct financing agency, but also as a refinancing and rediscounting as well as promotional agency. In view of its refinancing functions, it was no longer felt necessary to retain the Refinance Corporation for industry as a separate body, it was merged with the IDBI.

In 1971, a new institution known as the Industrial Reconstruction Corporation of India Limited, was established as a limited company in order to look after the sick and closed industrial units and make efforts to revive them by providing finance and restructure their management. This was converted into a full - fledged financial institution in 1985 and renamed as Industrial Reconstruction Bank of India. Again this is converted into Industrial Investment Bank of India from March 27, 1997.

Another investment institution, more analogous to the LIC and the UTI than to the normal term - lending institutions came into being in 1973; the General Insurance Corporation of India after the Central Government had nationalised general insurance.

12.5 Industrial Finance Corporation of India (IFCI)

IFCI was established in 1948 to provide medium and long term credit to industry. The IFCI Act specifies that the corporation would confine its operations to public limited companies and cooperative socities. The share capital of IFCI as follows:

IDBI - 50 per cent

LIC & GIC - 20 per cent

Scheduled commercial banks - 20 per cent

Cooperative banks 7.71 per cent

Others (Trusts and charitable institutions) 0.29 per cent.

The functions of IFCI can be listed as follows:

1) providing guarantee to loans floated in the public market which are repayable within a period of 25 years.

2) underwriting the issue of stocks, share and debentures, but to be disposed of within 7 years.

3) sanctioning loans or advances repayable within a period of 25 years.

4) extending guarantees in respect of differed payments by importers who are able to make such arrangements with foreign manufacturers. Such facilities were subsequently extended to cover loans raised from scheduled or cooperative banks and differed payments for purchase of capital goods within the country.

Coming to the achievement of objectives is was observed that the Corporation has not succeeded in contributing significantly to the industrial development of backward regions. But in course there have been substantial revisions in policy in this matter. During 1974 - 75 almost 50 per cent of the total sanctions were for backward regions.

The IFCI Operations were confined to public limited companies and cooperatives. It has therefore, a built in bias in favour of the larger industrial sector. But it is required to pay attention to circumstances where normal banking accommodation is inappropriate. The IFCI has frequently not paid much attention in this direction.

The engineering, textile, chemical and metallurgical industries were among those that received the major share of assistance in the first two years of its establishment. The sugar industry received more than 33 per cent of the total assistence in the first place period. In the second plan period paper and sugar alone accounted for 45 per cent of the total sanctions.

In 1965, priorities were fixed in the matter of choice of enterprises. The priorities accepted were that the project should make contribution to a) defence, b) agriculture c) exports, d) import substitutions.

A remarkable change in 1993 was the decision to change the statutory status of the IFCI, and to incorporate it as a company under the Companies Act. This was followed by the partial privatisation of the share capital leading to the gradual introduction of private sector norms of efficiency. For all practical purposes, IFCI, today, is a non - government company with government share less than 50 per cent in share holding. It has also promoted subsidiary institutions such as the Tourism Finance Corporation(TFCI), the Indian Credit Rating Agency (ICRA) and a corporation for promotion of venture capital and technology development.

12.6 Industrial Development Bank of India (IDBI)

IDBI was set up as a wholly owned subsidiary of Reserve Bank of India in 1964 under the IDBI Act.

Following are the prime functions of IDBI:

1) To coordinate the activities of other financial institutions.
2) To supplement the resources of those institutions.
3) To plan and promote the important key industries.
4) To fix up and adopt priorities to promote industrial growth.

In 1976, the ownership of IDBI was transferred from RBI to the Government of India. It was changed into the apex development bank with all other Indian financial institutions, as its subsidiaries are having a coordinating function in respect of all financial institutions.

Unlike other financial institutiuons, IDBI is not hampered by any statutory limitations. There are no restictions regarding the nature or type of security that they may accept from industries. To meet the special assistence requirements of sick enterprises the IDBI took the initiative in setting up in 1971 the Industrial Reconstruction, Corporation of India (IRCI) which, further, has been changed into Industrial Investment Bank of India (IIBI). IDBI has opened regional zonal offices in the North, East and South and also opened branch offices in each state. The IDBI has initiated a survey in backward states in 1970, for the purpose of identifying specific projects in the light of natural and other resources, demand conditions and infrastructural facilities.

An Inter - Institutional Group was formed under the leadership of IDBI representing financial institutions like SFC, SIDC, SIIC, the lead banks in the states, State Government Industries Departments and other term lending institutions, such as the IFCI, ICICI and the ARC.

In 1995, in line with other public financial institutiuons the IDBI also went in for substantial public issue thereby ending its status as a wholly owned government corporation. It is no longer a apex financial institution, but one among several competing institutions where there is both government and private share - holding. It has also promoted a Commercial Bank, namely, the IDBI Bank Ltd. a Credit Rating Agency and an asset management company.

Industry - wise distribution of the assistance sanctioned by IDBI shows that core infrastructure sectors received a major proportion of assistance sanctioned during 1998 - 99.

IDBI has set up a number of subsidiaries and associates with a view to expand the functional reach of the IDBI group and take advantage of opportunities in a liberalised market economy.

To give focussed attention to the needs of small - scale industry, IDBI had set up the small Industries Development Bank of India (SIDBI) in 1990 as a wholly owned subsidiary. The SIDBI Act was amended in March 2000, enabling, among other things, the transfer of IDBI shareholding to a maximum of 51% from IDBI.

The IDBI Capital Market Services Limited (IDBI Capital) was set up in 1993 as a stock broking company to provide a range of capital market related services. It commenced operation as a primary dealer in November 1999. It also acts as a portfolio manager and manages the investment portfolios of several provident and pension funds.

The IDBI has set up a commercial bank the IDBI Bank Ltd. in 1994. This bank offers high technology based top-of-the-line branded products. Consequent upon the initial public offering of the equity share in February 1999, IDBI now holds 57.14% of the equity of IDBI Bank Limited.

To take advantage of the emerging business prospects of the IT sector, IDBI set up IDBI Intech Limited in March 2000 to undertake IT related activities. To realise its goals, INTECH will operate in multidimentional frame-work-as advisor, software developer , systems integrator and implementor, provider of share services, specialist in training and development and also as a forum for ideas on digital economy solutions.

Consequent to amendment of the Debenture Trustee Regulation, 1993, requiring arms length relationship to be maintained between the issues and the trustee, IDBI has set up IDBI Trusteeship Services Ltd, under the Companaies Act, 1956 in March 2001. It proposes to induct an international strategic partner into this venture in due course. The new company would be technology driven to provide safety, upto date information and professional services to the subscribers and issuers of debentures.

12.7 The Industrial Credit and Investment Corporation of India Limited (ICICI)

The ICICI was founded by the World Bank, the Government of India and representatives of private industry on January 5, 1955 to encourage and assist industrial development and investment in India. The main objectives of the ICICI were the following:

1) Providing assistance in the creation, expansion and modernisation of industrial enterprises,
2) Encouraging and promoting the participation of private capital, both internal and external in such enterprises, and
3) Encouraging and promoting industrial investment and the expansion of investment markets.

Over the years, ICICI has evolved into a diversified financial institution. Its main operations include,

1) medium - term and long - term project financing for the infrastructure and manufacturing sectors,
2) corporate finance to meet the treasury requirements of Indian companies,
3) Lease finance
4) A comprehensive range of financial and advisory services.

The liberalisation of Indian economy in the l990s offered ICICI an opportunity to provide a wide range of financial services. For regulatory and strategic reasons, ICICI set up specialised subsidiaries in the areas of commercial baning, investment banking, non-banking finance, investor servicing, broking, venture capital financing and state-level infrastructure financing.

The ICICI estabalished the ICICI Venture Funds as a wholly owned subsidiary. Its primary investment objective is capital investment by way of equity or equity related securities in unlisted companies with significant growth potential. Itís main areas of investments are information technology, biotechnology and life sciences, media and entertainment and retail services.

Formed in 1993 when ICICI’s Merchant Banking Division was turned into a new company, i - SEC today is Indias leading Investment Bank and one of the most significant players in the Indian Capital markets. i - SEC offers its clients widest and in - depth range of services in the market, with high standards of professionalism.

In March 1995, ICICI Brokerage services was setup as a 100 per cent subsidiary of i - SEC. It commenced its securities brokerage activities in February 1996 and is registered with the National Stock Exchange of India Limited and The Stock Exchange, Mumbai.

During the year 1998 - 99, there was a significant shift in the companie’s operations from leasing and hire purchase to distribution and serving of all retail products for the ICICI group. The company has become a critical part of ICICI’s retail strategy aimed at offering a comprehensive range of products and services to retail customers. In view of this change in business, the name of the company was changed from ICICI Credit Corporation Limited to ICICI Personal Financial Services Limited with effect from March 22, 1999.

ICICI Capital Service Limited was incorporated in the name of SCICI Securities Ltd. in Sept. 1994 as a wholly owned subsidiary of erstwhile SCICI Ltd. With the objective of providing stock broking services related to all retail and semi retail liability products of ICICI. The Company was previously involved in distribution of safety bonds, has now been focused its attention being a provider of a comprehensive range of financial products and services from December 1999 onwards.

ICICI Bank was established in 1994. In 2001, the ICICI and two of its retail finance subsidiaries, ICICI PFs and ICICI capaital services Limited, were merged with the ICICI Bank. It is India's second largest bank.

12.8 State Financial Corporations

The State Financial Corporation Act, 1951, has enabled the State Governments to set up State Financial Corporations in order to provide loans to small and medium industries making a significant contribution the industrial advancement to their respective States.

A SFC cannot grant assistance to any party exceeding Rs. 30 lakhs. Nor it can assist any industrial concern with its paid up capital and reserves exceeding Rs. 1 crore in the aggregate. The activities, coverage and overall performance of SFCs have expanded considerably over the years. With the passage of time, their operations have thrown up several problems connected with the organisations, management, resource mobilisation, operational efficiency and overall financial health.

With the introduction of financial sector reforms, the business environment of SFCs along with other financial institutions is becoming increasingly competitive. To enable SFCs to adopt themselves to the emerging environment and promote the growth of the small scale and tiny industries sector in the desired manner, Government has recently enacted amendments to the State Financial Corporations Act, 1951 with a view to enlarging their shareholders base, providing them with greater functional autonomy and operational flexibility and ability to respond to the needs of the changing financial system. Along with amendments to the SFCs Act, 1951, a need has been felt to restructure the SFCs for strengthening and revitalising them. Accordingly a high-level committee has been set up under the chairmanship of Shri G.P. Gupta, Chairman and Managing Director of IDBI for looking into the functioning of SFCs and to make recommendations for their restructuring and revitalisation.

The role of SFCs has become some what uncertain in the changed economic policy environment since 1991. They no longer enjoy the special facilities and their role in the present context should be redefined.

12.9 Industrial Investment Bank of India

In 1971, the Government of India established an institution, namely, Industrial Reconstruction Corporation 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 available with suitable assistance.

The need for more powerful institution provokes establishment of the Industrial Reconstruction Bank of India (IRBI) on March 20, 1985 to deal with the problem of industrial sickness under the provisions of 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 into a full-fledged financial institution known as Industrial Investment Bank of India Ltd. (IIBI). The Bank has shifted its operations from the revival of sick- units to business orientation.

Against the backdrop of the financial sector reforms initiated in the country and the emerging competitive environment, the organisation was restructured and converted into the present form of IIBI in 1997. Since August 2001 IIBI has undertaken an asset reconstruction exercise to unlock NPAs (non-productive assets) for productive purpose. For this purpose it has set up departments for asset reconstruction and risk management.

12.10 Life Insurance Corporation of India

While IDBI, IFCI, ICICI and SFCs are developmental term lending financial institutions, the Life Insurance Corporation, the General Insurance Corporatoin and the Unit Trust of India are not developmental banks but are considered as investment institutions.

The enitre share capital of the LIC which was set up in 1956 after the nationalisation of life insurance is held by the Central Government as a wholly owned corporation in order to carry on the business of life insurance and deploy the savings to the best advantage of the policy holders and the community as a whole.

LIC provides financial assistance to the industrial sector, by granting loans for setting up of industrial estates. A large part of the funds of LIC is deployed as loans to assist the development of social overheads like housing, rural electrification and water supply schemes.

Besides normal investment operations by way of sale and purchase of securities in stock markets and investment in Government securities, the corporation has been anticipating with other all - India institutions in extending direct assistance to industries in the form of loan and direct subscription to shares and debentures of industrial concerns.

12.11 Unit Trust of India (UTI)

The UTI, a public sector mutual fund was established in 1964. The share capital of UTI was subscribed by the IDBI, LIC, SBI and its subsidiaries and other scheduled banks and financial institutions. The main objective of the UTI is to mobilise the savings of the community and channelise them into productive corporate investments so as to provide for growth and diversification of the economy. The management and performance of the UTI for some time has been so bad that in by mid 2001 the financial crisis of the Trust become public and it has virtually betrayed the trust of millions of investors.

12.12 General Insurance Corporation of India

The GIC was set up in 1973 after the nationalisation of general insurance. It is wholly owned by lthe Central Government and has four subsidiaries, viz., National Insurance Company, The New India Assurance Company, The Oriental Insurance Company and the United India Insurance Company. The GIC provides assistance to industries in the form of loans, underwriting and direct subscriptions to shares and debentures, placement of short-term deposits with companies, etc. Along with LIC and UTI, GIC buys back debentures tendered by individual holders back to companies for encashment after a stipulated period and thus provides liquidity to such long-term financial assets.

12.13 Summary :

There are a number of institutions at all - India and State level for assisting the development of large, medium and small industries by providing financial and various other promotional assistance. Among them the most - important were IDBI, IFCI, ICICI and IIBI. IDBI is the apex institution which coordinates the activities of all other financial institutions.

Apart from that, some investment institutions like UTI, LIC and GIC and its subsidiaries are providing industrial finance. State Financial Corporations have also been set up in most of the states.

Development activities of Financial Institutions include 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 consultency, risk capaital assistance, etc.

12.14 Further Readings

1) Ruddar Dutt and Sundaram KPM, Indian Economy, S. Chand and Company Limited, New Delhi, 2001.

2) Aswathappa. K., Essentials of Business Environment, Himalaya Publishing House, New Delhi, 2000

12.15 Self - Assessment test

1) Review the performance of financial institutions.
2) What are the new directions in which the financial institutions must proceed?
3) Bring out the recent reforms followed by financial institutions.

LESSON - 13

Indian Foreign Trade and Exim Policy

Objectieves :

The main purpose of this unit is to help you to :

* understand the role of International or Foreign Trade in the economic development of country.
* identify the Trends in India's Foreign Trade
* examine the control and regulations of Foreign Trade
* outline the Direction of India's Foreign Trade
* review the Exim Policy toward India's Foreign Trade.

STRUCTURE:

13.1 Introduction

Foreign Trade or International Trade plays a vital role in any economic development of the country. It refers in ordinary terms as the trading of goods between countries.As in the words of D. H. ROBERTSON, Foreign Trade is an engine of growth' This International trade is an extension of Internal Trade which provides all commodities and services to any country by exporting required things. It means a single country cannot produce everything by its own, therefore a country should export those commodities which are made at cheaper cost by exchange with other country goods can produce at a lower cost.

Foreign Trade Provides many advantages / facilities like provision of capital through international investment, transmission of knowledge, skill, managerial ability entrepreneurship and influence of competition by preventing monopolies in home country. Finally, International Trade influences major segments of the economy like production, employment, technology and resource utilisation etc.,

13.2 Control and Regulation of Foreign Trade

A develoing economy may be required import of essential consumer goods due to short supply. In this situation, any country should import required scarcity of consumer goods for curbing inflationary conditions, like wise, India also imported foodgrains for a very long time to save from scarcity or food problem. But any country will have to be matched with their exports. Hence, in the early stages of any developing economy may suffer from deficits in balance of Payment in short - run. But heavy dependence on foreign assistance becomes burdensome in the long-run. For clearing all these problems, a country should follow certain control and regulations in Foregn Trade to strengthen the internal economy. All the Governments of any country should follow formal and informal policies to restrict imports and boost exports in addition to the quotas, tariffs and other restrictions. Administrative policies are bureaucratic rules and procedures which are formulated to make it difficult to import the goods into the country.

13.3 Foreign Trade Relations Economic Policies :

International Relations among different countries of government will influence the Foreign Trade directly and indirectly in size and growth. In the words of expert in foreign relations are the state of peaceful co-existence that prevails among the nations of the world, which is governed by various factors, some of which are the power politics, economic interdependence among states and social pattern that set in, due to verious happenings in the course of the passing years." International relations identifies the factory and activities affecting the external policies of the governments. Hence all governments of various countries maintain the balence between their national interests and international responsibilities.

Interaction among different countries of governments will develop the Foreign Trade Relations to co-operations or collaboration and conflicts. Here the Foreign Trade Relations are governed by the Foreign Policies of the governments interms of at social, technilogical, economic and political policies. All the economic policies at Foreign government certainly & influence the Foreign Trade Relations. Now we can observe the Foreign Trade Economic Policy as below :

Economic Policies :

Foreign Trade reletains mainly depends on Economic Policies of different foreign governments. In this way Foreign Trade among nations had developed over the period. Later, the Foreign nations have started co-operations among themselves by establishing various economic organisations like banks, industries, business firms in various countries. All these trade developmets over the period led to the formation of various economic policies like tariff policy, international certels, Intergovernmental commodity agreements, dumping, treemptive buying, Iuotas, licences, state trading and subsides etc.,

1) Tariffs Policy : Tariffs refers to the tax imposed on imports and exports Generally these tariffes are in two (2) forms like specific Tariffs and valorem tariffs. basically, the imposing of these tariffs to protect domestic industry from the competition of foreign companies and to get revenue to the government. These Tariffs Polices are different from country to country. and product to product.

Tariffs Protect domestic industry and also enhance inefficiency. This protectionalism has continued since world war II. The formation of GATT [General Agreement on Tariffs and Trade] and subsequent establishment of world Trade organisation (WTO) are the Erends towards the elemination of Tariffs.

2. International Cartels : International cartels are the agrements among companies or countries, carrying out the same business but located in different countries in order to exert monopolitic competition. Generally, to avoid competition among same businesses in order to exert monopolistic influence over price, quality and quantity of production. For instance the agreements between OPEC [organisation of petroleum Exporting Countries] countries and international Air Transort Association.

3. International Commodity Agreements : When the different countries producing the same products and exporting to the same countries will enter into on agreement in order to avoid competition among themselves.

This type agreement is known as “International commodity Agreement” Presently these agreements are in practice by the name of buffer stock agreements and price controls to meet their abjectives.

4. Dumping : Recently, in Foreign Trade the dumping policy playing a vital role to sell their products. Dumping means selling the products at a price less than the ongoing price in the market or less than the cost of production. By this dumping Foreign companies can sell the exless production or to earn foreign exchnage. Mostly major developed countries used this dumping world war II. Presently, China is using dumping tool by importing their products in Indian market. To avoid this problem, importing countries using anti-dumping duties to protect domestic economy.

5. Pre-emptive buying : This typect economic policy will protect the countries is war crisis situations generally, the countries which are in war crisis buy the goods from the neutral countries in order to depriving the economy from having the products needed by them.

6. Quotas and Licenses : These are quantitatives controls imposed by the importing country on input of goods. Quantitative restrictions or quotes are to protect the domestic industry, from the foreign competition. Recently, Indian government also used this quentitative controls to avoid dumping from Chinese products. However, quotas make the domestic industry inefficient.

7. State Trading : This type of economic tool used by the governments for trading in a limited number of goods and services, State Trading will provide freedom to domestic firm in the country to make healthy and wealthy.

8. Embargoes and Boycotts : These are also playing important role in foreign trade. Embargoes relates to prohibit the shipment of all goods to a particular country or to a group of countries... Where as boycot they are opposite of empbargo. This boycott stops the imports from country a group of countries.

13.4 Trends in Indian’s Foreign Trade :

The origin of India’s Foreign Trade is not a new phase which was back to the age of the indus valley civilisation in India’s History. The movement and growth could be identified during the period Britishers rule. At the Britishers regime, India was a supplier of raw materials and goods to England and an improt of manufactured goods. The actual organised system was developed made after Independence of the country. Particularly, the preperation of economic planning made a several changes in India’s Foreign Trade since five decades. There were many changes occured both in value of exports and imports of the country over the period.

Table 13.1 : India's Foreign Trade : Trends.

(Rs. Crore)

Year	Exports	Growth Rate	Imports	Growth Rate	Trade Balance
1950-51	606	-	608	-	- 2
1951-52	716	18.2	890	46.4	- 174
1952-53	578	-19.3	702	-13.1	-79
1954-55	593	11.7	700	14.8	-107
1955-56	609	2.7	774	10.6	-165
1956-57	605	-0.7	841	8.7	-236
1958-59	581	3.6	906	-12.5	-325
1959-60	640	10.2	961	6.1	-321
1960-61	642	0.3	1122	16.8	-480
1961-62	660	2.8	1090	-2.9	-430
1963-64	793	15.8	1223	8.1	-430
1964-65	816	2.9	1349	10.3	-533
1965-66	810	-0.7	1409	4.4	-599
1966-67	1157	42.9	2078	47.5	-921
1967-68	1199	3.6	2008	-3.4	-809
1968-69	1358	13.3	1909	-4.9	-551
1969-70	1413	4.1	1582	-17.1	-169
1970-71	1535	8.6	1634	3.3	-99
1971-72	1608	4.8	1825	11.7	-217
1973-74	2523	28.0	2955	58.3	-432
1975-76	4036	21.2	5265	16.5	-1229
1976-77	5142	27.4	5074	-3.6	68
1977-78	5408	5.2	6020	18.6	-612
1978-79	5726	5.9	6811	13.1	-1085
1980-81	6711	4.6	12549	37.3	-5838
1981-82	8803	12.8	14293	5.0	-5490
1983-84	9771	11.0	15831	10.8	-6060
1984-85	11744	20.2	17134	8.2	-5390
1985-86	10895	-7.2	19658	14.7	-8763
1986-87	15674	25.9	22244	10.7	-6570
1987-88	20232	29.1	28235	26.9	-8003
1989-90	27681	36.8	35416	25.4	-7735
1990-91	32553	17.6	43193	22.0	-10640
1991-92	44042	35.3	47851	10.8	-3809
1992-93	53688	21.9	63375	32.4	-9687
1993-94	69547	30.4	72806	15.7	-3259
1994-95	82338	18.4	88705	21.8	-6375
1995-96	106465	29.3	121647	37.1	-15182

Source : 1. Economic Survey, 1995-96,
2. Economic and Political Weekly, September 28, 1996

Here we may state some of the salient trends of India's Foreign trade during the periods of 1950 - 51 to 1995 - 96.

* In the first place, the value of exports rose from Rs 606 crores in 1950 - 51 to Rs 1,06,45 crores in 1995 - 96. Likewise the value of imports increased from Rs 608 crores to Rs 1, 21, 647 crores during the same period as quoted above.

* There has been larger growth of imports than exports. i.e., the growth rate for exports ranged from as low as -19.3 percent in 1952 - 53 to 42.9 percent in 1966-67. Similarly, the growth rate of imports varied from -21.1 percent in 1952 - 53 to 58.3 percent in 1973 - 74.

* The major identified factore is an expansion of exports is inaqeluate. During the first three plans, there was small increase in exports due to devaluation of the rupee in 1966 and later GOI introduced a series of fiscal aid, cash incentives to boost exports. But out exports did not find any good position than importing.

* During 1990-91, India has registered negative trade balance due to trade deficit in that year was Rs.10,640 crores.

* Due to change in the structure of exports and Industrialisation, exports of non-traditional terms (engineering goods, handicrafts, readymade garments, fish and fish products, precious stones and jewellery etc) have been increasing than traditional exports.Now, the value of these non-traditional export goods constitute more than 50% of exports.

In 1991, The Indian Govt, initiated major import and export liberalisation Programme as part of its what is now commonly known as the New Economic policy. Import liberalisation like gradual reduction of mport tarfifs and elimination of import restrictions.

13.5 Directions of India's Foreign Trade:

The role of India's Foreign Trade has placed a vital role with all other countries in the world. i.e., India's Foreign Trade covers the countires all around the world. For understanding of directions of India's Foreign Trade, the following classifications would provide a brief review about countries of the world as below

i) OECD (Organisation for Econoinc Co-Operation and Development) Countries, comprise of

* EEC Countires(The European Economic Community): UK, Germany, France, Belgium etc..
* North America : Canada, USA
* Asia and Oceania : Australia, Japan

ii) OPEC (Organisation? of petroleum exporting countries)

iii) Eastern Europe

iv) developing countries

v) Others

Here we can identify the directions of India's imports and exports with other countries of the world like as below

- Imports of India's Foreign Trade from other countries of the world.
- Exports of India's Foreign Trade to other countries of the world.

Imports :

It can be identified that the imports of India's foreign trade majorly depended on OECD countries. At initial years of 1960 - 61, major share of the imports were registered from OECD countres at 78 percent. In OECD countries, USA and UK also played a major role which are influenced the total imports of Indias Foreign Trade. After USA and Uk some of other European Economic Community(EEC) and Asian countries like Bilgium, Japan have become major partners in India's imports are concerned Basically, India imports capital goods, rawmaterials a semi - products from these countries. In this streamline, India imports mainly petrolium, Oil and Lubricants [POL] from OPEC countries the share of OPEC countries in the value of imports went up steeplydue to changes in POL price form time to time Mainly, In 1991, India suffered POL scarcity duly in Gulf crisis. Due to all these reasons, OPEC countries will be an important India's import country in the futute. If we observe, the India's import position from Eastern European countries like USSR, identified that the major import items steel, chemicals, capital eqiupments pharmaceuticals and petroleum products during mid-sixties and mid-eighties. But in mid-nintees, the vaue of imports from these Eastern European countries accounted for only 2 percent as compared to the previous imports. In this derection, other countries like SAARC (South Asian Association for Regional Co-operaion) also registered their exports to India since 1980s . On the whole, India has registered a significant value and volume of imports from different regional diversifications of countries.

Exports :

A significant share of Indias Exports were registered to OECD countries since 1960s. During 1970s and '80s the share of India's exports were declined but in later decades, it has improved significantly. In this deriction, India's exports deversified among othe OECD countries like, Japan, Belgium, France, Germany and Netherlands etc..,The share of Asian countries in Indias exports has steadily gone up. Particularly, due to the co operation of SAARC countries our India's exports were increased largely to the south Asian countries.

From the above India's imports and exports, we can identified the following important major implications like

* In India's imports the major share went to OECD countries.

* USA has registered its leading position for Indias Imports among othe OECD countries.

* The trade relations with East European countries like Russia have declined due to disintegration of the USSR since 1990-91

* Among other products of India's imports, the POL (Petroleum, Oil and Lubricants) & OPEC countries has registered a significant increase level. But interms of trade exports to OPEC is not too significant.

* The Importance of developing countries like Asian countries as trade partner is growing rapidly.

Table 13.2 : Direction of India's Imports 1960-61 - 1993-94 (% Share in value)

	Countries	1960-61	1970-71	1980-81	1990-91	1993-94
1.	OECD :	78.0	63.7	45.7	54.0	56.1
	1. EEC :	37.1	19.6	21.0	29.4	30.1
	- Belgium	1.4	0.7	2.4	6.3	8.1
	- East Germany	10.9	6.6	5.5	8.0	7.7
	- UK	19.4	7.8	5.8	6.7	6.6
	2. North America	31.0	34.9	14.7	13.4	12.7
	- USA	19.4	7.8	5.8	6.7	6.6
	3. Asia & Oceania	7.1	7.4	7.4	11.2	9.7
	- Japan	5.4	5.1	6.0	7.5	6.6
II	OPEC :	4.6	7.7	27.8	16.3	22.5
III.	Eastern Europe	3.4	13.5	10.3	7.8	1.7
	- USSR	1.4	6.5	8.1	5.9	1.1
IV.	Developing Countries	11.7	14.6	15.7	18.4	15.4
	- Asia	5.7	3.3	11.4	14.0	
V.	Others :	2.2	0.5	0.5	3.5	4.3
	Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : India : Towards Globalisation, UNIDO, 1995

Table 13.3 : Direction of India's Exports : 1960-61 - 1993-94 *(% Share in value)*

	Countries	*1960-61*	*1970-71*	*1980-81*	*1990-91*	*1993-94*
I.	OECD :	66.2	50.1	46.6	53.5	57.0
	1. EEC :	36.2	18.4	21.6	27.5	26.1
	- Belguim	0.8	1.3	2.2	3.9	3.0
	- Germany	3.1	2.1	5.7	7.8	6.9
	- UK	26.9	11.1	5.9	6.5	6.2
	2. North America	18.7	15.2	12.0	15.6	19.1
	- USA	16.0	13.5	11.1	14.7	18.1
	3. Asia & Oceania	10.1	15.2	10.6	10.4	9.1
	- Japan	5.5	13.3	8.9	9.3	7.8
II.	OPEC :	4.0	6.4	11.1	5.6	10.7
III.	Eastern Europe	7.0	21.0	22.1	17.9	3.8
	- USSR	4.5	13.7	18.3	16.1	2.9
IV.	Developing Countries	14.8	19.9	19.2	16.8	24.1
	- Asia	7.0	10.8	13.4	14.3	-
V.	Others :	8.0	2.6	1.0	6.2	4.4
	Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : India : Towards Globalisation, UNIDO, 1995

13.6 India's Exim Policy: A Review

EXIM policy implies export and import policy which refers a Trade Policy adopted by a country with other countries reference to exports and imports. Managing any exports and Imports of country strategically needs an understanding of the trade policies. But, in Internantional trade, Exim Policy deals with policies of the national government relating to exports of various goods and services to various countries either on equal terms and conditions or on discriminatory terms and conditions. In this connection, the trade policy can be free trade policy or protective trade policy. In frec trade policy, there is no restrictions on exchange of goods and services between different countries and absence of tariffs, quotas,taxes and exchange restrictions. This free trade policy may be beneficial to many importign and exportng countries, But particularly, the undeveloped countries were suffered from this free trade policy, In view of these things, International economy identified the emergence of protective trade policy in 20th century.

Like this restrictive trade Policy protecting the domestic country from the competition of advanced countries by imposing quotas. Trade policiesof some countries aim at building competencies among the domestic companies by providing subsidies. Thus the countries announce trade policies from time to time to conduct business in various countries. Thus, trade policy will strongly influence the direction, trend and growth of foreign trade of a country in the process of long-term economic development.

India's trade policy (Exim policy) has export and import sides. The major influence on Exim policy in the initial decades after independece. Industrialisation and self-sufficiency in essential commodities were the important objectives of India's trade policy. On the whole, import substitution and protection to domestic industrialisation through a system of tariff and non-tariff control became the highlights of India's Exim policy during 1950 - 51 to 1990 - 91. Since 1990 - 91, there are many remarkable changes placed in India's Exim policy due to remarkable liberalisation as part of the overall economic development.

Phases and changes in EXIM Policy of India:

India's EXIM Policy has undergone the following changes during different periods after Independence.

During 1950-56: During this period , ther was no clear Exim policy and import restrictions of any kind exist due to rough equilibrium in the BOp (Balance of Payment), and with import demand more or less equalling export earnings.

During 1956 - 61 : During the second half of the fifties, the Govt., imposed quantitative restricitons on imports due to heavy industrial planning and the rapid risk in imports put pressure on India's BOPs. During this period, Import substitution was stimulated while exporting were not considered a line of activity to be stimulated.

During 1961-66 : In the early sixties, the quantitative restrictions for imports were continued and boosted exports by creating a favourable atmosphere to export industries and the development of export support services. During this period, export subsidisation was also introduced to offset the penalties when quantitative restrictions imposed.

During 1968-75 : From the end of sixties up to the mid seventies, the country reinstated and augmented the export subsidies. Import policy became restictive and complex. All these steps were taken up due to the refugee inflow with Bangladesh war in 1971, stagment agricultural production and oil-price hike shock of 1973 etc., The scarcity of foreign exchanes became more acute. For this, a new set of restrictive measures for imports was introduced every year. In the letter of the 70's the foreign exchange reserve position improved due to increased agriculutural production and decline in the public investment.

During 1975 - 85 : In this period, the net result was a relaxation in the severity of import control. Protective quotas, remained intact and domestic industry continued to be completely shielded from import competition

During 1985-91: In april, 1985 the GOI [Government of India] announced new EXIM Policy for a period of three yeras. The objective of these policies was to bring some stability to the policy and there by reduce the uncertainity. These two three year policies (1985 - 88 and 1988 - 91) did represent some major simplicfications.

Since 1991 : The radical changes were introduced in India's Exim policy since 1991 for gradual and steady curtailment of import tariffs and liberalisation of quantitative restrictions, The major following changes in Exim Policy since 1991s can be identified. These are

* Liberalised exchange rate management system(LERMS)
* Import licencing liberalisation
* Export promotion capital Goods (EPCG) scheme introduced
* Improvement in Advance Licensing.
* Introducing of EPZs / EOUs
* Tariff Rationalisation.

Major New EXIM policy change in the 90's

Exim Policy, 1990 : The Government of India announced a New Exim Policy on 30th April 1990 which was a year in advance of 1988 - 91 Exim Policy. The main objective of this New Exim Policy are as below.

* The Open General Licence (OGL) List was expanded to facilitate easy access to import of items which are not available in the country.
* A scheme of star trading House was introduced for exports with an average annual net foreign exchange earnings of 7 crore in the preceeding three licensing years of the base period.
* The Import - Export pass book scheme was withdrawn which was introduced in 1986.
* A scheme of automatic licencing was introduced under which up to 10 percent of the value of previous year's lincense could be imported.

EXIM Policy In 1991: India introduced a programme of economic reforms in June 1991 to avoid all the crisis of Balance of payment and foreign exchange resources etc., These economic reforms were influenced the trade policies apart from Industrial policies etc., The major poicy changes in 1991 Exim Policy as follows :

* The Major change in the import Licensing system import entitlements linked to export earnings.
* A new system of advance licensing designed to provide exporters with duty free access to input by simplifying and speeding up the proces of issuing these licenses.
* Another major change in the procedure of import of capital goods was simplified which was up to 25% of the value of plant and machinery subject to a maximum of Rs 2 crore.
* In Trading Houses, 51% of Foreign equity has permitted with all the benefits available to domestic export and trading houses.

* To promote EPZs/EOU several changes were taken and implemented the international price Reimbursement scheme (IPRS) for supply of steel.

EXIM Policy during 1992 - 97: After June, 1991, The GOI introduced a new five (5) year EXIM Policy was announced on 31st march,1992. This exim policy gave a further push to liberalisation by freely allowing imports of all items except a negative list. The following changes were major influenced export and import position of India

* Free Import to all goods including capitl goods except negatice list of consumer goods with 28 specific items and 70 other items those imports would be restricted.
* Export of all itemes are free except a negative list.
* Another liberlised scheme was the export promotion capital goods [EPGG] by which import of capital goods was permitted at 25% import duty subject to export obligation of three plans the C.I.F value of imports.
* A New system of exchange rate management was introduced by the name of Liberalised exchange Rate management System [LERMS] As per this system, 40% of proceeds of exports and inward remittences was purchased at the official exchange rate by RBI for official use. All other receipts and payments are converted at the market exchage rate.
* Certain categories of exports and exporters are eligible for special import Licenses [SILA] inorder to enable them to import specified items which are on the restricted list.
* Imports of Kerosene oil, Liquid petrolium Gas [LPG], Low sulphr heavy stock amongst Petolium products and Phosphatic and potassic fertilizers are decanalised
* The maximum import duties were reduced from 110% to 85%. There were substantial reduction in customs duties on capital goods, ferrous and and non-ferrous metals and chemicals.

Exim Policy during 1997-2002: After1992 - 97 policy, the government of India announced new five year Exim policy for 1997 - 2002 on 31st march 1997. This policy carried further the process of trade liberalisation like cut down the list of quantitative restrictions on imports, simplified procedures, reduced multiplicity of schemes, provided special incentives for agro and allied sectors and encouraged domesetic sourcing of Imports. In addition to these changes the following were some of the identified changes during this EXIM Policy

* Shifting of restricted list of 542 items to the special import Licence (SIL) and OGL lists.
* Introduced a new duty entitlement pass book scheme instead of value based Advane Licence Scheme as it is.
* Continuation of Quantity based advance license scheme as it is.
* The duty has been reduced from 15% to 10% under export promotion capital Goods.[EPCG] scheme.
* The time period has been enhanced from 12 months to 18 months for export obligation period under advance licence.

  On the post-shipment basis, exporter, shall be entitled for duty - free credity at notified rates. He can use this facility to import any freely importable item.
* The new EXIM Policy has revised the threshold of export obligation for the different categories of export/trading houses. These revised thresholds limits and previous thresholds limits are prescribed in the following table.

Table 13.4 : Export Obligation

(Rs. in crore)

Item	*Export House*	*Trading House*	*Star Trading House*	*Super star Trading House*
F.O.B. 3 Year	20	100	500	1500
Average	(10)	(50)	(250)	(750)
Net Foreign Exchange (NFE)	16	80	400	1200
3 year Average	(6)	(30)	(125)	(400)
F.O.B. Preceeding	30	150	750	2250
year	(15)	(75)	(300)	(1000)
Net Foreign Exchange Proceeding	24	120	600	1800
year	(12)	(60)	(150)	(600)
SIL (%)	6	8	10	2
F.O.B. Basis	(4)	(5)	(6)	(11)
SIL (%)	7.5	10	12	15
NFE basis	(6)	(8.5)	(11)	(16)

* Figures shown in brackets relate to previous limits.

* As per the New EXIM policy quantitative based advance licence shceme (Qabal) will continue.
* The Export Promotion Capital Goody (EPCG) payable duty has been reduced from 15% to 10%.
* Another relexation to EOUs/EPZ unity in the Agro Sector will be allowed to sell 50% of their production in Domestic Tariff Area (DTA) without stipulation of any value addition and these units are allowed to input the with of improment at Rs 5 crore and above this limit come under the zero duty EPCG sheme.
* The export obligation period has been enhanced from 12 months to 18 months under advance licence scheme.
* Similerly the validity of advance licence system has been enhanced from 12 months to 18 months.
* An exporter can avil special inport licence (SIL) from 2 percent F.O.B. to 5 percent f.o.b.those who are holding ISO 9000 series certification.
* The volume limit for advance licence under production programme basis has been increased from 25% of average f.o.b. value at exports to 100% average f.o.b. value of exports.

Thus the new EXIM policy has attracted industry in general and exporters in particular. Because the simplification of procedures, reduction in duties and incentives to promote exports etc together helped for the growth of exports.

13.7 SUMMARY :

The India's Foreign Trade is not a new phase which was back to the age of the Indus valley civilisation in India's History. The movement and growth could be identified during the period of Britishers rule. It has grown remarkably, both interms of value and quantity. The role of India's Foreign trade has placed a vital role with all other countries in the world. i.e. The Directions of India's Imports and exports with other coutries at the world made a significant changes in the economic development of the country. India's Foreign Trade has got momentum due to changes in India's Exim policy since 1950 - 51. The objectives of achieving self - sufficiency, protecting domestic industry and Bops, problems and for import control regime through quantitative and non-quantitative restrictions, particularly, India adopted a radical changes in Exim policy since 1990 - 91 crisis. All these changes have opened up the economy to internatinal competition considerably.

13.8 Key words :

Import substitution: The process of developing Industries to produce indigenous goods instead of imported goods and to acquire self sufficient technology to produce by own.

Balacne of Trade: It refers to the diference between teh values of exports and imports in the Interational trade.

Negative List : refers to list of items whose imports are totally banned or stopped.

CIF : Implies cost, insurance and frieght or charged in full.

OGL List: refers open General licence [OGL] which can be imported without a licence and without quantitative restrictions, but with the payment of existing customs duties.

F.O.B : implies free on board. A term given to the system of paying for goods shipped from or to another country when the amount is sufficient only to cover the value of the good and excludes insuracne and freight.

13. 9 Self Assessment Questions :

1. Write the role and significance of foreign trade for a developing economy and analyse the major trends in the growth of India's foreign trade ?
2. India's Import are more critical and indispensable than exporting Do you agree ? Why ?
3. Analyse the trade policy [Exim Policy] reforms implemented by India in the 1990s ? write a new exim policy briefly ?
4. List out the major changes effected in India's exim policy in the '90s and its implications ?

13.10 Further Readings :

LESSON - 14

INDIAS BALANCE - OF - PAYMENT

Objectives:

This lesson familiarises you with the

* The concept of Balance - of - Payment, Balance - of - Trade, and difference between these two
* Different elements of balance - of - payment
* significance of BOP
* Analyse the causes for disequilibrium in BOP and correction of disequilibrium
* BoP crisis in India in 1990's
* Identifying the ways to have a favourable BOP Position.

STRUCTURE:

14.1 Introduction:

The Balance of Payments (BOP) is a systematic record of all economic transactions between the residents of a country and the rest of the world in a specific period of time. Generally BOP statement presents or consists of all receipts on account of goods exported

* services rendered and capital received by resident country
* Payments made by the countries on account of goods imported and services received
* Capital transferred to non residents / foreigners.

Thus the BoP is a wider statistical statement for a given period consists of

* current Account
* capital Account, and
* Cash Account/ official reserve Account.

In this connection we need to have some idea about Balance - of - Trade with reference to Balance of Payment.-

The Balance of Trade is a narrow term which covers / takes into account only merchandise exports and imports, thus BOP considers the visible items of export and import transactions. It means, the Balance - of-Trade will not covers any invisible items like services of banking sector, transport sector, insurance sector, tourism Industry including interest payments and receipts etc., But the BOP takes into account both visible and invisible items. It means, the BOP considered the export and import of goods all kinds, and services like banking, transport, insurance, tourism, Payment of interest, salaries, dividends, etc.,

Thus, the BOP covers wider areas like economic and financial transactions of a country with the rest of the world.

14.2 COMPONENTS OF BOP:

In a BOP statement / table, we can identify the following major parts of BOP transactions. This BoP statement is the summerise of nation's transactions with the outside world.

The BOP consists of
* Current Account
* Capital Account
* Cash Account/official Reserve ASSET Account

Current Account: - It Consists of visible exports and imports of goods and services and invisible export and imports. visible / merchandise exports include the sale of goods to foreign countries. likewise, visible imports include purchase of goods from foreign countries. All merchandised export claims will be Credit and merchandised import claims will be Debit. In the same manner invisible exports include the sale of service to the foreigners like insurance, tourism and banking etc., and interest, dividends received from the foreign countries. Invisible imports include Purchase of services from the foreigners like Insurance, tourism, transportation, banking and financial services etc.,

Generally, the following Debit, Credit examples of BOP will be presented below.

BALANCE OF PAYMENT
COMPONENTS IN CURRENT ACCOUNT

	CREDITS		DEBITS
1.	Merchandise/visible exports (sale of goods)	1.	Merchandise/visible imports (purchase of goods)
2.	Invisible Exports (sale of services)	2.	Invisible Imports (purchase of services)

Capital Account: - It consists of the volume of private foreign investment and public grants and loans from individual nations and multilateral donor agencies such as the IMF and World Bank etc. This private foreign investment / capital will be classified into two (2) categories, like

* Long-term private foreign capital
* short-term private foreign capital
* Long-term private foreign capital includes Foreign investment-both Direct and Portfolio,
* Long-term loans, Foreign currency, Deposits etc,
* Short-term private foreign capital includes loans investment by foreigners with the maturity Period of one year or less.

Here the capital outflow from the home country will treated as a "Debit" item and the inflow capital from a foreign country will be treated as a "Credit" item. These capital inflow and outflow includes both visible and invisible payments (or) receipts.

BALANCE - OF -PAYMENT

Components in Capital Account

CREDIT ITEMS	DEBIT ITEMS
* Private foreign long-term investment in the home country.	* Private Long-term investment in foreign/abroad
* Private short-term Foreign investment in the home country	* Private short-term foreign Investment in abroad
* Unilateral transfers like pension payments, Govt., Grants received from abroad	* Unilateral Transfers like pension payment Govt., grants to abroad,

Official Account: It represents the official sales of foreign currencies and other reserves to foreign countries or official purchase of foreign currencies or other reserves from foreign countries. This Account is the balancing item in response to current and Capital Accounts transactions. Thus, the balance on Current Account plus the balance on Capital Account must always be offset by the balance on official asset Account

14.3 Importance and Format of BOP:

The BOP [Balance of payment] of any Country reveals various aspects of country's international economic position. This BOP Statement shows the country's Financial position at International level. and it helps the country to take decisions regarding monetary and Fiscal policies. It also promotes external trade of the country a lot. There are many provisions regarding BOP towards economic development of country as below:

* The BoP shows the extent of dependence of the country's economic development on the financial assistance by the developed countries
* The greatest importance of BOP lies in its serving as a indicator of changing international economic position of a country.
* The BOP is the economic barometer which can be used to appraise a nation's short-term international economic prospects, and
* helps to evaluate the degree of its international solvency, and to determine the appropriateness of the exchange rate of country's currency.

However, a country's favourable BOP cannot be taken as an indicator of economic Prosperity and unfavourable BoP is not a reflection of bankruptcy. Despite all these reasons, the significance of BoP lies in the fact that it provides vital information to understand a country's economic dealings with other countries.

PROFORMA OR FORMAT OF BOP OF A HYPOTHETICAL COUNTRY

)A BOP table for a hypothetical country is presented in the following table.)

Table 14.1

(Rs crores)

(1) ITEMS	(2) DEBIT (-)	(3) CREDIT (+)	(4) NET BALANCE
I. Merchandise trade (Visible items)			
(a) Exports of goods		30,000	
(b) Imports of goods	10,000		
BALANCE OF TRADE (a)-(b)			(+) 20000
II. Trade in services (invisible items)			
(a) Transportation		8000	4000
(b) Travel.	5000	2000	
(c) Investment Income of Interest & Dividends	3000	1000	
BALANCE IN SERVICES			(-) 9000
	26,000	37,00	(+) 11000
III. Unilateral (Unrequired) Transfers	6,000	-	-
Private remittances, gifts and donations	-	-	(-) 6000
CURRENT ACCOUNT BALANCE (I) + (II) + (III)	32000	37000	(+) 5000
[IV] Long-term foreign capita	3000	1000	-
(a) Direct Investments			
(b) Portfolio Capital			
(c) Official Capital	-	-	2000
BALANCE (I) + (II) + (III) + (IV)	35,000	38,000	(+) 3000
[V] Official Reserves Assets & Liabilities	3000	1000	-2000
(a) gold foreign exchange			
(b) SDR s & GDP s allocated			
(c) IMF Funds			
Total BoP	38,000	39,000	(+) 1000

14.4 Key Indicators in India's BoPs :

Now, we can observe key indicators of India's, balance of payments and ratios of selected items of the balance of payments of India. The major strength of current account of Bop includes two major items which are merchandise exports, imports and invisible export of imports. Incase of the major strength of capital Account of Bop includes capital flows in the form of Direct Foreign Investments. These larger flow of direct foreign investment helps is clearing the current Account deficit without imposing an excessive burden on the external debt management.

Table 14 .2 : Indian's Balance of Payments : Key Indicators

(In US $ million)

	1990-91 (P)	1991-92 (P)	1992-93 (P)	1993-94 (P)	1995-96 (P)	1996-97 (P)	1997-98 (P)
1. Exports	18477	18266	18869	22683	32311	34133	34849
2. Imports	27915	21064	23237	25069	43670	48948	51126
of which : POL	6028	5364	6100	5754	7526	10036	8217
3. Trade balance	-9438	-2798	-4368	-2386	-11359	-14815	-16277
4. Invisibles (net)	-242	1620	842	1228	5460	10321	9804
Non - factor services	980	1207	1129	535	-186	851	1143
Pvt. Transfers	2069	3783	2773	3595	8506	12367	11830
Official Grants	461	460	363	368	345	410	351
5. Current Account Balance	-9680	-1178	-3526	-1158	-5899	-4494	-6473
6. External Assistance (net)	2210	3037	1859	1901	883	1109	899
7. Commercial Borrowing (net)	2249	1456	-358	607	1275	-975	-618
8. IMF (net)	1214	786	1228	187	-1715	-975	-618
9. NRI deposits (net)	1536	290	2001	1205	1103	3350	1125
10. Repee debt service	-1193	-1240	-878	-1953	-952	-727	-767
11. Foreing investment of which :	102	139	555	4235	4604	5838	4993
(i) FDI	97	135	313	586	1943	2526	3165
(ii) FIIs	0	0	0	1665	2009	1926	979
(iii) Euro equities and others	5	4	242	1984	6522	1386	849
12. Other flow[2]	2284	286	-213	2940	-2235	-1131	735
13. Capital account total (net) (Add 6 to 12)	8402	4754	4254	10022	2963	10312	10366
14. Foreign Exchange Reserve use (- increase) (5 + 13)	1278	-3576	-728	-8864	2936	-5818	-3893
Memo Items :	As Per cent of GDP						
Exports	6.2	7.3	7.8	8.8	8.9	8.6	8.3
Imports	9.4	8.3	9.8	9.7	12.0	12.3	12.2
Trade balance	-3.2	-1.1	-2.0	-0.9	-3.1	-3.7	-3.9
Invisibles balance	-0.1	0.7	0.2	0.5	1.5	2.6	2.3
Current account balance	-3.2	-0.4	-1.8	-0.5	-1.6	-1.1	-1.6

(P) : Premilinary Actuals

Q. E : Quick Estimates

1. Figures include receipt on account of India Development Bonds in 1991 -92 and related repayments, if nay, in the subsequent years.

2. Include delayed exports receipts and errors and omissions. For the year 1992 -93, it also includes errors and omissions arising out of dual exchange rates applicable under the Liberalised Exchange Rate Management System (LERMS).

Source : Economic Survey, 1998 -99, Quoted in P.K. Dhar, pp. 891 - 892.

Table 14.3 : Ratios of Sected Items of hte Balance of Payments of India

	Item/Years	1980-81	1990-91	1991--92	1992-93	1993-94	1994-95	1995-96	1996-97
1.	Exports/Imports (%)	51.8	66.2	86.7	81.2	90.5	84.3	78.4	88.2
2.	Current account deficit (US $ million)	2804	9680	1178	3526	1158	2634	5434	4860
3.	Current account/GDP (%)	-1.6	-3.2	-0.4	-1.8	-0.5	-0.9	-1.7	-1.4
4.	ECB/TC (%)	12.6	26.8	30.6	-8.4	6.1	13.6	21.0	n.a.
5.	NRI deposits / TC (%)	11.3	18.3	6.1	47.0	12.0	10.7	37.6	n.a.
6.	External assistance/TC(%)	70.4	26.3	63.9	43.7	19.0	18.9	31.0	n.a.
7.	External Debt (End of period) (US$ million)	23500	83801	85285	90023	92695	99008	92199[2]	n.a.
8.	External Debt/GDP (%)	14.3	30.4	41.0	39.8	35.9	32.7	28.7	n.a.
9.	Debt services payments	10.2	35.3	30.2	28.6	26.9	27.5	25.7	25.1

1. Projection : Based on DGCI & S trade data for APri /- Decemberí96

Notes : (i) TC : Total Capital flows (Net)

(ii) GDP :Gross Deomestic Product at Current Market Prices

(iii) ECD :External Commercial Borrowing.

(iv) n.a : not available.

Source : Economic Survey, 1996 -97.

14.5 DISEQUILIBRIUM IN THE BOP:

As already mentioned earlier that, the balance on current and capital Account is negative, it would represent balance of payments “deficit”. But, if the balance on current and capital accounts is positive, it would be called a balance of payments “surplus”. If there is an overall deficit (payments exceeds receipts) the country in question will meet the deficit either by short - term borrowings or gold and foreign exchange movements. Hence both the surplus and deficit positions represent the disequilibrium in the balance of payments. In reality, almost all countries are experiencing the same problem like surplus or deficit BoP. Only few countries experience equilibrium BoP position. The following are some of the factors / reasons identified for disequilibrium of BoP.

CAUSES FOR DISEQUILIBRIUM

Economic Factors	political Factors	social Factors

In Economic Factors of disequilibrium, some of sub economic Factors may be classified as

* Cyclical Disequilibrium,
* secular Disequilibrium
* Structural Disequilibrium
* Fundamental Disequilibrium

i) ECONIMIC FACTORS:

(i) **Cyclical Disequilibrium: -** It is concerned with the fluctuations in imports and exports due to business cycles. The cyclical alteration between prosperity and depression will give rise to disequilibrium in BoP. Basically, these cyclical disequilibrium influenced by

* fluctuations in the level of income
* different income elasticities, and
* different price elasticities.

(ii) **Secular Disequilibrium: -** It refers to secular trends in the economy. Generally, this type of disequilibrium occurs due to changes in capital formation., technological changes, growth of population, extension of Markets etc.,

(iii) **Structural disequilibrium:** It refers structural changes in economy is cause for this disequilibrium like shift from agricultural sector to service sector, development of effective substitute, changes in transport channels and casts. Generally, this type of disequilibrium enhances the import of capital goods and consumer goods thus resulting in BoP Deficit.

Table - 14.4

Structural changes VIS-A-VIS New changes in imports of India

(Amount in US$ million)

	Particulars of Goods	weights	1999-2000 (during April-Oct.)	2000-01 (during April-Oct.)
1.	Petroleum, oil and Lubricants (POL)	32.8	5637.4	9771.6
2.	Electronic Goods	6.9	1463.6	2046.8
3.	Dying, Tanning, Colouring Meterials	0.5	109.9	147.9
4.	Textiles yaru/Fibrics etc.,	1.1	266.2	337.5
5.	Fertilizer crude	0.5	120.0	144.6
6.	Coal coke etc.	2.2	550.7	650.9
7.	Menufectures of Metals	0.8	208.2	225.5
8.	Paper boards, of News pirnt	0.9	248.3	265.5
9.	Electrical Machinery	0.8	234.0	248.2
10.	Cashew Nuts	0.5	140.8	148.6
11.	Professional Instruments Optical goods etc.,	1.6	473.2	489.7
12.	Iron and Steel	1.5	445.7	455.4

Source : DGCI, Kolkata and the Economic Survey, Government of India.

The growth of POL imports increased from US$ 5637.4 million in 1989-2000 to US$ 9771.6 million in 2000-21 due to the structural chenges in India. At the same time, import of electronic goods increased from US$ 1469.6 millian in 1999-2000 to US$ 2046.8 million in 2000-2001. Inceseet import at textile yaru, Febrics etc., increased from US$ 266.2 in 1999-2000 to US$ 337.5 million in 2000-2001. If we abserve the major weightage of imports, the first place goes to POL imports, (32.8%) and followed by electronic goods (6.9%). Others imports at coal also changed significantly. Imports of these items contributed to the positian of 2.2%. These are the changed structure of imports include : Electrical Machinery, Paper and electronic goods, etc., When imports of these products increased contributed to the deficit in India's Balance of payment.

(iv) **Fundamental disequilibrium:** It implies any disequilibrium creates deficit in BoP for long - time continuously. There is no clear definition regarding this Fundamental Disequilibrium. Though, there is a devaluation prescribed as a remedy for this disequilibrium.

(II) **Political Factors:** Generally political instability, internal disturbances due political changes, Govt., policies due to political parties change in positions create a big problem of BoP disequilibrium in any country. Hence, these factors influence towards the outflow of capital, decline in domestic production and import of goods. for instance, developing countries like Srilanka, India, Pakistan and Etheopia suffers from these factors.

(III) **Social Factors:** Generally, cultural changes, consumer tastes, fashions and preferrence of any country will influence the BoP disequilibrium. These factors increases in imports and deficit in BoP of the country.

14.5 CORRECTIONS OF DISEQUILIBRIUM OF BOP:

Generally, positive (surplus) disequilibrium BoP of any country will enjoys the position as it would be most desirable. But, If negative (deficit) disequilibrium occurs, the country suffers from this situation nationally and internationally. To avoid this problem some measures to be considered by taking Automatic Corrections and Deliberate Corrections.

Correction of BoP Diseequilibrium

- Automatic Correction
- Deliberate Correction
  - Trade Measures
  - Monetary Measures
  - Miscellaneous Measures

Automatic corrections: When deficit BoP exists in any economy indicate that the demand for foreign exchange is higher than that of supply for the same. These demand for and supply factors result in devaluation of the domestic currency in terms of foreign currencies. The increased exchange rate makes the imports costlier and exports cheeper. Therefore, the country reduces imports and increases exports, which inturn increases foreign exchange reserves and restores equilibrium position.

Deliberate Measures:

Generally, govt,. takes certain measures deliberately to control deficit BoP position. These measures may be classified into

(a) Monetary measures

(b) Trade measures and

(c) Miscellaneous measures

The Monetary measures includes,

* Reduction in money supply
* Devaluation
* Exchange control

The Trade measure includes,

* Export promotional measures
* Import Control measures

The miscellaneous Measures includes,

* Loans in foreign currencies
* Attracting foreign investments
* Attracting NRI Deposits, and
* development of tourism etc.,

14.6 India's BOP crisis in 1990's :

In 1990, the Gulf crisis led to a sharp in oil prices. This led to an increase in the import bill of PoL [Petroleum, oil and lubricants]. Thus India suffered from deficit balance both in trade balance and net invisibles in 1990-91 and consequently India suffered from the highest deficit amount of the BoP (Rs. 17,369 crores) during the period 1951-52 to 1994-95. The main reasons for the BoP crisis of 1990 include the economic and import liberalisations announced by Rajiv Gandhi.

- heavy imports,
- devaluation of rupee
- Gulf War
- high price of PoL imports, and
- declining balances of invisible accounts etc.

In this situation, the Government of India has taken some measures to manage the BoP crisis, which are include,

- India taken Import control to stop the import of good gleins, edible oils, iron & steel, paper, fertilizers etc.,
- India has taken export promotion measures to encourage exports of engineering goods, processed foods, fruits, handicrafts etc.
- Attraction of NRI Deposits, loans and advances to the home country
- Introduced liberalised Exchange Rate Management system which enables 40% current account transactions are conducted at the official exchange rate determined by the RBI and the remaining 60% at the market determined rate.
- Current Account Convertibility by which the elimination of restrictions on payments relating to Current Account.
- Liberalised export policy to encourage and boost exports.

14.7 SUMMARY:

BOP is a double entry system of all economic transactions between the residents of Country and the rest of the world carried out in a specific period time. Components of BOP includes Current Account, Capital Account and official reserve Account. India continuously experienced deficit position in its current Account due to deficit in trade balance. However, the some of BOP Disequilibrium measures were taken to make BOP into surplus position. India faced severe BOP crisis in 1990. Steps taken by the Government to manage this crisis include import control, export promotion, liberalized exchange rate management system, and current Account Convertibility.

14.8 Key words:

Balance of Trade: relates to difference between merchandise exports and imports between two countries at a particular period.

Balance of payment: is a double entry system of record of all economic transactions between the residents of a country and the rest of the world.

Current Account: It includes visible exports and imports and invisible items.

Capital Account : It shows the volume of private foreign investment and public grants and loans from individual nation and mutual donors such as IMF and World Bank etc.,

14.9 Self Assessment Questions

1) what is BOP? what is its significance in Indian Economy? Discuss its composition.

2) Describe the trends of India's Bop during 90's? Analyse its features?

LESSON - 16

MULITINATIONAL CORPORATIONS

OBJECTIVES: -

This lesson helps you to understand and femiliarise with :

* What is Multi National Corporation [MNC]
* Differences among various related concepts of MNCs.
* Benefits and Demerits of MNCs.
* Role of MNCs in India.
* Impact of MNC

STRUCTURE: -

16.1 Introduction :

The MNC is not a recent creation. Major companies of colonical power extended their operations in occupied countries. Most of the MNCs in India had originally entered the Indian Market during the colonical era. For ex: the East India Company, which was established in 1600, was given trade with the East Indies and India. Although MNCs existed as for as early civilisation, a new breed of dynamic and aggressive MNCs emerged only over the last four decades. During the past independence era, the actual no of MNCs entered was small. The entry was generally made through collebration with Indian Big businesses. Thus, these MNCs have been contributing to the growth of the developing countries presently, Multinational business enterprises have been followed by financial institutions, insurance companies and accounting firms.

There is no universally accepted definition of the term Multinational corporation. Though As per ILO report, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country (referred to for convenience as the "home Country") while the enterprise carries out operations in a number of other countries as well ("host countries") obviously, what is meant is a corporation that controls production facilities in more than one country, such facilities having been acqurired through the process of foreign Direct investment."

According to Jame. C. Baker defines

The MNC as a company

- Which has a direct investment base in several countries; and
- Which generally derives from 20% to 50% or more of its net profits from foreign capital; and
- Whose management makes policy decisions based on the alternative available anywhere in the world"

Large corporations having investment and business in a no., of countries, known by various names such as Multinational Corporations, International Corporations and Global Corporations have become a very powerful driving force in the world's economy.

16.2 Different Related Concepts of MNC:-

As we discussed earlier MNC has different folds by its Nature. But, In practice each and every activity of MNC can be considered as a separate organisations, such as,

* Multinational Corporation.
* Transnational Corporation
* International Corporation.
* Global corporation / Multinations.

International Corporation: - A company with manufacturing investment or service operation in atleast one foreign country may considered as international corporation.

Multinational Corporation: - It is much wider its operation when compared to International corporation. It must have direct investment in several countries and a considerable share of the total business being in foreign countries. A Multination Corporation is an international corporation. Both have a national headquarters from which international control is exercised.

Transnational Corporation: - It is Multinational in which both ownership and control are so dispersed internationally, for eg., Uniliver and P&G. It means no one central source of power against their subsidiaries on host countries.

Global Corporation: - A Global Corporation is one which views the entire world as a single, homogeneous, market which should be catered by globally standerdised Products. Hence, it is often used to mean more of less the something as the Transnational Corporation.

16.3 Merits and Demerits of MNCs:-

For every concepts of business organisation some merits and demerits are inevitable. Like that, MNCs also have some merits and demerits as follows.

Merits: - Advantages to the Home Countries :

- MNCs will provide the facility of marketing the products of home country throughout the world.
- Industrial Activity of employment opportunities will increase in Home Country of MNC.
- MNCA will enhance/increase the Foreign exchange there by balance of payment (BoP) of the Home Country also strengthen.
- Advantages to the Host countries :
- The investment level, income level and employment level of host countries will certainly improved some extent by entry of MNCs.
- developing countries will have some source of transfer of knowledge and managerial expertise through MNCs arrival.

- Host countries can improve their expert strategies (or) supplies and can decrease their imports by the welcoming of MNCs.
- The cost of production factor for entire globle will be equalise
- Host country can utilise all their material and human resources with the entry of MNCs.
- MNCs can provide cheaper and Qualitative goods to customers in the host country and avoid monopolistic nature of business activities.
- Demerits:- However, MNCs also suffering with some criticisms, which are mentioned below:
- MNCs can influence the policies of host govt., and can control the operations of economy.
- Entry of MNCs in host country can leads to unfavourable effect on BoP (Balance-of Payment)
- MNCs may kill the domestic industry by monopolising the host country's market.
- Another problem is depletion of natural resources in host country by over utilisation of MNCs.
- Some extent the MNCs can influence the political parties and it leads to changes in policies of govt., to favour MNCs.
- Majority of host country culture can influence of favour of change with the entry of MNCs.

16.4 Organisational Operations of MNCs :

Organisations are economic and social entities in which a number of persons Perform various activities to attain overall organisation objectives. In this cannection, MNCs also perform their activities in different countries subject to legal requirements, and international agreements. These operations to MNCs can be find in the following five (5) alternatives.

which are
* Branches
* Subsidicries
* Joint Venture Companies
* Franchiese Hold Type Companies
* Turn - Key Projects.

Branches : One of the way to extend organisation operation of MNC is Branch oriented organisation. Though the branches are working in outside country of parental MNC country, total independent entity is linked up to parent company. As per Indian companies Act 1956, all those companies which are incorporated outside India and have sepup their business in India as Foreign companies.

Subsidiaries : Another way of operations of MNC is in the form of subsidiary Firm. This form of subsidiary, company will enjoy the laws of that subsidiary country and take advantage of the financial, managerial skill of the holding company. This subsidiery organisation has separate entity and also benefit by the international reputation.

Joint Venture Companies : The MNCs can enter their operations in the form of Joint Venture Company. Two or more firms join together to create a new business entity that is legally separate and distinct from its parents. Joint Ventures are established as corporations and owned by the funding partners in the predetermined proportions. Under this form of organisation the MNC makes available machinery, capital goods and technological expertise to the indigenous firm for instance Suzuki corporation entered into a joint venture with Maruti Udyog Ltd., to enter into Indian market by producing cars and other vehicles.

Franchies Hold Type Company : In this form of organisation. The MNC and affiliate firm come under licence agreement. Asper this licence contract,. Affiliate firm produces or markets the produce of a multinational firm. Generally the MNC (Franchisor) can exercise (franchiisee). Under this agreement the franchisee pay a fee to the franchisor. Generally the following facilities provided by franchiser to franchiesee. Which are

--- Trade Mark usage facility

--- operating system.

--- Product reputations.

--- Continuous support system

This Franchising is more popular in USA. Mostly Fast food companies like Mc Donalds, Pizza Hut, and Dairy Queen have franchised restarent as Franchisee world wide.

Turn - Key Projects : As per this form of projects, the MNC undertakes, to complete the project from scratch to the operational stage. Hence, A Turn - key project is a contract under which a firm agrees to fully design, construct and equip a manufacturing, business / service when it is ready for operation for a remuneration. The forms of remuneration includes :

--- a fixed price

--- payment on cost plus basis.

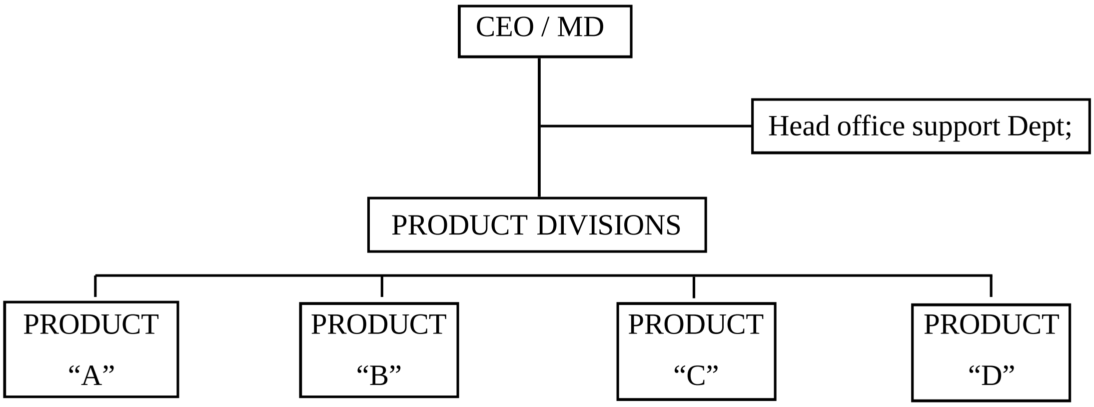
Frequently undeveloped countries invite tenders for construction of certain projects requiring high technical skill. With their huge resources and managerial and technical expertise the MNCs are most suited to carry out this job. Mostly, International turn-key projects include nuclear and railway lines etc... To complete these turnkey project by MNCs, normally the host country's Governments approach the international Finance Corporation or EXIM (Export _ Import Bank) Bank of USA for financial assistance.

16.5 Different Structures Of MNCs

Any organisation, whether it is national and international, must work is any form of business structure. In case of MNCs also should work in different forms / structures. The following are the identified structures of MNCs

* Product type of structure
* Geographical type of structure
* Decentralised organisation
* Strategic business units, and
* Matrix type of structure.

16.5.1 Product type of structure : This type of organisation activities are divided based o individual products, and product line. Here each department of the organisation performs all important activities like marketing, finance, production and human resources. This type of organisation structure overcome all the problems of functional organisation structure. Now we can observe the product type of organisation structure as below.



-- Model of Product organisation structure

This type of organisation structure have some advantages and disadvantages as below.

Advantages :

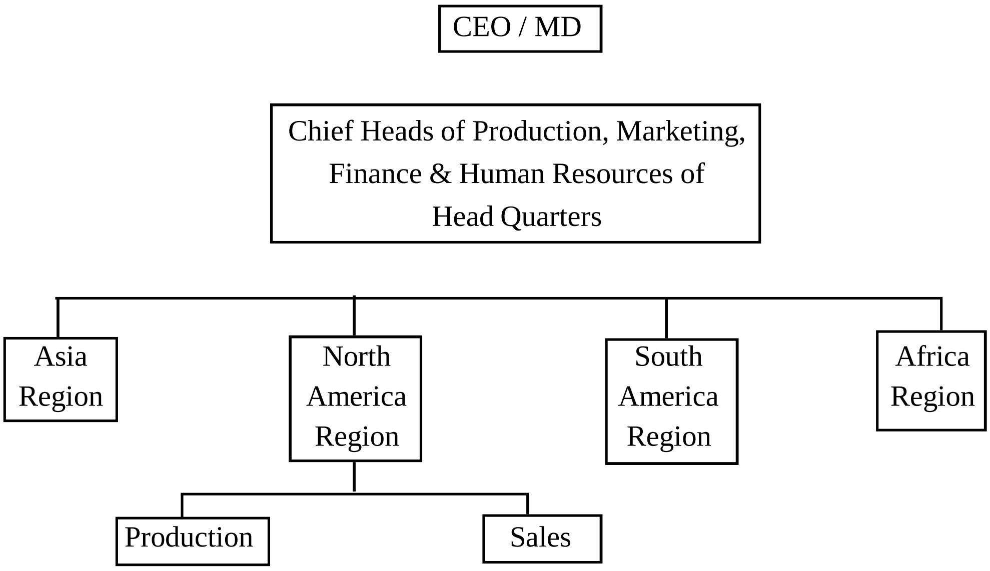
* This type of structure is more appropriate than functional organisation structure.
* Each department in the organisation will performs all activities like marketing, distribution and product design etc.,
* Here each depatment is an individual centre, so that they can take independent decision without consulting of top management and can avoid delays in decision making.
* Whenever the each department take individual decisions, automatically the success or failure can be clearly attributed to the concerned departments.

Disadvantages:

* Here, each department will have production, finance, marketing and human resources. As such specialised personnel and equipment cannot be produced.
* Due to common resources and overhead expenses in the organisation struture lead to Inter - departmental conflicts.
* There was a loss of specialisation due to duplication of equipment and personnel among various departments.

16.5.2 Geographical type of structure :

Here the organisation activities are grouped in each department based a geographical regions. Each Geographical area performs all required functions of organisation like proudce and market the products. Mostly MNCs will perform their operations based on the geographical structure. Generally this structure is also used by chain stores, power companies, dairy products, banking companies and restaurant chains.



Advantages :

* Required products and services of each region will be provided through this type of organisation structure.

* This type of organisation structure built on responsibility of profits or losses.

* Technical development and innovations are improved by the needs of different international areas.

* Following different legal systems depends on different geographical areas.

Disadvantages :

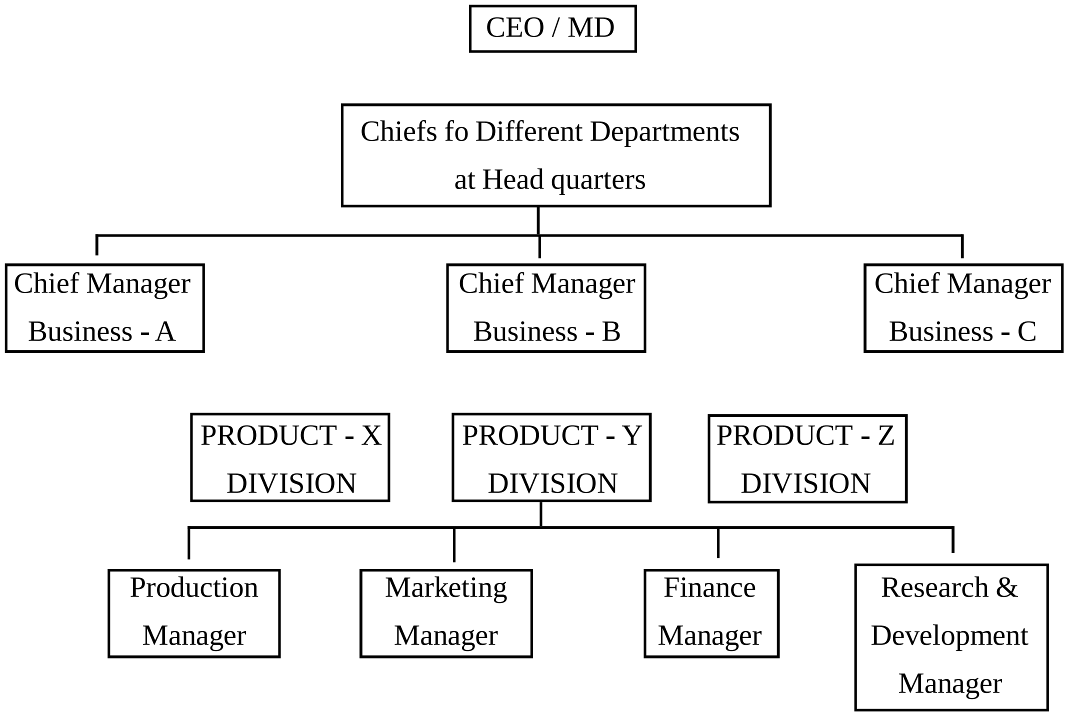
* Co-ordination of all the activities of the entire company would be difficult.

* It is difficult to maintain consistent component image or reputation.

* There would be a problem of imposing degree of uniformity.

16.5.3. Decentralised organisation :

In the Golobalised scenario, the decentralised organisaions are playing a vital role in International Trade. In a deversified firm, the basic organisational building blocks are its business units, each business is operated as a stand - along profit centre. The main purpose of welcoming the decentralised type of orgaisation is to get quality of production and earn more profits. This is a complex oriented structure compare to other product and geographical structures.



Decentralised Business Structure :

Advantages :

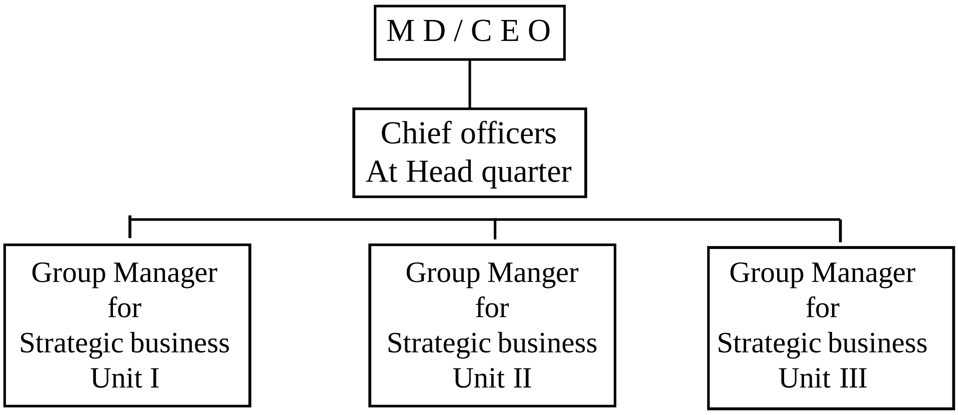
* Authority and responsibility will be delegated to take decisions independently
* Each business unit operates as an individual profit centre.
* Entrepreneurially oriented general manager will manage these business units and he will delegete authority and formulate business plans.

Disadvantages :

* There is an absence of mechanism in co - ordination of related activities across business units.

16.5.4 Strategic business unit :

A strategic business unit is a grouping of business subsidiaries based on some inportant strategic elements common to each. Generally, a single executive cannot control a number of decentralised units of a broadly diversfied company. Hence, the business can be effectively controlled by implementing strategic business structure. In means all the related businesses are grouped into strategic units and the efficient senior executive is delegated with the authority and responsibility for its management. Here, we can observe the business model under this structure.



Model of strategic business unit.

Advantages :

* The main advanteged of this structure is better co - ordination among different divisions with similar missions, products, markets and technologies.
* Another advantage is to control of all the general managers of the strategic business units by chief executive of Head quarter.
* All grouped units will work on the strategically relevant method.
* It helps to allocate corporate resources to areas with greatest opportunities.

Disadvantages :

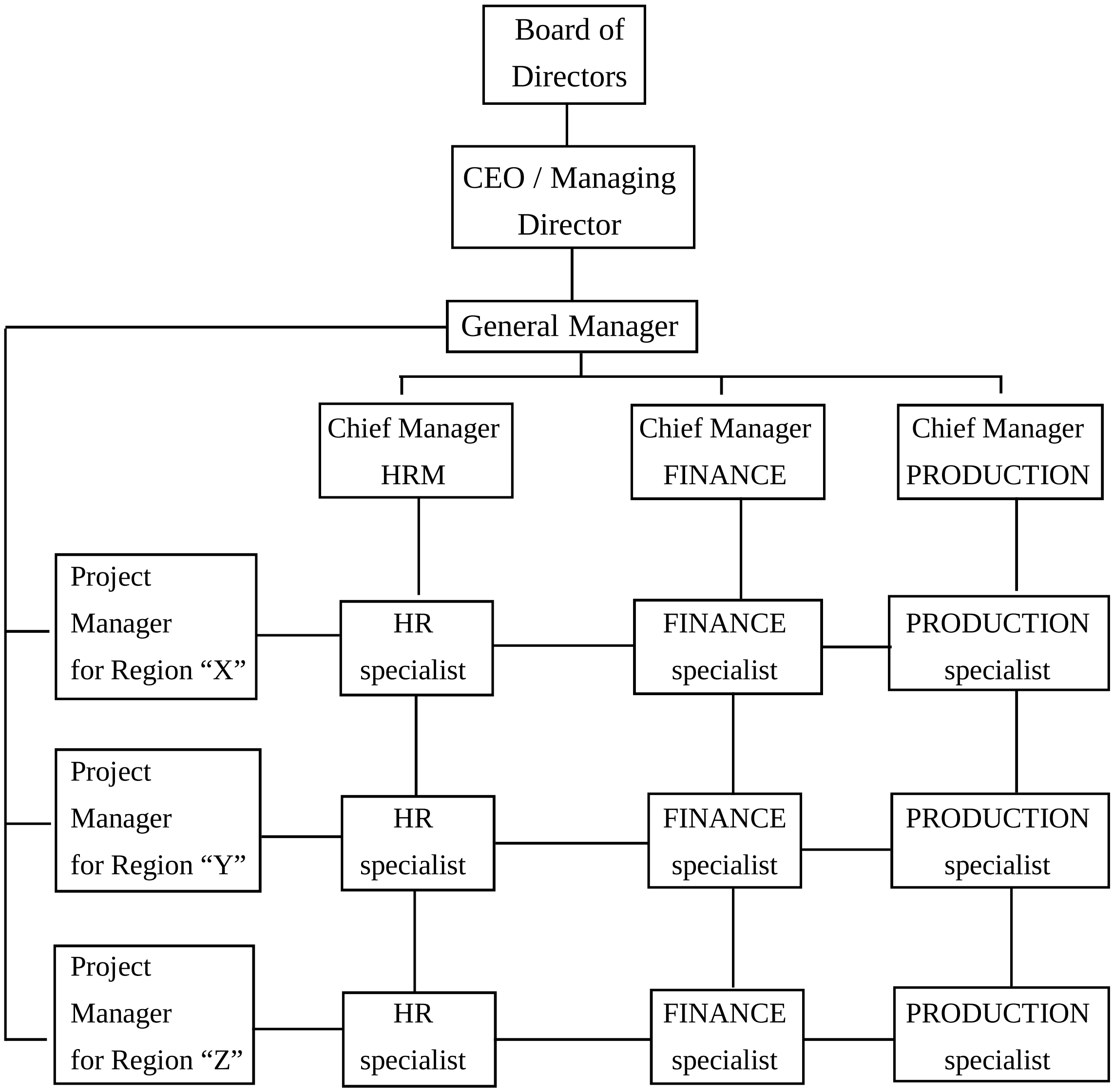
* This structure may cause of conflicts between or among strategic business unit managers for greater share of corporate resources can become dysfunctional.

16.5.5 Matrix type of organisation :

All the observed organisation structures previously possessed a single chain of command. It means the employees should report to only one manager in earlier structures. But, here a dual chain of command exists. i.e, both the functioal and project managers exercise over organisational activites. This type of organisations are called as Matrix type of units. This two (2) type of personnel i.e., a Project Manger and the manager of the functional department at head quarters will perform their respective functions to develop the organisation.

Generally, this type of structure will be useful to the organisation under these circumstances

* When Management concentrate on two (2) key objectives / issues forex : consumer needs and functional effeciency.
* When problem solving is complex
* When lartge scale of diverse information needed.



MATRIX MODEL BUSINESS UNIT

Advantages :

* The organisation can have the advantages of both project type and functional type of organisational sturctures.
* The flexibility is more in this type of structure compare to other structures.
* Here each manager is incharge of unit. Therefore, he can be developed as a general manager through performing general management functions.
* The lower level of functional employees are highly motivated and satisfied with their jobs as they are involved in decision - making.

16.6 REASONS FOR THE GROWTH OF MNCs :

Multinational Corporations undoubtedly, carryout business with the ultimate goal of a profit making like any other domestic business. According to the ILO Report "for some, the multinational companies are on invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others they are monsters which our present institutions, national or international cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept." There are few reasons for the growth of multinational corporations are menifold, the important on Cs being as follows :

1. **Expansion of Mark places activities :** As the countryís GDP and per capital income increase automatically, the large organisations expand its national and international market activities in different territories. In this connection, MNCs also increased their activities / expands beyond the physical boundaries of the country.

2. **Marketing superiorities :** Along with the expansion of market territories of MNC another marketing superiorities also helping the growth of MNCs alot. These superiorities can be summerised as below

   * Availability of more funds and reliable up-to-date information

   * No problem of marketing of its products over the countries.

   * effective advertising and sales promotion techniques help the growth of MNCs.

   * MNC will have market reputation and quick transportation, warehousing facilities.

3. **Financial superiorities :** Generally, MNC will have more financial superiorities compare to National Level Companies. The following are mostly influence the MNC as financial superiorities which are Availability of huge resources and by which MNCs can change the environment and circumstances in their favour. and excellent utilisation of funds / resources in one country for the requirements of another country.

   * MNC can easily get finance from international reputed financial institutions.

4. **Technological Superiorities :** Mostly the underdeveloped countries suffer from unquailability of technological superioties compare to MNCs. Hence, these developing and underdeveloped counties invite MNC for technological support / assistance. Generally, the following are identified technological superiorities will cause for the growth of MNCs.

   * Industrialisation is one of the cause for developing and under developed country's growth. This will be possible only through the transfer technology from MNC of developed countries.

   * Generally, developing countries good at mineral and natural resources but unable to utilise resources due to lac of technology.

   * Unavailability of managerial expertise with technical skills in developing countries. This is the cause for importing these expertises form MNCs of developed countries.

5. **Product innovation :** One of the major strength of MNC is product development and innovation due to more research and development progremmes adopted. Ass they are lack in under developed countries. These things will be provided by MNCs to the developing funder developed countries. So, MNCs collect information regarding customers taste and preferences to make product development and innovations.

16.7 ROLE OF MNCs IN INDIA:-

MNCs have been playing a significant role in the international economy in creating a ‘global shopping centre’ Many of the sophisticated and Qualitative goods have come to the door steps even the remotest places. Thus, the liberlisation of policies, besides other things, have given rise to boosting effect on MNCs operations in India. That to there is no distinction between an MNC and a domestic company in India. Particularly, MNCs are covered under Foreign Exchange Management Act [FEMA] Playing MNCs in India pivotal role in economy. Hence, the role of MNC can be discussed wit the following heads.

* MNCs major objective is profit maximisation by selling more and more goods & services in host country like in India.
* India will be getting more foreign exchange with the operations of MNC in host country.
* Majority of MNCs are concentrating on consumer products rather than capital goods in India to make more profits.
* Particularly MNC will diversify one industry to another industry like ITC entered into Hotel Industry in India.

MNCs contributes to some extent for the growth of Indian economy, Industry and business.

16.8 IMPACT of MNCs : -

In the post - independence period, multinationals from different countries of the world, entered into foreign collaborations in different forms into India. There are at present 300MNcs, are operating in a country. Particularly, After liberlisation of foreign direct investment and removal of FERA restriction in India, a large no, of MNCs have hiked their equity stake to 51% and acquired majority control in their Indian enterprises. We can mentioned some of the important factors which are mostly influence the Indian economy like follows.

- Out of lll subsidiaries of MNCs 116 had parent companies in USA and 25 in U.K.
- With the liberalisation policy of 1991, In Indian economy changed with merger and acquisition in order to build up big mean’ positions in various business areas. These mergers and acquisition could achieve a market capitalisation of over Rs 30,000 crores per Annum in India.
- Due to entry of MNC in Fast Moving Consumers Goods Market (like icecreams, cooking oils, grosseries, kitchen-wares, pickles & cosmetics) of India, the medium size manufacturers of the country faced a threat to survival.
- By the observation of MNCs on India population and potentiality, they are making in roads to enter into every sector of the economy like autos, electronics and fast foods etc.,
- Undoubtedly the foreign companies have made contribution to the development of our economy. Over the year MNCs have perfected not only their products and services but also their management and marketing techniques, into India.

We can observe the top MNCs operations in India and their country of origin from the following list. This list will provide total top 500 MNCs operating in India.

Top 500 MNCs Operating in India and their origins

Name of the country	*No. of MNCs*
USA	157
Japan	119
UK	43
Germany	33
France	32
Sweden	14
South Korea	13
Switzerland	10
Canada	9
Italy	7
Netheralands	7
India	6
Finland	6
Belgium	4
South Africa	4
Spain	4
Norway	3
Turkey	3
Mexico	2
Britain / Netheralands	2
Others	13
Total	**500**

16. 9 RECENT TRENDS:-

Due to Globalisation, Liberalisation and Privatisation, there is a considerable change in the attitude of Indian business towards MNCs. Even Communist Countries in the world opened their economic policy doors to the MNCs.

* Many more nations are now competing with US multinationals in setting up foreign activities for ex., Japanese and European firm accounted significantly among new multinationals.
* Developing countries themselves are now establishing MNCs.
* Now MNC are entering more into service sector other than traditional sectors.

  For ex: banks, retailers, BoPs, consulting firms and trading companies etc.,
* Regional economic integration, which has involved both the worldís largest economies as well as selected developing countries like India.

16.10 SUMMARY :

Multinational Corporation refers produces, markets, invests and operates across the world, particularly, Developing countries allow the MNCs into their countries due to the technological, financial and managerial superiority, MNCs have been increasing their operations in India particularly since economic liberlisational of 1991 policy. However, some countries control the operations of MNCs in their country due to negative impact of MNCs. Finally regional economies integration, which has involved both the word's largest economies as well as selected developing countries.

16.11 KEYWORDS:

Fully owned subsidiary: - A company incorporated in India under the Indian companies Act, 1956. But having 100% equity holding by a single foreign company.

International Corporation: - It conducts the operations in one or more foreign countries, but with domestic orientation. i.e., it extends the domestic products, domestic price, promotions and business policies to the foreign markets.

16.12 SELF ASSESSMENT :

1) What is MNC? How do you differentiate among MNC, International Corporation transnational Coporation & Global corporations?

2) Explain the role of MNC in India? and describe its impact on economy of country.

3) How do you say MNC are playing a vital role in Global economy and describe the recent trends of MNC in Indi

LESSON - 15

FOREIGN CAPITAL AND COLLABORATION

OBJECTIVES: -

The main purpose of this lesson is to familiarise you with,

* To know the need of foreign investment and Technology.
* To identify the various forms of Foreign Capital inflows.
* To Assess the policies towards Foreign Investment/ Capital during different periods.
* To evaluate the Govt., policy towards Foreign Investment.
* To Analyse the composition, direction and magnitude of foreign Investment including Direct and Portfolio investment.

STRUCTURE: -

15.1 Introduction of Foreign Investment / Capital.

15.2 Different kinds of Foreign capital.

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15.1 INTRODUCTION: -

The globalisation of domestic markets in the developing countries has necessitated the need for raising foreign capital to make up the deficiency of internal savings and investments, as the high rates of investments in physical and human capital are the prerequisites to achieve faster growth. Thus Foreign capital has been widely recognised as a herbinger of a country's economic growth in recent years. Several countries have taken appropriate measures to welcome foreign investment. In such circumstances, Foreign assistance in the form of investment or technical collaborations is a pivotal role in economic development of any country.

In India, private foreign investments and technical collaborations have been playing predominant role in economy of a country. Though, the Government policy towards foreign investment has undergone remarkable changes from time to time.

15.2 KINDS OF FOREIGN CAPITAL:-

Foreign capital includes official financing and private financing. Official Development finance (ODF) comes in the form of Grant and loans from individual Government or international agencies like the World Bank and International Monetary Fund [IMF].

Private foreign capital is in the form of loans or investment. The loans component consists of lending by commercial banks and bonds issue by companies. The investment component is also of two kinds.

* Foreign Direct Investment [FDI]
* Foreign Portfolio Investment [FPI]

Foreign Direct Investment (FDI) is defined as investment made by Transnational Corporation or by a non- resident in an enterprise of host (recipient) countries in order to earn private return.

Foreign Portfolio Investment (FPI) is defined as indirect inflow of capital into stock and shares. It includes foreign purchase of securities i.e., shares in the companies located in host country either from domestic or global markets. However, foreign purchases from the secondary market do not directly result in real investment in the economy.

Since the 1990s, there has been a shift from debt to equity financing and from bank to non- banking financing, like that FDI is favoured because of it relative permanancy in the host country. But FPI wouldn't result directly in real investment in the economy.

15.3 MERITS OF FOREIGN CAPITAL:-

In developing countries like India, domestic resources are inadequate to meet the financial requirements of economic development. Hence, the foreign capital is the means of acceleration of growth mechanisms in developing countries. The inflow of foreign capital provides the recipient country with means for importing necessary material and equipment directly needed for developing projects. The widely hoped for gains of foreign capital as follows.

* Foreign Investment resolves the foreign exchange constraint i.e,. enhance the available foreign exchange.
* Foreign capital / Investment fill the resource gaps i.e., between desired investment and locally mobilised savings
* Foreign Investment will transfer technology.
* Foreign Investment provides tax based and revenue to the government.
* Foreign Investment will promote employment opportunity and wage levels.
* Foreign Investment will secure external economies likely organisational expertise, entrepreneurship and skilled labour.

15.4 FOREIGN INVESTMENT POSITION IN GLOBAL SCENARIO :

World Financial markets today show a much higher degree of integration with large amounts of capital flowing across borders to take advantage of the slightest perceived financial or diversification benefit. Much of this cross - border flow has been in the form of easily tradable securities, bonds, equities or other negotiable instruments. All this has happened against the background of inrecreased liberalisation of domestic financial markets and an opening - up markets to foreigners. All capital Controls and other barriers have been removed especially in developing countries.

Some 25 countries are classified as emerging markets by the International Finance corporation, Washington DC. The group companies seven Latin American markets including Mexico and Brazil, ten Asian Market, including India, China, Malaysia and Pakistan, and eight European middle eastern and African nations.

At the global level aggregate private capital flows to emerging markets are now placed at around us $ 90 billion a year, against US $ 20 billion a decade ago. So for, Asian and Latin American countries have absorbed most of the equity flow. Africa, middle east and other areas remain largely ignored. The emerging markets of Asia attracted almost all the private equity investment from japan and half the equity dollars invested in developing countries by the US in 1998. Within regions, there are also big difference. Hang kong attracted more us equity investment than other emerging Asian countries combined. In Latin America, most of the funds have gone to Argentina, Brazil and Mexico . Countries such as Singapore, Taiwan, Malaysia and Indonesia, which have reformed their markets well, attracted greater of global attention than India.

All over world, FDI is seen as an important source of non - debts inflows and is increasingly being sought as a vehicle for technology flows and as a means of building interrfirm linkage in a world in which multinational corporations (MNCs) are primarily operating on the basis of network of global interconnections.

Since the beginning of 80ís, capital flows to developing regions have started gaining momentum and bx the end of 80ís, There had been an enormous increase in the volume of capital flows to developing regions. Large private capital flows to emerging countries area phenomenon of the 90ís. Prior to the 90ís, developing countries received capital flows primarily through official aid. In 1990, official creditors accounted for 50% of the total net capital flows to the emerging markets. In the 80ís they accounted for even a much larger shere.

In table 15.1, the net capital flows to emerging countries is general, flows i.e, private capital flows and official flows in a private capital flows, three types of capital flows are witnessed. Viz, direct investment, portfolio investment and other investments. According to this table, the total net private capital inflows to emerging markets increased from US $ 113 billion in 1992 to US $ 216 billion in 1996. But during this period net official capital inflows to emerging countries come down from US $ 21 billion in 1992 to negligible figure (US $ 0.40 billion) in 1996. Since then, the overall level of net private capital inflows into emerging countries have remained positive but at levels far lower than reached in 1996.

Looking at the composition of the capital flows, net foreign investment represented the larger share of private capital flows to emerging countries. Net FDI flows increased from US $ 35 billion (31%) of total net private flows in 1992 to US $ 113 billion (52%) in 1996 and further to US $ 139 billion (94%) in 1997. But during the same period, net private flows in 1992 to US $ 77.8 billion (36%) in 1996 and further to US $ 52.9 billion (36%) in 1997. Here, net Portfolio investment and even also an important source of finance to emerging countries, though these flows were more volatile after 1994. However, Portfolio flows increased again in 1996 (US $ billion) and decreased by US $ 53 billion (32%) in 1997, because of the Asian places.

Banking flow, formed a major component of private flows until 1996. In addition to syndicated lending, inter - bank loans have accounted for an important share of bank lending to emerging markets, particularly Asia. These flows have also remained volatile.

To Sum - up, the nineties until 1997 market - shift in the composition of capital flows to emerging countries, with a significant increase in net private capital inflows to emerging markets and a decline in the share of official flows. FDI was the most stable component of private flows. Both net Portfolio investment and banking flows, were volatile and the period witnessed major reversals in both, one following the Mexican crisis of 1994 and the other following the Asian crisis of 1997.

Table 15.1

Net Capital Flows To Emerging Markets (in US $ billion)

Year	(A) Net private capital Flows				(B) Net Official Flows	Total (A) + (B)
	NDI	NPI	ONI	TOTAL		
1	2	3	4	5	6	7
1992	35.4	56.1	21.0	112.6(84)	21.2(16)	133.8
1993	59.4	84.4	28.3	172.1(91)	17.2(9)	189.3
1994	84.0	109.6	-57.3	136.3(98)	3.4(2)	139.7
1995	92.6	36.9	97.4	226.9(96)	11.7(4)	238.6
1996	113.2	77.8	24.9	215.9(99.8)	0.4(0.2)	216.3
1997	138.6	52.9	-43.9	147.6(87)	23.5(13)	171.1
1998	143.3	8.5	76.7	75.1(63)	44.7(37)	119.8
1999	149.8	23.3	-92.5	80.5(96)	3.0(4)	83.5

Note : Figures in Parenthesis indicate percentage to total

NDI : Net Direct Investment

ONI : Other Net Investment

NPI : Net Portfolio Investment

Source : World Economic Out look, International Monetary, Fond (IMF), May 2000

15.5 Foreign Investment Policy in India:-

An overview: - Foreign Investment Policy in India ca be studied in two (2) phases, which are

- Foreign Investment Policy Since early independence to 199.
- Foreign investment Policy Since 1991 onwards.

Since early independence to 1991: - The govt., policy towards foreign investment in India is divided into three- (3) periods i.e.,

* During 1948 to 1967
* During 1968 to 1979
* During 1980 to 1991

During 1948 to 1967: - India got political freedom in 1947. The Govt., Since then, has been trying t0 develop agriculture and industrial Sectors in order to eliminate poverty and achieve self-reliance in the economy. In this period, India tried on a strategy of impact substituting of local capability in heavy industries including the machinary manufacturing of sector. The attitude towards Foreign Investment was increasing receptive due to MNC's started showing real interest in India..

During 1968 to 1979: - The government policy during 1968 - 1979 has followed restrictive attitude towards Foreign Investment to protect the domestic base created assets. Locally available skills and capabilities needed some sort of internal industry protection, as these were not able to face competition from more established industrialised country sources. All these factors together prompted the government to streamline the procedure, for foreign collabration approvals and adopt more restrictive attitude towards foreign Investment. In 1973, the Govt., revised Industrial Policy, identifying priority sector where foreign companies were permitted. A regulatory framework the Foreign Exchange Regulation Act (FERA) was promulgated. For the development of International trade, import technology, and policy of the govt., towards the scope of foreign companies in India.

During 1980 to 1991: - During 1980s, some changes in industrial trade policies were promulgated to encourage the inflow of foreign technology, promotion of exports and competition hither/ to much protected domestic market. Some relaxation were make in FERA to argument funds from NRIs including permission of foreign Investment in priority industries under 74%. Scheme.

Since 1991 onwards: - To overcome all economic, social and political crisis India introduced new industrial policy in 1991 for attracting more foreign funds. In this connection, the Govt., has changed various existing economic polices VIZ., foreign Investment policy, taxation and financial policy and NRIs investment policy. These changes ensure a liberal FDI policy. Some of the salient features are:

* There are two types of FDI approvals: one is automatic Approval by RBI., and other is approved by Govt., through the FIPB.

* Foreign collaboration upto 51% equity participation would be automatically approved and equity participation above 51% in foreign collaborations are also permitted subject to approval of FIPB.

* The foreign technology agreements for high priority industries are automatically approved.

* NRIs and Overseas Corporate Bodies (OCBs) are allowed for investment upto 100% equity in high technology Industries.

* The Foreign Investment Promotion Board (FIPB) was revamped for making rules and regulating to make foreign Investment more transparent.

15.5 Foreign Investment Flows into India:-

The foreign Investment flows to India registered its growth momentum. Particularly, the foreign Investment in the form of FDI has changed its dimension. There are certain flows occurred in the wake of the reform of the foreign Investment regulation, the companies have increased their equity stake by these inflows.

The unprecedented liberalisation of the foreign investment policy in India in the 90's (through the dilution of FERA, 1973) has given an alltogether new image to the country regarding the investment destination for foreign Investments. Here we can observe the. Foreign Investment flows into India since 1990s with different segments, which are

* Overall Foreign Investment Flows
* Overall value of FDI approvals in India

* Sector- wise FDI approvals.
* Country - wise FDI approvals
* FDI Flows to Asian Countries Vis-a-vis India.

Overall Foreign Investment Flows into India: - The Foreign Investment Flows to India through FDI and FPI are presented in the following table. It is evident that Foreign Investment in the form of FDI has changed its dimension. The total Foreign Investment inflows was US$ 28897 million during the period 1990-91 to 1998- 99 of which FDI US$ 13425 million with 46.46 percent and Foreign portfolio Investment (FPI) was US$ 15472 million with 53.54 Percent. But portfolio Investment becoming more prone to fluctuations have imported volatility in the total flows. FDI is relatively less volatile and there by creates confidence among foreign Investors.

TABLE 15.2

Foreign Investment Flows to India.
[Direct Investment & Portfolio Investment]

Year	*(A) Direct Investment US $ millions*	*(B) Portfolio Investment US $ millions*	*Total (A) + (B) US $ millions*
1990- 91	97	6	103
1991- 92	129	4	133
1992- 93	315	244	559
1993- 94	586	3567	4153
1994- 95	1314	3824	5138
1995- 96	2144	2748	4892
1996- 97	2821	3321	6133
1997- 98	3557	1828	5385
1998- 99.	2462	(-)61	2401
Total	**13425(46.6%)**	**15472 (53.34%)**	**28897(100%)**

Source: RBI (1999), Hand book of Statistics Indian Economy, Mumbai,

Overall Value of FDI Approvals in India: The data relating to the amount of FDI approvals reveals that there has been continuous increase in the amount of FDI approvals from Rs 534 in crore 1990- 91to Rs. 54891crore by 1996-97. The years 1997-98 and 1998-1999 witnessed a slowdown in the amount of FDI approvals into Indian Economy due to Pokhran and Kargil war. In aggregate terms a total of Rs 2,09, 759 crore were received through FDI approvals.

TABLE 15.3

FDI Approvals in India

Year	*Amount of Approvals (Ps, crore)*	*Amount in per cent (%)*
1990- 91	534	0.25
91- 92	3888	1.85
92- 93	8659	4.22
93- 94	14187	6.76
94- 95	32072	15.3
95- 96	36142	17.23
96- 97	54891	26.17
97- 98	30814	14.7
98- 99	28367	13.52
Total	2,09,759	100.00

Source: GoI, Ministry of Commerce & Industry, Dept., of Industrial Policy and Promotion and Dept., of Industrial Development (2000) New Delhi.

Sector - wise FDI Approvals :-

The sector wise Financial and Technical collaboration Approvals in India have been changing its scenario since 1990s, share the relatives have of financial collaborations were dominating the technical collaborations for electrical equipment, chemical and food processing Industries. The Technical Approvals are more only in the case of metallurgical and service Industries. Industrial policy changes, especially with regard to public sector led to dramatic upsurge in approvals for new projects in power, oil and telecommunication. Nearly half of the total approved foreign investment was proposed in these sectors.

TABLE - 15.4

SECTOR - WISE CUMULATIVE FDI APPROVALS IN INDIA

(Number of approvals during 1990 - 99)

	Name of the Industry	Number of Approvals			Share of Financial Collaborations as% of total
		Total	Technical	Financial	
1.	Power	248	23	225	90.73
2.	Telecommunications (Radio Paging, cellular, Mobile/Basic Telephone services)	586	113	473	80.72
3.	Oil Refinery	425	192	233	54.82
4.	Transport Industry (Including Automobile)	1112	498	614	55.21
5.	Service Sector (Financial, Non Financial, Banking & Other Service)	726	42	684	94.22
6.	Metallurgical Industries	595	320	275	46.22
7.	Chemicals (Other than Fertilizers)	1489	736	753	50.57
8.	Electrical Equipment (Computer Software & Electronics)	2957	1052	1905	64.42
9.	Food Processing Industries	749	138	611	81.58
10.	Hotel & Tourism	395	135	260	65.82
	Others	7172	2967	4205	58.63
	Total	16454	6216	10238	62.22

Source : Government of India, Ministry of Commerce and industry, Department of Industrial policy and promotion and, Department of Industrial Department (2000), Annual Report 1999 - 2000, New Delhi

FDI Flows to Asian countries vis a vis India :

Capital inflows are generally welcome in a developing economy. Of late, there has been an increase pick up invest of FDI. As per FDI Flows to Asian Countries Vis - a - vis India, it is cleared that the FDI inflows to China ranked first followed by Hong Kong, Singapore, Malaysia, Republic of Korea, Thailand, India, Indonesia and so an, where India ranked at the 7th position. During 1994 - 99, China received US $ 238 billion of direct investment, while the total FDI over the entire 90's in India has been of the order of US $ 15 billion, the inflow into China in 1994 alone has been US $ 33.8 billion. In comparison the inflow into India pales into insignificance. The share of India in all Asian countries was 1.51% in 1994, which rose to 3.92% in 1997 and again decreased to 2.32% in 1999. To avoid these problem, India as a country must take full advantage of the global changes in capital flows and attract not only more but also high fuality investment which has strong link to the domestic economy, export orientation and advanced technology.

TABLE - 15.5

FDI inflows to Asian countries *(South, East and South - East Asia of Which)*

(In US $ million)

REGION ECONOMY	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**TOTAL (1994 - 99)**
Bangladesh	11	2	14	141	308	150	626
Brunei	6	13	11	5	4	5	44
Darussalam							
Cambodia	69	151	294	168	121	135	938
China	3378	3584	4018	4423	4375	40400	238203
	7	9	0	6	1		
Hong Kong	7828	6213	1046	1136	1477	23068	73713
China			0	8	6		
India	973	2144	2426	3577	2635	2168	13923
Indonesia	2109	4346	6194	4677	-356	-3270	13700
Korea, Republic	991	1357	2308	3088	5215	10340	23299
Malaysia	4581	5816	7296	6513	2700	3532	30438
Maldives	9	7	9	11	12	10	58
Myanmar	126	277	310	387	315	300	1715
Nepal	7	8	19	23	12	132	201
Pakistan	419	719	918	713	507	531	3807
Philippine	1591	1459	1520	1249	1752	732	8308
Singapore	8550	7206	8984	8085	5493	6984	45302
Srilanka	166	65	133	435	206	202	1207
Tailand	1343	2000	2405	3732	7449	6078	23007
Vietnam	1936	2349	2455	2745	1972	1609	13066
All Asian	6450	6998	8593	9115	8687	93111	491555
Countries	2	1	6	3	2		
Share of India in Asian	**1.51**	**3.06**	**2.82**	**3.92**	**3.03**	**2.33**	**2.83**

SOURCE : World Investment Report 2000.

Country - wise FDI Approvals:

As per the country - wise FDI approvals, the US tops in the list of country- wise FDI approvals from 1990- 91to 1998-99. The second position is occupied by Mauritius. Generally, Speaking Mauritius based investments are nothing but US investments re- routed through Mauritius for Tex benefits. Among other leading FDI partners are U.K., United Korea, Japan, Germany, Australia, Malaysia, Netherlands and others. The contribution of NRIs to FDI in India in also observed to be high (5.33%.) Hence efforts should be directed to attract NRI funds for improving investment prospectus for the country.

Table 15.6

Country - wise FDI Approvals in India

Name of the country	*Amount of Approvals (Rs, crore)*	*% share*
USA	46,185	31.12
MAURITIUS	22,198	15.00
UK	15,977	10.77
KOREA (UNITED)	9690	6.53
JAPAN	9,108	6.14
GERMANY	7903	5.33
AUSTRALIA	6555	4.42
MALAYSIA	5561	3.75
NETHERLANDS	4696	3.16
ITALY	4448	3.00
ISRAEL	4235	2.85
SINGAPORE	3919	2.64
NRIs	7916	5.33
TOTAL	**2,09,664**	**100.00**

Source: GoI, Ministry of Commerce & Industry, Annual Report 1999- 2000,New Delhi,

15.7 SUMMARY : -

India is a country with abundant diversified potential natural as well as human resources. Since Independence, policy makers have been striving to utilize the available abundant natural resources at optimum level. Economic reforms have played a crucial role in the performance of the Indian Economy since 1991. In this situation, Foreign capital has been widely recognised as a harbinger of economic upliftment of a country. Foreign private Capital to any country takes the form of Foreign Direct Investment (FDI) and Foreign Portfolio

Investment (FPI). The performance evaluation of FDI inflows to India since initiation of economic reforms from 1991 witnessed a growth momentum in the history.

15.8 Key Words:

Foreign Direct Investment [FDI]: - The Investment made by a company in new manufacturing and on marketing facilities in a foreign country is referred as FDI

Foreign Institutional Investment [FII]: - It means investment made any foreign institutions such as pensions funds, mutual funds, investment trusts and other Assets.

Global Depository Receipts (GDRs): - It indicates that the depository receipts are marketed globally rather than in any specific country or market.

Dividend Balancing: - The outflow of foreign exchange due to dividend payments is matched by inflow of foreign exchange due to export earnings.

15. 9 Self Assessment Questions:-

1) Describe the need for foreign capital for a developing country like India.

2) Do you on subscribe to the view that liberal foreign Investment Policy is indispensable for globalisation? Why?

3) Explain the concept of Foreign Investment and describe the advantages and govt. Policy towards foreign Investment in India briefly?

4) How do you describe the FDI is more favourable then FPI in Foreign Investment trends?