

BUSINESS ENVIRONMENT

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for
Lovely Professional University
Phagwara

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SYLLABUS

Business Environment

Objectives: The business environment in India has undergone a dynamic change with liberalisation & privatisation in almost all major sectors of the economy. The nature and extent of roles of the state has encountered fundamental changes. With such changes it is necessary for management students to understand how such changes affect business environment.

BUSINESS ENVIRONMENT

Sr. No.	Topics
1.	**Theoretical Framework of Business Environment:** Concept, significance and nature of business environment.
2.	**Elements of environment-** Internal and External; Changing dimensions of business environment, Techniques of environmental scanning and monitoring.
3.	**Planning in India:** Emergence of Planning, Planning Commission, National Development Council, Five Year plans-Achievement and Failures with special reference to 11th five year plan.
4.	**Economic Environment of Business:** Significance and elements of economic environment, Economic Trends: Savings and Investment, Industry, Growth of Infrastructure Balance of Payment. Inadequacies of the program of Industrialization.
5.	**Problems of Growth:** Unemployment, Inflation, Regional imbalances and Social Injustice.
6.	**Government Policies-** Industrial policy, Fiscal and Monetary policies, EXIM policy; SEZ policy, LPG 1991, Direct and Indirect Taxes with special reference to GST and VAT.
7.	**Political and Legal Environment of Business:** Changing dimensions of legal environment in India, Brief introduction to Competition Act, 2005, FEMA, Corporate Governance and Social Responsibility of Business.
8.	**Foreign Investment:** FDI, FII, Determinants of Foreign Investment, Multinational Corporations: Favourable and Harmful effect of the operations of MNCs on Indian economy, Liberalization and MNC's.
9.	**International Business Environmen**t: World bank, IMF, General agreement on Tariff and trade.
10.	**WTO:** the WTO agreement, TRIPS, TRIMS, Non-tariff barriers and Dispute settlement mechanism, Kyoto Protocol.

Unit 1: Indian Business Environment

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Objectives

After studying this unit, you will be able to:

- Assess the theoretical framework of business environment
- Discuss the recent developments in political, economic and financial environment
- Explain the techniques of scanning the environment
- Conduct a SWOT analysis of the Indian economy
- State the achievements of five year plans in India.

Notes

Introduction

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organization is "the aggregate of all conditions, events and influences that surround and affect it." Davis, K, The Challenge of Business, (New York: McGraw Hill, 1975), p. 43.

Environment refers to all external forces which have a bearing on the functioning of business. Jauch and Gluecke has defined environment as "The environment includes factors outside the firm which can lead to opportunities or a threat to the firm. Although there are many factors the most important of the sectors are socio-economic, technological, supplier, competitor and govt."

The recent changes in tariff rates have changed the toy industry of India with the market now being dominated by Chinese products. A slight change in the Reserve Bank of India's monetary policy can increase or decrease interest rates in the market. A slight shift in the government's fiscal policy can shift the whole demand curve towards the right or the left.



Example: Hindustan Lever Limited (HLL) took advantage of the new takeover and merger codes and acquired brands like Kissan from the UB group, TOMCO (Tata Oil Mills Company) and Lakme from Tata and Modern Foods from the government, besides many other small takeovers and mergers.

The new moguls of the Indian business are those who predicted the changes in the environment and reacted accordingly. Azim Premji of Wipro, Narayana Murthy of Infosys, Subhash Goyal of ZEE, the Ambanis of Reliance, L.N. Mittal of Mittal Steel, Sunil Mittal of Bharti Telecom are some of them.

Even a small businessman who plans to open a small shop as a general merchant in his town needs to study the environment before deciding where he wants to open his shop, the products he intend to sell and what brands he wants to stock.

The relation between a business and an environment is not a one way affair. The business also equally influences the external environment and can bring about changes in it. Powerful business lobbies for instance, actively work towards changing government policies.

The business environment is not all about the economic environment but also about the social and political environment. Politically, after the Congress government came to power at the center with the support of the CPI in May 2004, the whole process of disinvestments took a U-turn. Similarly, a new sociological order in India today has created a market for fast foods, packaged foods, multiplexes, designer names, Valentine day gifts and presents, and gymnasiums and clubs etc.

So it is quite obvious that success in a business depends upon better understanding of the environment. A successful organization doesn't look at the environment on an ad hoc basis but develops a system to study the environment on a continuous basis to try and protect the organization from every possible threat and to take the advantage of every opportunity. Some times better and timely understanding of the environment can even turn a threat into an opportunity.

1.1 Theoretical Framework of Business Environment

Notes

The framework of business environment can be divided into three broad dimensions:

1. Internal Environment
2. Macro Environment (External Environment)
3. Micro Environment (Relevant Environment, Competitive Environment)

1.1.1 Internal Environment

Internal environment is internal to the organization and it is controllable. In brief important internal factors are as follows:

1. ***Culture and Value System:*** Organizational culture can be viewed as a system of shared values and beliefs that shape a company' behavioral norms. A value is an enduring preference for a mode of conduct or an end - state. The value system of founders has a great and lasting impact on the value system of organization. Value system not only influences the operations and behavior it also influences the choice of business.
2. ***Mission and Objectives:*** The business domain of the company. The mission and objectives of the company guide priorities, direction, of development, business philosophy, and business policy.
3. ***Management Structure and Nature:*** Structure is the way in which the tasks and sub tasks are related. Structure is about the hierarchical relationship, span of management relationship between different functional areas. Structure of top management, pattern of share holding etc.
4. ***Human Resource:*** It deals with factors like manpower planning, recruitment and selection, and development, compensation, communication, and appraisal. Besides this internal environment includes corporate resources, production/operation of goods and services, finance and accounting system and methods, marketing and distribution.

1.1.2 External Environment

External or Macro or General Environment consists of factors external to the industry that may have significant impact on the firm's strategies. Here we will look at six broad dimensions: Demographic, Socio-cultural, Political/Legal, Technological, Economic and Global.

All these dimensions of general environment are interrelated. These dimensions not only influence businesses, but also influence each other. After a political change in 1991, when Congress government came to power, major economic change took place in the form of LPG, i.e., Liberalization, Privatization, and Globalization. This led to an enhancement in the technological environment of the country. This technological and economical change has transformed the socio-culture environment of the country.

Globalization has also enabled India to become the software superpower of the world. All global organizations now have a new and vast market, as well as cheap manufacturing hub, which has compelled them to change their global marketing and manufacturing strategies.

With this, over the last ten years there has been a drastic change in the India's demography as per capita incomes have risen. The number of young achievers and high earners has increased drastically, which changed the entire demand schedule of products:

1. ***Political Environment:*** It is the political environment of the country which decides the fortune of the business in a country.

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Did u know? After 1917 revolution in USSR suddenly a political change transform the whole equation of business. In India in 1977 Janta government came in power and because of this Coca Cola and IBM have to leave the country. Because of Janta government all liquor company have to close their operations. After the change in the regime in the USSR in late 1980s and early 1990s the whole equation of business changed in Russia.

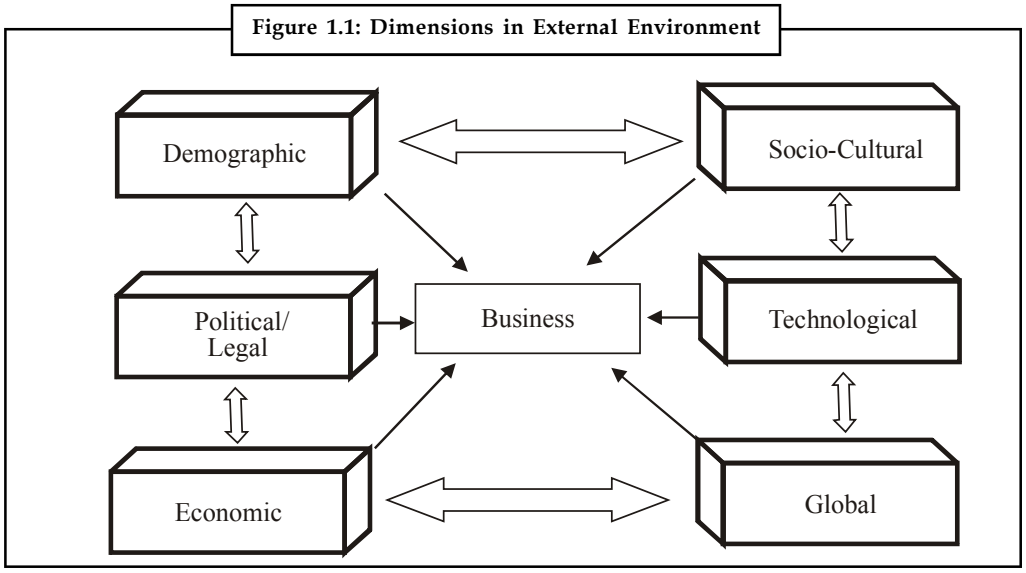
Recently when Dr. Manmohan Singh led UPA government came in power and new economic policy changed the whole definition of business in India on the one hand it gave a bulk of new opportunities for business on the other hand it also brought threat for inefficient organizations. Not only political philosophy but also political stability has a significance importance. More stable will be the political environment of country the more conducive will be the environment for business. The consensus among various political parties on key issues are also relevant in this case.

2. ***Regulatory and Legal Environment:*** The political environment governs the legal and regulatory environment of country. The regulatory environment plays a vital role by dictating the do's and don'ts of a business. Every country has a different legal environment.

   In India we have the Companies Act that governs companies, the MRTP Act which restricts monopoly, various laws regarding shares, the Consumer Protection Act, environmental laws, and the implementation of GATS. GATS has resulted in the implementation of international laws regarding patents. There are also laws for import and export, licensing etc. that have a drastic impact on business and the future of organizations.

   When an NRI Lord Swaraj Paul, a British citizen, tried to take over Escorts, its owners, the Nandas approached the government to save their company. A law restricting any NRI from purchasing shares of an Indian company came into force, and Escorts was saved.

Figure 1.1: Dimensions in External Environment



3. ***Demographic:*** It is the demographic environment which decides the marketing mix for an organization. It decides the type of product the organization comes out with. In India a lot of research and efforts are undertaken to reduce the cost of products and to launch products at the cheapest possible rates.

Example: A one rupee sachet of shampoo or a five rupee ice-cream cone.

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It is the demography that decides the pricing, promotion and distribution strategies. 70% of India's population is lives in villages and of this, 70% are youth, which is why every business house is launching new products, specifically for rural market.



Example: ITC launched its unique and ambitious programme called e-chaupal, targeted at the rural market.

4. ***Socio-culture:*** Socio-culture variables like the beliefs, value system, attitudes of people and their demographic composition have a major impact on their personality and behavior style. The consumers' preferences have undergone a drastic change through the 1990s. This has led to the production of more cars, refrigerators, air conditioners and other articles that were at one time considered ostentatious and luxurious.

   Not only this, socio-culture paradigms also dictates the preference of consumer in different regions.



Example: Companies launch different products in the south and north because of differing preferences. Companies have to change their product portfolio because of cultural preferences as McDonalds and KFC did when they launched their restaurant chain in India.

5. ***Technological:*** Technological forces present a wide range of opportunities and threats that have to be accounted for in the process of business strategy formulation. Technological advancement may dramatically affect an "organization's products, services, markets, suppliers, distributors, competitors, customers, manufacturing process, marketing practices, financial composition, and competitive position." Some of the important factors that influence operating in the technological environment are:

   (a) Sources of technology like company sources, external sources and foreign sources, cost of technology acquisition, collaboration and transfer of technology.

   (b) Rate of change in technology, rate of obsolesce.

   (c) Impact of technology on human being, the man machine system, and the environmental effect of technology.

   (d) Communication and infrastructural technology in management.

   In fact, technology is today a decisive factor. From FMCG to the microprocessor industry, everybody is investing heavily in technology. The technological knowledge of a consumer also influences the decisions. Organizations have to modify products according to the level of technological knowledge of the target costumer, because in developing nations complex household machines that need programming will not work. So they have to be technologically more and more focused.

6. ***Global Environment:*** The international environment consists of all factors that operate at the transnational, cross-cultural level and across the border. The world is a global village today and it is getting closer and closer as far as business is concerned.

   For the sake of business, countries are burying their grievances and forging economic relationships. Erstwhile adversaries like America and Russia are today good friends and China and India are coming closer.

   India has signed a bilateral treaty with Sri Lanka, it is developing close economic relationship with South Africa and Brazil, and is planning to develop a road network in South East Asia. India is also a close all of ASEAN, and is also a signatory of WTO which has a multilateral trade agreement among more than 100 nations.

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India is in a process of laying down a gas pipeline from Iran via Pakistan. All this is just a glimpse of the present international environment. Every new bilateral and multilateral agreement opens new vistas for business and also brings a new threat in the form of global competition.

7. ***Economic Environment:*** The economic environment consists of macro level factors related to the means of production and distribution of wealth, which have an impact on the business of an organization.

   The economic structure of a country, whether it is socialist, mixed or capitalist, has a drastic impact on the economy. Economic policies such as foreign trade policy, industrial policy, fiscal policy, GDP growth rate, policy of licensing, monetary policy, development of financial institutions, development of money and stock market, and the extent of globalization are some of the aspects of an economy that reflect on business in an economy. A slight change in monetary policy can release crores of rupees into the economy that may result in a decrease in interest rate, which further increases investment as well as inflation.

   Also, banks' lending rates decide the level of investment in any country. The higher the interest rate, the lower the level of investment.



Example: In most industrialised nations like the US, this interest rate is between 4% to 6%. In India in 1991, the PLR (prime lending rate) was 17% to 18%, which was reduced to 8% to 10% by 2000 because of a change in the country's economic policy. The current Prime Lending Rate (PLR) with effect from Jan 1, 2009 is 14.75% p.a.

8. ***National Competitive Advantage:*** Despite globalisation, industrialization is clustered in a small and specific number of countries. Most successful computer and biotechnology firms are based in the US, the successful chemical and engineering industry is based in Germany, and the cream of the electronics industry is based in Japan.

   Similarly, the successful call centers are clustered in India as are many of the customised software companies. This suggests that the nation and its environment in which a company is based may have an important bearing on the competitive position of that company in the global marketplace.



Task

Collect some data pertaining to the political and legal framework, that has bought significant changes in India's business environment.

Importance of Environment

1. ***Environment is complex:*** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these interact with each other to create entirely new sets of influences.
2. ***Environment is dynamic:*** The environment is constantly changing in nature. Due to many and varied influences operating there is dynamism in the environment causing it to change its shape and character continually.
3. ***Environment is multi faceted:*** The same environment trend can have different effects on different industries. As the GATS is an opportunity for some companies and threat for some companies.
4. ***Environment has a far reaching impact:*** The environment has far reaching impact on the organization. The growth and profitability of an organization depends critically on the environment in which it exists.

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5. ***The impact of an environmental trend often differs significantly for different firm within the same industry:*** Any change in environment may have different impacts on different firms operating in the same industry.



Example: As in pharmaceuticals industry in India the Impact of new patent law will different on research based pharmacy companies as Ranbaxy and Dr. Reddy's Lab and will be different on small pharmacy companies.

6. ***The general environment usually holds both opportunities for, and threat to, expansion:*** Development in general environment often provides opportunities for expansion in terms of both products, and markets.



Example: Liberalization in 1991 opened lot of opportunities for companies and HLL took the advantage of opportunities and acquire many companies like Lakme, TOMCO, Kissan etc.

Changes in environment also pose serious threat to entire industry. As liberalization of 1991 poses serious threat of new entrants in the form of MNC to Indian firms.

7. ***Development in the general environment change competitive battle line:*** General environmental changes may alter the boundaries of an industry and change the nature of its competition. This has been the case with deregulation in the telecom sector in India. Where since the deregulation every second year new competitor emerges old foes become friends, M&A take place with every new regulation.

8. ***Many developments in the general environment are difficult to predict with any degree of accuracy, while others are readily predictable:*** Macroeconomic development such as interest rate fluctuations, the rate of inflation, and exchange rate variations are extremely difficult to predict on a medium or long-term basis. On the other hand some trends as on demographic, income level, age can be forecast.

1.1.3 Micro Environment

Micro Environment or the competitive environment refers to the environment, which an organization faces in its specific arena. This arena may be an industry, or it may be what is referred to as a strategic group.

Besides looking at primary demand and supply factors, firms examine the state of competition they face because that determines whether they will remain in the same industry or start a new one. All the business decisions – what business, pricing, distribution channel, promotion strategy, product portfolio, etc., depends on the competitive position of the firm.



Example: A new entrant in the glucose biscuit segment will have to study and consider the marketing mix as well as strategy of existing players like Britannia, Parle, Priyagold, etc., before deciding its marketing mix.

Following are the key Micro Environment factors:

The Five Forces of Competition

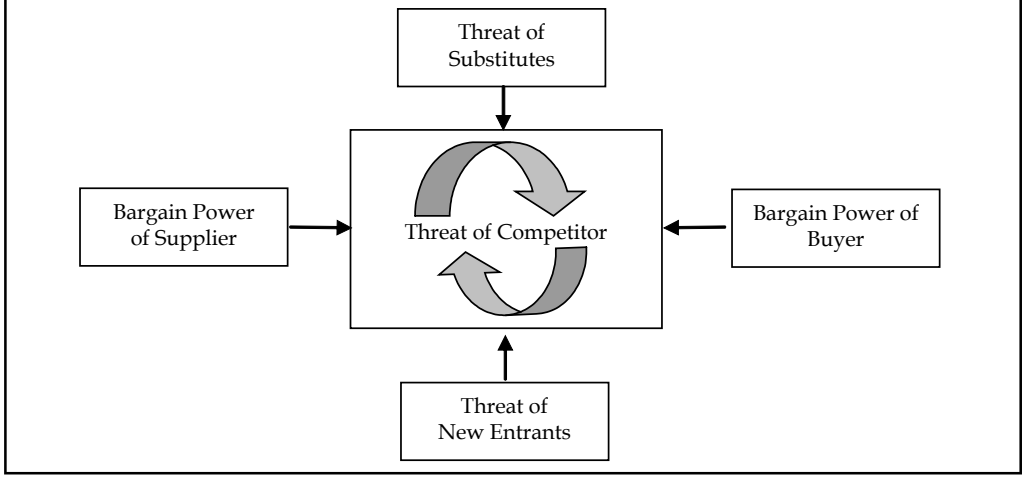
Professor Michael Porter of the Harvard Business School has demonstrated the state of competition in an industry as a composite of five competitive forces. Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates.

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According to Michael Porter the five forces of competition are:

1. ***Threat of Competitors:*** The rivalry among sellers in the industry.
2. ***Threat of New Entrants:*** The potential entry of new competitors.
3. ***Threat of Substitutes:*** Market attempts of companies in other industries to win customers over to their own substitute products.
4. ***Bargaining Power of Suppliers:*** The competitive pressure stemming from the supplier-seller collaboration and resultant bargaining.
5. ***Bargaining Power of Buyers:*** The competitive pressure stemming from seller-buyer collaboration and bargaining.

Figure 1.2: Michael Porter's Five Forces Model



To help make this tool more relevant and useful we've used two different examples after each force: An example based on a mythical childcare charity interested in bidding for a local authority contact to provide respite care for parents of disruptive children.

Children Charity Co. (CCC): CCC is currently a small provider of 'relief' services for parents of children with behavioural difficulties. They have heard that the local authority in the area where they work will be considering whether to continue using the NSC (National Society for Children) to provide residential childcare for children who are in care/looked after. This contact could be worth £5M and could lead to a national series of contracts for CCC. The CEO and senior team are trying to decide what to do.

1. ***Threat of Competitors:*** When rivals compete to win over customers to improve market share or profitability - that is rivalry among competing sellers. The intensity of rivalry among competing sellers is a function of how vigorously they employ tactics such as lower prices, snazzier features, expanded customer service, longer warranties, special promotional offers, and introduction of new product. All these lead to adverse impact on the profits of the firm. Rivalry intensifies as the number of competitors increases and as competitors become equal in size and capability.

   Rivalry becomes stronger when the demand for a product grows, and industry conditions tempt competitors to cut prices or use other competitive weapons to boost unit volume. Rivalry is also intensified when one or more competitors are dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals, or when exit barriers are very high and it costs more to get out of business than to stay on. Sometimes,

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stronger companies outside the industry acquire weak firms in the industry and launch aggressive, well-funded moves to transform their newly acquired competitors into major market contenders.

Rivalry is weak when most competitors in the industry are relatively well satisfied with their sales growth and market shares. Such companies rarely make concerted attempts to steal customers away from one another, and have comparatively attractive earning and returns on investment.

(a) *Is it difficult to compare competitors?* In a way it's more difficult if competitors are very different. For example you could agree that trains compete with buses in terms of getting from A to B. But actually they are very different I terms of who uses them and why. Equally for our charity if a competitor came along who said disruptive child behaviour is a medical problem - i.e. that the children should stay at home and be given medicine that would change this from a social care challenge to a medical one. If the competition changes this makes it difficult for the childcare charity to decide what to do. (Back to Ritalin?)

(b) *Is there very high 'exit barriers'?* 'Exit barriers' mean that it is difficult - economically, emotionally and legally - to leave the market. In a commercial example there may be a contract or the redundancy costs may be high. For our childcare charity these concerns may also exist - but many charities also have a high emotional commitment to their work. This may exist long after that work has ceased to be relevant.

2. ***Threat of New Entrants:*** A new entrant in an industry represents a competitive threat to established firms, sometimes called the incumbents. The entrant adds new production capacity and brings substantial resources that were not previously required for success in the industry. But there are various barriers to entry that the new player has to face. These barriers are a challenge for the new entrant and a protective shield for the established player and include:

(a) *Economies of Scale:* Existing large firms enjoy lower costs per unit. They have enough room to reduce prices as they may enjoy higher profits. Also, they could be selling products at such a low price that new player may not able to produce the same output.

(b) *Cost Disadvantage Independent of Scale:* Besides economies of scale, existing firms have other many cost advantages such as proprietary product knowledge, patents, favorable access to raw material, favourable location, lower borrowing cost and government subsidies.

(c) *Learning and Experience Curve:* Established companies have the advantage of learning curve. Because of this learning curve established firms are in a better position as they have skilled and trained human resource.

(d) *Product Differentiation:* Differences in physical or perceived characteristics make an incumbent's product unique in the eyes of the consumer.

(e) *Capital Requirement:* It is said the offender must have three times the power than that of the defender. Thus, an offender requires capital not only to establish a new business but also to compete with established firms. Even the, cost of capital is higher for a new firm as lenders hesitate to provide capital to new entrant.

(f) *Switching Costs:* Sometimes, the costs (physical, psychological and financial) incurred in switching from one supplier to another also resists the customer from going for a new vendor.

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(g) *Access to Distribution:* The middlemen are reluctant to deal with a product that is new to the market. This situation becomes more critical in industrial and international markets as there are few middlemen because they usually prefer established products.

Here consider above example of CCC

(a) Is it easy to enter the market or are there economic or legal barriers to entry?

(b) Does it cost a lot to set up in competition? E.g. it's expensive to start a railroad, and you need a license. For a CCC it's expensive to set up a nationwide network of childcare centres - and they would need licenses/LA approval.

(c) Is it difficult to persuade consumers/users to switch from existing providers - because of brand loyalty, cost of switching, or length of contract, E.g. competing against Coca Cola or persuading people to switch from Windows to Macs is a challenge. If the local authority has a 3 year contract with NSC - the existing charity supplier - to provide support for 'difficult' children then CCC getting that contract from that other charity could be very expensive and challenging.

(d) Do existing providers have a 'scale-independent' costs advantage? e.g. in a commercial setting this is a unique advantage like a copyright like for Windows, or a broadcast license like ITV which no n eels can have. In the case of CCC if they or their rivals have an accredited training programme for care workers childcare workers, or the ability to use funds from their general fundraising to support local childcare, then these would be similar advantages.

3. ***Threat of Substitutes:*** This refers to the market attempts of companies in other industries to win customers over to their own substitute products.



Example: A producer of scooters will compete with motorcycle makers, newspapers compete with television operators, tea competes with coffee, CD players compete with DVD players, Aspirin manufacturers compete with the makers of Acetaminophen, Brufen and other pain relievers. Makers of eyeglasses compete with the makers of contact lenses, road transport services compete with the railways.

Strong competitive pressure from substitute products depends upon three factors:

(a) Whether attractively priced substitutes are available?

(b) Whether the buyers view the substitutes as being satisfactory in terms of quality, performance, and other relevant attributes?

(c) Whether buyers can switch to substitutes easily?

The presence of readily available and attractively priced substitutes creates competitive pressure by placing a ceiling on the prices an industry can charge for its product without giving customers a reason to switch to substitute and thus risk sales erosion. How readily available and cost comparable are substitutes? In the mobile phone industry the big providers are all very similar and the cost of switching very small - except for the contract! For our childcare charity this might be more of a challenge if, for example, the local authority was comparing fostering as an alternative proposition - or even giving out Ritalin to kids in schools

4. ***Bargaining Power of Suppliers:*** Suppliers have little or no bargaining power when there are many suppliers and supply exceeds demand. Suppliers compete with each other to grab orders. On the other hand, bargaining power is high when it comes to high technology

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and the supplier has an expertise, or if the supplier is working at economies of scale. The supplier has high bargaining power if he has significant cost advantage or constantly improves the product in the interest of the consumer, or finances the buyer. what's the 'relationship' of buyers to sellers? this is important if there are relatively few suppliers compared to buyers since it will give them lots of say on cost and form of supply e.g. directory enquiries before deregulation to 118 numbers meant it was more or less a monopoly. Equally if the suppliers don't need to use you as a channel then this can create problems e.g. when companies like Dell decide to sell direct this causes challenges for computer resellers. For our childcare charity they could consider whether many other organisations are actually in competition for this contract. If not they have a better position. Also do they need the authority to provide this service? Could they instead 'sell' direct to parents or could they persuade private donors to pay for this service?

5. ***Bargaining Power of Buyers:*** Today we are living in a market-oriented economy, where consumer is king. The buyer enjoys significant bargaining power when there are many sellers, few buyers or when production capacity exceeds the demand.

   The buyer can bargain for reduction of prices, quantity discount, better quality at same price, better after sales service, or even credit or finance facility. Boeing, for instance, arranges finances for its buyers. Today the consumer durables industry and the two wheelers and automobile industry arranges finances for customers in collaboration with banks.

   (a) *is scale or volume important in this transaction?*



Example: Wall mart can buy in bulk more cheaply than your local corner store and so has a massive advantage. In our charity example NSC - the current provider - may be able to provide a very good deal if it is providing many places for many local authorities. Or the authority itself may be seen as the buyer and able to demand large discounts or conditions in exchange for providing a large contact.

   (b) *how is the cost of supplying the service made up?* If a large part of the cost is profit then a buyer who knows this will bargain hard. Some fundraising consultants often discount heavily to secure work since much of their fee is profit. Is our charity using local authority contracts as 'cash cow' to fund other work that isn't available to contract? If so this might lead the LA to want negotiate on price.

   (c) *Is there the potential for the buyer to become a provider themselves?* this technically known as 'backwards integration'. In this case a mobile phone manufacturer might set up their own phone network. Or in our care example, the local authority might decide to set up their own provision and create an in-house bid through the social work department.



Notes The Indian steel industry comprises of the producers of finished steel, semi-finished steel, stainless steel and pig iron. Indian steel industry, having participation from both public sector and private sector enterprises, is one of the fastest growing markets for steel and is also increasingly looking towards exports as driving the growth of the industry.

Aruvian's R'search analyzes the Indian Steel Industry in Michael Porter's Five Forces Analysis. It uses concepts developed in Industrial Organization (IO) economics to derive five forces that determine the competitive intensity and therefore attractiveness of a market. Porter referred to these forces as the microenvironment, to contrast it with the more general term macro-environment. They consist of those forces close to a company that affect its ability to serve its

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customers and make a profit. A change in any of the forces normally requires a company to re-assess the marketplace.



Caselet

Porters five forces at Tesco PLC

This section considers how Porters five forces might be applied to the problems facing Tesco PLC, including an investigation of the threat of substitutes from other supermarkets, buyer power in relation to grocery purchases, grocery supplier power, and the power of the customer at the till.

Classical economics predicts that rivalry between companies should drive profits to zero. This is partly down to the threat of substitutes. For instance, Tesco has competition from companies like Sainsbury that can provide substitutes for their goods. This drives the price of groceries down for customers of both companies.

Buyer power acts to force prices down. If beans are too expensive in Tesco, buyers will move to Sainsbury. Fortunately for Tesco, there are few other large supermarket companies. This means the market is disciplined; that is, the supermarkets have a disciplined approach to price setting. Discipline stops them destroying each other in a profit war.

Supplier power is an important part of the Porters five forces model. Implications for Tesco are many. Supplier power is wielded by suppliers demanding that retailers pay a certain price for their goods. If retailers don't pay the price, they don't get the goods to sell. But large supermarkets, like Tesco, have an overwhelming advantage over the small shopkeeper-they can dictate the price they pay the supplier. If the supplier does not reduce the price, they will be left with a much smaller market for their produce.

Tesco, Asda, Sainsbury and other supermarket chains put up considerable barriers to entry. Anyone starting up a new supermarket chain has barriers imposed on them, implicitly or explicitly, by the existing supermarkets. For instance, Tesco may have cornered the market for certain goods; the new supermarket will not be able to find cheap, reliable suppliers. Tesco also has the advantage of economies of scale. The amount it pays suppliers, per-item, is a lot less than the corner shop. It achieves this, partly, through buying large volumes of goods. A small supermarket chain can only buy a relatively small volume of goods, at greater expense.

Before developing a Porters five forces model of Tesco consider other industries, from real estate agencies to the bicycle manufacturing industry. This will give you the broadest picture of how Porters five forces can be used. Here we'll consider, briefly, two industries outside the supermarket sector.

The Sixth Force

According to Andrew Grove, the former CEO of Intel: "Porter's five forces model ignores a sixth force: the power, vigor and competence of complementors". Complementary products are those products that add value to some other product. They are consumed with some other product. Because they are used together, the demand of one product depends upon the demand and availability of another product.



Example: Like the demand of personal vehicles in a country depends upon the availability and price of fuel. Demand for personal computers depends upon the availability and affordability

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of user-friendly software. In fact the business of accessories like car and motorcycle accessories, computer accessories, etc., depends upon the key product.

In fact, both substitutes and complementary products influence the demand for a product. So while studying the environment one should not forget complementary products because at some point in time, they can be the decisive factor for sales and profits.

1. ***Marketing Intermediaries:*** Marketing intermediaries are an important part of the micro environment. These are firms and persons, who help in distribution, promotion, selling, and provide services like consultancy. Almost every business has to take the help of these intermediaries. Sometimes they play a decisive role. Like in the FMCG business, distribution is of critical importance and there is intense competition to acquire the support of a strong distributor.



Example: The primary reason Coca-Cola acquired Parle was to gain access to the distribution network of Parle, which was wide and penetrated. Besides this there are brokers, agents, logistics companies, private transporters etc., which play an important role.

There are incidences of retailers boycotting the product of particular companies because of low margins. Companies also spend a significant amount on promotion and advertising firms. For instance, companies like HLL spend as much as ₹ 800 crores on advertising as part of their marketing strategy.

2. ***Financial Institutions (FIs):*** For any business, FIs plays a critical role, especially at the micro level. FIs not only make available the finance but also create an environment for investment. They also give expert opinion and consultancy to the corporate. Every corporate is dependent on FIs – whether it is banks or consultancies or NBFCs – for its financial needs. They also facilitate the mode of payment. For the industrial development of any country a well-established financial institutions is a prerequisite. These FIs mobilize the savings of the public to the corporate world. An organization that has a good rapport with FIs usually gets finance easily and at easy terms, which makes a lot of difference in this competitive environment.

3. ***Strategic Group:*** Strategic groups are conceptually defined as clusters of competitors that share similar strategies and therefore compete more directly with one another than with other firms in the same industry. A strategic group is to identify a more defined set of organizations so that each grouping represents those with similar strategic characteristics. They are not a formal group or an association:, in fact they are conceptual clusters in the sense that they are grouped together for the purpose of improving analysis and understanding of competition within their industry.

   Strategic groupings look for these similarities:

   (a) Extent of product diversity.

   (b) Extent of geographic coverage.

   (c) Number of market segment served.

   (d) Distribution channel used.

   (e) Extent of branding.

   (f) Marketing effort.

   (g) Extent of vertical integration.

   (h) Pricing, etc.

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Example: Coca Cola and Pepsi will be considered a strategic group because both have similar products and both follow similar strategies. P&G, HLL and NIRMA can also be considered to be the same strategic group.

This sort of grouping in order to analyse and understand competition is very useful. It also helps in tracing close competitors and in formatting counter strategies.

4. ***Critical Success Factors (CSFs):*** Many industries have small but extremely important set of factors that are essential for successfully gaining and maintaining a competitive advantage. Critical success factors are those areas in which good results will help ensure an organization's success against competition and where poor results usually lead to declining performance.

   CSFs which are relevant to any company are determined by a variety of environmental and firm-specific considerations. During environmental analysis one should find out what are the critical factors for the firm.



Example: For an FMCG, distribution network is a critical success factor, for pharmaceutical companies, R&D is a factor, and for a generic product company like steel or aluminum manufacturing firms, cost is a CSF. For a food chain organization like McDonalds, logistics and supply chain management is a CSF.

5. ***Driving Force:*** Behind every change in environment there is some driving force and these driving forces lead to a sequential change in environment. To understand and forecast future trends it essential to understand the driving force behind them. In fact, sometimes changes in segment A can be the result of changes in segment B and on the other hand, to influence B one has to influence A.

   For instance, if there is a sudden rise in the sale of a certain product of an organization, it may presume this to be a result of the hard work of its sales force, whereas it may actually because its competitor's product is in short supply.

1.2 Recent Developments in Political, Economic and Social Environment

Political Environment

Decade of 1990 saw the rise of many political parties in India at regional level which not only flourished but also become they force to reckon with. The BJP Govt. was a Coalition Govt. By the year 2000 many regional political parties become so strong in their specific regions that they share power at the centre. We can define this era as a Coalition era. The political Mantra of this era was to associate with strong Regional Parties. So the two National Political Parties that is Congress and BJP associate themselves with regional parties. A look at the results of the last five General Elections reveals that there is a decline in the performance of the National Parties taken together both in terms of total number of seats won as well as their vote share. State Parties and Other Registered Parties gained at the cost of National Parties during this period. This is one of the factors that had contributed to federal coalition governments in the recent past. While the National Parties got a total of 470 seats in the 543 member Lok Sabha in 1989 elections with a share of 79.34 percent of total votes polled, in the next elections, two years later, they got 465 seats although the vote share rose to 80.91 per cent. But their vote share declined to 69.08 percent and 67.98 percent in 1996 and 1998 General Elections respectively. Correspondingly during 1996, they got a total of 403 seats which further declined to 387 in 1998 and 369 in 1999.

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All the State Parties, put together, could get only 27 seats in 1989 elections. They improved their tally to 51 in 1991 and 129 in 1996. But there was a decline in seat share to 101 in 1998 and subsequently an increase to 158 in 1999. There was a corresponding increase in their vote share also. In 1989 their vote share was 9.28 percent of the total valid votes polled. In 1991 they improved by a clear 3.7 per cent in their vote share taking it to 12.98 percent. In 1996 elections they got 22.43 percent of votes. In 1998 their vote share declined marginally to 18.79 percent but increased again to 26.93 percent in the 1999 polls.

These Regional Parties not only share the Power at Centre but they also work as a Pressure Group. They tries to impose their agenda on the national polices. In 1999 General Election Congress Led Coalition came to power under the leadership of Mrs Sonia Gandhi and Dr. Manmohan Singh became the Prime Minister of India. On the national level CPI supported the Indian National Congress-led United Progressive Alliance government, but without taking part in it. The party is part of a coalition of leftist and communist parties known in the national media as the Left Front. Upon attaining power in May 2004, the United Progressive Alliance formulated a programme of action known as the Common Minimum Programme. The Left bases its support to the UPA on strict adherence to it. Provisions of the CMP mentions to discontinue disinvestment, massive social sector outlays and an Independent Foreign Policy. It is the pressure of CPI that Dr. Manmohan Singh has to apply break on his agenda of Disinvestment and Privatization.

On July 08, 2008, Prakash Karat announced that left front is withdrawing its support over the decision by the government to go ahead on the United States-India Peaceful Atomic Energy Cooperation Act. At this moment Mulayam Singh Yadav led Samajwadi Party of Uttar Pradesh came forward and extending its support to Congress. Thus the Central Govt. was on the mercy of regional political parties having their own agenda and regional interest.

In 2009 people of India voted for stability. The people of India gave clear majority to the Congress led Alliance that is UPA the other constituents of the UPA are

1. Dravida Munnetra Kazhagam
2. Nationalist Congress Party
3. Jharkhand Mukti Morcha
4. All India Majlis-e-Ittehadul Muslimeen
5. Republican Party of India (Athvale)
6. Sikkim Democratic Front
7. Indian Union Muslim League
8. Trinamool Congress

In totality this alliance won 262 Seats out of 543 seats. The Communist Party led Third Front could manage only 80 seats. Most of them are of BJD in Orissa.

The 2009 Election clearly indicates that the pressure group politics of regional political parties is over. In current political scenario can be marked by following facts:

1. Strong Presence of Indian National Congress at the National Level
2. Stable Government
3. Unanimity among the Political Parties on Economic Issues

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Strong Presence of Indian National Congress at the National Level

In the Election of 2009 INC led Coalition has won the seats in the Pan India. They got significant support from rural India and Middle Class. Congress won seats even in its weak fort that is Uttar Pradesh. This election also saw the emergence new leader Mrs Sonia Gandhi and emerging leader Mr. Rahul Gandhi. It was the Congress who initiated the Liberalization, Privatization and Globalization. With the full majority in the house it is expected that Congress will follow the same route.

Stable Government

Stability of the Government raises image, brand and ratings of the nation. Stable Govt. attracts investment Foreign Direct Investments and Domestic Investments. All this generates Employment and Demand. In totality a stable Govt. beget congenial environment for the business if it supports the business and the present Government is stable and as well as it supports the business.

Unanimity among the Political Parties on Economic Issues

This is the biggest plus point of Indian Politics. INC, BJP and other political parties are unanimous regarding economic policies. Even the Left Parties are inviting FDI and private investments in their ruled states.

Economical Environment

The face of the Indian economy has changed drastically since 1991. Earlier, pricing in India was governed by administered price mechanisms, but market forces today govern pricing. Supported by wide ranging reforms over the past decade, India's economic growth has been robust. A vibrant middle class with rising spending power has emerged, and a new generation of industrialists and entrepreneurs has begun to compete globally. With Gross Domestic Product (GDP) in nominal terms of US$692 billion in 2004, India is now the world's tenth largest economy.

The country's external position is also significantly stronger. Exports, specifically of services, have grown substantially in 2004/5. Growth in services has largely been fueled by the information technology boom in which India has emerged as a world leader. Some of the key factors of India's new economy are as follows:

1. India is the fourth largest economy of the world in terms of PPP today.
2. It is an attractive destination for global FDI. Almost all the major MNCs of the world, from GM and GE of USA to Sony and Samsung see their future in India.
3. India is emerging as a global manufacturing hub. More and more companies are establishing their manufacturing unit in India. These include Nokia, Samsung, GM, Hyundai, Posco, Ispat, Lafarge, Holcim, Toyota etc.
4. India is today a labelled as the back office of the world. As India is becoming the major outsourcing theater of the world. India commands more than 30% of the world's outsourcing business. Indian companies are working for almost all the major companies of the world like GM, GE, Microsoft, Oracle, etc.
5. India is also regarded as the customised software factory of the world. Almost all the major software companies of the world have their operations in India. The list includes players like Microsoft, Oracle, HP, IBM, etc.
6. India is also emerging as the R&D hub of the world. Companies like GE have six R&D centres outside the USA and the first of them was established in India under the name Jack

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Welch Centre. Similarly, many MNCs have established their R&D centres in India and many others are following suit.

7. Indian companies are earning laurels in terms of quality, earlier considered a major drawback of Indian companies. But in the last few years India has won a good number of Deeming Prizes for quality.

8. "Over the last seven years one country has been figuring prominently on the list of Deeming Prize winners. It's not Japan, but India. Ever since Sundaram - Clayton became the first Indian company to win the award in 1998, 11 more Indian firms have won it." (Business Today, Jan 29, 2006, P.88)

Financial Environment

The major objectives of the financial sector reforms fall under the three broad categories:

1. Measures aimed at removing the external constraints bearing on the profitability of banks,

2. Measures aimed at improving the financial health of banks by introducing appropriate prudential norms, and

3. Measures aimed at institutional strengthening including improving the competitiveness of the financial system.

However, for convenience these measures can be related to issues of ownership, competition, regulation and policy stance.

The thrust of reforms in this area relates to privatization and restructuring. Public sector banks have been permitted diversified ownership by law subject to 51 per cent holding of Government/ RBI/SBI. IFCI and IRBI were converted into public limited companies. The Industrial Development Bank of India Act, 1964 was amended to allow IDBI to raise capital up to 49 per cent of its paid up capital from the public. Legal amendments have been made to induct private participation in the Board of Directors. As a part of restructuring efforts, weak public sector banks were recapitalised through budgetary support.

New private sector banks have been established and Local Area Banks have been licensed to instill a greater element of competition in the financial system. There is a more liberal policy of permitting branches of foreign banks. In the area of interest rate, the administered structures were dismantled, both on the deposit and lending side. The lending rates were rationalized to two categories and on the deposit side, the Reserve Bank of India (RBI) prescribes only one rate in the 30 days to one year category and that too in the form of 'not exceeding 9.0 percent'. Further, credit norms have been liberalized and banks now have more freedom to open new branches/upgrade existing extension counters.

Prudential norms have been introduced based on objective criteria for income recognition, asset classification and provisioning. The Basle Committee framework for capital adequacy has been adopted. A Board for Financial Supervision has been set up for exercising integrated supervision both, on-site and off-site over banks, financial institutions and finance companies. Besides, several steps have been taken to improve the audit system in general. Non-banking financial companies have been brought under more effective supervision of RBI.

The Indian banking system operated on a high level of reserve requirements for a long time. Progressive reduction has brought down the Statutory Liquidity Ratio from 37.5 per cent to 25 per cent on an incremental basis and the Cash Reserve Ratio, including incremental CRR from 25.0 per cent and 10.0 per cent. As mentioned earlier, there is near full deregulation of both deposit and advances interest rates. The financial sector is now operating in a more open and more market oriented environment. Government debt is now mostly at market rates. Foreign exchange rate is also market-determined.

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The budget of 1997-98 and the monetary policy for the first half of 1997-98 are considered landmarks in the process of economic reform in India. In the budget of 1997-98, there are some elements of great relevance to the financial sector, while the monetary policy announcement that followed has been described as a 'big bang' in financial sector reform.

1.3 Techniques of Environmental Scanning and Monitoring

The process by which organization monitors their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.



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Factors to be Considered for Environmental Scanning

The external environment consists of variety of factors we can explain them as follows:

1. ***Events*** are important and specific occurrences taking place in different environment sector.
2. ***Trends*** are the general tendencies or courses of action along which events takes place.
3. ***Issues*** are the current concerns that arise in responses to events and trends.
4. ***Expectations*** are the demands made by interested groups in the light of their concern for issues.

Source: Aghor Kazmi, TATA McGraw Hill, p. 118

1.3.1 Environmental Analysis

Collection of Information

Analysis is done by means of a search of verbal and written information, spying, forecasting and formal studies and information system.

At first there is the gathering of verbal information, the sources of verbal information are:

1. Media such as radio and television
2. The firm's employees such as peers, subordinates and supervisors.

Other sources of verbal information outside the firm are:- Customers of the enterprise, persons in industry channel (such as wholesalers, brokers, distributors, etc.), suppliers doing business with the firm, competitors and their employees, financial executives such as bankers, stockholders, and stock analysts, consultants and the government.

Besides verbal sources, information can be gathered by reading. Information about the environment is readily available in newspapers, trade journals, industry newsletters, journals and publications, government reports, reports of various marketing research agencies such as Gallup, ORG, etc. It is said (is it not true?) that behind every business activity there is one government department and one association. This department or association publishes information related to business on regular intervals.

The second solution to environmental analysis is to design a Management Information System. A formal MIS gives quick relevant information to the decision-makers, which helps a lot in making timely decisions. Beside this, information regarding competitors can be gathered through Corporate Intelligence and Spying.

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Corporate Intelligence: Corporate Intelligence (CI) can be described "as a technique of adopting industry/research expertise to analyse the information available on competition from public sources and to draw conclusion based on this data." A typical CI activity involves collection, organization, analysis and utilisation of business-related data of competitors to make informed decisions.



Example: Some of the major companies that use CI include: Microsoft, Motorola, P&G, HP, GE, IBM and Xerox.

Spying: Corporate espionage can be defined as 'spying' on business competitors to acquire proprietary information such as product design, research projects, marketing plan, trade secret, source code for new software, intellectual property and research information and other business strategies. In 1996 the US government passed the Economic Espionage Act to restrict espionage.



Did u know? Once GM alleged that Volkswagen stole its trade secret by luring its head of production. GM won case against Volkswagen and obtained a hefty compensation.

Similarly, in 1943, a P&G employee reportedly bribed an employee of Levers Brothers to steal a bar of soap that was under development.

Deciding Priorities

Various changes take place in the environment and it is difficult, cumbersome and a costly affair to keep a regular eye on every aspect of these changes. So it is essential for a strategist to rate the environmental factors on the basis of criticality and then invest time and resources in environmental analysis. The Nine-cell Matrix is one method of deciding priorities regarding environmental issues.

The issues that are critical need maximum attention of the management and quick action or preparation. On the other hand issues of low priority need just monitoring at regular intervals. Issues of high priority need attention standby plans in case and also need regular observation.

Figure 1.3: Identifying High Priority Environmental Sector

Probability of Actions	High	Medium	Low	
	Critical	High Priority	Low Priority	High
	High Priority	High Priority	Low Priority	Medium
	To be Watched	Low Priority	Low Priority	Low

Methods Environmental Analysis

Environmental Analysis can be divided into two methods

1. ***Environmental Evolution:*** There are three components that are useful to describe changes in the environmental segments:

   (a) Type of change

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(b) Forces driving change

(c) Type of future evolution.

Changes in the microenvironment may be systematic or discontinuous. Gradual changes, changes in a phased manner, or those that are predictable are systematic changes. As after liberalization, a change in the ratio of youth in population of India, rise in the income of middle class and especially of the youth can be seen as systematic change. Unpredictable or sudden changes are discontinuous, like the twin tower terror attacks in the US and its aftermath.

Sometimes changes in one segment may be the result of driving forces in another segment. The driving force behind the acceptance of packaged food in India could be because of the purchasing power of the middle class, or because more women are working, or it could be more awareness among the youth via the mass media. These driving forces constantly interact with each other.

Environmental evolution can be completely predictable and sometimes it is dependent upon actions of the firm or other entities in the environment.

2. ***Process of Environmental Analysis:*** The process of environmental analysis can be divided into four parts:

(a) Scanning the environment to detect warning signals

(b) Monitoring specific environmental trends

(c) Forecasting the direction of future environmental changes and

(d) Assessing current and future environmental changes for their organizational implications.

(a) *Scanning:* Environmental scanning is aimed at alerting the organization to potentially significant external impingement before it has fully formed or crystallised. Successful environmental scanning draws attention to possible changes and events well before occurrence, giving time for suitable action. Scanning frequently detects environmental change that is already in an advanced stage. Scanning is most ill-structured and ambiguous environmental analysis activity. The data sources are many and varied. Moreover a common feature of scanning is that early signals often show up in unexpected places. Fundamental challenge for the analyst in scanning is to make sense of vague, ambiguous and unconnected data and to infuse meaning into it.

(b) *Monitoring:* Monitoring involves following the signals or indicators unearthed during environmental scanning. In monitoring the data search is focused and much more systematic than scanning. By focused, it is meant that the analyst is guided by a priori premonition. Systematic refers to the notion that the analyst has the general sense of the pattern and he is looking for and collects data regarding the evolution of the pattern.

As monitoring progresses the data frequently move from the imprecise and unbounded to reasonably specific and focused. The output or monitoring are threefold:

(i) A specific description of environmental patterns to be forecast,

(ii) Identification of trends for further monitoring, and

(iii) Identification of patterns requiring further scanning.

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(c) *Forecasting:* Forecasting is concerned with the development of plausible projections of directions, scope, speed and intensity of environment change, to lay out the evolutionary path of anticipatory change. There are number of key analytic tasks and outputs involved in forecasting. The first concern untangling of forces that drive the evolution of a trend. The second concern understanding the nature of the evolutionary path; that is whether the change is a fad or of some duration, or cyclical or systematic in character. The third concern more or less clearly delineating the evolutionary path or paths leading to projections and alternatives futures. Forecasting is well focused and is much more deductive and complex activity.

(d) *Assessment:* Assessment involves identifying and evaluating how and why current and projected environmental change will affect strategic management of an organization. In assessment, the frame of reference moves from understanding the environment – the focus of scanning, monitoring and forecasting – to identifying what that understanding of environment means for the organization. Assessment thus tells about the implication of environment change on the organization.

There is not always a linear relationship between scanning, monitoring, forecasting and assessment. If some trends are disclosed in scanning process an organization can directly jump to find out how it is going to influence the organization. Even after having the assessment of the external environment factor an organization may continuously monitor and forecast the factor about is future development. So sometime assessment monitoring and forecasting go simultaneously. A good strategist always keep an eye on development in environment.



Example: Like when Vijay Mallaya came to know that there is some internal problem in Chabaria (owners of Shaw Wallace) family, he started monitoring it and when he found suitable time he purchased his arch rival that is Shaw Wallace and became second largest brewery of world.

1.3.2 Environment Technology Opportunities Portal

The full form of ETOP is Environmental Technology Opportunities Portal. It is a Web site. It is designed to present programs that foster development of new cost-effective environmental technologies. It is an education-based organization. It concentrates on workplace skills and job competencies. It is a national joint labor/management program. It improves the relationship between the Union and the Company. It focuses on job security and advances productivity through education and training. ETOP, Inc. is a joint labor/management education and training program. It relays information on existing EPA environmental technologies for air, water, and waste treatment and control. Its mission is to provide worker education and training for IBEW represented employers to enhance individual employability and improve employer productivity. To achieve its mission it applies some core values to all of its corporate activities, which are given as under:

1. ***History:*** ETOP is a joint labor/management program that was negotiated in 1986 between the International Brotherhood of Electrical Workers (IBEW) and AT&T, now Lucent Technologies, to provide IBEW represented employees with education and training opportunities. To carry out this mission, the ETOP organization was established. It is governed by a Board of Directors and professionally managed by two Co-Executive Directors. In 2000, ETOP revised its by-laws to become a multi-employer organization. The IBEW endorsed ETOP as the training program of choice for IBEW manufacturing members in September 2001.

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2. ***Its Quality:*** ETOP aims to maintain high standards and wants to exert a positive impact on continuing education by holding a strong commitment to quality for the sustenance and advancement of excellence in working atmosphere to make it informative.

3. ***Its Services:*** ETOP has decided to commit itself to render excellent services to its member organizations by maintaining excellent relationships that are responsive and flexible to industry requirements, needs and interests.

4. ***Its Collaboration:*** ETOP works simultaneously in tandem with the fellow joint labor management organizations and is committed to the sustenance and advancement of learning at workplace. Besides, ETOP's sister concerns include other organizations, which are also committed to accrual learning, these include professional organisation and institutes of higher education at local, state, regional, national, and international levels, which collaborate for the advancement of learning at workplace.

5. ***Its Contribution to Learning:*** ETOP's incessant endeavour is to enhance its operations by seeking continuous appraisal. For the purpose it collects information to improve its operation and support teamwork, and provides learning opportunities for its staff and collaborating organizations. It works with its members to promote an environment enhancing acquisition of learning and skills.

   For the purpose of the enhancement of learning ETOP programs are conducted on-site at enhanced learning centers.

   The workers don't need to waste their time in traveling to far off locations, which are rather inconvenient. These learning centers include classroom settings; individual, computer-equipped study carrels; and private areas for career and related counselling. It has established learning centers at its participating employer organization's manufacturing facilities. These centers are generally located adjacent to the production area. Ease of access increases usage of the center. Services provided in the center range from educational advising, career development counseling, and computer skills training to on-site credit courses, test preparation, workplace skills, and preparation for General Education Diplomas (GED). All centers are equipped with modern infrastructure and library facilities etc.

6. ***Its Local Joint Committees:*** The ETOP local joint committee is an advisory body that functions as ambassadors for ETOP programs. There is a separate Local Joint Committee established at each location. It consists of equal Union and Management participation. The Local Joint Committee works closely with the ETOP staff, as well as, the National Office to improve outreach and support structure for the ETOP Learning Center. Their tasks are to promote life-long learning and encourage participation in ETOP programs.

1.3.3 PESTLE

In business PESTLE analysis role is very important. PESTLE analysis is a useful tool for understanding the "big picture" of the environment, in which you are operating, and the opportunities and threats that lie within it. Originally it is designed as a business environmental scan; this analysis is an analysis of the external macro environment in which a business operates. By understanding the environment in which you operate (external to your company or department), you can take advantage of the opportunities and minimize the threats. These are factors which are beyond the control or influence of a business, however are important to be aware of when doing product development, business or strategy planning.

A **PESTLE analysis** is a business measurement tool, looking at factors external to the organization. It is often used within a strategic **SWOT** analysis. The **PESTLE analysis** headings are a framework for reviewing a situation, and can also be used to review a strategy or position, direction of a company, a marketing proposition, or idea.

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Notes **PESTLE** is an acronym for **Political, Economic, Social, Technological, Legal** and **Environmental** factors, which are used to assess the market for a business or organizational unit strategic plan

It is important to clearly identify the subject of a **PESTLE analysis** (that is a clear goal or output requirement), because an analysis of this type is multi faceted in relation to a particular business unit or proposition – if you dilute the focus you will produce an unclear picture – so be clear about the situation and perspective that you use PESTLE to analyze.

PESTLE Analysis on an HR Department or other Internal Function

While the PEST or PESTLE analysis is primarily aimed at looking at the external environment of an organization, many HR courses ask students to use the PEST or PESTLE analysis model to look at their own function. In this context we need to imagine that the department (HR) is an organization in its own right and look outside. Factors to include in your analysis may include the following:

1. ***Political***
   - (a) What is the culture of the organization?
   - (b) How is the HR function viewed by other functions?
   - (c) Who are the political champions of HR (or its adversaries)?
   - (d) Shareholder views
2. ***Economic***
   - (a) What is the budgetary position of the department?
   - (b) Is more money available?
   - (c) Are our customers likely to spend more or less money on the services we offer?
   - (d) What is happening to the financial status of the organization?
   - (e) Interest rates
   - (f) Inflation
   - (g) Salary trends in the sector
3. ***Sociological***
   - (a) Other departmental attitudes to HR
   - (b) Population shifts (age profile)
   - (c) Education
   - (d) Fads
   - (e) Diversity
   - (f) Immigration/emigration
   - (g) Health
   - (h) Living standards

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(i) Housing trends

(j) Fashion & role models

(k) Age profile

(l) Attitudes to career

4. ***Technological***

(a) What changes may be coming our way?

(b) What new technology/systems?

(c) How do we record attendance, performance? how might this change?

(d) Use of and encourage home working?

(e) Communications technologies

(f) Changes of technology that will increase/reduce the need for recruitment

(g) Changes to HR software

5. ***Legal***

(a) What is happening in our sector that will impact what we do?

(b) Minimum wage,

(c) Working time,

(d) Food stuffs,

(e) Under 18 working,

(f) Occupational/ industrial Training etc.

(g) What changes will impact the services of the organization?

6. ***Environmental***

(a) Staff morale

(b) Staff engagement

(c) Need to reduce storage needs

(d) Management attitudes (inside dept/ function)

(e) Organizational culture

1.3.4 Social, Legal, Economic, Political and Technological (SLEPT) Analysis

It is important to 'scan' the external environment before creating business plans or when evaluating existing ones. Doing this takes the form of a SLEPT analysis and thus there is a scanning or an investigation of the Social, Legal, Economic, Political, and Technological influences that can be or likely to be on a business. It is important that you should be aware of the actions of your competitors in business.

Social factors relate to the pattern of behaviour, tastes, and lifestyles. A major component of this is a change in consumer behaviour resulting from changes in fashions and styles. The age structure of the population also alters over time (currently we have an ageing population). To give your business a better shape it is better to have a good knowledge of the social factors around you.

Notes

The legal factors i.e. laws especially the government policy relating to the businesses often undergoes a change with each budget session and the amendments and laws changed from time to time especially in a country like India. There are consumer protection legislation, environmental legislation, health & safety and employment law, etc., which are continually modified in a wide range of areas.

Economic factors are affected with every change in the social ones. There are multiple fluctuations associated with general booms and slumps in economy. In a boom nearly all businesses benefit and in a slump most lose out. Other economic changes that affect business include changes in the interest rate, wage rates, and the rate of inflation (i.e. general level of increase in prices). Businesses will be more encouraged to expand and take risks when economic conditions are right, e.g. low interest rates and rising demand.

Political changes relate to changes in government influence. In recent years these changes have been particularly significant because as members of the European Union we have to adopt directives and regulations created by the EU which then become part of UK law. Political changes are closely tied up with legal changes.

Changes in technology have also become particularly significant in the post-millennium world. This is particularly true in terms of modern communication technologies. The creation of databases and electronic communications have enabled vast quantities of information to be shared and quickly distributed in a modern company enabling vast cost reductions, and often improvements in service. Organisations need to be aware of the latest relevant technologies for their business and to surf the wave of change.



Notes SLEPT factors affecting the airline industry in recent years include:

1. ***Social:*** Increased popularity of foreign travel leading to a boom in demand for air travel. However, this has been adversely affected by international terrorism.
2. ***Legal:*** There are increasingly tight rules about the materials that need to go into aircraft construction in order to make them safer and more resistant to fire hazards. This has had the impact of raising costs.
3. ***Economic:*** Lower interest rates have meant that people have more disposable income to spend on luxuries like long distance air travel.
4. ***Political:*** The development of freedom of movement and trade in the European Union has led to greater levels of competition on European routes coupled with increased movement of people.
5. ***Technological:*** Modern aircraft are safer and more economic to run than in the past making possible cheap air travel.

1.3.5 Methods of Scanning the Business Environment

There are three ways of scanning the business environment:

1. ***Ad-hoc scanning:*** Short term, infrequent examinations usually initiated by a crisis
2. ***Regular scanning:*** Studies done on a regular schedule (say, once a year)
3. ***Continuous scanning:*** (also called continuous learning) – continuous structured data collection and processing on a broad range of environmental factors

Notes

Some management gurus believe that in today's turbulent business environment the best scanning method available is continuous scanning. This allows the firm to act quickly, take advantage of opportunities before competitors do, and respond to environmental threats before significant damage is done.

1.3.6 Scanning the Macro Environment

When we refer to environmental scanning, we usually refer just to the macro environment, but it can also include industry and competitor analysis, consumer analysis, product innovations, and the company's internal environment. Macro environmental scanning involves analyzing:

1. ***Economy***
    (a) GDP per capita
    (b) Economic growth
    (c) Unemployment rate
    (d) Inflation rate
    (e) Consumer and investor confidence
    (f) Inventory levels
    (g) Currency exchange rates
    (h) Merchandise trade balance
    (i) Financial and political health of trading partners
    (j) Balance of payments
    (k) Future trends
2. ***Government***
    (a) Political climate – amount of government activity
    (b) Political stability and risk
    (c) Government debt
    (d) Budget deficit or surplus
    (e) Corporate and personal tax rates
    (f) Payroll taxes
    (g) Import tariffs and quotas
    (h) Export restrictions
    (i) Restrictions on international financial flows
3. ***Legal***
    (a) Minimum wage laws
    (b) Environmental protection laws
    (c) Worker safety laws
    (d) Union laws
    (e) Copyright and patent laws

Notes

(f) Anti-monopoly laws

(g) Sunday closing laws

(h) Municipal licences

(i) Laws that favour business investment

4. ***Technology***

(a) Efficiency of infrastructure, including: roads, ports, airports, rolling stock, hospitals, education, healthcare, communication, etc.

(b) Industrial productivity

(c) New manufacturing processes

(d) New products and services of competitors

(e) New products and services of supply chain partners

(f) Any new technology that could impact the company

(g) Cost and accessibility of electrical power

5. ***Ecology***

(a) Ecological concerns that affect the firms production processes

(b) Ecological concerns that affect customers' buying habits

(c) Ecological concerns that affect customers' perception of the company or product

6. ***Socio-cultural***

Demographic factors such as:

(a) Population size and distribution

(b) Age distribution

(c) Education levels

(d) Income levels

(e) Ethnic origins

(f) Religious affiliations

Attitudes towards:

(a) Materialism, capitalism, free enterprise

(b) Individualism, role of family, role of government, collectivism

(c) Role of church and religion

(d) Consumerism

(e) Environmentalism

(f) Importance of work, pride of accomplishment

Cultural structures including:

(a) Diet and nutrition

(b) Housing conditions

Notes

7. ***Potential Suppliers***

Labour Supply

(a) Quantity of labour available

(b) Quality of labour available

(c) Stability of labour supply

(d) Wage expectations

(e) Employee turn-over rate

(f) Strikes and labour relations

(g) Educational facilities

Material Suppliers

(a) Quality, quantity, price, and stability of material inputs

(b) Delivery delays

(c) Proximity of bulky or heavy material inputs

(d) Level of competition among suppliers

Service Providers

(a) Quantity, quality, price, and stability of service facilitators

(b) Special requirements

Stakeholders

(a) Lobbyists

(b) Shareholders

(c) Employees

(d) Partners

While scanning these macro environmental variables for threats and opportunities requires that each issue be rated on two dimensions. It must be rated on its potential impact on the company, and rated on its likeliness of occurrence. Multiplying the potential impact parameter by the likeliness of occurrence parameter gives us a good indication of its importance to the organisation.



Task

What could be the five forces as per Porter's model for the automobile manufacturer, Hyundai?

1.4 SWOT Analysis of Indian Economy

SWOT analysis of the Indian economy can be done in following way:

Strengths

1. India has huge pool of labour force
2. There are high percentage of cultivable land

Notes

3. Diversified nature of the economy
4. It has huge English speaking population, availability of skilled manpower
5. Stable economy, does not get affected by external changes
6. Extensive higher education system, third largest reservoir of engineers
7. High growth rate of economy
8. Rapid growth of IT and BPO sector bringing valuable foreign exchange
9. Abundance of natural resources

Weaknesses

1. Very high percentage of workforce involved in agriculture which contributes only 23% of GDP
2. Around a quarter of a population below the poverty line
3. High unemployment rate
4. Stark inequality in prevailing socio economic conditions
5. Poor infrastructural facilities
6. Low productivity
7. Huge population leading to scarcity of resources
8. Low level of mechanization
9. Red tapism, bureaucracy
10. Low literacy rates
11. Unequal distribution of wealth
12. Rural-urban divide, leading to inequality in living standards

Opportunities

1. Scope for entry of private firms in various sectors for business
2. Inflow of Foreign Direct Investment is likely to increase in many sectors
3. Huge foreign exchange earning prospect in IT and ITES sector
4. Investment in R&D, engineering design
5. Area of biotechnology
6. Huge population of Indian Diaspora in foreign countries (NRIs)
7. Area of Infrastructure
8. Huge domestic market: Opportunity for MNCs for sales
9. Huge natural gas deposits found in India, natural gas as a fuel has tremendous opportunities
10. Vast forest area and diverse wildlife
11. Huge agricultural resources, fishing, plantation crops, livestock

Notes

Threats

1. Global economy recession/slowdown
2. High fiscal deficit
3. Threat of government intervention in some states
4. Volatility in crude oil prices across the world
5. Growing import bill
6. Population explosion, rate of growth of population still high
7. Agriculture excessively dependent on monsoons

1.5 Planning in India

Planning in India dates back to the 1930s. Even before independence, the colonial government had established a planning board that lasted from 1944 to 1946. Private industrialists and economists published three development plans in 1944. Thus, even before independence, planning was not totally new to the economy.



Notes A 'Bombay Plan' was formulated by J.R.D. Tata and some others as a blueprint for rapid industrialisation. Jawaharlal Nehru visualised planning as a means of "avoiding the unnecessary rigours of an industrial transition in so far as it affected the masses resident in India's villages" as well as a "positive instrument for resolving conflict in a large and heterogeneous subcontinent". It was Nehru who persuaded P.C. Mahalanobis to evolve the basic strategy for the Second Five-Year Plan, while Nehru himself was involved in drafting the introduction to its third edition.

India's leaders adopted the principle of formal economic planning soon after independence as an effective way to intervene in the economy to foster growth and social justice. The Planning Commission was established in 1950. Responsible only to the Prime Minister, the commission is independent of the cabinet. The Prime Minister is the chairperson of the commission, and the Minister of State with independent charge for planning and program implementation serves as its Deputy Chairperson.

A staff drafts national plans under the guidance of the commission; draft plans are presented for approval to the National Development Council, which consists of the Planning Commission and the Chief Ministers of the States. The council can make changes to the draft plan. After the council's approval, the draft is presented to the cabinet and subsequently to Parliament, whose approval makes the plan an operating document for Central and State Governments.

1.5.1 Brief View of Five Year Plans

1. ***First Five-Year Plan*** (FY 1951-55) attempted to stimulate balanced economic development while correcting imbalances caused by the World War II and India's partition. Agriculture, including projects that combined irrigation and power generation, received priority.
2. ***Second Five-Year Plan*** (FY 1956-60) emphasised industrialisation, particularly of basic, heavy industries in the public sector, and improvement of the economic infrastructure. The plan also stressed social goals, such as more equal distribution of income and extension of the benefits of economic development to the large number of disadvantaged people.

Notes

3. ***Third Five-Year Plan*** (FY 1961-65) aimed at a substantial rise in national and per capita income while expanding the industrial base and rectifying the neglect of agriculture in the previous plan. The third plan called for national income to grow at a rate of more than 5 % a year; self-sufficiency in food grains was anticipated in the mid-1960s.

   Economic difficulties disrupted the planning process in the mid-1960s. In the 1960s, India faced two wars – one with China in 1962 and then with Pakistan in 1965. This come as a huge set back to the economy as defence expenditure increased sharply and there was negative impact on industrial and agriculture growth. During the 1965 war, foreign aid was also reduced. All this resulted in a hike in prices. Three annual plans guided development between FY 1966 and FY 1968 while plan policies and strategies were re-evaluated.

4. ***Fourth Five-Year Plan*** (FY 1969-73) called for a 24 % increase over the third plan in real terms of public development expenditures. The public sector accounted for 60 % of plan expenditures, and foreign aid contributed 13 % of plan financing. Agriculture, including irrigation, received 23 % of public outlays; the rest was mostly spent on electric power, industry, and transportation. Although the plan projected national income growth at 5.7 % a year, the realised rate was only 3.3 %.

5. ***Fifth Five-Year Plan*** (FY 1974-78) was drafted in late 1973 when crude oil prices were rising rapidly; and rising prices quickly forced a series of revisions. The plan was subsequently approved in late 1976 but was terminated at the end of FY 1977 because the new government had different priorities and programs. The fifth plan was in effect only one year, although it provided some guidance to investments throughout the five-year period. The economy operated under annual plans in FY 1978 and FY 1979.

6. ***Sixth Five-Year Plan*** (FY 1980-84) was intended to be flexible and was based on the principle of annual "rolling" plans. It called for development expenditures of nearly ₹ 1.9 trillion (in FY 1979 prices), of which 90 % would be financed from domestic sources, 57% of which would come from the public sector. Public sector development spending would be concentrated in energy (29%), agriculture and irrigation (24%), mining (16%), transportation (16 % and social services (14 %). The plan called for a 5.1 % a year growth in GDP, a target that was surpassed by 0.3 %. Only about 10 % of the poor rose above the poverty level.

7. ***Seventh Five-Year Plan*** (FY 1985-89) envisioned a greater emphasis on the allocation of resources to energy and social spending at the expense of industry and agriculture. In reality, the main increase was in transportation and communications, which took up 17% of public-sector expenditure during this period. Total spending was targeted at nearly ₹ 3.9 trillion, of which 94% would be financed from domestic resources, including 48% from the public sector.

8. ***Eighth Five-Year Plan*** was launched in April 1992 and emphasised market-based policy reform rather than quantitative targets. Total spending was planned at ₹ 8.7 trillion, of which 94 % would be financed from domestic resources, 45 % of which would come from the public sector. Government documents issued in 1992 indicated that GDP growth was expected to increase from around 5 % a year during the seventh plan to 5.6 % a year during the Eighth Plan. However, in 1994 economists expected annual growth to be around 4 % during the period of the Eighth Plan.

9. ***Ninth Five-Year Plan*** was launched during the 50th year of India's Independence. The Ninth Five-Year Plan, adopted by the National Development Council, had given priority to agriculture and rural development with a view to generating adequate productive employment and eradication of poverty; accelerating the growth rate of the economy

Notes

with stable prices; ensuring food and nutritional security for all, particularly the vulnerable sections of society; providing the basic minimum services of safe drinking water, primary health care facilities, universal primary education, shelter, and connectivity to all in a time bound manner; containing the growth rate of population; ensuring environmental sustainability of the development process through social mobilisation and participation of people at all levels; empowerment of women and socially disadvantaged groups such as Scheduled Caste, Scheduled Tribes and Other Backward Classes and Minorities as agents of socio-economic change and development; promoting and developing people's participatory bodies like Panchayat Raj institutions, co-operatives and self-help groups; and strengthening efforts to build self-reliance. These very priorities constitute the objectives of the Ninth Plan.

10. ***Tenth Five Year Plan*** was only the first phase of the ten-year road map. It was felt that the Prime Minister's vision could be realised through targeting a growth rate of 8% during the Tenth Plan period and 9.3 % during the Eleventh Plan, and by focusing attention on the growth of employment intensive sectors.

    Tenth plan aims at an indicative growth of 8% in GDP. For the period of 2002-2007 economic growth is not the only objective of national planning. Over the years, development objectives are being defined not just in terms of increases in GDP or per capita income but more broadly, in terms of enhancement of human well being.

11. ***Eleventh Five Year Plan*** (2007-2012) India's centralized planning process is governed by seven cardinal policy objectives: growth; social justice & equity; modernization; self-reliance; food; productivity and employment. These would continue to be the guiding principles for the Eleventh Plan (2007-12) which commences from 1st April, 2007.

    A very large part of our planning is concerned with fiscal aspects and physical targets. It must, however, be recognized that it is the human and natural resources, scientific methods and technologies which are the fundamental elements in the creation of wealth for higher productivity, increased efficiency and completely new ways of doing things. The Eleventh Plan, therefore, would place emphasis on these components which have received inadequate attention in the past. Eleventh Plan would be the vehicle that would position the country to be a super power- economically, strategically and scientifically. For the Eleventh Five Year Plan the Government of India is envisaging the economy to grow at an annual growth rate of 8.5%%. This implies that Agricultural Sector will have to grow at a rate of 3.9%, industry at 9.9%, services at 9.4%, and exports at 16.%, while keeping the imports at a level of 12.1%. The implicit growth of manufacturing sector which is a subset of industry is targeted for 12%. The above growth rates interwoven with each other, of course, would depend upon many factors. Some of these factors are internal to the Indian economy and some are influenced by the external environment. The growth in the agricultural productivity can be sustained on a long term basis only through continuous technological progress and this calls for well structured strategies for research & development. Industrial sector has gained a lot over the past decade or so due to liberalization and is gradually integrating with the world economy. Some of the sub-sectors like automobiles, pharmaceuticals, biotechnology products, speciality chemicals, textiles have acquired unprecedented level of global competitiveness and need to be supported to maintain the present edge. The Eleventh Plan is also placing special emphasis on infrastructure and skill development, the two crucial and critical catalysts for growth.

    The services sector is currently the fastest growing sector of economy accounting for about 54% of GDP. It is estimated that this sector has the potential for creating 40 millions jobs and generating additional $ 200 billion annual income by 2020. In the Eleventh Plan, the government is placing special focus on this sector so that its potential to create employment as growth parameter is fully realised.

Notes

Along with high growth rate aiming for improving livelihood support and increasing employment, the Eleventh Plan strategy calls for new emphasis on education, health and other socially relevant issues. The approach to the plan by the Planning Commission has very appropriately reflected in its title "Towards Faster & More Inclusive Growth". The importance of S&T in the development process envisages innovative solutions.

Eleventh Plan is being formulated at a crucial juncture. In a unipolar and truly globalized world where trade barriers are getting dismantled, an organization has to perform and deliver in real time. The global competition is real and severe for every sector including R&D organizations like CSIR. Either we stay relevant by increased and defined focus with well set and articulated delivery protocols or be swamped by competition, primarily from private sector, R&D laboratories both national and international.

1.5.2 Five Year Plans: Target vs. Achievements

1st Plan (1951-56)

1. The first five year plan was presented by Jawaharlal Nehru in 1951. The First Five Year Plan was initiated at the end of the turmoil of partition of the country. It gave importance to agriculture, irrigation and power projects to decrease the countries reliance on food grain imports, resolve the food crisis and ease the raw material problem especially in jute and cotton. Nearly 45% of the resources were designated for agriculture, while industry got a modest 4.9%. The focus was to maximize the output from agriculture, which would then provide the impetus for industrial growth.
2. Though the first plan was formulated hurriedly, it succeeded in fulfilling the targets. Agriculture production increased dramatically, national income went up by 18%, per capita income by 11% and per capita consumption by 9.

2nd Plan (1956-61)

1. The second five year plan was initiated in a climate of economic prosperity, industry gained in prominence. Agriculture programmes were formulated to meet the raw material needs of industry, besides covering the food needs of the increasing population. The Industrial Policy of 1956 was socialistic in nature. The plan aimed at 25% increase in national income.
2. In comparison to First Five Year plan, the Second Five Year Plan was a moderate success. Unfavorable monsoon in 1957-58 and 1959-60 impacted agricultural production and also the Suez crisis blocked International Trading increasing commodity prices.

3rd Plan (1961-66)

1. While formulating the third plan, it was realized that agriculture production was the destabilizing factor in economic growth. Hence agriculture was given due importance. Also allotment for power sector was increased to 14.6% of the total disbursement.
2. Emphasis was on becoming self reliant in agriculture and industry. The objective of import substitution was seen as sacrosanct. In order to prevent monopolies and to promote economic developments in backward areas, unfeasible manufacturing units were augmented with subsidies. The plan aimed to increase national income by 30% and agriculture production by 30%.

Notes

3. The wars with China in 1962 and Pakistan 1965 and bad monsoon in almost all the years, meant the actual performance was way of the target.

4th Plan (1969-74)

1. At the time of initiating the fourth plan it was realized that GDP growth and rapid growth of capital accumulation alone would not help improve standard of living or to become economically self-reliant. Importance was given to providing benefits to the marginalized section of the society through employment and education.
2. Disbursement to agricultural sector was increased to 23.3% .Family planning programme was given a big stimulus.
3. The achievements of the fourth plan were below targets. Agriculture growth was just at 2.8% and green revolution did not perform as expected. Industry too grew at 3.9%.

5th Plan (1974-79)

1. As a result of inflationary pressure faced during the fourth plan, the fifth plan focused on checking inflation. Several new economic and non-economic variables such as nutritional requirements, health, family planning etc. were incorporated in the planning process. Investment mix was also formulated based on demand estimated for final domestic consumption.
2. Industry got the highest allocation of 24.3% and the plan forecasted a growth rate of 5.5% in national income.
3. The fifth plan was discontinued by the new Janata government in the fourth year itself.

6th Plan (1980-85)

1. The Janata government moved away from GNP approach to development, instead sought to achieve higher production targets with an aim to provide employment opportunities to the marginalized section of the society. But the plan lacked the political will.
2. The Congress government on taking office in 1980 formulated a new plan with a strategy to lay equal focus on infrastructure and agriculture.
3. The plan achieved a growth of 6% p. a.

7th Plan (1985-89)

The first three years of the seventh plan saw severe drought conditions, despite which the food grain production rose by 3.2%. Special programmes like Jawahar Rozgar Yojana were introduced. Sectors like welfare, education, health, family planning, employment etc. got a larger disbursement.

8th Plan (1992-97)

1. The eighth plan was initiated just after a severe balance of payment crisis, which was intensified by the Gulf war in 1990. Several structural modification policies were brought in to put the country in a path of high growth rate. They were devaluation of rupees, dismantling of license prerequisite and decrease trade barriers.

Notes

2. The plan targeted an annual growth rate of 5.6% in GDP and at the same time keeping inflation under control.

9th Plan (1997-2002)

It was observed in the eighth plan that, even though the economy performed well, the gains did not percolate to the weaker sections of the society. The ninth plans therefore laid greater impetus on increasing agricultural and rural incomes and alleviate the conditions of the marginal farmer and landless laborers.

10th Plan (2002-2007)

1. The aim of the tenth plan was to make the Indian economy the fastest growing economy in the world, with a growth target of 10%. It wanted to bring in investor friendly market reforms and create a friendly environment for growth. It sought active participation by the private sector and increased FDI's in the financial sector.
2. Emphasis was laid on corporate transparency and improving the infrastructure.
3. It sought to reduce poverty ratio by 5 percentage points by 2007 and increase in literacy rates to 75 per cent by the end of the plan.
4. Increase in forest and tree cover to 25 per cent by 2007 and all villages to have sustained access to potable drinking water.



Case Study

Doordarshan's Problems

After years of falling revenues, in 1999-2000 Doordarshan (DD) had a revenue growth at 50%. In 1999-2000, DD earned revenues of ₹ 6.1mn compared to ₹ 3.99 mn in 1998-99. DD showed signs of revival with the launch of DD World (a channel for NRIs) and had relative success with some of its regional channels.

However, by the end of 2000-01, DD's honeymoon with success seemed to be over. In 2000-01, DD's revenues were projected to grow at 6-15% while private channels such as Zee TV, Star, Sony had projected 40-50% revenue growth. Analyst's felt that DD's sagging revenues were only tip of the iceberg.

DD was plagued by multiple problems, which found their roots in the mismanagement of affairs. By the late 1990's the private producers, advertisers and audience had deserted DD. Not even one car company advertised on DD and even two-wheeler manufacturers kept a low profile. Ads of Pepsi and Coca-Cola were found only during sports telecasts.

Only FMCG companies stuck to DD because of its terrestrial network to reach the rural and semi-urban audience. In spite of having over 21,000 employees, DD outsourced 50% of its programmes from the private producers. In late 1990's DD faced number of allegations of large-scale scams and irregularities. Under utilized infrastructure, improper investments and poor financial management plagued the performance of DD. In 1992, when the Government opened airwaves to private players, DD faced the heat of competition from private satellite channels.

In the Cable & Satellite (C&S) homes it was found that there were hardly any viewers for the DD programmes. The depleting Television Viewer Ratings (TVRs) of the DD

Contd...

Notes

programmes was also a cause of concern as advertisers deserted due to its low viewer ratings. Analysts felt that DD would need a budgetary support of ₹ 5 bn during the fiscal 2000-01 to sustain itself as its revenues would not be enough to meet its expenditure. Analysts questioned the capacity of the Government to own DD and many felt that privatization would be the only solution.

Questions

1. Was DD unable to assess the changing business environment?
2. Do a SWOT analysis for DD?

Source: icmrindia.org

1.6 Summary

- Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organization is the aggregate of all conditions, events and influences that surround and affect it.
- The framework of business environment can be divided into three broad dimensions: Internal Environment, Macro Environment (External Environment), and Micro Environment (Relevant Environment, Competitive Environment).
- Internal environment is internal to the organization and it is controllable. The important internal factors are as follows: culture and value system, Human resource, mission and objectives, and nature and structure of management.
- External or Macro or General Environment consists of factors external to the industry that may have significant impact on the firm's strategies. It consists of six broad dimensions: Demographic, Socio-cultural, political/legal, technological, economic and global.
- Globalization has also enabled India to become the software superpower of the world. All global organizations now have a new and vast market, as well as cheap manufacturing hub, which has compelled them to change their global marketing and manufacturing strategies.
- The environment is constantly changing in nature. Due to many and varied influences operating there is dynamism in the environment causing it to change its shape and character continuously.
- Micro Environment or the competitive environment refers to the environment, which an organization faces in its specific arena. This arena may be an industry, or it may be what is referred to as a strategic group.
- Professor Michael Porter of the Harvard Business School has demonstrated the state of competition in an industry as a composite of five competitive forces.
- According to him, five forces are: threat of competition, threat of new entrants, threat of substitutes, bargaining power of suppliers and bargaining power of buyers.
- According to Andrew Grove, the former CEO of Intel: "Porter's five forces model ignores a sixth force: the power, vigor and competence of complementors". Complementary products are those products that add value to some other product.
- A strategic group is to identify a more defined set of organizations so that each grouping represents those with similar strategic characteristics. They are not a formal group or an association; in fact they are conceptual clusters in the sense that they are grouped together for the purpose of improving analysis and understanding of competition within their industry.

Notes

- The face of the Indian economy has changed drastically since 1991. Earlier, pricing in India was governed by administered price mechanisms, but market forces today govern pricing.
- India's external position is also significantly stronger. Exports, specifically of services, have grown substantially in 2004-05. Growth in services has largely been fueled by the information technology boom in which India has emerged as a world leader.
- The thrust of reforms in the financial sector relates to privatization and restructuring. Public sector banks have been permitted diversified ownership by law subject to 51 per cent holding of Government/RBI/SBI. IFCI and IRBI were converted into public limited companies.
- The process by which organization monitors their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.
- Analysis is done by means of a search of verbal and written information, spying, forecasting and formal studies and information system.
- Various changes take place in the environment and it is difficult, cumbersome and a costly affair to keep a regular eye on every aspect of these changes. So it is essential for a strategist to rate the environmental factors on the basis of criticality and then invest time and resources in environmental analysis.
- Changes in the microenvironment may be systematic or discontinuous. Gradual changes, changes in a phased manner, or those that are predictable are systematic changes.
- ETOP is designed to present programs that foster development of new cost-effective environmental technologies. It is an education-based organization. It concentrates on workplace skills and job competencies.
- It is important to 'scan' the external environment before creating business plans or when evaluating existing ones. Doing this takes the form of a SLEPT analysis and thus there is a scanning or an investigation of the Social, Legal, Economic, Political, and Technological influences that can be or likely to be on a business.
- Some management gurus believe that in today's turbulent business environment the best scanning method available is continuous scanning. This allows the firm to act quickly, take advantage of opportunities before competitors do, and respond to environmental threats before significant damage is done.
- When we refer to environmental scanning, we usually refer just to the macro environment, but it can also include industry and competitor analysis, consumer analysis, product innovations, and the company's internal environment.
- Planning in India dates back to the 1930s. Even before independence, the colonial government had established a planning board that lasted from 1944 to 1946. Private industrialists and economists published three development plans in 1944.
- India's centralized planning process is governed by seven cardinal policy objectives: growth; social justice & equity; modernization; self-reliance; food; productivity and employment. These would continue to be the guiding principles for the Eleventh Plan (2007-12) which commences from 1st April, 2007.

1.7 Keywords

Ad-Hoc Scanning: Short term, infrequent examinations usually initiated by a crisis

Business Environment: Aggregate of all conditions, events and influences that surround and affect a business

Notes

Complementary Products: Products that add value to some other product

Continuous Scanning: Continuous structured data collection and processing on a broad range of environmental factors

Corporate Intelligence: Technique of adopting industry/research expertise to analyse the information available on competition

Critical Success Factors: Areas in which good results will help ensure an organization's success against competition

Environment Scanning: Process by which organization monitors their relevant environment to identify opportunities and threats

ETOP: Environmental Technology Opportunities Portal

External Environment: Factors external to the industry having significant impact on the firm's strategies

Internal Environment: Internal to the organisation and can be controlled

Macro Environment: Environment, which an organization faces in its specific arena

Regular Scanning: Studies done on a regular schedule

SLEPT Factors: Social, legal, economical, political and technological factors

Spying: Corporate espionage

Strategic Groups: Clusters of competitors that share similar strategies

Substitute Products: Products that can replace another product

1.8 Self Assessment

State whether the following statements are true or false:

1. RBI makes changes in the changes in the monetary policy to control the increased demand in the market.
2. The goal of the firm to takeover a significant amount of marker share and take a lead form competitors forms a part of the internal environment.
3. Business environment has the same meaning and same impact on all businesses.
4. Products like motorcycle and scooter are complementary products.
5. An organisation brings out the facts related to its standing in the market vis-à-vis the competition by doing a SWOT analysis.
6. Sales manager and salesmen have to be in regular touch with the market so that they are updated with the currents trends. They do a regular scanning.
7. The field of biology and bio-technology poses a big weakness for Indian economy.
8. National Development Council consists of Planning Commission and governors of the state.

Fill in the blanks:

9. The economic environment is a subset of …… environment.
10. Kellogg's failed miserably in India in its first attempt because it failed to assess India's …… environment.

Notes

11. India has changed a lot after the LPG policy was introduced in 1991. This shows that business environment is …….
12. …… helps in study of strategic positioning of the firm and help to assess the business environment also with respect to the competition.
13. Automobile majors like Mercedes Benz, BMW, Volkswagen, Rolls Royce etc. all are a part of ……..
14. For a firm like ITC and HUL, widespread distribution is one of it's ……..
15. In ……. the lookout for information is in a more structured and systematic manner.
16. The period of …… five year plan saw a significant growth in the transportation and communications expenditure.

1.9 Review Questions

1. "The relation between a business and an environment is not a one way affair". Comment.
2. Analyse how Indian automobile market has changed over these years. What are the critical success factors for some of the major players in this industry?
3. India's industrial outlook changed significantly after 1991. Why and how?
4. Discuss the major changes that have taken place in India's political scenario over the years. Has the situation improved or worsened? Give reasons.
5. How do the demographic variables decide the marketing mix of the organisation? Explain with detailed example of any two companies from different industries.
6. "Environment is dynamic and multi-faceted". Discuss.
7. A company should not only monitor its own performance but competition also. Why is it so important to assess the competition? Take any close competitors from any industry and compare & contrast the two.
8. Suppose you are the CEO of a fast food restaurant chain. Your company wants to enter India and position itself in the same category as McDonalds, KFC and Pizza Hut. What factors will you have to keep in mind before entering India?
9. Is there any practical difference between scanning and monitoring? If you were to assess the competition, which one is better for you?
10. "A good strategist always keeps an eye on development in environment." Comment.
11. Do a SWOT analysis of the Indian Tourism industry?
12. Suppose you are going a researcher interested in knowing the actual position of the fashion industry. What will be better for you-SWOT analysis or SLEPT analysis? How will you do analysis?
13. Discuss how volatility in crude oil prices across the world and growing import bill poses a big threat for Indian economy.
14. What is the rationale behind the Five year plans? Do you think five years are enough for a plan to be put up and implemented successfully? Critically analyse the planning process in India till now.
15. Critically evaluate the eleventh five year plans. Do you think they cover all the issues that need to be addressed? What suggestions can you give for improvement in these plans?

Notes

Answers: Self Assessment

1.	True	2.	True
3.	False	4.	False
5.	False	6.	False
7.	False	8.	False
9.	Business	10.	Socio-cultural
11.	Dynamic	12.	Porter Five Forces Model
13.	Strategic Group	14.	Critical Success factors
15.	Monitoring	16.	7th

1.10 Further Readings



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Unit 2: Industrial Policy and Regulatory Structure

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Objectives

After studying this unit, you will be able to:

- State the objectives of industrial policy
- Assess the industrial policies of India
- Know about stock exchanges and Securities and Exchange Board of India (SEBI)
- Explain the concepts of Liberalisation, Privatisation and Globalisation

Introduction

This unit deals with two major topics – industrial policy and regulatory structure. Industrial policy is one of the important government documents, which has a lasting impact on a country's industry. It is a policy document prepared by the government which states how the industrial environment of the country will take shape in the future.

The role of industrial policy is more important in a planned economy like India. Till liberalisation came about, the industry was totally regulated by the government. In a planned economy, industrial policy demarcates the areas in which the government will spend and the role it is going to play in regulating the private industry. The past 55 years have seen many changes in India's industrial policy.

Before independence, the industrial policy of British India was formulated with the sole purpose of exploiting the resources of the country for Britain's advantage. This was because before independence the India's balance of trade with Britain was positive but the balance of payment was adverse.

Soon after independence, in 1948, India's first industrial policy was unveiled, and in 1956 a second and more comprehensive industrial policy was announced. This policy remained broad guideline for almost all the industrial policies which were followed upto 1980. To understand industrial policy, it is essential to understand the policy makers and the situation in which the policy was framed.

Almost all the leaders of India's freedom movement were ardent believers in a socialist philosophy, regardless of their political differences. Both Jawahar Lal Nehru and Netaji Subhash Chandra Bose wanted to build a socialist system in India. Even Shaheed-e-Azam Bhagat Singh was a socialist by heart.

These ideas were reflected in the economic decisions made by the government of free India. The objective of the Industrial Policy of India at the time was to achieve equality in society. But in the coming years, India turned from an agriculturally rich nation to one of the poorest nations. Nehru's model had failed and India had to resort to the characteristics of a capitalist economy.

The Union Government enacted the Securities Contract (Regulation) Act in 1956 (SCR Act) for the regulation of stock exchanges and contracts in securities traded on the stock exchanges and contracts in securities traded. The SCR Act and the Securities Contracts (Regulation) Rules (1957) constitute the legal framework for the regulation of stock exchanges and protection of the interest of investors.

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

Notes

2.1 Objectives of Industrial Policy

1. It strives for a balanced regional development, i.e., it tries to ensure that industries are not clustered in specific areas but develop in all parts of the country.
2. It tries to ensure that the scarce resources of the nation are utilised in the interest of the nation and not in the interest of profit.
3. It tries to create employment opportunities.
4. It provides enough power to the government to regulate the industry.
5. It checks the concentration of economic power in a few hands. This happened in South Korea where a major portion of GDP came only from five major companies.
6. It promotes entrepreneurship in the nation.
7. It clearly demarcates the areas where the government will invest and where the private sector will invest, and specifies how the government will regulate the industry.
8. It ensures that there is no flight of capital.
9. It aims at providing the juvenile Indian industry enough protection from multinationals.
10. It provides direction to financial institutions as to which industry they have to lend to liberally, and where they have to restrict the availability of finance.

2.2 Industrial Policies

2.2.1 Industrial Policy 1948

The first industrial policy itself paved the path for mixed economy in the nation. It accepted the existence of both public and private sectors in the economy. It assigned a progressive role for the State, for investment in industrialisation, and in regulating the private sector. It also accepted the importance of small and cottage industries in the development of local resources such as capital, labour, raw material, etc. It recognised the role of foreign capital in industrial development but stated that there should be strict regulation of foreign capital. The 1948 policy divided the industry into four categories:

1. ***Industries where the State had a Monopoly:*** Three industries were put under this category: Arms and Ammunition, Atomic Energy, and Rail Transport.
2. ***New Investment by State:*** Six industries were specified under this: coal, iron and steel, aircraft manufacturing, ship building, manufacture of telephone, telegraph, and wireless apparatus (excluding radio sets) and mineral oil. However, existing private sectors were allowed to continue for ten years after which the government could review the situation and acquire any undertaking.
3. ***The Field of Government Control:*** These industries were to be regulated and directed by the government. Some of these industries were automobiles, heavy chemicals, heavy machinery, machine tools, fertilisers, electrical engineering, sugar, paper, cement, cotton, and woolen textiles.
4. ***Industries open to Private Sector:*** The remainder of the industrial field was open to the private sector.

Notes

2.2.2 Industrial Policy 1956

The draft of the 1956 industrial policy was very comprehensive. This laid emphasis on the establishment of a socialist pattern of society. This policy also emphasised that industrial development of the country should be guided by the Directive Principles of the Constitution.



Did u know? The 1956 Policy was regarded as the "economic constitution of India". The 1980 policy statement paid the highest tribute when it stated that, "the industrial policy announcement of 1956 reflects of the value system of our country and has shown conclusively the merit of constructive flexibility."

Objectives of the 1956 Industrial Policy

1. To accelerate the rate of growth and speed up industrialisation.
2. To expand public sector.
3. To develop heavy and machine industry.
4. To check the concentration of economic power in a few hands.
5. To reduce the disequilibrium in the distribution of income and wealth.
6. To build a cooperative sector.
7. To expand cottage, village and small-scale industry.
8. To achieve balanced regional development and other socio-economic objective.

Features of the Policy

The 1956 resolution divided industries into three categories:

1. Monopoly of the State
2. Mixed Sector (Public and Private both allowed)
3. Industries left for private sector

Monopoly of State

In this list (Schedule A) industries whose future development would be the exclusive responsibility of the state were included. The 17 industries listed in this categories were: arms and ammunition, atomic energy, iron and steel, heavy castings, heavy machinery, heavy electrical industries, coal, mineral oils, iron ore and other important minerals like copper, lead and zinc, aircrafts, air transport, railway transport, shipbuilding, telephone, telegraph and wireless equipment generation and distribution of electric energy.

Mixed Sector of Public and Private Enterprise

In this section 12 industries (listed in Schedule B) were included. These will be progressively state owned and where the State will generally take the initiative in establishing new undertakings.

Notes

But in these private enterprises will also be expected to supplement the efforts of the State. Minerals (except minor minerals), road transport, sea transport, machine tools, ferro-alloys and tool steels, basic and intermediate products required by chemical industries such as manufacture of drugs, dyestuffs and plastics, antibiotics and other essential drugs, fertilizers, synthetic rubber, chemical pulp, carbonization of coal, and aluminium and other non-ferrous metals are included here. In these industries, the State would increasingly establish new units and increase its participation but would not deny the private sector opportunities to set up units or expand existing units.

Industries Left for the Private Sector

All remaining industries and their development were left to the private sector. The division of industries was not very strict. That is, there can be overlapping, for instance, licenses were later given to the private sector to invest in mining and oil. The government also invested in areas that were left for the private sector. The 1956 policy increased the area of operation for the State. Thereafter, the State began taking keen interest in the development of heavy industry and invested a good amount of money and resources. Not only this, it also promoted the private sector to work together as a manufacturer and supplier and also as a user of by-products.

The State accepted the role of the private sector and established and encouraged financial institutions to provide assistance to the private sector.

The 1956 Policy provided for rapid growth of villages and small industries. To remove regional disparities, this policy emphasised balanced regional growth. For this, it encouraged the establishment of industries in backward areas. This policy intended to improve the working conditions for labourers and expected industry to take care of the working conditions of labour and to ensure industrial peace for its rapid development. Like the 1948, Policy this one also accepted the importance of foreign capital in national development but maintained that the major interest and effective control should always be with Indians.

The 1956 industrial policy has been severely criticised on the basis that it laid too much emphasis on the public sector and restricted the development of the private sector. Also, the public sector performance was below par as there was no individual accountability. In the name of alleviating regional disparities, projects were established in locations that were not economically viable and only increased the cost of production.

The private sector did not take interest in long-term and big projects as the apprehension was that the public sector would play a dominant role in the economy and private sector would be further be squeezed. This feeling gained momentum as the State declared it could undertake any industry as and when it found suitable to do so. This restricted the growth of private sector.

It is also true that in 1956 the private sector was not in a position to invest in an industry with a higher gestation period. With the state investing heavily in this sector, it not only benefited the nation, but also the private sector, in the form of ancillary units, raw materials and machines, and in the overall growth of industry in the country.

The private sector was permitted to invest in certain areas reserved for the public sector-coal, oil, fertilisers, chemical engineering, etc. In the case of machine tools, nine licenses were given to HMT, whereas 226 licenses were given to the private sector in fertilisers. The public sector obtained 12 licenses and the private sector was given 42 licenses.

This shows that the Industrial Policy Resolution 1956 provided enough support and encouragement to the private sector.

Notes

2.2.3 Industrial Policy 1977

In March 1977 the first non-Congress government was at the centre. The Janata Party assumed power and Morarji Desai, a die-hard Gandhian, became the Prime Minister. The new government declared a new industrial policy.

The Janata govt. was of the views that during the past 20 years the excessive emphasis on heavy industry had to be corrected; emphasis has been given to heavy industry, and to curb unemployment and poverty small scale industry should be promoted. As a result, the number of items reserved for the small scale were increased significantly. The main elements of the Industrial Policy of 1977 were:

Development of the Small Scale Sector

The policy of Janata government was that anything which could be produced in small scale industry should be produced by them alone. As a result, items reserved for small scale industry went up from 180 to 807 in 1978. The small scale sector was classified into three categories:

1. Cottage and household industries that provide self-employment on a wide scale;
2. Tiny sector including investment in industrial units, in machinery and equipment upto ₹ 1 lakh, and situated in towns with a population of less than 50,000;
3. Small-scale industries comprising industrial units with an investment upto ₹ 10 lakh and in case of ancillaries, with an investment in fixed capital upto ₹ 15 lakh.

The government established District Industries Centres (DIC) in each district for the development of small scale and cottage industries. The objective was to provide clearance to small scale industry projects under a single roof. A separate wing of IDBI was established to fulfil credit requirements of small scale industry. Khadi and village industries were revamped.

Large Scale Industry

The industrial policy prescribed the following areas for the large scale sector:

1. Basic industries, essential for providing infrastructure as well as development of small scale and village industries, such as steel, non-ferrous metals, cement, oil refineries;
2. Capital goods industries for meeting the machinery requirement of basic industries as well as small scale industries;
3. High technology industries which required large scale production and which were related to agriculture and small scale development such as fertilizers, pesticides, petrochemicals, etc.; and
4. Other industries that were outside the list of reserved items for the small scale sector and which were considered essential for the development of the economy such as machine tools, organic and inorganic chemicals.

Large Business Houses

The industrial policy of 1977 stated that funds of the public sector financial institutions and banks should be devoted to the growth of the small scale and medium scale units. Thus large business houses have to rely on their internally generated resources for financing new projects or expansion of existing ones.

Notes

Public Sector

The Janata government was not satisfied with the then role of the public sector. It felt that the public sector should not confine its role to strategic and heavy goods, but was rather of the view that the public sector should foray into consumer goods. It should encourage development of a wide range of ancillary industries, and contribute to the growth of decentralised production by making available its expertise in technology and management to small scale and cottage industries. This is the reason that government launched a soft drink named "Double Seven".

Approached towards Sick Units

The industrial policy 1977 declared support for Sick Units and efforts to revamp them. But it clearly mentioned that this was not blanket support. The process of continuously financing sick units would not continue indefinitely.

Assessment of Industrial Policy 1977

The 1977 Industrial Policy failed to achieve its objectives. On the one hand, as intended, it failed to restrict the growth of big business houses and multinationals. This is despite the fact that expansion was restricted for big business houses because they were denied any help from public financial institutions. The government forayed into consumer goods but without much success. The government reserved 807 items for the small scale industry but it increased its cost of production.



Example: Even big houses remained in sectors reserved for small scale such as bread, biscuits, etc. In these three years the GDP growth rate was approximately 3% and unemployment increased a great deal because of low level of economic activity.

2.2.4 Industrial Policy 1991

The New Industrial Policy was announced on July 24, 1991 by the government, headed by Prime Minister P.V. Narasimha Rao. The New Industrial Policy (NIP) was a big departure from the erstwhile industrial policy. When all the earlier industrial policies talked about how to regulate the private sector in a so-called national interest, NIP talked about deregulation and delicensing. When with every next industrial policy, the role of the public sector increased in the economy and newer restrictions were introduced on the private sector, this NIP not only limited the role of PSUs but also talked about disinvestment and enough room to the private sector and foreign capital to develop and invest.

Objectives of New Industrial Policy

1. The key objective was rapid industrialisation of the country.
2. To increase employment opportunities in private sector.
3. To improve balance of payments by promoting export-oriented industries.
4. Ensure profitability in the public sector.
5. Encourage entrepreneurship.
6. To deregulate and delicense the industry to achieve rapid industrialisation.
7. To invite foreign capital for industrialisation and to boost exports.

Notes

8. To encourage R&D and to bring new technology to produce world class products and services.
9. To link Indian economy with the global economy.
10. To encourage big business houses and projects to achieve economies of scale.
11. Increase competitiveness of the industry to benefit the common man and the nation.
12. Rapid development of infrastructure, specially roads and electricity, with active participation of the private sector and FDI.

Radical Steps of the New Industrial Policy

The New Industrial Policy took radical steps in the following areas:

1. Industrial Licensing
2. Foreign Investment
3. Foreign Technology Agreement
4. Public Sector Policy
5. MRTP Act

1. ***Industrial Licensing:*** Industrial licensing is governed by Industries (Development and Regulation) Act, 1951. It is a very effective tool used by the government to regulate the private sector. Over the years it has become a tool for exploitation. The NIP did away with licensing in a big manner.

   It abolished all industrial licensing, irrespective of the level of investment, except for 18 industries related to security and strategic concern, social reasons, concerns related to safety and overriding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. Later this list was trimmed, and as of now license is required only for 6 items listed in Annexure II. These are as follows:

   List of Industries for which Industrial Licensing is Compulsory under Industries (Development & Regulation) Act, 1951:

   (a) Distillation and brewing of alcoholic drinks.

   (b) Cigars and cigarettes of tobacco and manufactured tobacco substitutes.

   (c) Electronic Aerospace and defense equipment.

   (d) Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches.

   (e) Hazardous chemicals:

      (i) Hydrocyanic acid and its derivatives.

      (ii) Phosgene and its derivatives.

      (iii) Isocyanates and disocyanates of hydrocarbon, not elsewhere specified (example: Methyl Isocyanate).

   (f) Drugs and Pharmaceuticals (according to modified Drug Policy issued in September, 1994 and subsequently amended in February, 1999).

Notes

All areas of industrial activity excluding of areas listed in Annexure I were opened for the private sector. Six items were included in this list: Arms and ammunition and allied items, defence aircraft and warships, Atomic Energy, Coal and Lignite, Mineral Oils, Minerals specified in Schedule to the Atomic Energy (Control of Production and Use) Order, 1953 and Railway Transport. But today only Railway Transport and Atomic Energy and its minerals are reserved for the public sector. In others, private equity and even FDI are allowed though proper procedures.

Entrepreneurs are required to submit an Industrial Entrepreneurs Memorandum (IEM) to the Secretariat for Industrial Approvals (SIA) which acknowledges receipt.

Phased Manufacturing Programmes (PMP), have been abolished for all new industries and subsequently for all existing projects. Under PMP a concerned enterprise has to progressively replace imported material, parts and components with materials parts and components produced in-house or by other Indian firms.

An Investment Promotion and Project Monitoring Cell is set up in the Department of Industrial Policy and Promotion, Ministry of Industrial to provide information to entrepreneurs and to monitor progress of implementation of various projects.

Delicensing has been the key feature of Industrial Policy of 1991. This provided a big impetus to investment and employment creation in the coming years.

2. ***Foreign Investment:*** This was a revolutionary step taken by the Rao government. In the first 50 years of India's economic planning nobody ever imagined that one day a socialist economy like India would provide free access to foreign equity. Though the 1956 Industrial Policy accepted the role of foreign equity, since independence we have always looked at foreign equity as some sort of economic slavery. But in last 50 years, the enormous underutilisation of resources, unemployment, poor infrastructure and pervasive poverty compelled the government to open the doors for foreign equity. Today, India welcomes foreign equity in almost every sector. In 1991 it allowed:

   (a) Automatic approval for foreign equity participation upto 51% granted in high priority industries listed in Annexure IV of Industrial Policy, 1991.

   (b) Foreign trading companies are allowed to invest upto 51% in Indian trading houses engaged in export activity.

   (c) In hotel and tourism related industry upto 51% foreign equity is allowed.

   (d) Even in the mining sector foreign investment upto 50% was allowed.



Caution In fields where foreign investment was not allowed through the automatic route, either because it doesn't cover the foreign exchange requirement for import of capital goods, or if it requires more than 51% equity, or if it is not a high priority area, proposals have to be submitted to the Secretariat of Industrial Approvals (SIA) or Foreign Investment Promotion Board or to Indian Embassies or Consulates abroad.

Use of foreign brands names/trade marks for sale of goods in India is permitted. Initially all projects involving foreign equity upto 51% in high priority industries were required to adhere to dividend balancing conditions. Earlier, outflow of foreign exchange on account of dividend payments had to be balanced by export earning for a period of seven years from the date of commencement of production. Now the dividend balancing condition has been withdrawn.

Notes

Foreign equity of upto 24% is allowed in the small scale sector too.

Manufacture of items reserved for the small scale sector can also be taken up by non-small scale units, if they apply for and obtain an industrial license. In such cases, it is mandatory for the non-small scale unit to undertake minimum export obligation of 50%. This will not apply to non-small scale EOUs that are engaged in the manufacture of items reserved for the SSI sector, as they already have a minimum export obligation of 66% of their production. In addition, if the equity holding from another company (including foreign equity) exceeds 24%, even if the investment in plant and machinery in the unit does not exceed ₹ 10 million, the unit loses its small scale status.

Foreign equity upto 100% is particularly encouraged in export-oriented units, power sector, electronics and software technology parks.

In 1997, the government announced its first ever guidelines for Foreign Direct Investment (FDI) for expeditious approval of foreign investment in areas not covered under automatic approval. Priority areas for foreign direct investment proposals included infrastructure, export potential, large scale employment potential particularly for rural areas, items with linkages with the farm sector, social sector projects like hospitals, health care and medicines, and proposals that lead to induction of technology and infusion of capital.

FDI approvals are subject to sectoral cap: 20% (40% for NRIs) in banking sector, 51% in non-banking financial companies, 100% in power, roads, ports, tourism and venture capital funds, 49% in telecommunication, 40% (100% for NRIs) in domestic airline/taxi, 24% in small scale industries, 51% in drugs/pharma industry for bulk drugs, 100% in petroleum, and 50% in mining except for gold, silver, diamonds and precious stones. The list was further expanded and in the same year, equity investment upto 100% by NRIs/OCBs was permitted in high priority industries in metallurgical and infrastructure sectors and 13 other priority industries, hitherto eligible for 74% and 51% equity investment respectively. Foreign equity investment in mining was also allowed upto 100% for NRI/OCBs.

During 1999-2000, the government decided to put all items under the automatic route for foreign investment/NRIs and OCB investment, except for a small negative list.

Now the automatic route for FDI/NRI/OCB investment is also available to India's existing companies to induct foreign equity. For existing companies with an expansion programme, the additional requirements are that:

(a) the increase in equity level must result from the expansion of the equity base of the existing company without acquisition of existing shares by NRI/OCB/foreign investors;

(b) the money to be remitted should be in the sector(s) under the automatic route. Otherwise the proposal would need government approval through the FIPB. For this, the proposal must be supported by a Board Resolution of the existing Indian company.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic route are:

(a) that they are engaged in the industries under automatic route (including additional activities covered under the automatic route regardless of whether the original activities were undertaken with government approval or by accessing the automatic route);

(b) the increase in equity level must be from expansion of the equity base; and

(c) the foreign equity must be in foreign currency.

Notes

(i) Global Depository Receipts (GDRs)/American Deposit Receipts (ADRs)/ Foreign Currency Convertible Bonds (FCCB): Foreign investment through GDRs/ADRs and Foreign Currency Convertible Bonds (FCCBs) are treated as Foreign Direct Investment. Indian companies are allowed to raise equity capital in the international market through the issue of GDRs/ADRs/FCCBs. These are not subject to any ceilings on investment. An applicant company seeking government approval in this regard should have a consistent track record for good performance (financial or otherwise) for a minimum period of 3 years. This condition can be relaxed for infrastructure projects such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads.

(ii) Location Policy: Industrial undertakings are free to select the location of a project. In the case of cities with population of more than a million (as per the 1991 census), however, the proposed location should be at least 25 km away from the Standard Urban Area limits of that city, unless it is to be located in an area designated as an 'industrial area' before July 25, 1991. Electronics, computer software and printing (and any other industry which may be notified in the future as a 'non polluting industry') are exempt from such locational restrictions. Relaxation in the aforesaid locational restriction is possible if an industrial license is obtained as per the notified procedure.

(iii) Environmental Clearances: Entrepreneurs are required to obtain statutory clearances relating to Pollution Control and Environment for setting up an industrial project. A Notification [SO 60(E) dated 27.1.94] issued under the Environment Protection Act, 1986 has listed 29 projects in respect of which environmental clearance needs to be obtained from the Ministry of Environment, Government of India.

This list includes industries like petrochemical complexes, petroleum refineries, cement, thermal power plants, bulk drugs, fertilizers, dyes, paper, etc. However, if investment is less than ₹ 500 million, such clearance is not necessary unless it is for pesticides, bulk drugs and pharmaceuticals, asbestos and asbestos products, integrated paint complexes, mining projects, tourism projects of certain parameters, tarred roads in Himalayan areas, distilleries, dyes, foundries and electroplating industries.

3. ***Foreign Technology Agreements:*** Foreign technology collaborations are permitted either through the automatic route under delegated powers exercised by the RBI, or by the government. However, cases involving industrial licenses/small scale reserved items do not qualify for automatic approval and would require consideration and approval by the government.

(a) *Automatic Approval:* The Reserve Bank of India, through its regional offices, accords automatic approval to all industries for foreign technology collaboration agreements subject to:

(i) lump sum payments not exceeding US $ 2 million;

(ii) royalty payable being limited to 5% for domestic sales and 8% for exports, subject to a total payment of 8% on sales over a 10 years period; and

(iii) the period for payment of royalty not exceeding 7 years from the date of commencement of commercial production, or 10 years from the date of agreement, whichever is earlier (the aforesaid royalty limits are net of taxes and are calculated according to standard conditions).

Notes

Payment of royalty upto 2% for exports and 1% for domestic sales is allowed under the automatic route on use of trademarks and brand names of the foreign collaborators without technology transfer. In case of technology transfer, payment of royalty subsumes the payment of royalty for use of trademark and brand name of the foreign collaborator.



Example: Royalty on brand name/trade mark shall be paid as a percentage of net sales, viz., gross sales less agents'/dealers' commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts, components imported from the foreign licensor or its subsidiary/affiliated company.

Payment of royalty upto 8% on exports and 5% on domestic sales by wholly owned subsidiaries to offshore parent companies is allowed under the automatic route without any restriction on the duration of royalty payments.

(b) *Government Approval:* For the following categories, government approval would be necessary:

(i) Proposals attracting compulsory licensing

(ii) Items of manufacture reserved for the small scale sector

(iii) Proposals involving any previous joint venture, or technology transfer/ trademark agreement in the same or allied field in India. The definition of "same" and "allied" field would be as per 4 digit NIC 1987 Code and 3 digit NIC 1987 Code

(iv) Extension of foreign technology collaboration agreements (including those cases which may have received automatic approval in the first instance)

(v) Proposals not meeting any or all of the parameters for automatic approval.

4. ***Public Sector Policy:*** Since the Industrial Policy of 1956, the public sector was playing a strategic role in Indian economy. They were enjoying a preferential treatment from the government, and played a significant role in the GDP of the country. The 1956 policy reserved 17 industries for the Public Sector but the 1991 policy reduced this number to eight, which was further reduced to two.

The performance of public sector was far from satisfactory. Most of the PSUs posted losses.



Example: Even companies like SAIL, which enjoyed high demand posted losses year after year.

Lack of accountability, political interference, excessive labour, poor project management, inadequate attention to R&D, socialist objectives, etc., lead to even the erosion of paid up capital of some PSUs.

The 1991 industrial policy took the following steps to improve the conditions of PSUs:

(a) *Memorandum of Understanding:* Memorandums of understanding were signed with PSUs, giving more autonomy and accountability to PSUs. It was a contract between the government and PSUs. It was started in 1987-88 with four public enterprises. Presently more than 100 PSUs are covered by the MOU.

(b) *BIFR:* Sick unviable units were referred to the Board of Industrial and Financial Reconstruction (BIFR) to advice the government on whether to invest further in PSUs to close them down or to divest govt. stake in them. The National Renewal

Notes

Fund (NRF) provided assistance to cover the cost of retraining and redeployment of labour and also provide compensation to labour affected by the closure of unviable public sector units.

(c) *Disinvestments and Privatisation:* The government decided to reduce its stake in PSUs and also decided to privatise a few PSUs. In the coming years, many PSUs were in fact were privatised and disinvested.

5. ***MRTP Act:*** Under the MRTP Act, all firms with assets above a certain size (₹ 100 crores since 1985) were classified as MRTP firms. The principle objective of the MRTP Act was:

(a) Prevention of concentration of economic power and control of monopolies

(b) Prohibition of monopolistic, restrictive and unfair trade practices.

There were many restrictions on MRTP firms as they were permitted to enter into selected industries, that too on a case by case approval basis. Besides licences, these firms require separate permission for any further investment.



Example: This restricted the growth of Indian industry and units like TISCO, TELCO, HINDALCO and Ranbaxy, which though having the capacity to become global players, remained confined to India, producing substandard goods.

In 1991, the MRTP Act was restructured and pre-entry restrictions removed with respect to new undertakings, expansion, amalgamation, merger, takeover, registration, etc. under Sections 20-26 of Part A of Charter III of the Act. The amended act gave more emphasis to the prevention and restriction of restrictive and unfair trade practices.

Appraisal of the Industrial Policy

The New Industrial Policy was a new experience for India. On the one hand it provided a conducive environment to the industry, allowing it to spread it wings and on the other hand, it opened the doors for MNCs and sent a clear message to Indian firms to either perform or perish.

In this way it opened many avenues for the industry and which, the industry took advantage of. Indian companies began expanding and firms like Ranbaxy, Asian Paints, Aditya Vikram Birla Group and many others became global players.



Example: Today Asian Paints is operates in 27 countries and Tata Tea acquired the international tea brand Tetley.

In the past 15 years, India has witnessed drastic changes. People who have seen the 70s and 80s would not have imagined that in 1990 they have to wait only for weeks to get a telephone connection and by 1998 they can get a phone right on the spot and carry them in their pockets. By mid-2005, the number of mobile connections had crossed the number of basic telephone users.

Today, India has one of the largest grass root refineries of the world in private hands, i.e., Reliance, and the country is now exporting aviation fuel. The Indian economy has shifted from mini-plants to economies of scale, from economies of scarcities to economy of surplus in many goods.

This liberalisation has proved to be a big boon for the service sector. Today, the service sector produces more than 50% of the total GDP of India. India is becoming a manufacturing hub as many companies are shifting their manufacturing utilities to India. This includes companies like GE, Nokia and DuPont.

Notes

India is also becoming the back office of the world as more and more countries are shifting their back office work to India. New employment opportunities have been generated in the new economy industries like telecommunication, software, call centres, biotechnology, education, media, etc. Because of increasing competition, the quality of produced goods has improved. Earlier India produced substandard goods, now it is setting the benchmark.

Critics says that there is no evidence of positive growth rate after liberalisation as the growth of industrial production fell from 7.8% per annum in the pre reform period (1980s) to 6.6% in 1990s. But the decade of 1990s was a decade of transformation and a process, which takes time. There is a great difference in the quality and level of production of the 1980s and the 1990s.

The biggest criticism of the NIP is MNCs may soon take over Indian companies.



Example: This is true to a certain extent-Coca Cola acquired Parle, Pepsi acquired Uncle Chipps, HLL acquired Modern Bread, Lakme, TOMCO, Kissan etc.

But this is only one side of the picture. On the other side, many Indian firms also acquired MNCs. Videocon recently acquired the picture tube plant of Thomson and the Indian arm of Eletrolux. Asian Paints also acquired Berger International. Although this threat is true to an extent because it is very difficult for Indian firms to compete with MNCs' financial strength. India has moved from too much protection to too little protection.



Task

Make a note of all items possible that were affected by the New Industrial Policy. Also make a note of the companies that gained and that made losses due to this policy.

2.3 Stock Exchanges

The emergence of Capital Markets can be traced back to the second half of the eighteenth century when the transactions were limited to loan stock transactions of the East India Company. By 1830, some corporate stocks had emerged due to the economic boom and establishment of textile mills. A Stock Exchange means any 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.

The Bombay Stock Exchange was formalised in 1875 with the establishment of 'Native Share and Share Brokers Association'. The stock exchanges of Calcutta and Chennai were established in 1908 and the Delhi Stock Exchange in 1947. There are 23 stock exchanges in India and their organization varies. Some are public limited companies (15), while others are limited by guarantees (5) or are voluntary non-profit making organizations.

In the period of 1994-1995, the number of stock exchanges went up from 7 to 22. In March 2000, the number of stock exchanges increased to 23 with the formation of Inter Connected Stock Exchanges of India Ltd. (ICSEL), the number of listed companies from 1125 to 9477, the market value of listed companies from ₹ 971 crore to ₹ 6,39,575 crore.

2.3.1 Definition of Stock Exchange

Under the SCR Act, an exchange is defined as any 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. The SCR says that a stock exchange must be recognised by the government.

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According to this Act, securities include: (i) Shares, scrips, stocks, bonds, debentures, stock or other marketable securities of a like nature in or of any incorporated company or body corporate; (ii) Government securities or such other instruments as may be declared by the Central Government to be securities, and (iii) Right of interest in securities.

Stock exchange is regarded as "an essential concomitant of the capitalistic system of economy. It is indispensable for the proper functioning of corporate enterprise. It brings together large amounts of capital necessary for the economic progress of a country. It is the citadel of the capital and the pivot of money market".

It provides necessary mobility to capital and directs the flow of capital into profitable and successful enterprise. It is the barometer of general economic progress in a country and exerts a powerful and significant influence as a depressant or stimulant of business activity. It may be defined as "the place or market where securities of joint stock companies and of government or semi government bodies are dealt in".

2.3.2 Major Stock Exchanges in India

Bombay Stock Exchange

The Bombay Stock Exchange is one of the oldest stock exchanges of India and Asia and it is also one of the biggest stock exchanges of the world. It is said to be the nerve of the Indian economy which reveals the health of economy. The Bombay Stock Exchange had a turnover of ₹ 6,8,028 crore and a market capitalisation of ₹ 9,12,842 crores in 1999-2000. Its business is no more confined to Mumbai alone. In March 2000 it had 275 cities covered by the BOLT network and an increase in the number of Trader Work Stations to 3803. Its daily turnover had increased from ₹ 11 crore in 1979-80 to ₹ 4587 crore in 2000-01.

It was established in 1857 and at that time its membership fee was just Re. 1. It increased to ₹ 5 in 1877, ₹ 1000 in 1896, ₹ 2,500 in 1916, ₹ 6,600 in 1929, and ₹ 62,000 during post World War II period. It was more than ₹ 3 crore in 1992, and was about ₹ 2 crore in 1997.

The BSE introduced Bombay On-Line Trading (BOLT) System on January 19, 1995. It provides a quote-driven automated trading facility with an order book functioning as an auxiliary jobber. The process of transferring the equity scrips listed on the BSE from trading in the ring to the BOLT system was completed on July 3, 1995. The BSE also began debt trading also on the BOLT system from June 26, 1995 in respect of 60 actively traded debentures.

National Stock Exchange

The NSE was incorporated in November 1992 with an equity capital of ₹ 25 crores. It is sponsored by IDBI and co-sponsored by other term-lending institutions, LIC, GIC, other insurance companies, banks and financial institutions, viz., SBI Capital Market Ltd., Infrastructure Leasing and Financial Services Ltd. (ILFS), Stock Holding Corporations Ltd. (SHCL), and the International Securities Consultancy (ISC) of Hong Kong which have helped in setting up of the NSE. NSE has a fully automated, electronic, screen-based trading system through which it has overcome geographical barrier.

The market capitalisation of NSE was ₹ 10,20,426 crores on March 1, 2000. Its objectives of NSE are:

1. To provide fair, efficient and transparent nationwide trading facility for equities, debt instrument and hybrids.

Notes

2. To provide access to investor all over the country through an appropriate communication network.
3. To enable shorter settlement cycles and book entry settlement systems.
4. To bring the Indian stock market in line with international markets.
5. To promote the secondary market in debt instruments such as government and corporate bonds.

NSR has an order-driven market and it allows members to trade through their office through communication networks. NSE is the first exchange in India to introduce mark to market system of margin which reduced the risk of default by members.

Over the Counter Exchange of India (OTCEI)

The OTCEI is primarily meant for small sized companies and small investors. This exchange has the advantages of transparency, fast settlements and potential to reach the nooks and corners of the country. OTCEI was modeled on National Association of Securities Dealers Automated Quotation System (NASDAQ) in the US. In the USA all off-exchange trading was referred to as the Over the Counter (OTC) Market.

OTCEI was incorporated as a company in 1990 under the Companies Act. It became operational in 1992 and was the first stock exchange in India to introduce screen based automated ring less trading system. It is promoted by the UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Caps, and CANBANK as a company under Section 25 of the Companies Act 1956, with its headquarters at Mumbai.

Its objective are: (a) to help companies raise capital from the market at the cheapest costs and on optimal terms (b) to help investors to access capital market safely and conveniently (c) to cater to the needs of the companies which cannot be listed on other official exchange (d) to eliminate the problems of illiquid securities, delayed settlements, and unfair prices faced by the investors.

Apart from the above stock exchanges are other national and regional stock exchanges in:

1. Ahmedabad
2. Bangalore
3. Bhubaneshwar
4. Kolkata
5. Cochin
6. Coimbatore
7. Delhi
8. Guwahati
9. Hyderabad
10. Jaipur
11. Ludhiana
12. Madhya Pradesh
13. Chennai
14. Magadh
15. Mangalore

Notes

16. Saurashtra-Kutch
17. Uttar Pradesh
18. Vadodara
19. Pune

2.3.3 Recognition of Stock Exchange

The Securities Contract Regulation Act, 1956 provides *inter alia* for recognition of stock exchanges and regulation of their functioning, licensing dealers, recognition of contracts, controlling speculation, restricting rights of equitable holders of shares and empowering the government to compel any public limited company to get its shares listed. Under the Securities Contract Regulation Act, the government has promulgated the Securities Contract (Rules) 1957 for carrying into effect the objects of legislations. The rules are statutory and constitute a code of standardised regulations applicable to all recognised exchanges.

2.3.4 Listing of Securities

Listing of Securities on a recognised stock exchange means that they are admitted on a recognised stock exchange which provides a forum for purchase and sale of securities.

According to Section 73 of the Companies Act, 1956, every company intending to offer shares or debentures to the public for subscription by issue of a prospectus has to first make an application to one or more recognised stock exchanges for their listing.

2.3.5 Obligation on Listed Companies

Listed companies have to follow the following obligations:

1. Subject themselves to various regulatory measures of SEBI and stock exchanges;
2. Submit required books, documents and papers and disclose any other information which the stock exchange asks for;
3. Send to all shareholders the notices of Annual General Meetings, Annual Reports etc., and
4. Place their securities with the public.



Notes

1. ***Stock Brokers:*** Stock Brokers are members of recognised stock exchanges who buy, sell or otherwise deal in securities. For a broker to deal in securities on a recognized stock exchange, it is obligatory that he should be registered as stock broker with SEBI.
2. ***Sub-brokers:*** A sub-broker is not a member of a stock exchange. He acts as an agent of a stock broker or otherwise assist the investor in buying, selling or dealing in securities through such the stock broker. For dealing in securities, a sub broker must obtain a certificate of registration from SEBI.

Notes

2.3.6 Stock Exchange Operations

1. ***Bulls and Bear:*** A bull is a buyer in the stock market. He is optimistic about the security prices. A bear is a seller of securities. His expectation is that the market would go down. When a bear sells without owning the shares, it is called short trade.
2. ***Order/Customer Driven and Quote/ Dealer Driven Trading System:*** Trading in a stock exchange takes place either on the basis of the auction system on a trading floor which is order-driven or customer driven or a broker-dealer market which is quote - driven or dealer - driven. In an-order driven system, customers buy and sell orders and reach at central point where they are matched. In a quote driven system dealers compete to give customers the best price.
3. ***Market Maker:*** Market makers make both bid and offer at the same time. The quoted price they would charge from a prospective buyer is offer price or asking price. The quoted price which they would pay to a prospective seller of a security is known as bid price.
4. ***Margin Trading:*** When investors buy securities on margin, they buy some shares with cash and borrow from the broker to pay for additional shares, using the paid shares as collateral. The margin customer has to sign a margin agreement, pledging securities as loan collateral.

To lend the clients margined securities, the brokers also ask the customers to sign a stock loan consent form.

2.3.7 Badla System/Carry Forward Transactions

The Badla System involves trading for clearing with a facility of carrying forward the transaction from one settlement period to another. They don't pay the entire amount at the time of the purchase but against the security of blank transfer deed and share certificates. The Badla rates were fixed on the basis of demand and supply conditions and were on a fortnightly basis. Badla led to high speculative activity which is why this system was banned by SEBI since December 1993 and later was introduced in a modified manner. Badla system involves following:

1. ***Transfer of Market Position:*** Carry forward facility means that the buyer/seller can either settle the transactions at the end of a settlement period by actual payment/receipt and acceptance/transfer of the security or carry forward the transactions from one settlement period to another by reversing the transactions.
2. ***Short Lending/Short Selling:*** Short sellers are those who sell shares without owning them. Thus they provide scope for higher investment. In a falling market, the short seller has to purchase to cover his sales position. Similarly, in a rising market those who have contracted to purchase, have to sell securities to square their position, thus arresting further rise in share prices.

   In November 18, 1996, the SEBI decided to make it mandatory for short sellers to report their short sales position at the end of each day.
3. ***Borrowing/Lending in Money Market:*** In the Badla system both bulls and bears either need resources to cover their position till the next settlement or have surplus resources. As a result, in most cases, either they have to borrow from the money market or they turn into lenders to the money market.

Notes

2.3.8 Revised Forward Trading System

SEBI introduced modified forward trading system on October 6, 1995 effective from October 9, 1995. Capital adequacy norms of 3% had been stipulated for individual brokers and 6% for corporate/institutional brokers. Due to implementation of capital adequacy norms, the limit of 25% of the turnover imposed on carry forward deals by brokers has been removed.

Instead of monthly audit, the brokers are now allowed self-certification on their status on settlements. SEBI has reserved the right to re-check the certification. Now transactions can be carried forward for a maximum of 90 days, but squaring off is permitted only up to fifth settlement, i.e. 75 days. Transactions remaining open at the expiry of this time limit have to be compulsorily settled by delivery or payment as the case may be.

Stock exchanges are allowed to resume forward trading/carry forward transactions only after permission from SEBI. The permission is granted only if the stock exchange has screen-based trading, effective monitoring, surveillance and reporting system and fulfils other infrastructural requirements.

2.3.9 Derivatives Trading

1. ***Derivatives:*** These are financial instruments that are valued according to the expected price movements of an underlying assets, which may be a commodity, currency or a security. Examples of derivatives are futures, options, swaps, etc.
2. ***Futures:*** These are agreements to buy or sell a fixed quantity of a particular commodity, currency, or security for delivery at a fixed date in the future at fixed price. Unlike an option, a future contract involves a definite purchase or sale and not an option to buy or sell.
3. ***Options:*** These are instruments granting the right to buy or sell a fixed quantity of a commodity, currency, security, etc., at a particular date at a particular price (also called exercised price). Unlike futures, the purchaser of an option is not obliged to buy or sell at the exercise price and will only do so if it is profitable; the purchaser may allow the option to lapse, in which case only the initial purchase price of the option is lost.
4. ***Swaps:*** These are means by which intending parties can exchange their cash flows, usually through the intermediary of a bank. A Currency Swap will enable parties to exchange the currency they possess for the currency they need. An Interest Rate Swap (IRS) is an agreement between two parties to exchange interest obligations (or receipts) for a given notional principle for a defined period.

2.3.10 Capital Issues (Contract) Act (CICA), 1947

According to the CICA Act, companies had to obtain prior approval for any new issue, and for pricing or public and rights issue. This act gives powers to Government of India to regulate the timing of new issues by private sector companies, the composition of securities to be issued, interest rates which can be offered on debentures and preference shares, the timing and frequency of bonus issues, the amount of prior allotment to promoters, floatation costs, and the premium charged on securities. Now this Act has been repealed by Capital Issues (Control) Repeal Act, 1992.

Notes

Table 2.1: Companies in Sensex

NAME	SECTOR
Infosys Technologies	Information Technology
ICICI Bank Limited	Finance
ITC Ltd	FMCG
Larsen & Tourbo	Capital Goods
HDFC	Finance
HDFC Bank	Finance
State Bank of India	Finance
TCS Limited	Information Technology
ONGC	Oil and Gas
Bharti Airtel	Telecommunications
Tata Steel	Metal, Metal Products and Mining
Tata Motors	Automobile
BHEL	Capital Goods
NTPC Limited	Power
Mahindra & Mahindra	Automobile
Hindalco Industries	Metal, Metal Products and Mining
Hindustan Unilever Limited	FMCG
Sterlite Industries	Metal, Metal Products and Mining
Jindal Steel	Metal, Metal Products and Mining
Wipro Limited	Information Tech Nology
Tata Power	Power
Bajaj Auto	Automobile
Maruti Suzuki	Automobile
Cipla Limited	Pharmaceuticals
Hero Honda Motors	Automobile
Reliance Infrastructure	Power
Jaiprakash Associates	Infrastructure
DLF Limited	Infrastructure
Reliance Communications Limited	Telecommunications

Source: www.bseindia.com

2.4 Securities and Exchange Board of India (SEBI)

Notes

A major development in the Indian stock market took place in 1988 when Securities and Exchange Board of India (SEBI) was established through an administrative order, on the lines of the Securities and Investment Board of the U.K. But it became really powerful in 1992 when CICA was repealed and the office of Controller of Capital Issues was abolished. The Securities and Exchange Board Act of 1992 provides for the establishment of a board to protect the interest of investors and to promote the development and regulation of the securities market. The Board of SEBI consists of six members comprising the chairman, two members from the amongst the official of the ministries of the central government dealing with finance and law, two members who are professional and have expertise or special knowledge relating to securities market, and one member for the RBI.

SEBI is entrusted with following functions:

1. Regulating the business in stock exchanges and any other securities market
2. Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other 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 organizations
5. Prohibiting fraudulent and unfair trade practices relating to securities market
6. Promoting investors' education and training of intermediaries of securities market
7. Prohibiting insider trading in securities
8. Regulating substantial acquisition of shares and take-overs and mergers of companies
9. Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchange and intermediaries and self-regulatory organization in the securities market
10. Levying fees or other changes for carrying out the above purposes.

SEBI has five operational departments. Besides that it has two more departments – the legal department and the investigation department. Their scope is as follows:

1. ***The Primary Market Policy, Intermediaries, Self-Regulatory Organizations (SROs), and Investor grievances and Guidance Department:*** It looks after all policy matters and regulatory issues in respect of primary market, registration, merchant bankers, portfolio management services, investment advisers, debentures trustees, underwriters, SROs and investor grievances, guidance, education and association.
2. ***The Issue Management and Intermediaries Department:*** It is responsible for vatting of all prospectuses and letters of offer for public and rights issues, for coordinating with the primary market policy, for registration, regulation and monitoring of issue-related intermediaries.
3. ***The Secondary Market Policy, Operation and Exchange Administration, New Investment Products and Insider Trading Department:*** It is responsible for all policy and regulatory issues of the secondary market and new investment products, registration and monitoring of members of stock exchanges, administration of some of the stock exchanges, market

Notes

surveillance and monitoring of price movements and insider trading, and EDP and SEBI's database.

4. ***The Secondary Market Exchange Administration, Inspection and Non-member Intermediaries Department:*** It looks after the smaller stock exchanges of Guwahati, Indore, Mangalore, etc. It is also responsible for inspection of all stock exchanges, registration, regulation and monitoring or non-member intermediaries such as sub-brokers.

5. ***Institutional Investment, Mergers and Acquisition, Research and Publication, and International Relations and IOSCO Department:*** It looks after policy, registration and monitoring of Foreign Institutional Investors (FIIs), domestic mutual funds, merger and substantial acquisition of shares, and IOSCO (International Organization of Securities Commissions) membership, and research, publication and Annual Report of SEBI.

6. ***Legal Department:*** This department looks after all legal matters under the supervision of the General Counsel.

7. ***Investigation Department:*** This department carries out inspection and investigation under the supervision of the Chief of Investigation.

SEBI has its regional offices at Kolkata, Chennai and Delhi. SEBI has also formed two non-statutory advisory committees, the Primary Market Advisory Committee and Secondary Market Advisory Committee with the members from market player, recognized investors associates and other eminent persons. SEBI is also a member of International Organization of Securities Commissions (IOSCO)

2.4.1 Powers and Scope of SEBI

The functional area of SEBI is very wide. It is the rule maker, a custodian, and a watch dog of the security market. In brief, it has the full power to regulate : (i) depositors and participants, (ii) custodians, (iii) debentures trustees and trust deeds, (iv) FIIs, (v) inside traders, (vi) mutual fund, (vii) portfolio manager, (viii) investment advisers, (ix) merchant bankers, (x) registrars to issue and share transfer agents , (xi) stock brokers and sub - brokers, (xii) underwriters, (xiii) venture capital funds, and (xiv) bankers to issue.

The SEBI can issue guidelines in respect of the following:

1. Information disclosure, operational transparency, and investor protection.
2. Development of financial institutions.
3. Priding of issues
4. Bonus issues.
5. Preferential Issues
6. Financial Instruments
7. Firm allotment and transfer of shares among promoters.

SEBI is empowered to register any agency or intermediary who may be associated with the securities market, except under and in accordance with the conditions of a certificate of registration issued by the SEBI.

After the suspension of CICA (Capital Issues Control Act 1947), SEBI is now authorized to govern all the matter related to issue of capital. SCRA also authorizes the SEBI to conduct inquiries into the working of the stock exchange, they are required to submit their annual reports to the SEBI and requires the approval of SEBI for amending their rules and bye laws; SEBI

Notes

can direct them to amend their bye-laws and rules including reconstitution of their governing boards/councils; and it is empowered to license security dealers operating outside their jurisdiction.

SEBI has been empowered to demand explanation, to summon the attendance and call for documents from all categories of market intermediaries in order to enable it to investigate irregularities, impose penalties, and initiate prosecution. It is also empowered to notify its regulations and file complaints in courts without the prior approval of the Government of India.

2.4.2 Certain Guidelines and Reforms Introduced by SEBI

Primary Securities Market

1. The issue of capital no longer requires any consent from any authority for making issue and for pricing it.
2. SEBI raised the standards of disclosure in public issues and enhanced the transparency.
3. The offer document is now made public even at the draft stage.
4. Companies without track record making first issue can price the issue at par only. At the first issue companies are free to price their securities, provided they have shown net profits in the immediately preceding three years, subject to their fulfilling the existing disclosure requirements.
5. Companies with three years' track record or companies without track record, but promoted by companies with five years of track record are free to price the issues. They can list the shares on a stock exchange.
6. Not less than 20% of equity (issued) should be offered to public.
7. For issues above ₹ 100 crore, book building requirement has been introduced.
8. The pricing of preferential allotment scheme, a minimum of 50% of the net offer to the public is to be reserved for individual investors applying for securities not exceeding 1000 securities, and the remaining part can be allotted to applications for more than 1,000 securities.
9. Draft prospectus will be vetted by the SEBI to ensure adequacy of disclosure.
10. Bankers to an issue and portfolio managers have to be registered with the SEBI.
11. Existing listed companies are allowed to raise fresh capital by freely pricing their further issues. However price should be determined in consultation with the lead managers to the issues. The high and low prices for the last two years should be indicated in the offer document. The draft proposal will be vetted by SEBI to ensure adequacy of disclosure.

Secondary Market and Various Intermediaries

1. The governing body and various committees of Stock Exchanges (SEs) have been recognised, restructured and broad based.
2. Inspection of all 22 SEs has been carried out to determine, inter alia, the extent of compliance with the directives of the SEBI.
3. Corporate membership of SE is now allowed, encouraged, and preferred. The Articles of Association of SEs have been amended so as to increase their membership.

Notes

4. All the SEs have been asked to established with a clearing house or a clearing corporation.
5. The BSE has been asked to reduce its trading period or settlement cycle from 14 to 7 days for B group shares.
6. All the recommendations of the Dave Committee for improving the working of the OTCEI have been accepted.
7. In accordance with the recommendations of G.S. Patel Committee, the BSE has been allowed to introduce a revised carry forward system (CFS) of trading. Other SEs can introduce forward trading only with the prior permission of the SEBI.
8. Brokers are required to segregate the client and its own account.
9. The capital adequacy norms of 3% for individual brokers and 6% for corporate brokers introduced.
10. Both the brokers and the sub brokers have been brought within the regulatory fold for the first time now; and the concept of the dual registration of stock brokers with the SEBI and the SEs has been introduced.
11. Panel action can now be taken directly by the SEBI against any member of a stock exchange for violation of any provision of the SEBI Act.
12. It has been mandatory for stockbrokers to disclose the transaction price and brokerage separately in the contract notes issued by them to their clients.
13. Compulsory audit of the brokers' books and filling of the audit reports with the SEBI has now been made mandatory.
14. Insider trading has been prohibited and such trading has been made a criminal offence punishable in accordance with the provision of SEBI.

2.4.3 Investment Protection Measures

The SEBI has introduced an automated complaints handling system to deal with investor complaints. To create awareness, SEBI issues fortnightly press releases, disclosing names to the companies against whom maximum number of complaints have been received. A representative of SEBI now supervises the allotment of shares process. Besides many other measures, it also issues advertisements frequently to make investors aware of various issues of the securities market and of their rights and remedies.

2.4.4 Insider Training

Insider training in securities is prohibited by SEBI under Insider Trading Regulations 1992. Insider training can be defined as the sale or purchase of securities by persons who possess price sensitive information about the company, on account of their fiduciary capacity involving confidence or trust. SEBI Insider Regulations 1992 defines the insider as any person who is or was connected with company and who is reasonably expected to have access by virtue of such connection, to unpublished price sensitive information with respect to the securities of the company, or who has received or has had access to such unpublished price sensitive information. Broadly, insiders can be of two types: (a) Primary Insider e.g. Directors, stock exchanges, merchant bankers, registrars, brokers of the company, top executives, auditors, banks, etc. (b) Secondary insider e.g. dealers, agents, other employees, etc. (c) Others having access to price sensitive information due to their proximity with the company.

Notes

The SEBI Insider Regulations, 1992 prohibits insider trading and lays down that no insider should:

1. Either on his own behalf or on behalf of any other person, deals in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information; or
2. Communicate any unpublished price sensitive information to any person, with or without his or her request for such information except as required in the ordinary course of business or under any law; or
3. Counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.

2.4.5 Underwriting

Underwriters make a commitment to get the underwritten issue subscribed either by others or by themselves. They agree to take unsubscribed portions of the issue. They render this service for a commission agreed upon between the issuing company and the underwriter subject to the ceiling under the Companies Act.

Underwriter services are available from brokers, investment, companies, commercial banks and term-lending institutions. Only such person (an individual, firm or a company) who has obtained certificate of registration from SEBI can act as an underwriter.



Example: Merchant bankers and stock brokers already have a valid certificate from SEBI for working as underwriters.



Task

Find out the underwriters involved in some of the biggest IPOs that have taken place in last five years.

2.5 LPG Policy

2.5.1 Liberalisation

The ongoing reforms in India are referred to as economic liberalisation of India. After Independence in 1947, India adhered to socialist policies. The extensive regulation was sarcastically dubbed as the "Licence Raj"; the slow growth rate was named the "Hindu rate of growth". In the 1980s, the Prime Minister Rajiv Gandhi initiated some reforms. His government was blocked by politics. In 1991, after the International Monetary Fund (IMF) had bailed out the bankrupt state, the government of P. V. Narasimha Rao and his Finance Minister Manmohan Singh started breakthrough reforms. The new policies included opening for international trade and investment, deregulation, initiation of privatization, tax reforms, and inflation-Controlling measures. The overall direction of liberalization has since remained the same, irrespective of the ruling party, although no party has yet tried to take on powerful lobbies such as the trade unions and farmers, or contentious issues such as reforming labor laws and reducing agricultural subsidies.

As of 2009, about 300 million people – equivalent to the entire population of the entire United States – have escaped extreme poverty. The fruits of liberalization reached their peak in 2007, with India recording its highest GDP growth rate of 9%. With this, India became the second fastest growing major economy in the world, next only to China. An Organisation for Economic

Notes

Co-operation and Development (OECD) report states that the average growth rate 7.5% will double the average income in a decade, and more reforms would speed up the pace.

Indian government coalitions have been advised to continue liberalization. India grows at slower pace than China. McKinsey states that removing main obstacles "would free India's economy to grow as fast as China's, at 10 percent a year".

Indian economic policy after independence was influenced by the colonial experience (which was seen by Indian leaders as exploitative in nature) and by those leaders' exposure to Fabian socialism. Policy tended towards protectionism, with a strong emphasis on import substitution, industrialization, state intervention in labor and financial markets, a large public sector, business regulation, and central planning. Five-Year Plans of India resembled central planning in the Soviet Union. Steel, mining, machine tools, water, telecommunications, insurance, and electrical plants, among other industries, were effectively nationalized in the mid-1950s. Elaborate licenses, regulations and the accompanying red tape, commonly referred to as Licence Raj, were required to set up business in India between 1947 and 1990.



Notes The impact of these the economic reforms may be gauged from the fact that total foreign investment (including foreign direct investment, portfolio investment, and investment raised on international capital markets) in India grew from a minuscule US $132 million in 1991-92 to $5.3 billion in 1995-96.

Cities like Bangalore, Hyderabad, Pune and Ahmedabad have risen in prominence and economic importance and have become centres of rising industries and destination for foreign investment and firms.

2.5.2 Privatisation

Privatisation is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. In a broader sense, it connotes private ownership (or even without change of ownership) the induction of private control and management in the PSUs. Barbara Lee and John Nellis (1990) describe it thus: "Privatisation is the process of involving the private sector in the ownership of operation of a state-owned enterprise. Thus the term refers to private purchase of all or part of a company. It covers the contracting out and privatisation of management – through management contract, leases or franchise arrangement."

Privatisation can take these following forms:

1. ***Ownership Measures:*** The degree of privatisation is judged by the extent of ownership transferred from the public enterprise to the private sector. It can take the following forms:

   (a) *Total Denationalisation:* It is a complete transfer of a public enterprise to the private sector.



Example: As done in BALCO, which was acquired by Sterlite industries. Modern Foods was acquired by Hindustan Lever.

   (b) *Joint Venture:* This implies partial introduction of private ownership. The range of private ownership can vary; it can be as low as 25% and even as high as 75% or more. As in the case of Maruti Suzuki where earlier the majority share were with Maruti but after liberalisation, Suzuki increased its stake and became the majority stake holder.

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(c) *Liquidation:* The assets are sold to someone who may use those assets for the same purpose or for any other purpose.

(d) *Workers Co-operative:* Here ownership of the enterprise is transferred to workers who may form a co-operative to run the enterprise.

2. ***Organisational Measures:*** A number of organizational measures are conceived to limit state control. They include:

(a) *A Holding Company Structure:* Here, the organization is decentralised and sufficient autonomy of decision making is given at the operative level but the government still controls decisions made at the apex level. In this way a decentralised pattern of management emerges.

(b) *Leasing:* The government transfers the use of assets to private bidders for a specified period. In the leasing agreement the bidder is required to be assured regarding profit sharing between the State and bidder. This is a kind of tenure ownership.

(c) *Restructuring:* Restructuring is of two types: financial and basic restructuring. Financial restructuring means the writing off of accumulated losses and rationalisation of capital composition in respect of debt-equity ratio. The main purpose of rationalisation is to improve the financial health of the enterprise and basic restructuring is said to occur when the public enterprise decides to shed some of its activities to be taken up by ancillaries or small scale units.

3. ***Operational Measures:*** The objective of operational measures is to improve efficiency of the organisation. Operational measures include the following measures:

(a) Grant of autonomy to public enterprise in decision making.

(b) Provision of incentives for workers and executives consistent with increase in efficiency and productivity.

(c) Freedom to acquire certain inputs from the market.

(d) Development of proper criteria for investment planning.

(e) Permission to public enterprises to raise resources from the capital market to execute plans of diversification and expansion.

Divestiture is one of the important ways of privatisation; it is a privatisation of ownership through the sale of equity. It entails selling stock to the public.

Example: In India various public sector banks such as State Bank of India, Vijay Bank etc., sold their stock to the public through IPOs.

The new industrial policy announced by the government in July 1991 emphasised the following four major to reform the public sector enterprise:

(a) Reduction in the number of industries reserved for the public sector from 17 to 8 (further reduced to 4 and then to 2) and the introduction of selective competition in the reserved area.

(b) The disinvestment of shares of a select set of public sector enterprises.

(c) The policy towards sick public sector enterprises to be the same as that for private sector.

(d) An improvement of performance through an MOU system.

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4. ***Dereservations:*** The 1991 industrial policy reduced the number of industries reserved for the public sector from 17 to 4. The reserved sectors are:

   (a) Arms and ammunition and allied items of defense equipment, combat aircraft and warships.

   (b) Atomic Energy.

   (c) Minerals specified in the schedule to the Atomic Energy Order, 1953.

   (d) Railway Transport.



Example: Presently, only Railways and Atomic Energy are reserved areas.

2.5.3 Globalisation

In the recent past, many meanings of the word 'globalisation' have accumulated.



Did u know? The word 'globalise' was first attested by the Merriam Webster Dictionary in 1944. To consider the history of globalisation, some authors focus on events since 1492, but most scholars and theorists concentrate on a much more recent past.

Long before 1492, people began to link together disparate locations on the globe into extensive systems of communication, migration, and interconnections. This formation of systems of interaction between the global and the local has been a central driving force in world history.

In **325 BC** Chandragupta Maurya becomes a Buddhist and combines the expansive powers of a world religion, trade, economy, and imperial armies for the first time. Greeks (Selukas) sue for peace with Chandragupta in 325 BC at Gerosia, marking the eastward link among overland routes between the Mediterranean, Persia, India, and Central Asia.

By **1350**, networks of trade which involved frequent movement of people, animals, goods, money, and micro-organisms ran from England to China, through France and Italy, across the Mediterranean to the Levant and Egypt, and then across Central Asia (the Silk Road) and along sea lanes down the Red Sea, across the Indian Ocean, and through the Straits of Malacca to the China coast.

Between 1492 and 1498: Columbus and Vasco da Gama travel west and east to the Indies, inaugurating an age of European sea-borne empires.



Example: In South Asia, it should be noted, the Delhi Sultanate and Deccan states provided a system of power that connected the inland trading routes of Central Asia with the coastal towns of Bengal and the peninsula and thus to Indian Ocean trade for the first time.

The commodities trade continued well into the seventeenth century, concentrating on local products from each region of the Eurasian system – Chinese silk and porcelain, Sumatra spices, Malabar cinnamon and pepper, etc. – but by the 1600s, long - distance trade was more deeply entrenched in the production process. An expansion of commercial production and commodities trade was supported by the arrival into Asia of precious metals from the New World, which came both from the East and West (the Atlantic and Pacific routes – via Palestine and Iran, and also the Philippines and China).

Liberalisation of the 19th century is often called "The First Era of Globalisation". The "First Era of Globalisation" is said to have broken down in stages, beginning with the First World War, and

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then collapsing with the crisis of gold standard in the late 1920s and early 1930s. Countries that engaged in that era of globalisation, including the European core, some of the European periphery and various European offshoots in the Americas and Oceania, prospered. Inequality between those states fell, as goods, capital and labour flowed remarkably freely between nations.

The 20th century was also governed by economic nationalism. Most of the European nations followed this policy. After the Second World War economic nationalism became the key for most nations in Asia and Europe. Even nations like the US and France were not untouched with the phenomenon of economic nationalism.

When the US started losing jobs because of globalisation it reacted sharply. Not only this, in the 20th century itself it took various measures to protect its domestic industry like automobiles and motorcycles. It imposed quantitative restrictions on the imports of automobiles from Japan. Similarly, when in 2006 a Britain-based NRI made a bid for Europe's largest steel maker France reacted sharply.

Economic nationalism is a term used to describe policies which are guided by the idea of protecting domestic consumption, labour and capital formation, even if this requires the imposition of tariffs and other restrictions on the movement of labour, goods and capital. It opposes globalisation in many cases, or at least it questions the perceived benefits of unrestricted free trade. Economic nationalism may include such doctrines as protectionism and import substitution.

Corporations are today changing their strategies and are reorganizing their functions to cope up with the changed scenario. Whether it is their production process or location, Product strategy, Marketing, Finance, HR policies etc. Organizations have incorporated the following changes:

Designing in Global Environment

If managing product development processes was a challenge before, it is not getting any easier as companies continue to adopt global design strategies. Global designing has cost benefits that are very attractive to today's manufacturer, but it also adds new Product Lifecycle Management (PLM) challenges and intensifies existing problem areas like that of protecting intellectual property.

Production Location Selection

Jeffrey Immelt of GE Medical Systems (GEMS), pushed for acquisitions to build up scale because for leading global competitors, an R&D-to-sales ratio of at least 8 percent represents a significant source of scale economies. But he also implemented a production strategy that was intended to arbitrage cost differences by concentrating manufacturing operations and, ultimately, other activities – wherever in the world they could be carried out most cost effectively.

Rationalised Production

Companies produce different components or different portions of their product line in different parts of the world to take advantage of low labour costs, capital, and raw materials. This is rationalised production. In a new, global world, rationalised production is easier. Now organizations can outsource or can establish their own production units in those areas where it is more economical.



Example: GE, for instance, used Mexico as a manufacture base for labour-intensive operations. Today, Japanese are selling their cars made in America to the American consumers, while Americans are selling American cars made in Japan.

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Case Study

Growing SME's in India

SMEs constitute almost about 50% of industrial output & 42% of India's total exports. It is also an important employment generation sector & a means for promoting balance regional development. Table 1 below gives certain important data about SMEs in India. A wide variety of products including consumer items, capital intermediary goods are produced by this sector. Despite all this, they seem to suffer from sub-optimal scales of operations and technological obsolescence. Government of India had a protectionist policy in place from 1951-1991 to protect the SMEs. Certain products were reserved for small scale units, though in recent times, this policy is fast changing.

Table 1

Year	% Share in No. of factories	% Share in Employment	% Share in value of production	% Share in gross value added
1989/90	93.00	66.00	52.00	44.00
1996/97	92.31	61.29	43.57	34.19

Source: EPW Research Foundation (2002)

Governmental policies towards SMEs always represented certain viable measures which could promote this sector creating more avenues for entrepreneurial development and substitute guarantee of employment in different sectors of the economy, affected by the forces of market fluctuations and variations in the employability conditions. The prospect of SMEs has a viable alternative for the economic development of the country can be listed as below:

1. High contribution to domestic production
2. Significant export earnings
3. Low investment requirements
4. Operational flexibility
5. Location wise mobility
6. Low intensive imports
7. Capacities to develop appropriate indigenous technology
8. Substitution of Imports
9. Contribution towards defense production
10. Technology-oriented industries
11. Competitiveness in domestic and export markets.

However, Indian SMEs were very hard hit by the liberalization and faced a number of problems which may be listed as follows:

1. Poor financial situations and low levels of R&D
2. Poor adaptability to changing trade trends
3. Desire to avoid risk

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4. Non-availability of technically trained human resources
5. Emphasis on production and not on production costs
6. Lack of management skills
7. Lack of access to technological information and consultancy services
8. Isolation from technology hubs
9. Low Capital base
10. Concentration of functions in one/two persons
11. Inadequate exposure to international environment
12. Inability to face impact of WTO regime
13. Inadequate contribution towards R&D
14. Lack of professionalism

SMEs in Indian Sector: Issues and Prospects

In this section we shall endeavor to analyze the specific issues and prospects that present them selves in certain specific sectors within SMEs. Each sector presents certain unique problems and the ways to tackle them are equally novel. Apart from certain secondary data which the authors have relied upon to describe the situation of SMEs in India, in the garment, electronic and automotive sectors, and primary information was also collected by the authors through the personal interview to find out first hand about SMEs in the packaging industry in the Indian context.

Garments

The garment industry is one of the dynamic sectors of the Indian economy, which is growing at a rate of 20 per cent per annum for the past two decades. It is also one of the major employment generating industries and larger earners of foreign exchange for the country. As regards the market, the Indian garment industry serves both the international and domestic market. However, the two segments of the market are independent of each other in terms of the units serving and the nature of product.

Prospects for Garment Industry

In order to effect the changes, the Indian garment industry has to undergo a total metamorphosis.

1. Dealing with the manufacturing and marketing of the products directly. Direct dealing with the manufacturing demands immediate in-house tailoring operations and vertical integration of as many operations as possible in the long run.
2. Vertical integration is expected to bring the requisite scale besides control over technology, quality and delivery.
3. A shift from low quality manually-operated machinery to power-driven machinery is essential to ensure speed and quality.
4. Marketing through direct channels like manufacturer-importers and developing strategic alliances with these will help Indian units to get to know the markets as well as technological changes and will equip them better to deal with the rapid market changes.

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Electronics (Hardware Electronics)

The electronics industry constitutes 7-8 per cent of the manufacturing value added of India. It is one of the fast growing and labor intensive industries of India. The Indian electronics industry comprises six categories namely, consumer electronics (34.4% in '97-98), instrumentation and industrial electronics & communication and broadcasting equipment (14%), data processing systems and other office equipment (13%), strategic electronics and electronic components (19.9%).

The electronics industry in India has so far been dominated by small and medium enterprises that are involved in the manual assembly of low-end consumer electronics with the help of few tools and instruments. However, the entry of global players in the wake of globalization and liberalization along with rapid technological developments in electronics is going to change the product composition and the structure of the industry. The entry of global players like Thomson, Sony and Gold Star has not only intensified competition in this already competitive industry but is likely to transform the Indian electronics industry along the lines of the global structure. These changes have made the manual assembly of lower end products by the small-scale units no longer feasible. The survival of the Indian electronic firms in future depends critically on developing or, acquiring and adopting the latest technologies. Given the high costs of technological development and short-product cycles, it is required that Indian firms to go in for collaboration with other firms both for acquiring technology and for marketing their products. All these demand that the Indian small-scale units effect not a marginal change but a total transformation such as a shift away from manual assembly to automation.

Automotive

The automotive components industry in India produces the entire range of parts required by the domestic automobile industry. It caters to nearly 82 per cent of the domestic market demand while the remaining 18 per cent is served by imports. This is a low volume and fragmented industry. In terms of turn over, it is only about one-tenth of the size of the world's largest automotive company namely, Delphi Automotive Systems Corporation of USA It has nearly 400 firms in the organised sector and more than 5000 firms in the unorganized small-scale sector. The unorganized small-scale sector is estimated to contribute nearly 23 per cent to the industry's total production.

The development and structure of the automotive components industry is closely connected with the development and structure of the vehicle industry. In India, the vehicle industry till the eighties was characterized by an oligopoly structure, small-scale operations, high cost of production, technological obsolescence and numerous government regulations. In this period, there was a tendency for the vehicle manufacturers to produce parts and components in-house and component manufacturers started mainly to cater the replacement demand. In the eighties, the entry of Maruti Udyog Limited in the passenger car segment and with many more entries all with foreign collaborations in the light commercial vehicle segment such as Allwyn and DCM, dynamism entered the industry. Relaxation of government regulations especially on foreign collaborations along with the programme of phased localization caused an upsurge in the components industry. Foreign collaborations, technological upgradation and closer relations with the buyers marked the automotive components industry in this time period.

The Indian automotive components industry was so far organized on the lines of a 'dominant firm with a competitive fringe' where, the competitive fringe comprises numerous small-scale units producing simple components or components that have high

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excise duty with older machinery. The new economic policy reforms of the nineties have changed the situation drastically by reducing the importance of fiscal concessions on the one hand and by raising the market competition on the other. Industry is now facing direct competition from the international players. In order to deal with the situation, Indian component manufacturers including the dominant players have to improve their technology as also quality and have to get into the global supply chains of the vehicle manufacturers or into the dealer network for the replacement market. In particular, small-scale units have to phase out their older and manual machinery and to go in for new and automatic machinery as also to improve their organizational methods so as to supply quality products in time.

Questions

1. How has the SME progressed in India?
2. Critically analyse the progress of garments and automotive industry.
3. Do you think Globalisation has any role in development of SMEs?

2.6 Summary

- Industrial policy is one of the important government documents, which has a lasting impact on a country's industry. It is a policy document prepared by the government which states how the industrial environment of the country will take shape in the future.
- Before independence, the industrial policy of British India was formulated with the sole purpose of exploiting the resources of the country for Britain's advantage. Soon after independence, in 1948, India's first industrial policy was unveiled, and in 1956 a second and more comprehensive industrial policy was announced.
- Industrial policy strives for a balanced regional development, i.e., it tries to ensure that industries are not clustered in specific areas but develop in all parts of the country and to ensure that the scarce resources of the nation are utilised in the interest of the nation and not in the interest of profit.
- The first industrial policy in 1948, itself paved the path for mixed economy in the nation. It accepted the existence of both "public and private sectors in the economy. It assigned a progressive role for the State, for investment in industrialisation, and in regulating the private sector.
- The draft of the 1956 industrial policy was very comprehensive. This laid emphasis on the establishment of a socialist pattern of society. This policy also emphasized that industrial development of the country should be guided by the Directive Principles of the Constitution.
- In March 1977 the first non-Congress government was at the centre. The Janata Party assumed power and Morarji Desai, a die-hard Gandhian, became the Prime Minister. The new government declared a new industrial policy.
- The industrial policy of 1977 stated that funds of the public sector financial institutions and banks should be devoted to the growth of the small scale and medium scale units.
- The New Industrial Policy (NIP) was a big departure from the erstwhile industrial policy. When all the earlier industrial policies talked about how to regulate the private sector in a so-called national interest, NIP talked about deregulation and delicensing.

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- Industrial licensing is governed by Industries (Development and Regulation) Act, 1951. It is a very effective tool used by the government to regulate the private sector. Over the years it has become a tool for exploitation. The NIP did away with licensing in a big manner.
- The New Industrial Policy was a new experience for India. On the one hand it provided a conducive environment to the industry, allowing it to spread it wings and on the other hand, it opened the doors for MNCs and sent a clear message to Indian firms to either perform or perish.
- The emergence of Capital Markets can be traced back to the second half of the eighteenth century when the transactions were limited to loan stock transactions of the East India Company.
- Under the SCR Act, an exchange is defined as any 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.
- The Bombay Stock Exchange is one of the oldest stock exchanges of India and Asia and it is also one of the biggest stock exchanges of the world. It is said to be the nerve of the Indian economy which reveals the health of economy.
- The NSE was incorporated in November 1992 with an equity capital of ₹ 25 crores. It is sponsored by IDBI and co-sponsored by other term-lending institutions, LIC, GIC, other insurance companies, banks and financial institutions.
- The OTCEI is primarily meant for small sized companies and small investors. This exchange has the advantages of transparency, fast settlements and potential to reach the nooks and corners of the country.
- The Securities and Exchange Board Act of 1992 provides for the establishment of a board to protect the interest of investors and to promote the development and regulation of the securities market.
- Underwriters make a commitment to get the underwritten issue subscribed either by others or by themselves. They agree to take unsubscribed portions of the issue. They render this service for a commission agreed upon between the issuing company and the underwriter subject to the ceiling under the Companies Act.
- The ongoing reforms in India are referred to as economic liberalisation of India.
- Privatisation is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. In a broader sense, it connotes private ownership (or even without change of ownership) the induction of private control and management in the PSUs.
- The formation of systems of interaction between the global and the local has been a central driving force in world history and has led to the phenomenon called globalisation.

2.7 Keywords

Bear: A seller of securities

BIFR: Board of Industrial and Financial Reconstruction

Bull: A buyer in the stock market

District Industries Centres: Centres for the development of small scale and cottage industries

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GDP: Gross Domestic Product of an economy; indicator of economic growth

IDBI: Industrial Development Bank of India

Industrial Licensing: Tool to regulate private sector industries

Monopoly: Where single seller dominates the market

MRTP Act: Monopolies and Restrictive Trade Practices Act

OCTEI: Exchange for small sized companies and small investors

Planned Economy: Where proper planning takes place and expenditures are planned

Sick Units: Business units which are generating no profits or less revenue

Stock Brokers: Members of recognised stock exchanges who deal in securities

Stock Exchange: Any body of individuals, whether incorporated or not, constituted for the regulating the capital market

Sub Brokers: Acts as an agent of a stock broker; assists him

2.8 Self Assessment

State whether the following statements are true or false:

1. One of the purposes of the industrial policy is to increase the number of entrepreneurs India.
2. The Industrial policy of 1948 propagated that foreign capital inflow should be minimised.
3. Under the Industrial Policy of 1956, machine tools and tools steel industry was left only for private sector.
4. New Industrial Policy allowed a 51% FDI in the hospitality sector also.
5. A stock exchange acts a regulator of the capital market.
6. SEBI is an autonomous body that controls the monetary policy of the government.
7. All the companies listed under a stock exchange have to compulsorily offer their securities to public.
8. Privatisation may refer to full or even part purchase of any business by private players.

Fill in the blanks:

9. ……regulates the Securities Exchange Board of India.
10. The problem of unequal distribution of income and wealth was first dealt in Industry Policy of……..
11. Under Industrial Policy of……, a separate wing of IDBI was established to feed the credit requirements of small scale industries.
12. Stocks of all the blue-chip companies are listed and traded in……
13. ……..was created as a company in 1990 under the Companies Act.
14. When the share market goes up, it is represented by the…….
15. Indian stock market is called the……
16. When government leases its assets to a private company, it transfers it the…….ownership.

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2.9 Review Questions

1. "The role of industrial policy is more important in a planned economy like India." Discuss.
2. Critically analyse the Industrial Policy of 1948. Do you think soon after independence, government did a good job by framing an industrial policy like that?
3. Was the Industrial Policy of 1956, an extension of Policy of 1948 or it was completely different? Bring out the main points as regards to the division of industries in the policy.
4. What was the political scenario in India in 1977? Bring out the connections between political environment then existing in India and the Industrial Policy of 1977.
5. "The policy of Janata Government was that anything which could be produced in small-scale industry should be produced by them alone". Why did they adopt such a policy?
6. What should be done with the sick industries, they should be locked out or revamped? Give reasons for your answer.
7. "Industrial Licensing is a very effective tool used by the government to regulate the private sector". Comment.
8. Did the Industrial Policy of 1991, do any wrong by allowing FDI in India as it was a danger to domestic industries? Justify your answer.
9. Critically analyse the MRTP Act.
10. "Liberalisation has proved to be a big boon for the service sector". Discuss.
11. "Stock Exchange is the barometer of general economic progress in a country". Substantiate.
12. Critically analyse the role of SEBI in regulating proceedings of stock exchanges.
13. Comment on the role of underwriters in a public issue. Give examples of some big names that have underwritten public issues in the past.
14. Did India benefit from the Privatisation that happened in 1991? Justify your answer.
15. Liberalisation of the 19th century is often called-The First Era of Globalisation. Why?

Answers: Self Assessment

1. True
2. False
3. False
4. True
5. True
6. False
7. True
8. True
9. Securities and Exchange Board of India Act, 1992
10. 1956
11. 1977
12. Bombay Stock Exchange
13. Over the Counter Exchange of India
14. Bull
15. Sensex
16. Tenure

2.10 Further Readings

Notes



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Unit 3: Economic Environment of Business

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Objectives

After studying this unit, you will be able to:

- Discuss the economic trends
- Identify problems of growth
- State the role of national income in economy
- Assess the role of industrialization in economic development
- Discuss the concept of inflation

Introduction

Business is an economic activity that has and will continue to influence mankind the most. Almost every citizen of the world obtains his/her bread and butter from some sort of business. Either he is himself engaged in business or is earning because somebody else is engaged in business. A deeper analysis reveals that the basis of international relations is also business.

The impact of business is so pervasive that besides judicial and administrative the third important work any government has to perform is to regulate business in the national interest.

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Whether political interests precede or follow economic interest is a debatable issue. A change in the government or change in the system can change the fate of an organization. Behind every political decision there may be economics and behind every economic decision, politics may be factor.

It is difficult to say whether the Iraq war is a political issue or an economic one because of the oil factor. It is also equally difficult to say with certainty that China is coming closer to India because it realizes India's political importance or because of our growing economy. If we look at world politics and economics, we find that they are two sides of the same coin and at any given point it is very difficult to determine which affects the other.

If we see a look at the events in the erstwhile USSR, we notice a close-knit relationship between politics and economics. Because of pathetic economic conditions and prevailing starvation among the common people, Russia rose in revolt. Thus, economic conditions resulted in a political revolt and a change in government. The new government believe in an entirely different ideology of communism imposed a communist economic system there. Therefore, because of political changes the entire economy of the USSR underwent a change. So in order to understand economics, one should first understand the political systems of world.

3.1 Economic Trends

From the late 1940s, many countries started a new beginning towards growth and development, but almost all of them followed different paths to achieve the goal of welfare of their people.

These countries include erstwhile rich countries, Britain, France, West Germany, Japan, Switzerland, Australia, etc., which were ravaged in the Second World War and fell under a debt trap. Their industries were wiped out and a whole generation of human resources was ruined.

Along with them, newly independent countries like India, and newly formed countries like North and South Korea also began their journey towards growth and development in this decade. But as stated, they chose different paths. On the one hand, countries like Japan, South Korea, West Germany, Britain and France followed a mixed capital economy, while countries like China, Cuba, East Germany, North Korea, etc., followed a socialist pattern. India while under the guidance of its late Prime Minister Shri Jawaharlal Nehru, choose a Mixed Socialist Economy. During World War II the US supported India's independence by exerting pressure on Britain to free India after the war. But after independence though India tried to forge close economic and political ties with both communist China and Russia, China treacherously attacked us in 1962, and the USSR denied us help when as kedo.

We thus see that different countries began their journey towards welfare, growth and development in late 1940s by adopting different routes. The countries that adopted mixed capitalist structure had a remarkable rise.

Example: South Korea, could not even manufacture a tyre of car in 1945 is now one of the largest exporters of automobiles in the world. And India, which was manufacturing and exporting automobiles in 1945, was producing same car in 1991.

South Korean companies are now teaching Indians to produce world-class cars. India that was still producing world-class steel, that too the cheapest in the world in 1945, was later importing steel from countries like Japan who produce steel after importing iron ore from India.

If we go by the parameters of development – per capita income, standard of living, rate of unemployment, availability of basic amenities, etc., we will find that these capitalist mixed economies have outstripped all the socialist economies and even the mixed socialist economies, including India, in every sector.

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In India, people still die of hunger, and commit suicides because of poverty. After fifty years, this is the state of affaire not only in India but almost all the socialist countries like China, Cuba, North Korea, etc. Today, these socialist and mixed economies have to accept the hard realities of the world and have to yield to market forces. These countries have accepted the characteristics of a capitalist economy in the last decade by promoting more and more private sector companies and opening their boundaries to the world.

India has a slowly developed a multiple mechanism of dual prices, ceiling prices, floor prices, subsidized prices, statutory prices, retention prices, procurement prices, levy prices, and free market prices. In India, there is a complex system of liberal rules, strict regulations, control mechanism, planning, and a host of price regulations.

During the 1980s, the Indian economy took a new direction, towards freedom and deregulation. MRTP and FERA companies were allowed to expand and various export promotion incentives were introduced. Liberalisation measures were supplemented by relaxation in price and distribution controls and amendment in the MRTP Act. During this period, the government took various steps to promote the private sector in various fields. Even the import policy was liberalised. The new economic policy was announced in July 1991, which is of far reaching importance. The Industrial Policy has five important features:

1. Industrial Licensing
2. Foreign Investment
3. MRTP
4. Public Sector
5. Foreign Technology Agreement

After liberalisation in 1991, the very face of Indian economy has changed. There is growth in national and per capita income, new opportunities in employment have been generated in telecom, software, call centers, biotechnology, pharmacy, tourism, education, etc. Today, the economy is going through a transition phase, the share of service sector in GDP and employment of India is steadily increasing.

Though is slight change in the growth rates of the 1980s and 1990s but there is a drastic sectoral change.



Example: In 1952 agriculture had a 56.5% share in GDP and in 1988-99 it fell to 29.2%.

Not only this, earlier we produced mostly substandard goods but today we produce goods of international standards from automobile to GSLV (Geo Stationary Satellite Launch Vehicle).

There has been rapid growth in the production of petroleum products and infrastructure in the last decade. India has also signed various bilateral and multilateral agreements with nations like China, the ASEAN nations, Brazil, South Africa, Argentina, Venezuela, etc.

In the last decade a few Indian companies like IOC and Reliance have gained a place among the Fortune 500 companies. While MNCs have spread their wings in India, Indian companies like Infosys, TCS and Wipro have also spread out across the world as leaders in customised software.



Example: Ranbaxy, Cipla and Dr. Reddy's Lab have also acquired firms in the US and Europe and are not only launching their products in these countries but also have manufacturing facilities there.

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Asian Paints has spreads its business in more than 20 countries with its manufacturing capacity spread all over Asia. In the last decade, not only did the Indian economy become global, Indian companies also achieved global standards.

3.2 Problems of Growth

Socialist countries, which used the word "Capitalist" in a very abusive sense, are now inviting companies from these very capitalist countries to invest in their countries and to provide employment to their people. After approximately sixty years of its journey, the following are the chief characteristics of the Indian economy, which are the basic hindrances in its path of growth:

1. ***Low Per Capita Income:*** India is one of the most underdeveloped countries in terms of per capita income. In 1998 India's Purchasing Power Parity estimate of GNP per capita was as low as $1,700, around 1/17th of USA's PPP of estimate of GNP per capita, which stood at $29,340.

2. ***Inequitable Distribution of Income and Poverty:*** The distribution of income and wealth in India is inequitable. The license and permit which were initiated to check concentration of economic power soon degenerated into a tool of creating inequalities and concentration of economic power in a few hands. We see that a few business houses were able to obtain licenses and they produced everything from pins to trucks, and that too of substandard quality. This was possible because of the artificial limitation placed on capacity expansion, which created a scarcity of practically every commodity in India. From kerosene to cement everything was available in black, which created a parallel black economy in the country. There was also an inequitable concentration of economic wealth.

   Not only this but poverty, is also a serious problem of the Indian economy. In 1993-94, the Planning Commission noted that 36% of India's population lived below the poverty line during that year. This estimate of poverty thus conclusively proves that the gains of more than four decades of economic growth in India have failed to reach vast sections of our society.

3. ***Dominance of Agriculture:*** In 1998, agriculture contributed 25% to the total GDP. On the other hand, about 65% of India's population is still dependent on agriculture for its livelihood. In contrast, the US only 3% of the population is engaged in agriculture, which is not only sufficient for the country but also for exports to the world. Dependency on agriculture of such a large population is a major reason for poverty in India.

4. ***Rapid Growth of Population:*** India is facing a situation of population explosion as death rates are falling without a corresponding decline in birth rate. Population growth is the highest in the villages and among the poor people. This makes the problem more acute.

Example: According to the 2001 census, the population of India has crossed over one billion. Because of this, over the years, per head availability of agricultural land has steadily declined, which is today less than 2 hectares per head.

This increasing population eats up the fruits of development and the rate of economic growth remains sluggish. In fact today we are caught in a trap of population, poverty and illiteracy.

Did u know? According to Human Development Index (HDI), India with a value of 0.545, ranks at 132 and 131 in term of real GDP per capita.

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Besides this, the Indian economy is characterised by a high rate of unemployment, scarcity of capital, fiscal imbalances, balance of payment disequilibria, inflation, and technological backwardness.



Notes

India at a Glance

Population (as on March 2001)	1028.5 Million
Gross Domestic Product during 2009-10	US$ 1597.5 billion (₹ 72.6 trillion)
Per capita income during 2009-10	US$ 1,345.5 (₹ 61,185)
Forex Reserves (February 2011)	US$ 298.7 billion
Exports (2009-10)	US$ 182.2 billion
Exports (April-January 2010-11)	US$ 184.6 billion
Imports (2009-2010)	US$ 299.5 billion
Imports (April-January 2010-11)	US$ 273.6 billion
Amount of FDI inflows during 2009-10	US$ 25.9 billion
Amount of FDI inflows during 2010-11 (April 2010-December 2010)	US$ 16.0 billion
Cumulative amount of FDI Inflows (August 1991-December 2010)	US$ 142.9 billion

(India's Macro Economic Indicators as of July 2005)
Source: India in Business

3.3 National Income

National income is a measure of the total value of the goods and services (output) produced by an economy over a period of time (normally a year). It is also a measure of the income flown from production, and/or the sum total of all the spending involved for the production of output.

As per Alfred Marshall, National Income is "The labour and capital of the country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial, including services of all kinds… This is the net annual income or revenue of the country, or the national dividend."

As per National Income Committee of India, National Income is defined as-"National income estimate measures the volume of commodities and services turned out during a given period counted without duplication."

Measures of national income and output are used in economics to estimate the total value of production in an economy. The standard measures of income and output are Gross National Product (GNP), Gross Domestic Product (GDP), Gross National Income (GNI), Net National Product (NNP), and Net National Income (NNI). In India, the Central Statistical Organisation has been estimating the national income.

National income per person or per capita income is often used as an indicator of people's standard of living or welfare. However, many development economists have criticized that GNP as a measure of welfare has many limitations. They argued that human well-being does not depend on national income alone. As measures of GNP exclude poverty, literacy, public health, gender equity, and many human issues of well-being, they developed other measures of welfare such as the Human Development Index (HDI). Some rich countries in terms of national income are poor in human development. Similarly, poor countries in terms national income

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have performed well in human development. In the case of India, though the GDP is growing faster, its performance in terms of HDI is far below than that of many countries.

Importance of National Income

A national income measure serves various purposes regarding economy, production, trade, consumption, policy formulation, etc. The need for estimation of national income, gives the importance of national income:

1. To measure the size of the economy and level of country's economic performance.
2. To trace the trend or speed of the economic growth in relation to previous year(s) as well as to other countries.
3. To know the structure and composition of the national income in terms of various sectors and the periodical variations in them.
4. To make projection about the future development trend of the economy.
5. To help government formulate suitable development plans and policies to increase growth rates.
6. To fix various development targets for different sectors of the economy on the basis of the earlier performance.
7. To help business firms in forecasting future demand for their products.
8. To make international comparison of people's living standards.



Task

Find out the various methods to calculate national income. Find which country has the highest National income and which has the lowest.

3.4 Industrialization and Economic Development

For any economy, whether developed or developing, economic development is very important, which is achieved largely through industrialization. However, even though we know that higher productivity of industries leads to improved economic outcomes, there has been no consensus among researchers about either the desired path of development or the role of state in economic development. The appropriate strategy for any country depends not only on its objective economic situation but also on its government policies and national views regarding the appropriate role of the state.

India's economic development strategy immediately after Independence was based primarily on the Mahalanobis model, which gave preference to the investment goods industries sector, with secondary importance accorded to the services and household goods sector.



Example: The Mahalanobis model placed strong emphasis on mining and manufacturing (for the production of capital goods) and infrastructural development (including electricity generation and transportation).

Any increase in planned investments in India required a higher level of savings but that was not there. Because of the low average incomes in India, the needed higher levels of savings had to be generated mainly by restrictions on the growth of consumption expenditures.

Notes

Over time, India created a large number of government institutions to meet the objective of growth with equity. The size of the government grew substantially as it played an increasingly larger role in the economy in such areas as investment, production, retailing, and regulation of the private sector.



Notes In the late 1950s and 1960s, the government established public sector enterprises in such areas as production and distribution of electricity, petroleum products, steel, coal, and engineering goods. In the late 1960s, it nationalized the banking and insurance sectors. To alleviate the shortages of food and other agricultural outputs, it provided modern agricultural inputs (for example farm machinery, irrigation, high yielding varieties of seeds, chemical fertilizers) to farmers at highly subsidized prices (World Economic Indicators, 2001). In 1970, to increase foreign exchange earnings, it designated exports as a priority sector for active government help and established, among other things, a duty drawback system, programmes of assistance for market development, and 100 per cent export-oriented entities to help producers export (Government of India, 1984). Finally, from the late 1970s through the mid-1980s, India liberalized imports such that those not subject to licensing as a proportion to total imports grew from five per cent in 1980-1981 to about 30 per cent in 1987-1988.

The activities of an economy are commonly divided into five components. The primary sector includes activities directly involving the physical environment; occupations such as agriculture, fishing, forestry, hunting, and mining. The secondary sector involves the processing of raw materials and manufacturing. Most workers in developed countries are in the tertiary sector where they provide services. The service sector includes wholesale and retail sales, transportation, and finance, insurance, real estate. Those whose work involves the exchange or application of information, knowledge, and/or capital are thought to be in the four or quaternary sector. Finally the expansion of the knowledge economy has necessitated the term quinary sector to refer to higher order, complex, and specialist tasks of control, production and management.

As a country goes through industrialization or economic development it is possible to see a marked shift in the percentage of the labor force involved in the each of the five sectors. Non industrial states have most of their workers involved in the primary sector. When industrialization begins there is great growth in the secondary sector and the percent of workers involved in primary production decreases. With continued growth in economic activity the labor force shifts toward the third, fourth, and fifth sectors.

3.5 Inflation

Although an overall increase in price is often referred to as inflation, in reality it means a continuous rise in prices, accompanied by a decrease in the purchasing power of the currency.

Inflation is measured by taking a 'basket' of goods, and comparing the prices at two intervals, and adjusting for changes in the intrinsic basket. Thus, there are different measurements of inflation, depending on the basket of goods selected. The most common measures are of consumer inflation, producer inflation and GDP deflators, or price indices. The last measures inflation in the entire economy. Thus, if the general price was say, 100 in 2000 and 110 in 2001 then there is an inflation rate of 10%. Hence it can be said that in an inflationary situation the purchasing power of money goes down.

3.5.1 Types of Inflation

Notes

The following are the types of inflation:

1. ***Hyperinflation:*** An extremely high rate of inflation is known as hyperinflation. It is a state of galloping inflation. N. Gregory Mankiw has defined Hyperinflation as "inflation that exceeds 50% per month, which is just over 1% over per day. Compounded over many months, the rate of inflation leads to very large increases in the price level".
2. ***Suppressed Inflation:*** Suppressed inflation is a situation where deliberate policies are pursued to prevent price rises in the present, but it is only a temporary suppression of inflation. These forces usually accumulate and are bound to burst in future and occasionally result in hyperinflation.
3. ***Deflation:*** This means a fall in prices, the opposite of inflation.
4. ***Disinflation:*** It refers to the slowing of the rate of inflation, that is, prices are still rising, but at a slower rate than before. It implies the process of bringing down prices moderately from their previous higher level.
5. ***Reflation:*** It is a term used to denote inflation after a period of deflation, meaning inflation designed to restore prices to a previous level.
6. ***Crawling Inflation:*** Crawling inflation is where inflation is low and which moves up and down slowly.

In controlled economies like India, there exist another type of inflation, i.e., Administered Inflation. In a few sectors, India still follows a policy of administered pricing and in some cases, it follows dual pricing in which the manufacturer has to sell a portion of the output at fixed prices while the rest are sold at market driven prices. India also follows the policy of support price for crops. All these administered prices changes from time to time create administered inflation i.e. rise in prices not by market forces but by the government. Though in today's liberalised economy, the government is slowly doing away with administered pricing.

Based on its cases or sources, we can identify three kinds of inflation:

1. ***Administered Pricing:*** Inflation caused by the revision of prices by the government.
2. ***Demand Pull Inflation:*** Demand-pull inflation arises when aggregate demand outpaces aggregate supply in an economy. It involves inflation rising as the real gross domestic product rises and unemployment falls. It is described as "too much money chasing too few goods", since only money that is spent on goods and services can cause inflation.
3. ***Cost Pull Inflation:*** This is because of rise in costs. Cost-push inflation or supply-shock inflation is a type of inflation caused by large increases in the cost of important goods or services where no suitable alternative is available.



Example: A situation of this kind that has been often cited was the Oil Crises of the 1970s, which some economists see as a major cause of the inflation at that moment. Since petroleum is critically important to economies, a large increase in its price can lead to increase in prices of most products, raising the rate of inflation.

Neo Keynesian theory describes three types of inflation: Demand-Pull Inflation, Cost-Pull Inflation, and Built-in Inflation.

Built-in Inflation: Built-in inflation is induced by adaptive expectation, often linked to the 'price/wage spiral' because it involves workers trying to match their wages up with prices, and employers passing higher costs on to consumers as higher prices as part of a 'vicious circle'.

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Built-in inflation reflects the events of the past, and so might be seen as hangover inflation. It is also known as 'inertial' inflation, 'inflationary momentum', and even 'structural inflation'.

Besides the above, other causes of inflation are low productivity and expansion of money.

1. ***Productivity:*** When productivity falls, it results in diminishing returns of production, and causes inflationary pressures. Increase in the velocity of money causes inflation and reduction in efficiency caused by excessive present consumption against investment. That is, a savings rate that is too low to fund the improvements in production which are required to keep pace with increases in aggregate demand. Thus, when production can not keep pace with the demand, inflation takes place.
2. ***Expansion of Money:*** Expansion of money or increase in the supply of money in the economy also results in inflation. A government can finance its spending in three ways: by raising revenue through taxes, by borrowing from the public by selling government bonds, or by simply printing money.



Did u know? The revenue raised through the printing of money is called Seigniorage . The term comes from seigneur, the French word for 'feudal lord'. In the Middle Ages, the lord had the exclusive right on his manor to coin money. When the government prints money to finance expenditure, it increases the money supply, which causes inflation.

Besides Seigniorage, the Government/Central Bank can increase the supply of money in the economy by many other means such as reduction in CRR, SLR, Bank Rate through purchase of government securities, reduction in personal taxes (income, corporate, dividend) etc. All this causes inflation.



Caselet

R.I.P Zimbabwe Dollar

–by Steve Hanke

"Zimbabwe is in the late stages of a classic hyperinflation. … Inflation is galloping ahead as the supply of Zimbabwe dollars surges and the demand for them shrinks. Eventually, the currency will totally collapse as people simply refuse to accept it." In recent months, facts on the ground have validated this prognostication. The Zimbabwe dollar is dead.

Last year, I developed a hyperinflation index for Zimbabwe. The index began on 5 January 2007, a month before Zimbabwe entered the hyperinflation zone. Due to a lack of reliable data, I stopped reporting the index on 14 November 2008. This index was based on non-cash Zimbabwe dollar transactions. These had accounted for the bulk of transactions in Zimbabwe. By the end of November, however, there were virtually no non-cash Zimbabwe transactions taking place and the Zimbabwe Stock Exchange had stopped trading. The non-cash Zimbabwe dollar is, therefore, dead.

Ashes are all that is left of the Zimbabwe dollar - a remnant of paper money. During Zimbabwe's hyperinflation, foreign currencies replaced the Zimbabwe dollar in a rapid and spontaneous manner. This "dollarization" process was legalized in late January 2009. Even though the Zimbabwe paper money remnant circulates alongside foreign currencies, its real value is tiny, its use is limited, and its value against the U.S. dollar is cut in half every two days.

Contd...

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Zimbabwe failed to break Hungary's 1946 world record for hyperinflation. That said, Zimbabwe did race past Yugoslavia in October 2008. In consequence, Zimbabwe can now lay claim to second place in the world hyperinflation record books. Top three hyperinflations are shown below:

Country	Month with highest inflation rate	Highest monthly inflation rate	Equivalent daily inflation rate	Time required for prices to double
Hungary	July 1946	1.30×10^{16}%	195%	15.6 hours
Zimbabwe	Mid-November 2008 (latest measurable)	79,600,000,000%	98.0%	24.7 hours
Yugoslavia	January 1994	313,000,000%	64.6%	1.4 days

Source: cato.org

3.5.2 General Causes of Inflation in India

Following are the main causes of inflation in India:

1. Supply Constraints
2. Demand Accelerators

Following are the main supply constraints because of which prices rise in India:

1. ***Fluctuation in Agricultural Output:*** Even today to a great extent, agriculture in India is dependent on nature's blessings. Because of small individual holdings, the output per hectare is very small in India. Peasants are unable to use modern technology, which makes them more vulnerable to nature. Also, they do not have a professional approach because of which they can't select the right crop according to the climate and market demand. All this results in fluctuations in agricultural output. As the output declines in the country, their prices rise sharply. Since agricultural products get a high weightage in the index of wholesale prices, a rise in their price gets automatically reflected in the general price index.



Example: Since industrial workers spend a big amount of their incomes on food, a hike in food prices leads them to purchase other goods, whose prices also see a rise in times of failure of agriculture produce.

2. ***Hoarding of Essential Goods:*** Expectations of crop failures and speculations have always encouraged big farmers and intermediaries to hoard agricultural products in the expectation that the prices of those commodities would increase. Such activities have aggravated the price situation in India.
3. ***Low Growth of Industrial Sector:*** In India the performance of the industrial sector left much to be desired, especially in the early post-independence period. It was bad during 1965-85 when it posted a measly growth of 4.7% per annum. Less production and rising gap between demand and supply resulted in inflation. The situation improved only after 1991.
4. ***Increment in Administered Prices:*** The government used to fix the prices of a number of goods such as coal, steel, electricity, fertilizers, petroleum products, etc. To increase the revenue of the inefficient public sector, the government used to keep raising the prices. Because most of these goods are raw material for other goods, a rise in heir prices affects the general price level and leads to inflation in the economy.

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5. ***Restrictions on Imports:*** In a move to protect domestic industry, the government restricted imports in the past. Because of this, diseconomies of scale crept the industrial sector as it was totally a seller's market, resulting in an increase in prices. Consumers were forced to purchase costly products made in India though they could be imported at very cheap rates. This policy also resulted in the inefficient use of resources as scarce resources were invested even in the production of those things which were easily available at very economical prices abroad, and could be easily imported.

The various factors that have accelerated demand thus have resulted in the increase in prices are:

1. ***Growth of Population:*** India's population keeps rising at more than 2% per annum. Increased population causes increase in the demand of wage goods. It also adds to the government expenditure at all levels to provide basic amenities to the population added and exerts pressure on demand indirectly.
2. ***Increment in Income and Employment:*** Post-liberalisation, income and employment have increased significantly. These have resulted in greater demand for wage goods whose supply is relatively inelastic. The result has been a continuous price rise.
3. ***Urbanisation:*** The migration of population from villages to city areas adds to the intensity of the demand factor.

Monetary and fiscal factors have also contributed to price rise in India as they work as demand accelerators. The following are important reasons in this respect:

1. ***Rising Level of Government Spending:*** India has witnessed a sharp rise in public expenditure since independence. This rose from 18.5 % of NNP to around 33 % in 1980-81 and further rose to around 45% in 1998-99. A significant part of government expenditure is on non-developmental activities including defense, interest on public debt, administrative expenditure, and maintenance of law and order in the country. The expenditure on these activities leads to inflationary trends in the economy; the purchasing power of the people increases but the supply of real goods remains more or less the same.
2. ***Deficit Financing:*** Deficit financing results in large- scale creation of money and intensifies the price spiral. Net bank credit to the private sector also contributes to inflationary pressures.

3.5.3 Measuring Inflation

Inflation is measured by observing the change in the prices of a large number of goods and services in an economy. The prices of goods and services are combined to give a price index measuring an average price level, the average price of a set of products. This price is then adjusted for changes in the underlying basket of goods, a process called hedonic adjustment.

Inflation Rate: The inflation rate is the rate of increase of the average price level, i.e., measure of inflation. Alternatively, the inflation rate is the rate of decrease in the purchasing power of money.

There is no single true measure of inflation because the value of inflation will depend on the weight assigned to each good in the index as well as the extent of the economic region being examined.

Inflation is measured through various price indices. The following price indices used in India to measure inflation:

1. GDP Deflator.

Notes

2. Consumer Price Indices.
3. Wholesale Price Index.

1. ***GDP Deflator:*** It is the broadest measure of the price level. Gross Domestic Product (GDP) deflator is the index of the average price for the goods and services produced in the economy. It includes the price of all finished goods. In other words, it doesn't include that means, it don't include intermediate goods and raw materials. It ignores the prices of imported goods, which enters the consumption basket and/or to the list of inputs in production. The GDP deflator is based on calculations of the Gross Domestic Product-it is based on the ratio of the total amount of money spent on GDP (nominal GDP) to the inflation-corrected measure of GDP (constant-price or 'real' GDP).
2. ***Consumer Price Indices (CPI):*** The Consumer Price Indices (CPI) measure the price of a selection of goods purchased by a 'typical consumer'. A consumer price index refers to the index of the goods and services contained in the consumption basket of the relevant group of consumers. It excludes the prices of capital goods (plant and equipments), raw materials and intermediate goods, and includes the prices of services as well as of imported goods. Because consumption pattern of families varies with their profession, place of living etc., there can be many CPIs. In India we have three such CPIs:
   (a) CPI for Industrial Workers (CPI-IW).
   (b) CPI for Urban Non-manual Employees (CPI-UNME).
   (c) CPI for agriculture labourers (CPI-AL).

   In many countries, annualised percentage changes in these indices are the most commonly reported inflation figure. These measures are often used in wage and salary negotiations, since employees wish to have nominal pay raises that equal or exceed the rate of increase of the CPI. Sometimes, labour contracts include cost of living escalators, or adjustments that imply nominal pay raises automatically occur due to CPI increases, usually at a slower rate than actual inflation (and after inflation has occurred).
3. ***Whole Price Index:*** It measures the change in price of a selection of goods at wholesale (i.e., typically prior to sales taxes). It includes the prices of raw materials and semi-finished goods, as well as of imported tangible goods, besides the prices of tangible goods included in the GDP, if they are transacted at the wholesale level. It excludes the prices of services.

3.5.4 Impact of Inflation

Inflation influences and touches the life of every individual and corporate entity. Hence, Inflation influences the decisions affects our lives in the following ways:

1. ***Indirect Tax:*** Inflation is considered the cruelest tax. The government can increase this through its right to create money, especially through seigniorage. When the government finances its deficit by issuing money, which the public adds to its holdings of nominal balances, to maintain the real value of money balances constant, we say that the government is financing itself through the inflation tax. The government can thus spend more resources, forcing people to spend lesser, just as if the government had raised taxes to finance extra spending.
2. ***Shoe Leather Costs:*** Inflation increases the cost of holding of currency as well as opportunity cost. That is, if people keep the money with themselves, their purchasing power will decrease because of inflation. People will tend to hold less cash, and will try to keep them in banks or will try to invest in other interest yielding instruments during times of inflation. This imposes real costs.

Notes



Example: The form of more frequent trips to the bank (there is a humorous reference to the cost of replacing shoe leather worn out when walking to the bank).

3. ***Menu costs:*** Under inflation, firms must change their prices more frequently, which imposes costs.



Example: A restaurants have to reprint their menus as they change them menu time and again.

High inflation induces firms to change their posted prices more often. Changing prices is a costly affair as it requires printing and distributing new catalogues.

4. ***Variability in Relative Prices:*** The higher the rate of inflation, the greater the variability in relative prices. To adjust to inflation firms usually change their price after specific intervals, usually annually. But prices don't increase annually. They increase daily, weekly or monthly, and this results in variability in prices.



Example: Suppose a firm increase its prices to adjust inflation every April. But if inflation is 1% per month, then from the beginning to the end of the year, the firm's relative prices fall by 12%. Sales from this catalogue will tend to be low early in the year (when its prices are relatively high) and high later in the year (when its prices are relatively low).

Hence, when inflation induces variability in relative prices, it leads to inefficiencies in the allocation of resources.

5. ***Negative Impact on Exports:*** This happens if the inflation in an exporting country is higher than inflation in the importing country. If the nominal exchange rate is not adjusted by the inflation differential then inflation causes appreciation of home currency in relation to the foreign currency. The appreciation in the real exchange rate adversely affects net exports.

In another sense, inflation results in higher procurement or manufacturing costs in the home country but if inflation is lower in the importing country, then the selling price will not increase by that magnitude. This reduces profits and increases competition for the export market from other exporting countries that have low inflation. Inflation thus reduces from exports.

6. ***Change in Yardstick:*** Money is a yardstick with which we measure economic transactions. But this yardstick changes when inflation occurs. In such an instance it becomes difficult to measure economic variables. The comparision of the economic variable of the country at different periods is an especially difficult task.. Comparing the per capita income of an Indian in 1980 and in 2000 will be of no use as it will not give true picture of his economic capacity. As we compare the size of the economy through the traditional route, that is by Per Capita GDP in Dollars, we find that India ranks through very low. But if we do through with the new route, i.e., Purchasing Power Parity (PPP), then we find that India is among the top five. This shows how difficult it is to compare economic data because of inflation.

7. ***Tax Anomaly:*** Inflation distorts the way taxes are levied. Because of inflation, a person can be taxed without having any income. Suppose a person buys some stock today and sells the same a year from now at the same real price. It would seem reasonable for the government not to levy a tax, since there is no income.

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Example: If there is no inflation, the outcome will be zero tax liability. But if the rate of inflation is 15% and a person initially pay ₹ 100 per share for the stock, for the real price to be the same a year later, the person sells the stock for ₹ 115 per share. In this situation, the tax code ignores the inflation and will take ₹ 15 as capital gain and will tax it.

Hence, an individual is taxed without having any real income and as a net effect, he suffers a loss.

8. ***Redistribution:*** Inflation will redistribute income from those on fixed incomes, such as pensioners, and shift it to those who draw a more flexible income (like profit makers and wage-earners), and can keep pace with inflation.

   Similarly, it will redistribute wealth from those who lend a fixed amount of money to those who borrow (if the lenders are caught by surprise or cannot adjust to inflation).



Example: Where the government is a net debtor, as is usually the case, it will reduce this debt, redistributing money towards the government.

9. ***Reduction in Investment and Savings:*** Sometimes inflation causes uncertainty in the economy, which discourages investment and savings in countries.

10. ***Vicious Circle of Inflation:*** An increase in inflation increases, it increases the tax on holding currency, and therefore encourages spending and borrowing, which increase the velocity of money. Such reinforcing of the inflationary environment creates a 'vicious circle'. Carried to extremes it can become hyperinflation.

Impact of Inflation on Different Groups

1. ***Loan Agreements/Future Contract/Future Payments:*** Inflation leaves its impact on loan agreement as it influences the gains/losses of debtors and creditors. In a loan agreement, if inflation turns out to be higher than expected, the debtor wins and the creditor loses because the debtor repays the loan with a less valuable rupee. On the other hand, if inflation turns out to be lower than expected, the creditor wins and the debtor loses because the repayment is worth more than the two parties anticipated.

2. ***Producers and Traders:*** Producers, traders and speculators gain during inflation as price rises faster than the cost and therefore their profits rise. The money value of their inventories also rises during inflation.

3. ***Fixed Income Group:*** Inflation has an adverse impact on wage earners and salaried people as it erodes their real income. Moreover, in trying to push up wages to sustain their real income, wage earners bring about cost-push inflation and in the process worsen their position.

4. ***Investors:*** Investors investing in debentures and fixed interest bearing securities, bonds, etc., lose during inflation. But investors investing in equities benefit because more dividend is yielded on account of the high profits made by companies during inflation.



Task

Consider the recent inflation that hit the economy and make note of the changes that you saw in the general marketplace.

Notes

3.5.5 Measures to Control Inflation

1. ***Monetary Policy:*** Inflation can be controlled by controlling the supply of money in the economy. The central bank, through its monetary policy, can control inflation to a certain extent. Through various measures like CRR, SLR, Bank Rate, Open Market Operations, Moral Suasion (for details see unit of Monetary Policy), etc. The Central bank can increase or decrease the supply of currency in the economy and thus control inflation to some extent.
2. ***Price Controls:*** Another method attempted is simply instituting wage and price controls. Through its fiscal policy, the central government can also check inflation. It can not only influence the supply of money in the economy but also control or create demand - pull inflation. It also influences the production and its cost, thus also influencing the cost pull inflation.



Case Study

Oil and New Economy

Your cannot get more old economy than to fret about the price of oil. Although the oil price is hard to miss when you come to refuel your car, economy watchers with any sophistication are encouraged at every turn to pay little attention. For instance, measures of "underlying" inflation exclude the oil price – too volatile, the argument goes, and no longer all that significant, one is led to suppose. Yet theory and empirical evidence suggest that the price of oil remains a fundamental driver of the business cycle. In all likelihood cheap oil has played a big role in creating the appearance of a "new economy" and dear oil, if the price stays up, may do more harm than many believe.

In Britain, the leading advocate of the view that oil still matters has been Andrew Oswald, a professor at Warwick University. In an article in the Financial Times last year he went so far as to claim that the so-called new paradigm is almost entirely an illusion caused by a prolonged period of extremely cheap oil. Now that the price has soared and assuming that it stays relatively high, he fears that the result will be a marked slowdown in the world economy.

Mr Oswald is therefore a doubly unusual fellow: an easy-money new-economy sceptic. Most new-economy sceptics want monetary policy in the United States tightened faster (because they believe the surge in labour productivity will not last and that inflationary pressures are building). Mr Oswald, in contrast, though a trenchant critic of the new economy, believes that monetary policy should be on recession watch in both Britain and America.

Mr Oswald, along with Alan Carruth of the University of Kent and Mark Hooker of the Federal Reserve, published an article in 1998 which helps to makes the case for this view. The starting point is the chart, which repays careful study. The association between changes in the price of oil and, after a delay, changes in American unemployment is impressively close. And the underlying model which Mr Oswald and his collaborators adduce is persuasive and simple. They concentrate on the supply side (that is, labour-market) implications of oil, rather than on the demand side effects. Dear oil raises producers' costs and squeezes their profit margins. To restore those margins, employers strive to cut labour costs. At the aggregate level and for any given pressure of demand, higher unemployment is the result: in effect, only with more people on the dole are workers

Contd...

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willing to accept lower wages. Mr Oswald and his colleagues showed that a forecasting model based on this version of the "efficiency wage" theory of labour markets fits the data very well. From the late 1970s to the mid-1990s, oil played a stronger and statistically more significant role in driving American unemployment than interest rates. In forecast extending beyond the sample period used in the study, a stern test of any model, Mr Oswald's approach easily outperforms its rivals, including consensus predictions of commercial forecasters.

The paper makes no attempt to test and reject the view that new technologies have changed the structure of the American economy in the late 1990s. New economy optimists may therefore be untroubled by these findings. But that would be a mistake. Mr Oswald's point is that there is no need to posit a new economy to account for the behaviour of the American economy since the mid-1990s. The boom has all the standard features of an oil price shock, except that, compared with the more familiar cases of 1973-74 and 1979-80 and the not-so-noticed case of 1990-91, this one happened in reverse. Profit margins widened dramatically as the price of energy fell; inflationary pressure subsided even as demand gained strength (under the influence of rising stockmarket wealth and other forces); the rate of unemployment consistent with stable inflation (the so-called natural rate) appeared to fall to an amazing low.

Lawrence Summers, America's treasury secretary, attracted attention recently when he likened the new technology boom to a positive supply side shock, the converse of the oil price shocks of the 1970s. And yet, Mr Oswald argues, the more natural parallel to draw between then and now is that for most of the 1990s there has been a "good" oil price shock. Even if you do not accept Mr Oswald's new economy scepticism in full, it is undeniable that oil was (rightly) given most of the blame for what went wrong in those earlier periods, but none of the credit for what has gone right more recently.

It seems highly likely, Mr Oswald's scepticism notwithstanding, that a surge of technological progress in America has indeed applied a significant positive supply shock to the economy. But it is certain, as opposed to merely likely, that the recent oil-price hike is a substantial negative supply shock. The future course of the economy will depend on which of these forces proves more powerful. If low inflation persists alongside very low unemployment, the new-economy shock can be declared the winner. But if, with oil pegged at more than, say, $ 20 a barrel, low inflation can be maintained only at the cost of rising unemployment, the oil price will have had its revenge. It was denied its full share of thanks for the current boom; it may be harder to ignore in any forthcoming recession.

Questions

1. What is the impact of oil price on international business and economy?
2. Do you agree with Mr Oswald? Give reasons.
3. Analyse the cause-effect relationship between unemployment and oil price.
4. Contrast the "demand side" and the "supply side" views on the case.

Source: The Economist, April 1, 2000

3.6 Summary

- The impact of business is so pervasive that besides judicial and administrative the third important work any government has to perform is to regulate business in the national interest.

Notes

- From the late 1940s, many countries started a new beginning towards growth and development, but almost all of them followed different paths to achieve the goal of welfare of their people.
- We see that different countries began their journey towards welfare, growth and development in late 1940s by adopting different routes. The countries that adopted mixed capitalist structure had a remarkable rise.
- India has a slowly developed a multiple mechanism of dual prices, ceiling prices, floor prices, subsidized prices, statutory prices, retention prices, procurement prices, levy prices, and free market prices.
- After liberalisation in 1991, the very face of Indian economy has changed. There is growth in national and per capita income, new opportunities in employment have been generated in telecom, software, call centers, biotechnology, pharmacy, tourism, education, etc.
- After approximately sixty years of its journey, the following are the chief characteristics of the Indian economy, which are the basic hindrances in its path of growth: inequitable distribution of income and wealth, low per capita income, increasing population etc.
- National income is a measure of the total value of the goods and services (output) produced by an economy over a period of time (normally a year).
- As per National Income Committee of India, National Income is defined as-"National income estimate measures the volume of commodities and services turned out during a given period counted without duplication."
- National income per person or per capita income is often used as an indicator of people's standard of living or welfare. However, many development economists have criticized that GNP as a measure of welfare has many limitations.
- A national income measure serves various purposes regarding economy, production, trade, consumption, policy formulation, etc.
- For any economy, whether developed or developing, economic development is very important, which is achieved largely through industrialization.
- The activities of an economy are commonly divided into five components: primary, secondary, service, quaternary and quinary sector.
- Inflation is measured by taking a 'basket' of goods, and comparing the prices at two intervals, and adjusting for changes in the intrinsic basket. Thus, there are different measurements of inflation, depending on the basket of goods selected.
- There are various types of inflation that can take place: hyperinflation, suppressed inflation, reflation, deflation etc. In India, there are demand pull and cost pull inflation.
- There are two main causes of inflation in India: supply side constraints and demand fluctuations. Supply side constraints can be fluctuation in agricultural output, hoarding of essential goods, restriction on imports etc.
- Inflation is measured by observing the change in the prices of a large number of goods and services in an economy. The prices of goods and services are combined to give a price index measuring an average price level, the average price of a set of products.
- Inflation influences and touches the life of every individual and corporate entity. Hence, Inflation influences the decisions affects our lives in the way of indirect taxes, shoe leather costs, menu costs, tax anomaly etc.

Notes

- There are two major ways practiced to control inflation: monetary control and price controls.

3.7 Keywords

Administered Pricing: Inflation caused by the revision of prices by the government

Consumer Price Index: Measures price of a selected goods purchased by a consumer

Cost Pull Inflation: Caused by large increases in the cost of important goods

Deflation: A fall in prices, the opposite of inflation.

Demand Pull Inflation: Arises when aggregate demand outpaces aggregate supply

Disinflation: The slowing of the rate of inflation

GDP Deflator: Index of the average price for goods and services produced in the economy

Hyperinflation: Extremely high rate of inflation

Indirect Tax: Direct liability to pay the tax lies not with the pay

Inflation: Continuous rise in prices, accompanied by a decrease in the purchasing power

Inflation Rate: Rate of increase of the average price level

National Income: Measure of the total value of the goods and services produced in a year by an economy

Reflation: Inflation after a period of deflation

Shoe Leather Costs: Cost of holding of currency and the opportunity cost

Seigniorage: Revenue raised through the printing of money

Whole Price Index: Measures the change in price of a selection of goods at wholesale

3.8 Self Assessment

State whether the following statements are true or false:

1. Countries like North Korea took a capitalist path for development.
2. India ranks very low on per capita income but relatively higher on human development index.
3. India faces a regular mismatch between its exports and imports thereby creating a negative BOP.
4. National income also includes the income earned by non-resident Indians.
5. National income can also used by the governments to prepare Human Development Index.
6. Measures of inflation differ on the basis of basket of goods chosen.
7. Hyperinflation is just an imaginary phenomenon; it does not happen for real.
8. Inflation takes a toll on real incomes of the employees working in organisations.

Fill in the blanks:

9. India shows the traits of being a …….. economy.

Notes

10. ..... was established to put a tab on the outside currency flowing in the economy.
11. Most of the SMEs face the problems in growth and development due to lack of .....
12. National income is also known as.....
13. If in an economy, prices are rising but not steadily or prices are lowered but moderately, the condition is called.....
14. The rising requirement of crude oil is most likely to result in ..... inflation in India.
15. India is still facing a sluggish growth in its primary sectors specially farming. It resulted in inflation caused due to ..... constraints.
16. In an economy, if the price of good A in 2009 is ` 225 and current inflation rate is 5%, then the price of good A in 2010 is most likely to be.....

3.9 Review Questions

1. "The basis of international relations is also business". Comment.
2. Comment on the economic scene of the world at the time of World War 2. What was the scenario in India around WW2?
3. "Even after more than 60 years of journey after independence, India has not come out as developed country". Discuss, making comparisons between Indian, Japanese and South Korean economies.
4. "The increasing population is eating up the fruits of development and economic growth". Discuss.
5. What do you think, does national income give a correct picture of developments and growth in an economy? Justify your answer.
6. How can the governments use national income to make international comparison of people's living standards? Is this correct?
7. "There is no consensus on the argument that higher productivity of industries and increased role of state lead to economic prosperity". Discuss.
8. Activity of any economy can be put up into five components. Analyse the case of Indian economy and categorize major industries or sectors operating under each component.
9. With continuous economic growth, the labour force in the country is fast moving away from primary and secondary sectors. Why?
10. Critically analyse the growth of the Indian economy pre LPG policy and post LPG policy.
11. "Inflation is not a general rise in prices but a continuous rise in prices". Discuss.
12. Being a student of Business environment, on what factors will you like to put a tab on to control inflation in the economy?
13. "Inflation is considered the cruelest tax". Comment.
14. Discuss the impact of inflation on various interest groups in an economy. Also suggest the minimise impact of inflation.

15. Calculate the GDP Deflator from the following:

Notes

(a)	GDP	₹ 3, 20,000
(b)	GDP on constant prices	₹ 2, 80,000
(c)	Nominal GDP	₹ 3, 20,000
(d)	NDP	₹ 2, 30,000

Answers: Self Assessment

1.	False	2.	False
3.	True	4.	True
5.	True	6.	True
7.	False	8.	True
9.	Mixed	10.	FERA
11.	Capital/Infrastructure	12.	GNP
13.	Disinflation	14.	Demand Pull
15.	Supply Side	16.	₹ 236.25

3.10 Further Readings



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Unit 4: Political Environment

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Objectives

After studying this unit, you will be able to:

- Discuss role of Government in business
- Explain Regulatory and Legal Role
- Discuss Infrastructure Development and Human Resource Development
- Describe Entrepreneurial Role and Planning Role

Introduction

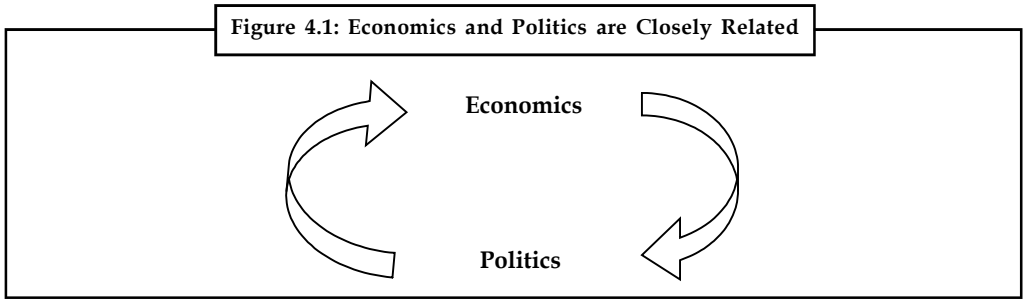
Does politics drive economics or does economics influence politics? This is a critical question. But if we analyse world history we will realise that it is a two-way traffic, wherein they influence each other. During medieval ages we find that foreigners invaded India for the sake of her wealth but these invasions changed the whole political system of India. The World War II was fought for the sake of colonies (money which colonies used to yields). Because of prevailing economic conditions, the famous revolts of France, Russia, USA and China took place and all these revolts not only changed the political system of the respective countries, but also their economic systems.

4.1 Political and Government Environment

Notes

In India, the British came for business and did everything here for money; but all this changed the whole political system of India. Not only this, the Indian freedom movement acquired strength to fight against Britishers when the common man, including farmers and artisans joined the movement. Gandhiji's first organized campaign in India was in Champaran for the economic rights of the peasants of Champaran. Similarly, the second big campaign which earned the title 'Sardar' for Sardar Vallabh Bhai Patel was 'Bardoli Satyagraha.' The results of political movements like Swadeshi and Dandi March too, lay in economics.

Figure 4.1: Economics and Politics are Closely Related



After the Second World War many countries were devastated and had to begin their journey towards development and growth afresh. Simultaneously, a few countries like India which won freedom too, had to begin start their journey towards development. But these countries chose different routes to reach their destination. While some chose the capitalist path, others followed the communist way, and certain other countries choose a mixed economy. But selection of the economic system was not on the basis of economic merits alone. It was the prevailing political system and the political beliefs in the respective country which governed its fate.

So it is clear that economics and politics are closely related. It is the beliefs of political leaders that decides the fate of economic policies and it is the economic condition of a country and masses which influences the political fate of the country.

This unit throws light on this topic with the objective of demonstrating how a government can influence business. It is the government that influences business and in some countries it even decides the following things:

1. What to produce?
2. Where to produce?
3. When to produce?
4. How much to produce?
5. How to produce? (manufacturing process)
6. To whom to sell?
7. How to distribute?
8. What should be the price?

Answers to these questions lies with the government to a great extent. It is true that in India, before liberalisation, license and permit raj was so deeply ingrained that before starting any venture, an entrepreneur or industrial house needed not only to get registered with the government authority, but also to obtain various licenses from the government.

Not only this, in India prior to 1991 it was the government that decided what the private sector would produce, and where and how much it would produce. In fact, it was not the market forces but the government that used to decide the interest rate and forex rate. Business was at the mercy

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of the government. And to do business one didn't have to be an expert in strategy but had to be good at liaisoning with the government.

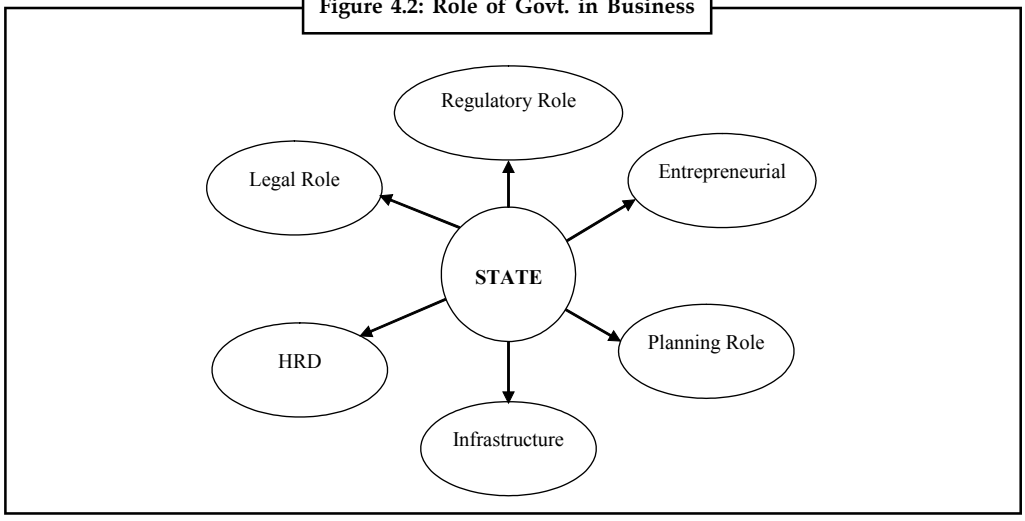
In 1991 after the failure of socialism the govt. was forced to ushere in a policy of liberalisation which brought innumerable opportunities but also many threat so. While some companies expanded manifold after liberalisation, quite a few had to close or sell their operations. Various Mergers and Acquisitions have taken place in the last 15 years in India.

Example: HLL acquired Lakme, TOMCO, Kissan, Modern Foods, etc. UB Group acquired Herbenston and Shaw Wallace and became the second largest liquor player in the world. TATA launched its small cars, which they couldn't launch in the 1980s because of the government policy. India became the battleground for multinational automobile companies. In the FMCG sector, Coca Cola purchased Parle and Pepsi purchased Uncle Chips. Soon, India may also see the advent of the multinational retail giant Wal-Mart.

4.2 Role of Government in Business

We have seen how the slightest change in government policy can change the whole scenario of business. Governments can influence business in the following manner:

Figure 4.2: Role of Govt. in Business



1. ***Regulatory Role:*** Governments regulate the business. They not only decide the rules of the game but also looks after the implementation of those rules.

   (a) *Reservation:* The govt. limits the spheres of investment by reserving the industry for small scale, public and the co-operative sector. For instance, before liberalisation, petroleum, telecommunication, coal, power, etc., were the monopoly of the public sector. But liberalisation brought new investment opportunities for the private sector. Now only two sectors, i.e., railways and atomic energy are reserved for the public sector.

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Notes Many industries are still reserved for the small scale sector. Because of this policy we have seen a boom in many industries over the last fifteen years. As of now, along with telecom services, Reliance has established one of the largest grassroots refineries of the world. Other big telecom players like Bharti Telecom and TATA have also invested heavily in telecommunication.

New power projects have been established by the private sector. Aviation is no more a government monopoly as dozen of private players as Sahara Airlines, Kingfisher Airlines, SpiceJet, Air Deccan have entered this field. Hosts of new players have entered the finance sector, especially the insurance, with business houses like TATAs, AVBirla, Bajaj, ICICI, etc., making the most of new opportunities.

(b) *Licensing:* Licensing is an effective tool in the hands of the government to regulate business. Earlier, for almost every new venture a licence was required from the government, which used to keep a tight control on production in the private sector. But now only investment in a few industries requires licences. Though in some cases industry may have to acquire license from other authorities like pollution control, ISI, Ministry of Environment & Forests, Food, Drug, Administration, etc.

(c) *Expansion:* The govt. can both provide business house, the opportunity to expand as well as restrict their expansion activities. Earlier, through the MRTP Act the government restricted the expansion of big houses, besides which various restrictions were imposed on increasing production capacity or launching new variants. Restriction existed even on the advertisement budget of big business houses or on their investments abroad.

This is the prime reason that we were still driving the same car in 1980 which we drove in 1950; even as late as 1990, we had just one new option in the form of the Maruti car. But when this restriction was repealed the whole equation of business underwent a change.



Example: Ranbaxy, AV Birla, Dr. Reddy's Lab, ONGC, L&T are now multinational companies, Asian Paints has operations in 28 nations of the world. Indian companies have achieved amendable economies of scale and consumers have a wider choice available from big product portfolios of companies. But even now the expansion of many companies continues to remain at is on the mercy of the government.

(d) *Foreign Direct Investment:* It is the government that decides whether MNCs can invest in a country or not. Because of these government policies there are very few MNCs in India. Even companies like IBM and Coca Cola had to leave India in the past because of government policies. Today MNCs are in present in sectors like insurance, petroleum, banks and publication, but are they are still not present in the retail sector as the government doesn't allow foreign participation in the retail sector.

(e) *Import and Export Policy:* With a small declaration the government can open and close various avenues for export and import. As a matter of policy the government can use various tools to impose restrictions on import such as quota, tariffs, cumbersome import process, import licenses, etc. Till 1991 India followed a protectionist policy to keep the industry from imports that were deemed harmful. But now the policy has been amended and imports are easy. Due to this, the Indian toy industry was very badly affected and many had to shut down operations. Thus it is the government which decides what can be imported or exported and what cannot.

Notes

(f) *Taxes:* Through taxes too the government regulates industry. The Government usually imposes a high rate of tax on the industry which it doesn't want to encourage. For instance after independence a very high excise was imposed on products like airconditioners, automobiles, etc., whereas there was virtually no tax on production of products reserved for the small scale industry. Also, to increase the use of certain products, the government provides subsidy on items such as fertilizers, tractors and other farm equipment. The government also tries to influence the location of the industry by permitting tax breaks for establishing industry in a particular region.

(g) *Supply of Money:* Demand depends upon the purchasing power of the consumer which, in turn, depends upon supply of money and the supply of money is decided by the government (RBI). There are many ways through which the government regulates the supply of money. The RBI can increase the supply of money in the market by decreasing the CRR, SLR etc. which reduced the interest rate in the market. In the last 15 years interest rates have fallendrastically, which has lent more purchasing power to the consumer. This has boosted the consumer goods industry and the housing industry as well as. The government can also increase or decrease the supply of money by increasing or decreasing income tax rate and interest rate on savings. So any industry is to an extent dependent on the government for enhancing demand.

(h) *Supply of Foreign Exchange (FOREX):* The government not only regulates import and export through its policy decisions, but also controls it through control of the supply of foreign exchange. Before liberalisation, it was the government which used to decide the exchange rate. To restrict import it restricts the supply of Forex whereas to boost export and discourage import, it devaluates the currency. Even after liberalisation, when the Rupee was convertible, the RBI controlled supply and exchange rate through open market operations. Besides all these, the government regulates business through administrative and physical controls. So we see that the government regulates almost every aspect of business. It provides the opportunity to invest and simultaneously restricts investment in particular area.

(i) *Incentives:* The government also regulates the industry by providing incentives in the key thrust areas. For instance, it gives tax beaks if an industrial unit is established in a backward area. It also grants subsidies under various schemes to the small scale sector. To support export, it establishes special zones like SEZs, it grants subsidies and tax relaxations on exports, import licenses and less import duty for exporters, and easy financing through banks. To support a particular industry in the national interest. It also directs financial institutions to give liberal loans to that sector at easy terms. To provide a boost to the housing industry, the government has given exemption to housing loans from income tax.

2. ***Legal Role:*** The Parliament is the law making authority and it is the Council of Ministers that presents the proposed law on the table of Parliament. It is the government which decides and implements the legal structure of the country. For instance, in the 1980s, the famous NRI Swaraj Paul attempted to take over Excorts, the prevailing legal environment of a period saved the company. A new law was enacted which stipulated that a Non-resident Indian could not acquire any stake in an Indian company beyond a certain limit.

The government has enacted many laws to regulate industry. As in the case of IDRA, the MRTP Act was amended to the Competition Act to ensure fair competition among organizations. The Essential Commodities Act, the Environment Act, the Companies Act, the SEBI Act, the Consumer Protection Act, Labour Laws have been enacted protect human

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resource from exploitation. While doing business, enterprises have to abide by the law. This not only ensures healthy competition but it also gives companies a level playing field. It is the law which protects the intellectual capital of an organization. Business flourishes only in states which have is a healthy legal system.

3. ***Infrastructure Development:*** In developing nations the growth of infrastructure is imperative and the government plays a critical role in this. It is said that take care of roads and electricity and development and employment generation will take care of itself. Well-established infrastructure is the basic requirement for the establishment and growth of industry. In a developing nation where infrastructure is in a poor state, the government has to take steps to develop the same, i.e. is construction of roads, development of railways, supply of power, transport, finance sector, training and guidance, research and development, etc.



Notes Since independence, the state in India has invested heavily on infrastructure. Now under the new regime even the private sector is playing a critical role in developing infrastructure. In the budget of 2005-06, provision of SPV (special purpose vehicle) has been made for the development of infrastructure.

4. ***Human Resource Development:*** Today, it is not the raw material or geographical proximity to the market which decides the location of a unit, but the availability of human resources which now days play a decisive role in settling down on the location of any establishment. Today, when research, new product development, economies of scale, low production cost are the mantra to success, trained and skilled human resource have become the critical success factors for every industry.

   But in developing nations like India, the state plays a critical role in developing human resources as at the time of independence, the private sector was not in a position to invest in higher and technical education. Unlike developed nations, the masses of India were and still are not in a position to afford higher technical education. This is the reason that the state invested heavily in higher technical education established premier education like IITs, IIMs, IVRIs, AIMS, BHU and other universities.



Notes Recently, Dr. Manmohan Singh, the Prime Minister of India announced an investment of ₹ 100 crore in a university in Bangalore to develop it as research house in science. Not only this, thanks to Nehru India retained English as a medium of instruction in education. Because of these efforts of the State, India is justifiably proud of its human resources. Today many businesses such as BPO, software, electronics, are flourishing in India because of its human resources and India is becoming a manufacturing hub for mobile phones, pharmaceuticals, fundamental research etc. Technical and knowledge Level of HR is also a critical input for the industry and the State plays a vital role in influencing and deciding this.

5. ***Entrepreneurial Role:*** The State also plays the role of an entrepreneur by investing in business. The Govt. of India has been one of the biggest investors in business and indusrty since Independence. Through its investment, the government considerably influences the business environment. In India after independence the government reserved some industries for only the Public Sector where the private sector cannot invest. But the government has invested in other areas, which were not reserved for the private sector. In a developing nation, investment by the government helps the private sector a lot.

Notes

After independence the Indian Government heavily invested in capital intensive industry where gestation period is high and private entrepreneurs are not interested-such as Steel (SAIL), Aluminium (Indal), Railways, Power (NTPC), Heavy Machines, Earth Moving Machines, Heavy Electrical Machinery (BHEL), Petroleum, Telecommunication etc. All these investments promoted the private industry by making available raw material and machines.

Investment by the government also changed the competitive environment as it became a competitor to the private sector in alluring the consumer. Its investment in the Automobile sector (MUL) changed the whole competitive environment of the automobile industry of India. The government also invested in soft drinks and launched the brand 'Double Seven', in Consumer Electronics (Jolly, Uptron), Two Wheelers (Scooter India), Cosmetic Soaps, Bakery Products, Milk Products, Distribution network, etc. Though the new industry policy is not in favour of any further investment, it follows a policy of disinvestment and privatisation. But in total, in the past fifty years the government has played a critical role in deciding the business environment of the country.

6. ***Planning Role:*** State is an architect of the industrial scenario in a country. It is truer for a country like India where the state also performs the task of a planner. India has followed a policy of five year planning system. It is the planning commission which plans the direction of investment for the following five years. This significantly influences the business environment. The planning commission declares the key areas where the state is going to invest and support in the coming five years. All this even influences the investment decision of the private sector, as they get support from the government when they invest in a priority sector.

So we see that the State Government play a vital role in deciding and influencing business environment. It in fact makes the rule of the game and also acts as an umpire and referee. Besides all this, the political stability of a country also plays a critical role in generating a conducive environment for business. Today, India is attracting foreign investment only because most of the political parties have a consensus on foreign investment except some issues like foreign investment in retail or more than 50% investment in the print media. Even political parties like CPI/M are trying hard to attract foreign investment in states ruled by them.

Whatever the degree of political differences, Chief Ministers of practically all states are promoting foreign investments. Recently, Orissa Chief Minister Biju Patnaik signed a pact with Korean Steel Major Pasco according to which Pasco will invest more than ₹ 50,000 crore in a steel plant in Orissa. Recent visits of foreign diplomats to India's IT hub Bangalore shows increasing confidence of foreigners in the Indian political system. Hence, political stability itself is a very positive statement for the industry.

4.3 The Indian Political System

Full Name of the Country: Republic of India

Type of Government: Multi-party parliamentary democracy, it is the largest democracy in the world.

Head of State: President of India: Dr. A P J Abdul Kalam

Head of Government: Prime Minister: Dr. Manmohan Singh

Notes

4.3.1 Political System

India is a federal state with its Central Government in New Delhi which is the capital of the country. India comprises 29 State Governments and 6 Union Territories.

The Constitution provides for trifurcation of responsibilities between the Executive, the Legislature and the Judiciary. The executive comprises the President, the Vice-President and the Council of Ministers headed by the Prime Minister. All executive powers are vested in the President, who acts on the advice of the Council of Ministers. The Prime Minister is the leader of the majority party in the Parliament and heads the Council of Ministers.

4.3.2 Political Institutions

The Union Legislature (Parliament) comprises two houses–the Lok Sabha (lower house, elected directly by the people of India) and the Rajya Sabha (upper house, elected by the state legislatures which in turn, are elected directly by the people). The Parliament is responsible for enacting laws in India.

A similar structure exists in the states, where the head of the Executive is the Governor, who is appointed by the President of India. The Council of Ministers is headed by the Chief Minister and is responsible to the State Legislature (Legislative Assembly). The people of each state elect the Legislative Assembly, which performs functions similar to those performed by the Parliament.

The Constitution of India has clearly demarcated the powers of the Centre and the States in the form of three lists–the Union, State and Concurrent lists. The Union and State Governments pass legislation on subjects under the Union and State lists, respectively. However, for subjects on the Concurrent list where both Centre and the States can enforce laws, the decision-making powers of the Centre supersede those of the states.

India is a secular country with no official religion. The Constitution guarantees fundamental rights to the people, including freedom of speech, occupation and religion. India has a well-developed independent judicial system. The Supreme Court is the apex judicial authority. Apart from the Supreme Court, the Indian judicial system has High Courts in every state, and lower courts at the town levels.

4.3.3 Prominent Political Parties of India

List of recognised political parties of India is given as under:

1. ***National parties***
    1. Indian National Congress - (INC, led by Sonia Gandhi)
    2. Bharatiya Janata Party - ("Indian People's Party", BJP, led by Rajnath Singh)
    3. Bahujan Samaj Party - ("Majoritarian Society Party", BSP, led by Mayawati)
    4. Nationalist Congress Party - (NCP, led by Sharad Pawar)
    5. Communist Party of India (Marxist) - [CPI (M), led by Prakash Karat]
    6. Communist Party of India - (CPI, led by Ardhendu Bhushan Bardhan)
    7. Rashtriya Janata Dal - (RJD, led by Lalu Prasad Yadav)
2. ***State parties:*** Parties that have received certain amount of votes or seats in a state might be recognized as a state party by the Election Commission. Recognition as a state party given the party the possibility to reserve a particular election symbol in the concerned state. A party might be recognized in more than one state. A party recognized in four

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states is automatically recognized as a national party. Below is the list of recognized state parties ahead of the Gujarat and Himachal Pradesh State Assembly elections in December 2007. The states where the party has gained recognition is also stated, although the party may very well be active in more states and territories than that.

Indian state governments led by various political parties as of 2007:

1. All India Forward Bloc (West Bengal)
2. All India Anna Dravida Munnetra Kazhagam (AIADMK, "All India Anna Federation for Progress of Dravidians") (Tamil Nadu, Puducherry)
3. All India Trinamool Congress (Meghalaya, West Bengal)
4. Arunachal Congress (Arunachal Pradesh)
5. Asom Gana Parishad ("Assam People's Federation") (Assam)
6. Biju Janata Dal (Orissa)
7. Communist Party of India (Marxist-Leninist) Liberation (Bihar)
8. Dravida Munnetra Kazhagam (DMK, "Federation for Progress of Dravidians") (Tamil Nadu, Puducherry)
9. Federal Party of Manipur (Manipur)
10. Indian Federal Democratic Party (Kerala)
11. Indian National Lok Dal ("Indian National People's Party") (Haryana)
12. Indian Union Muslim League (Kerala, registered as 'Muslim League Kerala State Committee')
13. Indigenous Nationalist Party of Twipra (Tripura)
14. Jammu and Kashmir National Conference (Jammu and Kashmir)
15. Jammu and Kashmir National Panthers Party (Jammu and Kashmir)
16. Jammu and Kashmir People's Democratic Party (Jammu and Kashmir)
17. Janata Dal (Secular) ["People's Party (Secular)"] (Karnataka, Kerala)
18. Janata Dal (United) ["People's Party (United)"] (Bihar, Jharkhand, Nagaland)
19. Janathipathiya Samrakshana Samithy ("Association for Defence of Democracy") (Kerala)
20. Jharkhand Mukti Morcha (JMM) ("Jharkhand Liberation Front") (Jharkhand, Orissa)
21. Kerala Congress (Kerala)
22. Kerala Congress (Mani) (Kerala)
23. Lok Jan Shakti Party (Bihar)
24. Lok Satta Party (Andhra Pradesh)
25. Maharashtrawadi Gomantak Party (Goa)
26. Maraland Democratic Front (Mizoram)
27. Manipur People's Party (Manipur)
28. Marumalarchi Dravida Munnetra Kazhagam (Tamil Nadu)

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29. Meghalaya Democratic Party (Meghalaya)
30. Mizo National Front (Mizoram)
31. Mizoram People's Conference (Mizoram)
32. Nagaland Peoples Front (Nagaland)
33. Pattali Makkal Katchi (Tamil Nadu, Puducherry)
34. Praja Rajyam Party (Andhra Pradesh)
35. Rashtriya Janata Dal ("National People's Party") (Bihar, Jharkhand)
36. Rashtriya Lok Dal ("National People's Party") (Uttar Pradesh)
37. Revolutionary Socialist Party (West Bengal)
38. Samajwadi Party ("Socialist Party") (Madhya Pradesh, Uttar Pradesh, Uttarakhand)
39. Shiromani Akali Dal (Party of Akal - Authority for the Political Matters of Sikhs) (Punjab)
40. Shiv Sena ("Army of Shivaji") (Maharashtra)
41. Sikkim Democratic Front (Sikkim)
42. Telangana Rashtra Samithi ("Telengana National Association") (Andhra Pradesh)
43. Telugu Desam Party ("Telugu Nation Party") (Andhra Pradesh)
44. United Democratic Party (Meghalaya)
45. United Goans Democratic Party (Goa)
46. Uttarakhand Kranti Dal ("Uttarakhand Revolution Party") (Uttarakhand)
47. Zoram Nationalist Party (Mizoram)

3. ***Other parties represented in the Lok Sabha***
    1. All India Majlis-e-Ittehadul Muslimen
    2. Bharatiya Navshakti Party
    3. Janata Dal (Secular) (Surendra Mohan faction)
    4. Loktantrik Jan Samta Party
    5. National Loktantrik Party
    6. Republican Party of India (Athvale)
    7. Sikkim Democratic Front
4. ***Other parties represented in the Rajya Sabha***
    1. Swatantra Bharat Paksh

4.4 Summary

There exists a close relationship between the political and economic environment of a country. The governing body of the State regulates and influences every aspect of the business. It is true not only in socialist economies but also of capitalist economies. The government performs various functions, which directly influence the business as it is the government which is a regulatory authority in the state. As a regulator of the economy it decides the policy by which it

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limits the spheres of investment by the industry for small scale, public and co-operative sector. It decides the licensing and expansion policy through which it restricts entry and exit in business. Through its Foreign Direct Investment policy the govt. decides the extent an the avenues where the FDI can be invested. Through its Import and Export Policy it can increase or lower the trade barrier. Through the taxation and monetary policy the government can influence the disposable income of people, interest rate and availability of funds for the industry, thus influencing both the supply and demand. Not only this, it is the government which influences business by investing in infrastructure projects, thus creating a conducive environment for business. It also invests in the development of HRD that provides trained and skilled HR to the industry. It is the government that makes laws for the smooth functioning of business. So we see that the government influences every aspect of business.

4.5 Keywords

Expansion: The govt. can both provide business house, the opportunity to expand as well as restrict their expansion activities. Earlier, through the MRTP Act the government restricted the expansion of big houses, besides which various restrictions were imposed on increasing production capacity or launching new variants.

Foreign Direct Investment: It is the government that decides whether MNCs can invest in a country or not. Because of these government policies there are very few MNCs in India.

Incentives: The government also regulates the industry by providing incentives in the key thrust areas. For instance, it gives tax beaks if an industrial unit is established in a backward area. It also grants subsidies under various schemes to the small scale sector.

Legal Role: The Parliament is the law making authority and it is the council of ministers that presents the proposed law on the table of parliament.

Licensing: Licensing is an effective tool in the hands of the government to regulate business. Earlier, for almost every new venture a licence was required from the government, which used to keep a tight control on production in the private sector. But now only investment in a few industries requires licences.

SEZ: To support export, it establishes special zones like SEZs, it grants subsidies and tax relaxations on exports, import licenses and less import duty for exporters, and easy financing through banks.

Supply of Foreign Exchange (FOREX): The government not only regulates import and export through its policy decisions, but also controls it through control of the supply of foreign exchange.

Taxes: Through taxes too the government regulates industry. The Government usually imposes a high rate of tax on the industry which it doesn't want to encourage.

4.6 Self Assessment

Fill in the blanks:

1. The govt. limits the spheres of ..... by reserving the industry for small scale, public and the co-operative sector.
2. ..... is an effective tool in the hands of the government to regulate business.
3. ..... is the government that decides whether MNCs can invest in a country or not. Because of these government policies there are very few MNCs in India.
4. The government also tries to influence the location of the ..... by permitting tax breaks for establishing industry in a particular region.

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5. ..... depends upon the purchasing power of the consumer which, in turn, depends upon supply of money and the supply of money is decided by the government (RBI).
6. The ..... provides for trifurcation of responsibilities between the Executive, the Legislature and the Judiciary.
7. The ..... comprises two houses-the Lok Sabha and the Rajya Sabha
8. The Parliament is responsible for ..... in India.
9. The ..... comprises the President, the Vice-President and the Council of Ministers headed by the Prime Minister.

4.7 Review Questions

1. Discuss how the government regulates business.
2. Explain, in brief, how the government can influence business by investing in infrastructure.
3. "Industry relives the Human Resource because the blessing of government". Discuss this statement.

Answers : Model Answer

1.	Investment	2.	Licensing
3.	FDI	4.	Industry
5.	Demand	6.	Constitution
7.	Union Legislature (Parliament)	8.	Enacting laws
9.	Executive		

4.8 Further Readings



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Unit 5: Monetary Policy

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Objectives

After studying this unit, you will be able to:

- Discuss monetary aggregates and new monetary aggregates
- Define liquidity measures
- Discuss factors affecting money supply in India
- Explain need to regulate the supply of money
- Describe money supply and inflation
- Discuss supply of money, interest rate and investment
- Describe monetary management
- Discuss Reserve Bank of India and Functions of Reserve Bank of India
- Explain monetary policy
- Explain RBI and credit control

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Introduction

Monetary policy is all about supply of currency in the country. If we are talking about supply of currency then the term has a wide meaning, since the supply of currency is affected by many means and in turn , affects many other variables many. It is a country's central bank that controls the supply of money. Monetary policy has direct bearing on inflation and commercial bank interest rate. So even the slightest change in the monetary policy affects inflation and bank interest rate.

5.1 Monetary Policy

The central bank designs the monetary policy in keeping with the government's economic policy. Monetary policy is about expansion and contraction of money and the central bank is the implementing body of the monetary policy. Given below is the study of money supply and our central bank, i.e., the Reserve Bank of India (RBI).

5.2 Measures of Money Supply in India (Monetary Aggregates)

There are two basic measures of money globally: narrow and broad. The former usually consists of the currency with the public and demand deposits with banks. The latter includes the time deposits with banks. Till 1998, the RBI calculated four components of money supply in India, now termed as old money measures. These are known as money stock measures of monetary aggregates.

Old Money Aggregates/Measures are as follows:

M_1 = Currency with the public, i.e., coins and currency notes + Demand Deposits with banks + Other deposits with RBI.

M_2 = M_1 + Post Office savings.

M_3 = M_1 + Time deposits of the public with banks; this is also known as broad money.

M_4 = M_3 + Saving and time deposits with the post office.

Out of the four concepts of money supply, RBI emphasises only two concepts, viz., ordinary money or narrow money (M_1) and money supply in the broad sense (M_3), which consists of M_1 plus time deposit of people with the bank. M_3 is also referred to as broad money or aggregate monetary resource of the people.

New Monetary Aggregates

M_0 = Currency in Circulation + Bankers Deposits with the RBI + 'Other' Deposits with the RBI.

M_1 (NM_1) = Currency with the Public + Demand Deposits with the Banking System + 'Other' Deposits with the RBI.

M_2 (NM_2) = M_1 + Time Liabilities Portion of Savings Deposits with the Banking System + Certificates of Deposit issued by Banks + Term Deposits of residents with a contractual maturity of upto and including one year with the Banking System (excluding CDs).

M_3 (NM_3) = M_2 + Term Deposits of residents with a contractual maturity of over one year with the Banking System + Call/Term borrowings from 'Non-depository' Financial Corporations by the Banking System.

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There are three major changes in the new and old monetary aggregates. New intermediate monetary aggregate, which is to be referred to as NM_2, comprises of currency and resident's short-term bank deposits that would stand between narrow money (M_1, which includes only the non-interest bearing monetary liabilities of the banking sector) and broad money (M_3).

The new broad money aggregate (referred to as NM_3 for purpose of clarity) in the Monetary Survey would comprise of NM_2, long-term deposits of residents, and call/term borrowings from non-bank sources which have emerged as an important source of resource mobilisation for banks. The critical difference between M_3 and NM_3, essentially, lies in the treatment of non-resident repatriable fixed foreign currency liabilities of the banking system in the money supply compilation.

Post office deposits have been dropped from the new money and thus the old concept of M_2 and M4 concepts have been dropped.



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Liquidity Measures

Three liquidity measures have been designed recently which are referred to as L_1, L_2, and L_3. These are defined as follows:

$L_1 = NM_3$ + Postal Deposits.

$L_2 = L_1$ + Liabilities of the financial institutions.

$L_3 = L_2$ + Public deposits with non-bank finance companies.

5.3 Factors affecting Money Supply in India

There are five sources which contribute to the aggregate monetary resources in the country (M_3):

1. Net bank credit to the bank
2. Bank credit to the commercial sector
3. Net foreign exchange assets of the banking sector
4. Government currency liabilities to the public
5. Non-monetary liabilities of the banking sector.

1. ***Net Bank Credit to the Government:*** There are two types of bank credit to the government: RBI credit to the Central and State Government and others banks' credit to the Central and State Government. The government provides its securities and IOUs to the RBI against which it receives loans from the RBI. The RBI prints and issues currency notes against govt. securities. This increases money supply in the country and when the government buys back its securities, it reduces the supply. Similarly, when the government borrows from commercial banks, it also increases the supply of money with the public.

2. ***Bank Credit to the Commercial Sector:*** When banks lend to customers it increases the supply of money in the hands of the public. Lending by the commercial sector has a multiplier effect. When banks lend to the customer, they do not hand over currency to him, but instead allow him the facility of withdrawal by cheque. These cheques come back to the banking system as fresh deposits. By giving more such loans, banks multiply their deposits. More bank loans mean more supply of money and more investment.

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3. ***Foreign Exchange Assets:*** Foreign exchange assets acquired by the banking system are also a source of money supply.

   When an exporter receives a payment in foreign exchange (forex) he surrenders it to the bank, which in turn gives him local currency. This increases supply of money in the country. On the other hand, when an importer asks for foreign exchange to import, he gives local currency to the bank and supply of money in the country is reduced.

4. ***Government Currency Liabilities to the Public:*** The Government of India prints/mints one rupee notes, rupee coins and small coins (50 paisa, 25 paisa etc.) which constitute the government's currency liabilities to the public. This leads to increase in the volume of money supply and the government's currency liabilities to the public.

5. ***Non-monetary Liabilities of the Banking Sector:*** Non-monetary liabilities of the RBI and other banks are deducted before we calculate the stock of money. These liabilities of bank include their paid up capital and reserves, pension fund, provident fund and other liabilities like bills payable over other assets of banks, errors and omission, etc. Since they are liabilities of the banking system, they have to be deducted to arrive at the money stock (M3).

5.4 Need to Regulate the Supply of Money

The supply of money has a direct impact on inflation, level of investment, employment generation, interest rate, etc. It is clear that supply of money has an effect on every aspect of the economy and has a close relationship with development. Supply of money is a sensitive issue as even a slight imbalance can create havoc in the form of deflation or hyperinflation in the country.

Example: In the initial stages of perestroika in the erstwhile USSR, because of imbalances in supply of money, the value of the Russian trouble decreased to such an extent much that people used to carry bags full of roubles to purchase bread. Every country manages supply of money in the national interest through its central bank.

5.4.1 Money Supply and Inflation

There is a direct relationship between the supply of money and inflation. It is based on the simple fundamental of demand and supply. The value of a currency is defined by its purchasing power. As the supply of money increases its value decreases. Decrease in purchasing power means an increase in inflation.

When the supply of money increases with the people it gives them more purchasing power, which results in an increase in demand. Prices rise if demand increases without a correspondent increment in supply. This doesn't mean that money supply is directly proportional to inflation. Because increment in supply of money not only increases the demand, it also increases investment, i.e., supply. Part of the increased money also goes into savings. This is the reason that with an increase in money supply, the government promotes investment and savings so that it does not have an inflationary impact. There is thus a close relationship between inflation and supply of money, but not a proportional relation.

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5.4.2 Supply of Money, Interest Rate and Investment

The supply of money also has an impact on interest rates and level of investment. In fact, economists have propounded the theory that to boost development and to create employment, the government should expand money.

Here too, the fundamentals are the same. As supply of money increases its value goes down. The price of money is its interest rate. So when banks get more money, they provide loans at low rates. This increases the level of investment in the country because more people go for investments with low interest rates. This results in creation of employment, which results in an increase in purchasing power. This in turn, increases demand and results in inflation, which again works as a catalyst for investment.

So it is clear that there is cyclical relation between money supply, inflation, interest and investment. We can put the four things in the following manner:

Figure 5.1: Relation between Supply of Money and Inflation



5.4.3 Monetary Management

It is the central bank of a country that is responsible for the regulation of supply of money. In India it is the RBI, which manages the supply of money.

5.5 Reserve Bank of India

In 1921, the Govt. of India established the Imperial Bank as the Central Bank of India. But it was not very successful. Upon the recommendation of the Central Banking Enquiry Committee, on April 1, 1935, the Reserve Bank of India began working. The entire share capital of RBI was initially owned by private shareholders. It was nationalised in 1949. Its head office is in Mumbai and it has branches in New Delhi, Kolkata, Chennai, Bangalore, Kanpur, Ahmedabad, Hyderabad, Patna and Nagpur. The State Bank of India works as its Agent in the cities where the RBI does not have an office.

The Preamble of the RBI Act, 1934 states that, "Whereas it is expedient to constitute a Reserve Bank of India to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in (India) and generally to operate the currency and credit system of the country to its advantage."

5.5.1 Functions of the Reserve Bank of India

1. ***Issue of Currency:*** The RBI has the sole right to issue currency notes. To issue notes, it follows a minimum reserve system. According to RBI (Amendment Act) modified in 1957, the bank has to keep a minimum reserve of ₹ 200 crore, of which ₹15 crore has to be in gold coins and bullion and ₹ 85 crore in foreign securities. Although one rupee coins and notes as well as coins of smaller denominations are issued by the Government of India, they are

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put into circulation through the RBI. The Bank also exchanges notes and coins of one denomination into those of other denominations as demanded by the public. The RBI has 15 full-fledged issue offices and 2 sub-offices, along with 4,127 currency chests where the stock of new and re-issuable notes, rupees and coins are stored at the end of March 1997.

2. ***Banker to Government:*** The Reserve Bank of India acts as the banker to the central government as also to the governments of the constituent units of India's federal system. Banks transact the banking business of the Government of India and accordingly perform the following functions: accept money on account of the government, make payment on its behalf, and carry out exchange remittance and other banking operations, including the management of public debt. The RBI plays an important role in financing government expenditure.

   In addition to financial transaction, the Bank acts as the agent of the government in respect of India's membership of the International Monetary Fund and International Bank of Restructuring and Development. It also acts as an adviser to the government on banking and financial matters.

   Ways and Means Advances: The Bank can make "Ways and Means Advances", i.e., temporary advances to both the Central and state governments to bridge the temporary gap between receipts and payments. The maximum maturity period of these advances is three months.

3. ***Banker's Bank:*** RBI has extensive powers to control the commercial banking system. All scheduled banks are under a statutory obligation to maintain a certain minimum of cash reserve which is to be decided by the RBI against their demand and time liabilities. With this, the RBI determines the deposits/credit creating ability of the bank. The RBI provides financial assistance to scheduled commercial banks and state co-operative banks in the form of discounting of legible bills, loans and advances against approved securities. The RBI is expected to help banks in their crises. RBI is not only a banker's bank but it also works as a lender of last resort.

4. ***Controller of Credit:*** The RBI functions as the controller of credit. As such, it regulates the quantity of credit and the rate at which it is made available. It does this through the use of general and selective controls.

5. ***Exchange Management and Control:*** The RBI is required to stabilise the external value of the rupee. For this purpose, it functions as the custodian of the nation's foreign exchange reserves. It is obligatory for the RBI to buy and sell currencies of all the members of the IMF. In this field the RBI has following dimensions:

   (a) To administer the 'foreign exchange control'.

   (b) To choose the exchange rate system and fix or manage the exchange rate between the rupee and other currencies.

   (c) To exchange reserve.

   (d) To interact or negotiate with the monetary authorities of the Sterling Area, Asian Clearing Union and other countries, and with international financial institutions such as the IMF, World Bank and the Asian Development Bank.

   The RBI administers 'exchange control' in terms of the Foreign Exchange Management Act (FEMA). The objective of exchange control is to limit the demand of foreign exchange in keeping with its supply. The RBI manages this through the buying and selling of foreign exchange from and to scheduled banks, which are the authorised dealers in the Indian Foreign Exchange market. The Bank also manages the investment of reserves in gold accounts abroad and the shares and securities issued by foreign government and international banks or financial institutions.

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The role of the RBI as a participant in the foreign exchange market, and as a stabiliser of the market and of the rupee exchange rate has become all the more important with the introduction of the floating exchange rate system and the rupee convertibility on trade, current and capital accounts.

6. ***Collection and Publication of Data:*** The RBI has been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy.

7. ***Supervisory Function:*** The RBI has a wide power of supervision and control over commercial and co-operative banks relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. The RBI is authorised to carry out periodical inspection of banks and to call for returns and necessary information from them. It has the following powers in this field:

   (a) To issue licences for the establishment of new banks.

   (b) To prescribe minimum requirement regarding paid up capital and reserves, transfer to reserve fund and maintenance of cash reserve and other liquid assets.

   (c) To inspect the working of banks in India as well as abroad in respect of their organizational set up, branch expansion, mobilisation of deposits, investment and credit portfolio management, credit appraisal, region-wise performance, man power planning and so on.

   (d) To conduct *ad hoc* investigation into complaints, irregularities and frauds in respect of banks, from time to time.

   (e) To control methods of operation of banks so that they do not fritter away funds in improper investments and injunctions advances.

   (f) To control appointment, reappointment, termination of appointment of the chairman and chief executive officers of private sector banks.

   (g) To approve or force amalgamations.

   In keeping with the recommendations of the Narshimhan Committee (1991), the RBI's functions of bank supervision was separated from its traditional central banking function by the creation of a separate Department of Supervision (DOS). The Board of Financial Supervision was set upto oversee the IFS.

   The RBI performs many development and promotional functions. It has done valuable work in aiding development and in promoting saving and banking habits. The RBI established Deposit Insurance Corporation of India in 1962 to provide securities to depositors against frequent bank failures. The RBI played an important role in the establishment of UTI, IFCI, SFC, IDBI, and Agriculture Refinance Corporation, etc.

8. ***Promoter of the Financial System:*** The RBI delivers various promotional and development services to strengthen the country's banking and financial structure.

9. ***Money Market:*** In order to increase the strength and viability of the banking system, it carried out a programme of amalgamations and mergers of weak banks with the strong ones. When the social control of banks was introduced in 1968, it was the responsibility of the RBI to administer it in the country to achieve the desired objectives. After the nationalisation of banks it was the responsibility of the RBI to develop banking interest in the national interest.

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With the help of a statutory provision for licensing and branch expansion of banks, the RBI has been trying to bring about an appropriate geographical distribution of bank branches. In order to ensure the security of deposits with banks, the RBI in 1962, took the initiative to create the Deposits Insurance Corporations.

10. ***Agriculture Sector:*** The RBI directs and increases the flow of credit to the agricultural sector. It has appointed a separate deputy governor in charge of rural credit. It has conducted many studies and research on the problem of rural credit. It has created a data base on rural credit through various surveys.

    The RBI has been strengthening the co-operative banking structure through the provision of finance, supervision, and inspection to increase the supply of agricultural credit. It provides short-term finance at a concessional rate for seasonal agriculture operations and marketing of crops through co-operative banks. It established the Agricultural Refinance Cooperation (now known as NABARD) in July 1963 for providing medium-term and long-term finance for agriculture. It also helped in establishing an Agriculture Finance Corporation.

11. ***Industrial Finance:*** The RBI has either created or has advised and helped in creation of many development institutions and financial institution at the centre and state level. These include IDBI, SIDBI, NHB, NCB and UTI. Through these institutions, the RBI has been providing short-term and long-term funds to the agriculture and rural sectors, to small scale industries, to medium and large industries and to the export sector.

5.5.2 RBI and Monetary Policy

From its inception, the RBI has followed the policy of controlled expansion, i.e., adequate financing of economic growth while ensuring reasonable price stability. Expansion of money is required in developing country for the purpose of development and investment. But this expansion results in inflation. So the RBI has to be cautious in order to achieve a trade-off between expansion and inflation. Not only this, the RBI also manages the forex exchange rate through open market operations, as after liberalisation it is the market forces that decide the exchange rate.

The keynote of monetary policy can be said to be controlled expansion of bank credit and money supply, with special attention to seasonal requirement for credit. The RBI regards money supply and the volume of bank credits as the two major intermediate variables, but it seeks to control the former through the latter. It is said that money supply doesn't change on its own; it changes because of certain underlying development with regard to bank credit.

5.5.3 RBI and Credit Control

For the sake of credit control, the RBI resorts to bank rate manipulations, open market operations, reserve requirement changes, direct action, and rationing of credit and moral suasion. Apart from employing these traditional methods of credit control, it directly influences commercial banks' lending policy, rate of interest, and form of securities against loans and portfolio distribution.

The instrument of monetary policy (methods of credit control) may be broadly divided into the following parts:

1. Open Market Operations
2. Bank Rate
3. Direct Regulation of Interest Rates on Commercial Banks' Deposits and Loans

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4. Cash Reserve Ratio (CRR)
5. Statutory Liquidity Ratio (SLR)
6. Direct Credit Allocation and Credit Rationing
7. Selective Credit Controls (SCC)
8. Credit Authorisation Scheme (CAS)
9. Fixation of Inventory and Credit Norms
10. Credit Planning
11. Moral Suasion
12. Liquidity Adjustment Facility (LAF)

1. ***Open Market Operations:*** Open market operations involve the sale and purchase of government securities by the RBI to influence the volume of cash reserve with commercial banks and thus influence the volume of loans and advances they can make to the industrial and commercial sectors. The environment for open market operations is quite favourable because the government securities market is fairly developed in the country. At present, the RBI is authorised to conduct purchase and sale operations in government securities, treasury bills and other approved securities.

   The RBI is also empowered to buy and sell short-term commercial bills. Through the sale of securities the RBI withdraws a part of the deposit resources of the banking sector, thereby reducing resources available with the banks for lending. This reduces the supply of money, which in turn reduces inflation. The opposite happens when the RBI purchases securities. The stock of securities with the seller banks is reduced and the cash with them expands. This augments the credit-creating capacity of banks, reducing the interest rates and increasing the level of investment. Some monetary economists and bankers assert that the bank rate policy and open market operations are complementary measures in the realm of monetary management.

   Open Market Operations have both monetary policy and fiscal policy goals. Their multiple objectives include: (a) To control the amount of and changes in bank credit and monetary supply through controlling the reserve base of banks, (b) To make bank rate policy more effective, (c) To maintain stability in government securities market, (d) To support government borrowing programme, (e) To smoothen the seasonal flow of funds in the bank credit market.

2. ***Bank Rate:*** The bank rate is also known as discount rate. It is the rate at which the central bank discounts, or more accurately rediscounts, eligible bills.

   In a broader sense it refers to the minimum rate at which the central bank provides financial accommodation to commercial banks in the discharge of its function as the lender of the last resort. The bank rate is the basic cost of refinance and rediscounting facilities. Section 49 of the RBI Act, 1934 defines it as the standard rate at which the Bank is prepared to buy or rediscount bills of exchange or other eligible commercial paper. The technique of bank rate and discretionary control of refinance are used to regulate the cost and availability of refinance, and to change the volume of lendable resources of banks and other financial institutions.

   If monetary policy is effective, then change in bank rate affects the prime-lending rate. Any increment in bank rate means that now the RBI will charge higher interest rate from banks against the advances, so it results in the increment in the interest rate charged by commercial banks. This results in low level of investment and low level of inflation. To control inflation, bank rate was increased to 12% from 10% in 1991.

Notes

In 1953, bank rate was 3.5% and rose to 10% in 1981, to 11% in July 1991, and to 12% in October 1991. In India, bank rate policy is not effective because commercial banks in India are not much dependent on the RBI for financial assistance. Also, because of bill market that is not well-organised, they lack adequate quantity of eligible bills which can be rediscounted to the RBI. Proper organisation of the various components of the money market is a prerequisite.

3. ***Direct Regulation of Interest Rates:*** It is expected that change in bank rate will bring a change in all market rates of interest in the same direction. But when the bank rate loses its significance in regulating market rates, the RBI is compelled to directly regulate interest rates on bank deposits and credit. Since 1964 it has been fixing all deposits rates of commercial banks, and since 1960, their lending rates. Deposit rates of co-operative banks came under regulation in 1974 and their lending rates in 1980. The RBI and some other authorities in India have been directly fixing many other interest rates also.

   Deregulation in interest rate began in 1985 after the recommendation of the Chakravarty Committee Report. In the past 14 years important changes in the deregulation of interest rate are:

   (a) The Bank Rate has been activated.

   (b) Most of the money market rates have been deregulated.

   (c) The ceiling on the call rate was withdrawn with effect from May 1, 1989.

   (d) The interest rates on treasury bills, certificates of deposits, commercial paper, and inter-bank participations are allowed to be flexible, variable and market determined.

   (e) The deposits and lending rates of commercial banks, RRBs, urban co-operative banks, and other co-operative banks have been freed.

   (f) Interest on public deposits accepted by all non-banking companies (financial and non-financial) have been deregulated.

   (g) The coupon rate on government dated securities has been made market-related.

   (h) The interest rates on convertible, non-convertible and other types of debentures have been made free.

   (i) The term lending institutions can now charge interest rates unhindered by State intervention.

4. ***Cash Reserve Ratio:*** The CRR refers to the cash which banks have to maintain with the RBI as a certain percentage of their demand and time liabilities.

   According to the RBI Act 1935, every commercial bank has to keep certain minimum cash reserve with the RBI. Initially, it was 5% against demand deposit and 2% against time deposits. Under the RBI (Amendment Act) 1962, the RBI is empowered to determine CRR for the commercial banks in the range of 3% to 15% for the aggregate demand and time liabilities. CRR has been quite often used to control inflation.

   An increase in CRR reduces the cash with commercial bank which results in low supply of currency in the market, higher interest rate and low inflation. In the late 1980s there was a rapid growth of liquidity which resulted in higher inflation and thus the CRR was raised to its maximum limit of 15%, which resulted in higher interest rate and liquidity crunch in early 1990s when Prime Lending Rate was raised to as high as 17%.

Notes

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CRR for Co-op Banks Raised by 50 BPs

After raising the cash reserve ratio (CRR) of commercial banks, the Reserve Bank of India (RBI) has increased the CRR for scheduled primary (urban) co-operative banks (UCBs) by half a percentage point to 5%.

The increase in the CRR will have no immediate impact on lending rates in the medium-term, said cooperative bankers, as there is ample liquidity in the banking system and credit demand has not picked up.

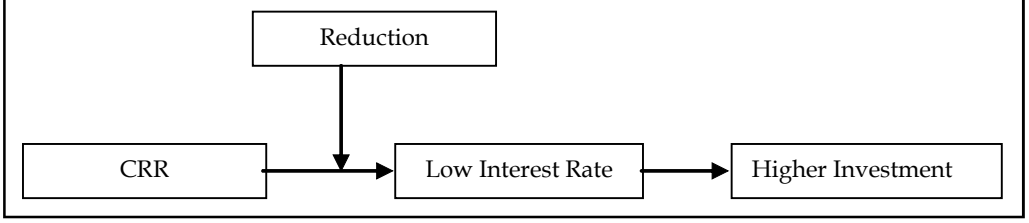
The rise in the CRR will be implemented in two stages, the first 25 basis point rise on September 18 to 4.75 percent, and the second on October 2 to 5%.

Punjab & Maharashtra Co-operative Bank Ltd. Managing Director Joy Thomas said that the increase in CRR is a move to curb the rising inflation rate in economy since the banking system is flush with funds. The increase is unlikely to have any impact on the lending rates in the medium rates, said Thomas.

Source: Business Standard, September 15, 2004

The Narsimhan Committee that submitted its report in November 1991 recommended that high CRR adversely affected bank profitability. Because of this, they charge higher interest rates, eventually reducing the level of investment and increasing the cost of production. The government decided to reduce the CRR in a phased manner. Initially it was reduced by .5% to 14.5% and by April 22, 2000 it was reduced to 8%. As a result, lending rate of banks was reduced to 12% from 17% of 1991.

Figure 5.2: Statutory Liquidity Ratio



5. ***Statutory Liquidity Ratio:*** Under the Section 24 of the Banking Regulation Act, 1949, commercial banks have to maintain liquid assets in the form of cash, gold and unencumbered approved securities equal to not less than 25% of their total demand and time deposits liabilities. This is known as statutory liquidity reserve requirements.

There are three objectives of the SLR:

(a) to restrict expansion of bank credit

(b) to augment banks' investment in government securities

(c) to ensure solvency of banks

Notes



Notes

IDBI Buys ₹ 3000 Cr Gilts to Bolster SLR Kitty

The Industrial Development Bank of India (IDBI) has bought ₹ 3,000 crore worth of government securities to build up its statutory liquidity ratio (SLR) portfolio. It has been granted five years forbearance by the Reserve Bank of India (RBI) to meet the SLR requirements following its conversion into a bank. IDBI's SLR requirement today would amount to ₹ 12,000 crore.

IDBI had deposited ₹ 2,200 crore with the Reserve Bank of India on October 1, the day it converted into a bank, towards cash reserve ratio (CRR).

Banks need to invest 25% of their net demand and time liabilities (deposits) in government securities for the purpose of meeting the SLR and place 5% of the deposits with the RBI for maintaining the CRR.

Source: Business Standard, Dec. 7, 2004

The Banking Regulation (Amendment Act, 1962) provides for maintaining a minimum statutory liquidity ratio of 25% by the bank against their net demand and time liabilities. It gradually reached as high as 38.5% in 1990 and remained there till 1992. The objective of such a high SLR is to counter inflationary pressure which touched double digits at that time. As an impact of SLR on inflation and interest rate is same as that of CRR, so it is the combined affect of CRR and SLR that during 1990-92, the economy faced severe liquidity crunch and commercial banks' interest rates were as high as 17% and even more. The RBI increased CRR and SLR for two reasons:

(a) Higher liquidity ratio forces commercial banks to maintain a larger proportion of their resources' illiquid form and thus reduces their capacity to grant loans and advances to business and industry. This it leads to an inflationary condition.

(b) A higher liquidity ratio diverts banks from loans and advances to investment in government and other approved securities. It diverts funds from banks to government expenditure.

After accepting the Narsimhan Committee recommendations, the RBI reduced in 1993-94 to 25% in a phased manner.



Task

Prepare a report on the changes in CRR and SLR that took place since 1991 and their influence on the CRR and SLR (Consult RBI website).

6. ***Direct Credit Allocation and Credit Rationing:*** The RBI directs the distribution and allocation of credit among different sectors, borrowers, and users through the fixation of specific and direct quantitative credit ceilings or credit targets. The objective was to mobilise the money in the priority sector. This technique was first introduced in November 1973 when the RBI stipulated a ceiling of 10% on the increase in non-food credit by the banking system for the busy season of 1973-74 over the outstanding amount, as at the end of September 1973.

In order to achieve regional or geographical balances in respect of credit disbursal, the RBI has been asking banks to achieve a certain prescribed credit-deposits ratio in respect of their rural and semi-urban branches separately.

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7. ***Selective Credit Control:*** Selective and qualitative credit control refers to regulations of credit for specific purposes or branches of economic activity. The aim of selective control is to discourage such forms of activity as are considered to be relatively inessential or less desirable. Selective control has been used in Western countries to prevent the demand for durable consumer goods outrunning the supply and generating inflationary pressure.



Example: They have been used particularly to prevent speculative hoarding of sensitive commodities such as paddy, rice, wheat, pulses, oil-seeds, oils, vanaspati, cotton sugar, gur etc.

Under the Banking Regulation Act, 1949, Section 21 empowers the RBI to issue directives to banks regarding their advance. The RBI mainly relies on three techniques of selective credit controls:

(a) The determination of margin requirement for loans against certain securities,

(b) Determination of maximum amount of advances or other financial accommodation,

(c) Charging of discriminatory interest rates on certain types of advances.

Besides this, the RBI may also give directions to banks in general or even some particular bank as to the purpose for which loans may or may not be given. These directions may relate to:

(a) The purpose for which advances may or may not be made.

(b) The margins to be maintained in respect of secured advances.

(c) The maximum amount of advances to any borrower.

(d) The maximum amount upto which guarantees may be given by the banking company on behalf of any firm, company, etc.

(e) The rate of interest and other terms and conditions for granting advances.

The Credit Authorization Scheme introduced in 1965 is also a kind of selective credit control. Under these schemes the RBI regulates not only the quantum but also the terms on which credit flows to the different large borrowers, so that credit is directed to genuinely productive purposes, that it is in accordance with the needs of the borrower, and there is no undue channelling of credit to any single borrower or group of borrowers.

8. ***Credit Authorization Scheme:*** This technique was introduced in November 1965 with a view to regulating the volume and terms of credit supplied to large borrowers. As per this scheme, if the fresh working capital limit (inclusive of bill finance) to be sanctioned to any single party by any one bank or the entire banking system exceeded a stipulated level, the bank would require prior authorisation of the RBI for sanctioning such a loan. This stipulated level or cut-off point was fixed at ₹ 1 crore at the beginning. It was subsequently increased to ₹ 2 crore in November 1975, ₹ 4 crore in 1983 and to ₹ 6 crore thereafter.

In the second half of 1988, the RBI withdrew the scheme, and in its place a Credit Monitory Arrangement was introduced. According to the new scheme, credit proposal for ₹ 5 crore and above in the case of working capital and ₹ 2 crore and above in the case of term loans, had to be submitted to the RBI for post-sanction scrutiny.

9. ***Fixation of Inventory Norm and Credit Norms:*** The banks were required to advance credit for working capital to different industries in the light of inventory norms laid down by the Committee of Direction (COD) and its sub-committees. These committees reviewed and revised the norms from time to time in case of different industries and banks had to implement the new norms as and when they were formulated.

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10. ***Moral Suasion:*** Besides all these, the RBI also circulates letters to the banks regarding the policies and priorities of the RBI about credit control and money supply. It also regularly discusses its policies with the bank. The objective is that the banks should work in the same direction.

11. ***Liquidity Adjustment Facility (LAF):*** LAF is a new technique of monitory policy in India. It matches the new requirement which emerges because of newer economic policies. LAF was introduced on June 5, 2000.

    LAF introduced variable REPO auctions with same-day settlement. The amount of REPO and reverse REPO are changed on a daily basis to manage liquidity. The maturity of REPOs is between one day to fourteen days. The funds under LAF are expected to be used by the banks for their day-to-day mismatches in liquidity. All transferable Government of India dated securities/TB (except fourteen days TBs) can be traded in REPO and reverse REPO markets.

    Interest rates in the REPO market usually emerge out of bids (i.e. auctions are conducted on "uniform price" basis), and the RBI occasionally conducts fixed interest rate (multiple price) auctions to send signals to the market. Under LAF, the RBI, periodically, if necessary even daily, sets/resets its REPO and reverses the REPO rate. It uses 3-day or 4-day REPOs to siphon off liquidity from the market. The REPOs are used for absorbing liquidity at a given rate (floor), and not infusing liquidity through reverse REPOs at a given rate (ceiling).

    REPOs: A REPO is purchase of one loan against the sale of another. They involve the sale of securities against cash with a future buy back agreement. Under such an agreement, the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date at a predetermined price. The transaction is called a REPO when viewed from the perspective of the seller of the securities, and a reverse REPO when viewed from the perspective of the buyer of the securities.

    REPOs are part of open market operations undertaken to influence short-term liquidity.

    There are two types of REPO auctions: discretionary price auctions and fixed rate auctions, or uniform price auctions. Under the former, bidders submit multiple price-quantity sealed bids. Under the fixed rate REPOs auction, the rates are pre-announced and the bidders are required to submit bids indicating the volume of REPOs.

    (a) Monetary policy in India has been formulated in the context of economic planning, whose main objective has been to accelerate the growth process in the country. In a country like India that has followed an expansionary fiscal policy, which leads to inflationary conditions, to manage a monetary policy under these circumstances is like tightrope walk. During the planning period prior to liberalisation, the RBI used higher CRR and SLR rates to control inflation.

    (b) After 1992, the demand of the day was development and investment and the development sector was expanding and was and in need of money.

    (c) Indian corporations had to compete with companies, which were getting money at 4% to 5% interest rates. Then the RBI had to reduce CRR and SLR to reduce interest rates and to make available money for investment purposes.


Task

Prepare the present Credit Policy of the RBI (Consult the RBI website).

Notes

5.6 Summary

- Monetary policy is about supply of the currency in the country, regulated by the RBI. Though the RBI does it in the light of the fiscal policy and macro objectives of the government, it is in this sense that fiscal policy and monetary policy are complementary.
- There are various factors affecting money supply in India. Some of them are as follows: net bank credit to the bank, bank credit to the commercial sector, net foreign exchange assets of the banking sector, government currency liabilities to the public, non-monetary liabilities of the banking sector.
- There is a direct relationship between supply of money and inflation. As the supply of money increases, it value goes down and inflation increases. Supply of money has also an impact on the interest rate and level of investment.
- It is the RBI, which regulates the supply of money in India. It performs various functions as Issue of Currency, Banker to Government role, Banker's Bank, Controller of Credit Exchange , Management and Control, Supervisory Function and Promoter of the Financial System.
- The RBI has various tools, which can be used to control the supply of the money in the economy. Some of them are Open Market Operations, The Bank Rate, Direct Regulation of Interest Rates, Cash Reserve Ratio, Statutory Liquidity Ratio, Direct Credit Allocation and Credit Rationing. Besides these, there are some other such as Cash Authorisation Scheme, Fixation of Inventory Norm and Credit Norms, Liquidity Adjustment Facility (LAF), Moral Suasion and REPOs.

5.7 Keywords

Bank Rate: The bank rate, which is also known as discount rate, is the rate at which the central bank discounts advances to the commercial banks.

Cash Reserve Ratio: The CRR refers to the cash that banks have to maintain with the RBI as a certain percentage of their demand and time liabilities.

Liquidity Adjustment Facility (LAF): In LAF the amount of REPO and reverse REPO are changed on a daily basis to manage liquidity.

Monetary Aggregates: These are two basic measures of money globally.

Open Market Operations: The open market operation involves the sale and purchase of government securities by the RBI.

REPOs: A REPO is purchase of one loan against the sale of another.

Selective Credit Control: Selective and qualitative credit control refers to regulations of credit for specific purposes or branches of economic activity.

5.8 Self Assessment

Fill in the blanks:

1. ..... is about expansion and contraction of money and the central bank is the implementing body of the monetary policy
2. ..... equals to M2 + Term Deposits of residents with a contractual maturity of over one year with the Banking System + Call/Term borrowings from 'Non-depository' Financial Corporations by the Banking System.

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3. ..... of the RBI and other banks are deducted before we calculate the stock of money
4. ..... of money is a sensitive issue as even a slight imbalance can create havoc in the form of deflation or hyperinflation in the country.
5. There is a ..... relationship between the supply of money and inflation.
6. ..... acts as the banker to the central government as also to the governments of the constituent units of India's federal system.
7. The keynote of ..... can be said to be controlled expansion of bank credit and money supply, with special attention to seasonal requirement for credit.
8. The bank rate is also known as .....
9. The ..... refers to the cash which banks have to maintain with the RBI as a certain percentage of their demand and time liabilities.
10. A ..... liquidity ratio diverts banks from loans and advances to investment in government and other approved securities.

5.9 Review Questions

1. What is Monetary Policy? Discuss the factors which influence the supply of money in the country.
2. Discuss how Monetary Policy influences inflation.
3. Discuss the relation between inflation and interest rates.
4. "Monetary Policy and Fiscal Policy are complementary." Discuss the statement.
5. Describe, in brief, the function of Reserve Bank of India.
6. Discuss how the RBI regulates the supply of money in the country.

Answers: Self Assessment

1.	Monetary policy	2.	M_3 (NM_3)
3.	Non-monetary liabilities	4.	Supply
5.	Direct	6.	The Reserve Bank of India
7.	Monetary policy	8.	Discount rate
9.	CRR	10.	Higher

5.10 Further Readings



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Unit 6: Fiscal Policy

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Objectives

After studying this unit, you will be able to:

- Discuss the monetary policy and fiscal policy of india
- Assess the foreign trade policy and BOP
- State the concept of direct taxes and indirect taxes

Introduction

In last unit you have studied about monetary policies, SLR and CRR. The sphere of state action on a country's budget is vast and all pervading. It includes "maintaining public services, influencing attitudes, shaping economic institutions, influencing the use of resources, influencing the

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distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment, and influencing the level of investment."

W.A. Lewis and Philip V. Taylor give a more comprehensive definition when they say, "A budget is a master financial plan of the government. It brings estimates of anticipated revenues and proposed expenditures, employing schedule of activities to be undertaken towards the direction of national objectives. It is a device for consolidating various interest, objectives, desires and needs of people into a programme whereby they provide for their safety, convenience and comforts." This unit will provide you a clear understanding of fiscal policies.

6.1 India's Fiscal Policy

It is through fiscal policy that the government tries to correct inequalities of income and wealth, which increase with the development of a country. Such inequalities expand internal market, reduce unessential imports, counteract inflationary pressure, provide incentives for desirable types of development projects, and increase the total volume of savings and investment. For all this, the government adopts appropriate taxation, budgetary expenditure and public borrowings policies.

Fiscal policy is the projected balance sheet of the country, prepared by the chief finance officer of the country i.e. the finance minister of the State. Public finance is the study of generating resources for the development of the country and about the allocation of those resources. Fiscal policy is implemented through the budget, which is a statement of the State's revenue and expenditure.

There are three major functions of a fiscal policy: The first is the function of allocation in the budget policy to make provisions for social goods. It is a process by which the total resources are divided between private and social goods and by which the mix of social goods is chosen.

The second is the distribution function of budget policy. This includes distribution of income and wealth in accordance with what the society considers a 'fair' or 'just' distribution. The third is the stabilisation function of a budget policy, that is marinating high employment, a reasonable degree of price stability, an appropriate rate of economic growth, with due considerations of its effects on trade and the balance of payment.

The budget includes revenue and expenditure. The two are divided into capital and revenue accounts. Thus, receipts are broken into revenue receipts and capital receipts, and disbursements are broken up into revenue expenditure and capital expenditure.

6.1.1 Revenue Budget

It consists of revenue receipts and revenue expenditure.

1. ***Revenue Receipts:*** This includes tax revenue and other revenues:
   (a) *Tax revenue:* These comprise of taxes and other duties levied by the Union government.
   (b) *Other revenue:* These receipts of the government mainly consist of interest and dividends on investment made by the government, fees and receipts for other services rendered by the government.
2. ***Revenue Expenditure:*** This includes expenditure for normal running of government departments and various services interest charges on debt incurred by the government, subsidies, etc. Expenditure which does not result in the creation of assets is treated as revenue expenditure.

Notes

6.1.2 Capital Budgets

1. ***Capital Receipts:*** This includes loans raised by the government from the public called market loans, borrowings by the government from RBI and other parties through sale of treasury bills, loans received from foreign bodies and governments, and recoveries of loans granted by the union government to states and union territory governments and other parties.
2. ***Capital Payments:*** These payments consist of capital expenditure on acquisition of assets like land, buildings, machinery, equipment, infrastructure, as also investment in shares, etc. and loans and advances granted by the union government to state and union territory government companies, corporations and other parties.

6.1.3 Expenditures of Central Government

All public expenditure is classified into:

1. ***Non-planned Expenditure:*** Non-plan expenditure of the central government is divided into revenue expenditure and capital expenditure. Revenue expenditure includes: interest payment, defence revenue expenditure, major subsidies (export, food and fertilizer), interest and other subsidies, debt relief to farmers, postal deficit, police, pension and other general services, social service, economic service (agriculture, industry, power, transport, communications, science and technology, etc.) and grants to states and union territories, and to foreign governments. Capital non-plan expenditure includes such items such as defence capital expenditure, loans to public enterprises, loans to states and union territories and loans to foreign governments.
2. ***Planned Expenditure:*** Plan expenditure is meant to finance central plans drawn up for agriculture, rural development, irrigation and flood control, and industries like energy, minerals, transport, communications, science and technology, environment, social services and others. Plan expenditure also includes central assistance for plans of states and union territories.

6.1.4 Budgets of State Government

In India, each State Government prepares its own budget of income and expenditure every year. State Governments collect revenue from different sources to meet their expenditure.

Example: The important sources of revenue for states are VAT (earlier sales tax), grants, aid and other contributions from the centre, the states own non-tax revenue consisting of interest receipts, dividends, profits, general services (of which state lotteries are the most important), social services and economic services.

Besides this, the state also collects taxes on income and commodities and imposes income tax on agriculture and other professions. It also receives income from taxes on property and capital transactions. The main sources are land revenue, stamps, and registration, and tax on urban and immovable property.

States also charge commodity taxes like motor vehicle tax, electricity duties, etc. The state is also empowered to impose taxes on alcoholic liquor, opium, Indian hemp, and other narcotics.

Notes

6.1.5 Financial Power of Central and State Governments

The constitution of India divides the functions and financial powers of the government between the Central and the State together with the concurrent areas. It also provides for sharing of taxes in various forms and the system of grants- in-aids. The Seventh Schedule of the Constitution of India divides the functions and financial resources between the Centre and States. It contains three lists namely, List I or Union List, List II or State List, and List III or Concurrent List.

List I: Union List. This comprises the following items:

Tax Revenue

The Union List contains of 97 items contains the following sources of tax revenues for the Central Government:

1. Taxes on income other than agricultural income.
2. Duties on customs including exports duties.
3. Duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption and (b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included this paragraph (entry 84).
4. Corporation Tax.
5. Taxes on the capital value of assets exclusively of agricultural land of individuals and companies, and taxes on the capital of companies.
6. Estate duty in respect of succession to property other than agricultural land.
7. Duties in respect of succession to property other than agricultural land.
8. Terminal taxes on goods or passengers carried by railways, sea, or air taxes on railways fares and freights.
9. Taxes on the sale stamp duties on transactions in stock exchanges and future markets.
10. Rates on stamp duty in respect of bills of exchange, cheque, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
11. Taxes on sale or purchase of newspapers and on advertisements published therein.
12. Taxes on sale or purchase of goods other than newspaper where such sale or purchase takes place in the course of inter-state trade or commerce.
13. Taxes on inter-state consignments of goods for trade or commerce.
14. Fees in respect of any of the matters in the list but not including fees taken in any court.
15. Fees taken in the Supreme Court.

Non-tax Revenue

Non-tax revenue includes borrowings (both internal and external), income from various government undertakings and monopolies, income from government property, etc.

Notes

List II: State List. Some of the financial resources as mentioned in constitution are:

Tax Revenue

1. Land Revenue.
2. Taxes on agricultural income.
3. Taxes on land and buildings.
4. Duties of excise on the following goods manufactured or produced in the state and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (a) alcoholic liquors for human consumption (b) opium, Indian hemp and other narcotic drugs and narcotics, but not including medicinal and toilet preparations containing alcohol or any substances included in this sub-paragraph (entry 51).
5. Taxes on the entry of goods into all local areas of consumption.
6. Taxes on electricity.
7. Taxes on sale and purchase of goods other than newspapers, excluding inter-state sale.
8. Taxes on advertisements other than those published in newspapers.
9. Taxes on vehicles for use on roads.
10. Tolls
11. Taxes on professions, trades, callings and employment.
12. Capitation Taxes.
13. Taxes on luxuries including taxes on entertainment, amusements, betting and gambling.
14. Fees in respect of any the matters in the State List but excluding court fees.
15. Share in some specified Union Taxes.

Non-tax Revenue

1. The State Government can borrow on the security of their respective consolidated funds, but only within the country, including loans from the Government of India.
2. Income from government undertakings owned fully or partly by State Governments.
3. Income from public property owned by the State Government.
4. Grants-in-aid from the Central Government.
5. Other grants for the Central Government.

6.1.6 Fiscal Policy and Economic Growth

Fiscal policy is a potent tool in the hands of the government for regulating economic growth. Deficit financing is an effective tool in the hands of the government to increase effective demand in recession. To fill the deficit the government borrows from the RBI, the market and even creates additional currency to increase the disposable income of people. This results in a conducive environment for investment.

The market mechanism of an underdeveloped economy is not likely to be able to generate enough savings and investment needed for rapid economic growth. Fiscal policy plays a leading role in affecting savings for the economy. The budget plays a direct role in capital accumulation

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and economic growth in an underdeveloped country. Saving potential in an underdeveloped economy is limited partly because of shortage of several specific resources, lack of adequate demand and high cost of production. This vicious circle can be broken by the government with the help of saving-oriented budgets.

Through its fiscal policy, the government can also encourage growth of certain particular industries in particular areas.



Example: For this, industries are provided with specific tax concessions and subsidies such as tax holidays, higher depreciation allowances, etc., designed and incorporated in the budgetary policy.

Further, the role of fiscal policy in economic growth can be understood through the impact of Public Debt, Deficit Financing, and Taxes.

Role of Taxes in Economic Growth

Taxation is an effective budgetary tool to influence the level of savings and investment in the country. Abolition and reduction of various taxes pushes the profits up and reduces the cost of production and prices. Lower prices are expected to increase demand production and employment, which in turn add to effective demand, and so on. Similar steps can be taken in the case of custom duties. Raising import duties diverts the domestic demand from imports to domestically produced goods. Reducing or abolishing export duties or providing export subsidies increases the demand for export and contributes towards recovery from depression.

It is more helpful to lower tax rates on those goods which have a higher elastic demand. Demand will be high if persons with a higher marginal propensity to consume are provided a relief in direct taxation. In he same manner, investment may be encouraged by specific tax concessions like tax holidays and greater depreciation allowance.

Taxes are also considered effective to control inflation. This happens in two ways: the first as in-built stabilizers and the second relates to the common belief that taxes can be used to curb prices and demand.

Public Debt in India

Public debt in the Indian context refers to the borrowings of the Central and State Governments. Gross public debt is the gross financial liability of the government. Net public debt is the gross debt minus the value of capital assets of the government and loans and advances given by the government to other sectors. Debt obligation can be of many types:

1. Short term debts are those where maturity is less than one year at the time of issue and consists of items like the treasury bills.
2. Some obligations may not have specific maturity but may be repayable subject to various terms and conditions. They are called Floating Debt like provident funds, small savings, reserve funds and deposits.
3. Permanent funded debts are loans having a maturity of more than one year at the time of issue. Usually, their maturity is between three and thirty years. Some of them may even be non-terminable so that the government is only to pay the interest on such debt without ever repaying the principle amount.

Notes

4. Obligations owed to foreigners – government institutions, firms and individuals are called external loans.

Debt obligations of the Central Government are broadly divided into two categories:

1. ***Internal debt:*** This includes loans raised within the country, like: (a) Current market loans, (b) others, comprising balance of expired loans, compensation and other bonds such as National Rural Development Bonds and Capital Investment Bonds (c) Special Bearer Bonds (d) Treasury Bills (e) Special floating and other loans (f) Special securities issued to the RBI (g) Small savings (h) Provident funds (i) other accounts (j) reserve funds and deposits.
2. ***External Debt:*** External debt is raised in foreign currency and a substantial part of it is also repayable in foreign currency. External debt represents loans raised by a country from outside sources and includes debt raised by the government and by non-government sources such as NRI deposits, commercial borrowings from abroad, suppliers' credit and short-term borrowings, etc.



Notes Public debt in India has grown immensely during the planning period. In 1999, the total debt of the Central Government was ₹ 8,75,925 and in 1998 the debt of the State Government stood ₹ 2,84,942. In the budget of 2005-2006, 22% of the total expenditure was only interest payment. If the debt is owned by the Central Bank of India it increases inflation as the RBI meets the growing demand by issuing additional quantity of money.

Public debt plays an important role in the economy. Public debt contributes to the saving efforts in the economy. LDCs are usually short of capital resources. As the saving capacity of the masses is very low, appropriate measures have to be taken to step up rates of saving and investment in the economy. The net effect of the borrowings also depends upon the sources from which they come:

1. If the government reduces it's the borrowings from the market, and the public reduces its own consumption and lends its savings to the government, the result will be a net increase in the rate of savings. But if loans are given to the government by diverting savings from private investment, then there will be no net increase in savings and investment activity. But even after that, public loans can help economic growth by reallocation of resources.
2. If money is borrowed from the central bank it results in an addition to aggregate money supply in the country. This results in increment in demand and an upward pressure on prices.

Deficit Financing

Deficit Financing can be defined as "the financing of deliberately created gap between public revenue and public expenditure or a budgetary deficit, the method of financing resorted to being borrowing of a type that results in a net addition to national outlay or aggregate expenditure." Therefore, we can say it is deliberate unbalancing of the budget in such a way that government expenditure exceeds government revenue. In India, great reliance has been placed on deficit financing for mobilising resources for the plans. Deficit financing has been explained in different ways:

Revenue Deficit: Revenue Deficit = Revenue Expenditure – Revenue Receipts.

Budget Deficit: Budget Deficit = Total Expenditure – Total Receipts.

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Total expenditure includes revenue expenditure and capital expenditure and total receipts include revenue receipts and capital receipts. This excess of total expenditure over total revenue is called budget deficit. It is also defined as the fiscal deficit minus government borrowing and other liabilities (public debt receipts). This is somewhat close to the concept of monetised deficit, which means the printing of new money by the Reserve Bank of India to part-finance the deficit.

But this conventional definition of deficit has lost relevance as it does not meet international practice. So this concept of Budget Deficit has been given up by the government in 1997-98. Now we follow the concept of Fiscal Deficit.

Fiscal Deficit: In simple terms, fiscal deficit is budgetary deficit plus market borrowings and other liabilities of the Government of India. It also refers to difference between the total expenditure and the government's total non-debt receipts.

Fiscal Deficit = Revenue Receipts (Net tax revenue + Non-tax Revenue)

+ Capital Receipts (only recoveries of loans and other receipts)

– Total Expenditure (Plan and non-plan)

OR

= Budget Deficit + Government's market borrowing and liabilities.

Primary Deficit: Primary deficit is obtained by subtracting interest payment (a component of non Plan expenditure) from fiscal deficit. Therefore, the primary deficit is the deficit of the current year and it is accordingly triggered by an expansionary fiscal policy during the year.

The Government of India adopted deficit financing to obtain necessary resources for development but this may beget many problems as it increases the public debt, which increases the interest burden of the government.

The most serious disadvantage of deficit financing is inflationary rise of prices. Deficit financing increases the total supply of money in the country and raises the aggregate demand of goods and services. In the absence of corresponding increase in supply of goods and services, deficit financing leads to a rise in the level of prices. Inflation works as a forced saving or indirect taxation on people. Because of increased prices they have to pay extra to maintain the same standard of living.

One way for a government to finance a budget deficit is simply to print money – a policy that leads to higher inflation. Some economists have suggested that a high level of debt might also encourage the government to create inflation. Because most government debt is specified in nominal terms, the real value of debt falls when the price level rises.

This is the usual redistribution between creditors and debtors caused by unexpected inflation. Here, the debtor is the government and the creditor is the private sector. But this debtor, unlike others, has access to the monetary printing press. A high level of debt might encourage the government to print money, thereby raising the price level and reducing the real value of its debts.

6.1.7 Impact of Fiscal Policy on Business

If there is any single document that has maximum impact on business, it is the Budget. Each year's Budget brings opportunities and threats for business. Every budget improves the bottom line of some businesses, while some businesses go into the red. The recent budget, for instance, compelled organisations to work on their Compensation plan because of the Fringe Benefit Tax (FBT). Similarly, the budget of year 2005 gave a big impetus to mutual funds, and in turn to the stock market, by allowing tax rebate on investment in mutual funds. The introduction of VAT also has a big impact on the business.

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In early 1990s, the electronic industry was in great pressure as market growth rate was very low. Understanding this, the then Finance Minister Dr. Manmohan Singh reduced the excise on electronics, especially CTVs, which resulted in decrease in prices and rise in sales.

Not only this, over the years, the government has reduced taxes which has increased the disposable household income. This increased demand and gave birth to the great Indian Middle Class, resulting in a spurt in the sale of white goods and readymade garments.

Taxes on intermediary goods, corporate tax and dividend tax have an obvious impact on business. One of the reasons that gave rise to the Indian consumer industry is the relaxation in fiscal policy. The last few budgets have reduced savings rate and have given a free hand to banks to distribute consumer loans to consumers.

A smart business person always keeps an eye on the fiscal policy to reap the maximum advantage from opportunities and to minimize the prospective losses because of threats in the budget. Like the budget of 2005-06 allows one to invest in mutual funds to avoid tax; it is now up to mutual funds to reap the maximum benefit from this. The budget creates an atmosphere for investment.



Task

Consider the economic budget of financial year 2009-2010. Make a note on the points related to the education and retail sector.

6.2 Foreign Trade Policy and BOP

6.2.1 Import Policy: Prior to 1991

In the pre-reform period Indian import policy had two constituents:

1. ***Import Restrictions:*** In the initial phases of development, India had to import capital equipment, machinery, spare parts, industrial raw material etc. From time to time it had to import food grains too, but because of stagnant exports, government had to decide to import curtail. Import was classified under the categories of: Banned items, restricted items, canalized items and items under OGL (Open General License.). Severe restrictions were imposed on imports of not-essential goods. High import tariffs were used to control import.
2. ***Import Substitution:*** Import substitution means reducing the dependability on imports i.e. to produce goods that we are importing. Two broad objectives of the programme of import substitution in India were:
   (a) to save scarce foreign for the import of more important goods,
   (b) to achieve self-reliance in the production of as many goods as possible.

6.2.2 New Trade Policy (1991)

The new policy substantially eliminates licensing, quantitative restrictions, and other regulatory and discretionary controls. The main features of the new trade policy are:

1. ***Free Import and Export:*** The new trade policy made major changes in the import licensing system by replacing a large part of administered licensing of imports by import entitlements linked to export earnings. The system of advance license, designed to provide exporters with duty free access to inputs, was strengthened further by simplifying and speeding up the process of issuing these licenses.

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The procedure of import of capital goods was simplified following the Industrial Policy of 1991. New units and units undergoing substantial expansion would be automatically granted licenses for import of capital goods without any clearance from the indigenous availability angle, provided their import is fully covered by foreign equity or the import requirement was up to 25% of the value of plant and machinery subject to a maximum of ₹ 2 crore.

Import of OGL capital goods, non-OGL capital goods and restricted goods would be allowed without a specific license, provided clearance was given by the RBI and foreign exchange, because their imports are fully covered by foreign equity.

2. ***Rationalisation of Tariff Structure:*** On the recommendation of Chelliah committee, import duty was drastically reduced to establish parity in prices of goods produced domestically and internationally.



Example: The 1993-94 Budget reduced the maximum rate of duty on all goods from 110% to 85%, except for few goods, which was further reduced to 40% in 1998-99 and further to 35% in 2000-01.

3. ***Decanalisation:*** The new trade policy aimed at progressive decanalisation. The government decontrolled 116 items allowing their exports without any licensing formalities. Another 29 items were shifted to OGL. It also decanalised 16 export items and 20 import items including new print, non-ferrous metals, natural rubber, intermediate and raw material for fertilizers. However, 8 items (petroleum products, fertilizers, etc.) remained canalised.

4. ***Exchange Rate Reforms:*** The government devalued the rupee in July 1991, which led to depreciation in the value of the rupee against the five major international currencies by roughly 22%. It also made the rupee convertible:

   (a) *Partial Convertibility of Rupee:* In Budget 1992-93, the finance minister announced Liberalised Exchanged Rate Systems (LERMS) under which 40% of the foreign exchange receipts were to be exchanged through the RBI at the official exchange rate and rest was allowed to be converted at market exchange rate. The official exchange rate was lower than the market exchange rate.

   (b) *Fully Convertible on Current Account:* The rupee was made fully convertible. Current account convertibility means the freedom to buy or sell foreign exchange for the following international transactions: (a) all payment due in connection with foreign trade, current business, and normal short-term banking and credit facilities (b) payment due as interest on loans and as net income from other investments (c) payments of moderate amount of amortisation of loans or for depreciation of direct investment and (d) moderate remittances for family living expenses.

5. ***Phased Manufacturing Programme:*** PMP, according to which organisations were required to substitute all the imported parts with Indian parts in a specified period, was abolished.

6. ***Trading House:*** The 1991, the policy allowed export houses and trading houses to import a wide range of items. The government also permitted the setting up of trading houses with 51% foreign equity for the purpose of promoting exports. Under the 1992-97 trade policy, export houses and trading houses were provided the benefit of self-certification under the advance license system, which permits duty free imports for exports.

7. ***EOU/EPZ/EHTP/STP:*** The units undertaking to export their entire production of goods may be set up at Export Processing Zones (EPZ), Electronic Hardware Technology Park (EHTP), Software Technology Park (STP) and Export-Oriented Units. EPZs are special enclaves separated from Domestic Tariff Area (DTA) by fiscal barriers and are intended to

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provide an internationally competitive duty free environment for export production at low cost. Units in these areas also enjoy tax holidays and duty free imports.

6.2.3 Foreign Trade Policy 2002-2007

Foreign Trade Policy is built around two major objectives namely, to double India's percentage share of global merchandise trade by 2009, and to act as an effective instrument of economic growth by providing a thrust to employment generation, especially in semi urban and rural areas.

The Union Minister Mr. Kamal Nath unveiled the new Foreign Trade Policy (2004 -07), which was earlier known as the EXIM Policy (Export and Import Policy). This policy unshackles the controls earlier levied. All goods and services exported, including those from Domestic Tariff Area, have been exempted from service tax and all exporters with minimum turnover of ₹ 5 crore have been exempted from furnishing bank guarantees. This will reduce their transaction cost.

1. ***Target Plus:*** This scheme has been introduced to achieve growth in exports. Exporters who will achieve a substantial higher growth than that of general export target will get duty free credit based on their performance.



Example: For a growth of over 20%, duty free credit will be 5%, for 25% it will be 10% and for 100% it will be 15% respectively, of FOB value of incremental exports.

To give impetus to trading in India a scheme was introduced to establish Free Trade and Warehousing Zones. These zones will have infrastructure to support import and export of goods and services. Foreign direct investment would be permitted up to 100% in the development and establishment of the zones and their infrastructure facilities.

Foreign Trade Policy 2004-2009 gave special emphasis to agriculture, handicraft, handlooms, gems and jewellery, and footwear. To promote this, it liberalised the import of seeds, bulbs, tubers, and planting material and also export of plant portion, derivatives, and extracts. Exports of medical plant and herbal products are likely to get a boost in the process. For the same purpose it also allowed import of restricted items. Export-oriented units engaged in production or processing of agro, horticulture and aquaculture products are allowed to move inputs and equipments to farms located in domestic tariff area.

To promote handloom and handicraft, duty-free import of trimmings and embellishments in these sectors have been increased to 5% of FOB value of exports. It will be also exempted from countervailing duty. A provision was made for the establishment of new Handicraft Special Zones.

2. ***Vishesh Krishi Upaj Yojna:*** The objective of this yojna is to provide boost to the exports of fruits, vegetables, flowers, minor forest produce, and their value-added products. Exporters of these products will get duty free credit.

3. ***Town of Export Excellence:*** The limit to become the town of export excellence has been reduced to 250 crore from ₹ 1000 crore. FTP gave several benefits including exemption from service tax in proportion to their exported goods and services and permission to retain 100 % earnings in the exchange earner foreign currency account.

4. ***Served From India:*** The Served From India scheme as a brand was instantly recognised the world over, under which individual service providers who earn foreign exchange of at least ₹ 10 lakh would be eligible for a duty credit entitlement of 10 % of total foreign exchange earned by them. In the case of stand-alone restaurants, the entitlement would be 20%, whereas in the case of hotels, it would be 5%.

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5. ***Service Export Promotion Council:*** This was set up with the objective of tapping opportunities in key markets and to develop strategic market access programmes. This includes brand-building in coordination with players of each sector and recognising nodal bodies of the services industry.

6. ***Common Facility Centre:*** The Common Facility Centre will be promoted by the government for use by home-based service providers, particularly in areas like engineering and architectural design, multimedia operations, and software developers at state and district levels, to draw a multitude of home-based professionals into the service export arena.

6.3 Direct Taxes

A Direct tax is a kind of charge, which is imposed directly on the taxpayer.



Example: Property tax and income tax.

Alternatively, it can be said that a direct tax is one that is taken away from one's salary or wages. When the tax is imposed by the government upon the property, then it is called property tax, which is also a direct tax.

Direct Tax is the tax paid to the government directly by the assessee like the Income Tax or the Capital Gains Tax. There has been a steady rise in the net Direct Tax collections in India over the years.

All the collections of the direct taxes in India like the Corporate Tax, Personal Income Tax, Securities Transaction Tax, Banking Cash Transaction Tax, and the Fringe Benefit Tax have been going through a healthy ascent.



Example: In the current year the personal income taxes collection have increased with the rate of TDS being higher than the previous years.

Overall, as per the estimates of the Budget of the financial year 2006-07, the target of Direct Tax growth rate was estimated to be 27.5%, but so far it has exceeded this limit and reached 41.2%. At present, the net Direct Tax collection of India is at ₹ 610.30 billion, which is estimated to rise to 42% over ₹ 429.80 billion as it was in the last financial year. This growth in the rate of Direct Tax reflects a continued increase in the economy, high tax compliance, and better tax administration.

One of the main forms of Direct Tax is the Taxes on Corporate Income, under which the companies residing in this country pays a tax on their global income arising from all sources. The payment of the tax follows the provisions of the Income Tax Act. On the other hand, the non-resident companies pay the Direct Tax on the income obtained from an India-based business connection. The resident companies pay a tax at the rate of 35% with a surcharge of 2.5% while for the non-resident companies the basic tax rate goes up to 40% along with the same 2.5% surcharge. Along with these the corporate companies also pay an education tax at the rate of 2% and a wealth tax at the rate of 1%. Moreover, a Minimum Alternative Tax at 7.5% also requires to be paid by the Domestic corporations.

Notes

	April-June 2010 P		
Item	**Credit**	**Debit**	**Net**
1	**2**	**3**	**4**
A.CURRENT ACCOUNT			
I. MERCHANDISE	53,726	87,920	-34,194
II.INVISIBLES (a+b+c)	42,725	22,263	20,462
a) Services	26,116	16,059	10,057
i) Travel	2,950	2,261	689
ii) Transportation	3,097	3,134	-37
iii) Insurance	404	310	94
iv) G.n.i.e.	94	143	-49
v) Miscellaneous of which	19,571	10,211	9,360
Software Services	12,655	575	12,080
Business Services	4,819	5,902	-1,083
Financial Services	1,228	1,404	-176
Communication Services	325	241	84
b) Transfers	13,754	700	13,054
i) Official	59	115	-56
ii) Private	13,695	585	13,110
c) Income	2,855	5,504	-2,649
i) Investment Income	2,628	5,042	-2,414
ii) Compensation of Employees	227	462	-235
Total Current Account (I+II)	96,451	110,183	-13,732
B. CAPITAL ACCOUNT			
1. Foreign Investment (a+b)	52,635	44,880	7,755
a) Foreign Direct Investment (i+ii)	8,569	5,419	3,150
i. In India	8,275	2,302	5,973
Equity	5,991	2,278	3,713
Reinvested Earnings	2,166	0	2,166
Other Capital	118	24	94
ii. Abroad	294	3,117	-2,823
Equity	294	1,914	-1,620
Reinvested Earnings	0	271	-271
Other Capital	0	932	-932
b) Portfolio Investment	44,066	39,461	4,605
In India of which	43,972	39,320	4,652
FIIs	42,858	39,320	3,538
ADRs/GDRs	1,114	-	1,114
Abroad	94	141	-47
2.Loans (a+b+c)	24,696	14,110	10,586
a) External Assistance	3,090	754	2,336
i) By India	14	20	-6
ii) To India	3,076	734	2,342
b) Commercial Borrowings (MT<)	4,521	1,850	2,671
i) By India	185	243	-58
ii) To India	4,336	1,607	2,729
c) Short Term to India	17,085	11,506	5,579
i) Suppliers' Credit >180days & Buyers' Credit	15,579	11,506	4,073
ii) Suppliers' Credit up to180 days	1,506	-	1,506
3. Banking Capital (a+b)	16,747	12,742	4,005
a) Commercial Banks	16,745	12,718	4,027
i) Assets	3,263	2,558	705
ii) Liabilities of which:	13,482	10,160	3,322
Non-Resident Deposits	11,254	10,133	1,121
b) Others	2	24	-22
4. Rupee Debt Service	-	16	-16
5. Other Capital	1,206	5,151	-3,945
Total Capital Account (1 to 5)	95,284	76,899	18,385

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C. Errors & Omissions	-	912	-912
D. Overall Balance	191,735	187,994	3,741
(Total Current Account, Capital Account and Errors & Omissions (A+B+C))			
E. Monetary Movements (i+ii)	-	3,741	-3,741
i) I.M.F.	-	-	-
ii) Foreign Exchange Reserves	-	3,741	-3,741
(Increase - / Decrease +) of which: SDR allocation	-	-	-
P: Preliminary. PR: Partially Revised.			

The Capital Gains Tax is another important form of Direct Tax in India which is payable on capital gains received upon the sale of assets. If the capital assets are in possession for more than three years and regarding the shares, stock exchange securities, mutual fund units the time frame for possessing the asset is one year. The basic tax rate of the long-term capital gains is fixed at 20% while for the short-term capital gains the rate is fixed at the normal corporate income tax rate. A rate of 10% is fixed on the transfer of equity shares from which the short-term capital gain emerges.

Personal Income tax is another type of Direct Tax, which is under the Central Government controlled by the Central Board of Direct Taxes. The taxpayer is required to pay a tax if the income level reaches above ₹ 100,000. If the income reaches ₹ 850,000 there is a surcharge of 10% imposed on the total tax.

6.4 Indirect Taxes

Indirect Tax or the tax that is levied on goods or services rather than on persons or organizations are of different types in India like Excise Duty, Customs Duty, Service Tax, and Securities Transaction Tax. In India, there are a series of Tax laws and regulations in order to control the indirect taxation, which can be either law, made by the central government or even can be state specific laws. As a result these taxes are an important part of the total cost. It is thus essential to make appropriate planning for such costs.

Nearly all of the activities that are subjected to indirect taxation range from manufacturing to those required for final consumption. Activities related to trading, imports, and services are also included in this list. As a result Indirect Tax has an impact on all business lines. At present the Indirect Taxes in India are under a transformation due to the changing fiscal reforms of the Indian government. Many new acts and laws are being introduced replacing the old laws and all related issues, which have become redundant. However, it should be remembered that such new laws while on one hand would create new opportunities, but also at the same time would lead to a certain extent of uncertainty and judicial proceedings.

In general, the Indirect Tax in India is a complex system of interconnecting laws and regulations, which includes specific laws of different states. For this there are many reliable organizations in India, which employs efficient Indirect Tax professionals to help their clients. These tax professionals with their in-depth knowledge and wide-ranging experience offers effective planning methods to their clients in order to help in their cost minimization.



Example: The Indirect Taxation regime encompasses various types of taxes like Sales Tax, Service Tax, Custom and Excise Duties, VAT and Anti-Dumping Duties, and the organizations provide services in all these related fields.

In the recent year, the Indian government has undertaken significant reform of indirect taxation system. This includes the initiation of a region-based and state-level VAT on goods. However,

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it should be noted that as taxes still forms a barrier to inter-state trading in order to attain a secured market for the activities related to services and goods more reform is needed. Some of the reforms that can be introduced for a better indirect taxation system in India are:

1. The serialized set of Indirect Taxes so far activated at the central and state levels should be amalgamated and treated as a single tax.
2. The integrated Indirect Tax should be neutral at all levels such that chances of fraudulence would be minimized.
3. The Central Sales Tax, which obstructs easy trading between different states, is being under the process of termination that would help to abolish the control measures on the inter-state trade.

By the year 2010 the Indian government has planned to activate a goods and services tax neutral at all levels in order to fulfill these objectives. The government can undertake either an introduction of a national VAT or a system, which would permit both a state VAT, or a central VAT. Along with this if the government also can incorporate a central VAT that can be rebated, on the trade across the boundary lines, then there would be minimum chances of fraudulence.



Case Study

India at the Time of Global Crisis

This morning, I had a meeting with the chiefs of major banks where we announced the monetary policy of the Reserve Bank for the remaining period of 2009-10 in the light of the macroeconomic developments so far. The meeting also provided a valuable opportunity for the Reserve Bank and the commercial banks to understand and appreciate each other's perspectives.

Bankers generally welcomed the Reserve Bank's policy stance. They felt that the status quo on policy rates would anchor interest rate expectations that could spur investment demand. They indicated that they are seeing signs of revival in the domestic economy and expect credit demand to pick up in the second half of the year. In this context, I emphasised the need to increase the flow of credit, particularly to agriculture and micro, small and medium enterprises. Banks were concerned that their liability structure is getting shorter with the reduction in the term structure of deposits, while the asset structure is getting elongated on account of the increasing share of long-term loans, particularly infrastructure. Several banks also indicated that the share of current and savings (CASA) deposits has been declining, which would put pressure on their Net Interest Margins (NIM). As regards credit quality, banks were of the view that Non-performing Assets (NPAs) are expected to increase, particularly, in the unsecured segments, although they will remain manageable. Going forward, public sector banks emphasised the need for raising capital as risk-weighted assets expand in their asset portfolio.

Global Economy

The global economy is showing incipient signs of stabilisation, albeit not recovery. The pace of decline in economic activity in several major advanced economies has slowed, frozen credit markets have thawed and equity markets have begun to recover. Recent months have also witnessed industrial activity reviving in a number of emerging market economies. Notwithstanding some positive signs, the path and the time horizon for global recovery remain uncertain in the light of subdued consumption demand, increased unemployment levels and in anticipation of further contraction in global trade and private

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capital flows. Business and consumer confidence are yet to show definitive signs of revival but the financial sector appears to be stabilising in response to concerted actions taken by governments and central banks across the world, economic recession in the real sector persists. According to the latest assessment by the International Monetary Fund (IMF), the global economy is projected to shrink by 1.4 per cent in 2009 before recovering and expanding by 2.5 per cent in 2010. The IMF, however, upgraded the growth outlook for developing Asia citing improved prospects in China and India.

The Crisis and India

The Indian economy experienced a significant slowdown in 2008-09, in comparison with the robust growth performance in the preceding five years, largely due to the knock-on effect of the global financial crisis. India's exports contracted during eight straight months which, in turn, impacted the industrial sector and the services sector. The financial sector, however, remained relatively unaffected despite the severe stress created by the global deleveraging process, which triggered capital outflows in the second half of 2008-09.

Quick and aggressive policy responses both by the Government and the Reserve Bank mitigated the impact of the global financial crisis. The large domestic demand bolstered by the government consumption, provision of forex and rupee liquidity coupled with sharp cuts in policy rates, a sound banking sector and well-functioning financial markets helped cushion the economy from the worst impact of the crisis. There are now progressive signs of recovery in India: food stocks have increased; industrial production has turned positive; corporate performance has improved; business confidence surveys are optimistic; leading indicators show an upturn; interest rates have declined; credit off-take has picked up after May 2009; stock prices have rebounded; the primary capital market has witnessed some activity; and external financing conditions have improved. On the other hand, there are some negative signs: delayed and deficient monsoon; food price inflation; rebound in global commodity prices; continuing weak external demand; and high fiscal deficit.

Questions

1. Comment on India's performance in the time of slowdown.
2. Compare the present performance with the performance of past few years.

Source: Excerpts from RBI Governor Dr. Subbarao's Speech, rbi.org.in

6.5 Summary

- According to the RBI Act, 1935, every commercial bank has to keep certain minimum cash reserve with the RBI. Initially, it was 5% against demand deposit and 2% against time deposits.
- It is through fiscal policy that the government tries to correct inequalities of income and wealth, which increase with the development of a country.
- Fiscal policy is the projected balance sheet of the country, prepared by the Chief Finance Officer of the country i.e. the Finance Minister of the State. Public finance is the study of generating resources for the development of the country and about the allocation of those resources.
- The budget includes revenue and expenditure. The two are divided into capital and revenue accounts. Thus, receipts are broken into revenue receipts and capital receipts, and disbursements are broken up into revenue expenditure and capital expenditure.

Notes

- In India, each State Government prepares its own budget of income and expenditure every year. State Governments collect revenue from different sources to meet their expenditure.
- The Constitution of India divides the functions and financial powers of the government between the Central and the State together with the concurrent areas. It also provides for sharing of taxes in various forms and the system of grants-in-aids.
- Deficit financing is an effective tool in the hands of the government to increase effective demand in recession. To fill the deficit the government borrows from the RBI, the market and even creates additional currency to increase the disposable income of people.
- Indian economy was affected by scarcity. To safeguard the domestic industry and to restrict the export of essential goods, international trade was regulated.
- In the initial phases of development, India had to import capital equipment, machinery, spare parts, industrial raw material etc. From time to time it had to import food grains too, but because of stagnant exports, government had to decide to import curtail.
- The new policy substantially eliminates licensing, quantitative restrictions, and other regulatory and discretionary controls.
- Foreign trade policy is built around two major objectives namely, to double India's percentage share of global merchandise trade by 2009, and to act as an effective instrument of economic growth by providing a thrust to employment generation, especially in semi urban and rural areas.
- A Direct tax is a kind of charge, which is imposed directly on the taxpayer. One of the main forms of Direct Tax is the Taxes on Corporate Income, under which the companies residing in this country pays a tax on their global income arising from all sources.
- Indirect Tax or the tax that is levied on goods or services rather than on persons or organizations are of different types in India like Excise Duty, Customs Duty, Service Tax, and Securities Transaction Tax.

6.6 Keywords

BOP: Balance of Payments

Budget Deficit: Total Expenditure - Total Receipts

Capital Payments: Loans raised by the government from the public, RBI and other bodies

Capital Receipts: Payments for, acquisition of assets and loans and advances

Deficit Financing: Financing of deliberately created gap between public revenue and public expenditure

Direct Taxes: Kind of charge, which is imposed directly on the taxpayer

External Debt: Debt raised in foreign currency

Fiscal Deficit: Budgetary deficit plus market borrowings and other liabilities of the Government of India

Indirect Taxes: Tax that is levied on goods or services rather than on persons or organizations

Internal Debt: Loans raised within the country

Primary Deficit: Fiscal Deficit – Interest Payments

REPO: Purchase of one loan against the sale of another

Notes

Revenue Deficit: Revenue Expenditure – Revenue Receipts

Revenue Expenditure: Does not result in the creation of assets

6.7 Self Assessment

State whether the following statements are true or false:

1. Economics and politics are closely related in the sense that economic theories are based on politics of the economy.
2. The inflation rate will escalate even with a slight change in the monetary policy of the government.
3. New aggregate NM3 is also known as narrow aggregate of money.
4. Supply of money in the economy can be regulated by any nationalized bank.
5. Bank rate is the rate at which RBI lends money to other banks.
6. Fiscal policy is concerned with balanced growth of the economy.
7. Foreign Trade policy of 2002-2007 lays stress on exports of medicinal products from India and import of seeds.
8. Entertainment tax, which is added in the cost of movie tickets, is a direct tax as individuals have to pay that.

Fill in the blanks:

9. Savings with the post office is a part of ……. aggregate of money supply.
10. People trust the stocks of the public sector units. This facilitates the ……..for controlling monetary supply in the economy.
11. ……ratio decides that how much a commercial bank is going to have in form of cash and other readily convertible assets.
12. Government wants to put a tab on the sale of automobiles in the country. It can effectively use …… to establish this objective.
13. Governments pay heavy interest rates on the equipments they hire from foreign nations. This type of expense is called……..
14. Money borrowed from banks increase the aggregate ……. in the economy thereby increasing the prices.
15. ……scheme provides incentives to the exporters if they achieve more than their set goals.
16. Inflationary pressures show their effect more on …….. taxes.

6.8 Review Questions

1. "Politics drives economics or does economics influence politics". Discuss.
2. Critically examine the old and new, and broad and narrow divisions of money in India.
3. "The slightest change in money policy can produce large effects". Comment.
4. Suppose RBI over does the expansionary drive to achieve fast economic development. What will happen in such a situation?

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5. Analyse open market operations and selective credit control as measures to control money supply in the economy.
6. "Supply of money is a sensitive issue as even a slight imbalance can create havoc". Elaborate.
7. "It is through fiscal policy that the government tries to correct inequalities of income and wealth". Discuss.
8. How does the budget of Central Governments differ from the budgets of the State Governments?
9. "Taxes are considered effective to control inflation". Justify the statement.
10. What is the difference between public debt and deficit? Explain giving examples.
11. "A smart business person always keeps an eye on the fiscal policy". Substantiate.
12. Critically analyse the New Trade Policy of 1991 vis-à-vis the Foreign Trade Policy of 2002-07.
13. Compare and contrast between direct and indirect taxes. Give examples to support your answer.
14. Which is more painful, direct or an indirect tax? Why? What are the advantages that both hold?
15. Discuss the basic issues involved in deficit financing and unplanned expenditures.

Answers: Self Assessment

1.	False	2.	True
3.	False	4.	False
5.	True	6.	True
7.	True	8.	False
9.	Old/Broad	10.	Open Market Operations
11.	Statutory Liquidity Ratio	12.	Selective Credit Control
13.	Revenue Expenditure	14.	Money Supply
15.	Target Plus	16.	Indirect Taxes

6.9 Further Readings



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Unit 7: Socio-cultural Environment

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Objectives

After studying this unit, you will be able to:

- Discuss the situation of poverty and unemployment in India
- Assess the need for Human Development and Rural Development
- Explain the need for Business Ethics and Corporate Governance
- State the concept of Corporate Social Responsibility

Introduction

Society and culture primarily govern the lifestyle of an individual. An individual's eating habits, shopping behaviour, dressing priorities, physical possessions, etc., are all influenced by the society. Many times people spend a lot amount of money for the sake of simply to adhere to social and cultural norms. It is only due to societal pressure that people spend so much money in marriages, celebrations, and even on funerals. In India, expenditure on festivals like Holi, Diwali, Id, Raksha Bandhan, Durga Puja, Ganesh Puja, Pongal, etc., runs into billions every year. So culture itself is a big opportunity for business.

If we study Maslow's Hierarchy of Human Needs, we will find that after fulfilling physiological, safety and security needs, it is only for social needs that a human being works. In most cases, once social aspirations are achieved, most people remain there and seldom strive for ego and self-actualisation needs.

When someone buys a gift for someone else, when he purchases clothes for a party or a morning walk, when he purchases a particular model of motorcycle or automobile, when he takes admission in a particular college/school, all of these decisions are influenced by the prevailing societal and cultural environment.

With all these purchases, he is satisfying his social needs because he has a subconscious desire to appear a smart and intelligent consumer and individual in the eyes of society. It has been seen that in the case of middle class and upper class, expenditure on social needs consumers a considerable part of their income. This ratio increases in favour of social needs as we go up the income ladder. This is the reason most organizations try to position their products around social needs.

7.1 Poverty in India

Poverty is one of the main issues, attracting the attention of sociologists and economists. It indicates a condition in which a person fails to maintain a living standard adequate for a comfortable lifestyle.

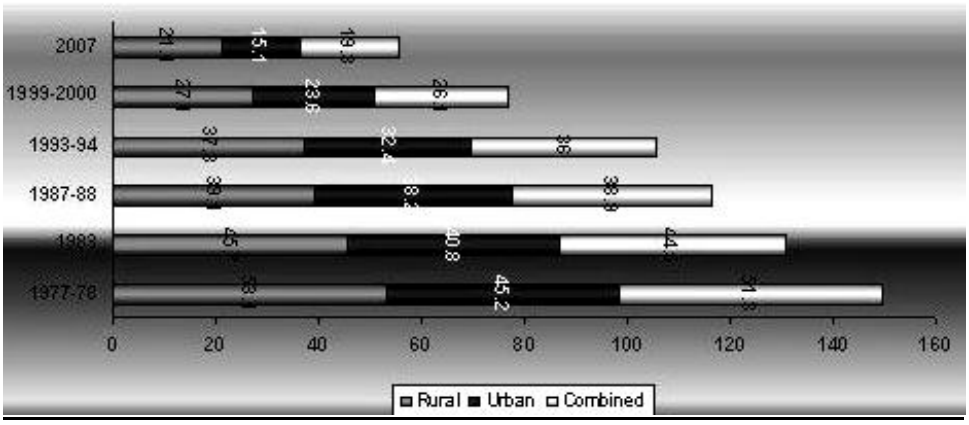
Though India boasts of a high economic growth, it is shameful that there is still large scale poverty in India. Poverty in India can be defined as a situation when a certain section of people are unable to fulfill their basic needs. India has the world's largest number of poor people living in a single country. Out of its total population of more than 1 billion, 350 to 400 million people are living below the poverty line. Nearly 75% of the poor people are in rural areas, most of them are daily wagers, landless laborers and self employed house holders. There are a number of reasons for poverty in India. Poverty in India can be classified into two categories namely rural poverty and urban poverty.

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Since its independence, the issue of poverty within India has remained a prevalent concern. According to the common definition of poverty, when a person finds it difficult to meet the minimum requirement of acceptable living standards, he or she is considered poor.

Millions of people in India are unable to meet these basic standards, and according to government estimates, in 2007 there were nearly 220.1 million people living below the poverty line. Nearly 21.1% of the entire rural population and 15% of the urban population of India exists in this difficult physical and financial predicament. The following chart presents the poverty situation:

Figure 7.1: Poverty Situation in India



Source: economywatch.com

The division of resources, as well as wealth, is very uneven in India – this disparity creates different poverty ratios for different states. For instance, states such as Delhi and Punjab have very low poverty ratios. On the other hand, 40-50% of the populations in Bihar and Orissa live below the poverty line. The poverty ratios illustrated here are divided in two types: urban and rural. Specific reasons for poverty vary in the urban and rural settings. A number of factors are responsible for poverty in the rural areas of India. Rural populations primarily depend on agriculture, which is highly dependant on rain patterns and the monsoon season. Inadequate rain and improper irrigation facilities can obviously cause low, or in some cases, no production of crops. Additionally, the Indian family unit is often very large, which can amplify the effects of poverty. Also, the caste system still prevails in India, and this is also a major reason for rural poverty – people from the lower casts are often deprived of a number of facilities and opportunities. The government has planned and implemented poverty eradication programs, but the benefits of all these programs have yet to reach the core of the country.

The phenomenal increase in the city populations is the main reason for poverty in the urban areas of India. A major portion of this additional population is due to the migration of the rural families from villages to cities. This migration is mainly caused by poor employment opportunities in villages. This situation is exacerbated by the fact that there are few job opportunities in the urban areas of India.

Since 1970, the Indian government has implemented a number of programs designed to eradicate poverty, and has had some success with these programs. The government has sought to increase the GDP through different processes, including changes in industrial policies. There is also a Public Distribution System, which has been somewhat effective so far. Other programs include the Integrated Rural Development Programme, Jawahar Rozgar Yojana, the Training Rural Youth for Self Employment (TRYSEM) and to the credit of the government, other on-going initiatives.

Notes

7.2 Unemployment in India

India as a nation is facing a massive problem of unemployment. Unemployment can be defined as a state of no work for a man fit and willing to work. It is a condition of involuntary and not voluntary idleness. Some features of unemployment have been identified as follows:

1. The incidence of unemployment is much higher in urban areas than in rural areas.
2. Unemployment rates for women are higher than those for men.
3. The incidence of unemployment among the educated is much higher than the overall unemployment.
4. There is greater unemployment in agricultural sector than in industrial and other major sectors.

Economists and social thinkers have classified unemployment into various types. Generally unemployment can be classified in two types:

1. ***Voluntary unemployment:*** In this type of unemployment a person is out of job of his own desire doesn't work on the prevalent or prescribed wages. Either he wants higher wages or doesn't want to work at all. It is in fact social problem leading to social disorganization. Social problems and forces such as a revolution, a social upheaval, a class struggle, a financial or economic crisis a war between nations, mental illness, political corruption mounting unemployment and crime etc. threaten the smooth working of society. Social values are often regarded as the sustaining forces of society. They contribute to the strength and stability of social order. But due to rapid social change new values come up and some of the old values decline. At the same time, people are not is a position to reject the old completely and accept the new altogether. Here, conflict between the old and the new is the inevitable result which leads to the social disorganization in imposed situation. In economic terminology this situation is voluntary unemployment.
2. ***Involuntary unemployment:*** In this type of situation the person who is unemployed has no say in the matter. It means that a person is separated from remunerative work and devoid of wages although he is capable of earning his wages and is also anxious to earn them. Forms and types of unemployment according to Hock are:
   (a) *Cyclical unemployment:* This is the result of the trade cycle which is a part of the capitalist system. In such a system, there is greater unemployment and when there is depression a large number of people are rendered unemployed. Since such an economic crisis is the result of trade cycle, the unemployment is a part of it.
   (b) *Sudden unemployment:* When at the place where workers have been employed there is some change, a large number of persons are unemployed. It all happens in the industries, trades and business where people are employed for a job and suddenly when the job has ended they are asked to go.
   (c) *Unemployment caused by failure of Industries:* In many cases, a business a factory or an industry has to close down. There may be various factors responsible for it there may be dispute amongst the partners, the business may give huge loss or the business may not turn out to be useful and so on.
   (d) *Unemployment caused by deterioration in Industry and business:* In various industries, trades or business, sometimes, there is deterioration. This deterioration may be due to various factors. In efficiency of the employers, keen competitions less profit etc. are some of the factors responsible for deterioration in the industry and the business.

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(e) *Seasonal unemployment:* Certain industries and traders engage workers for a particular season. When the season has ended the workers are rendered unemployed. Daily wage workers in specific agriculture based industry like sugar industry is an example of this type of seasonal unemployment.

The problem of unemployment has becoming a colossal. Various problems have caused this problem. There are individual factors like age, vocational unfitness and physical disabilities which restrict the people. External factors include technological and economic factors. There is enormous increase in the population. Every year India adds to her population afresh. More than this every year about 5 million people become eligible for securing jobs. Business field is subject to ups and downs of trade cycle and globalization. Economic depression or sick industries are often close down compelling their employees to become unemployed. Technological advancement contributes to economic development .But unplanned and uncontrolled growth of technology is causing havoc on job opportunities. The computerization and automation has led to technological unemployment. Strikes and lockouts have become inseparable aspect of the industrial world today. Due to these industries often face economic loses and production comes down. Since workers do not get any salary or wages during the strike period they suffer from economic hardships. They become permanently or temporarily unemployed. Today young people are not ready to take jobs which are considered to be socially degrading or lowly. Our educational system has its own irreparable defects and its contribution to the unemployment is an open truth. Our education does not prepare the minds of young generation to become self-employed on the contrary it makes them dependent on government vacancies which are hard to come. Our State right from the beginning of Five year plans has introduced several employment generating schemes and programmes over the years but in the absence of proper implementation and monitoring have failed to achieve the required targets. Recently UPA Government has come up with Rural Employment Guarantee program which aims to provide minimum days of employment to people living in the villages. This is a laudable programme if implemented sincerely because it will provide employment to people during natural calamities like drought, floods etc. The remedial measures for reducing unemployment may lay greater emphasis on creation of opportunities for self-employment, augmentation of productivity and income levels of the working poor, shift in emphasis from creation of relief type of employment to the building up of durable productive assets in the rural areas and instead of attempting to revert somewhat to protectionist policies the pace of privatization may be accelerated.

Table 7.1: Labor Force without Jobs

Year	Unemployment rate	Rank	Percent Change	Date of Information
2003	8.80 %	110		2002
2004	9.50 %	105	7.95 %	2003
2005	9.20 %	83	-3.16 %	2004 est.
2006	8.90 %	91	-3.26 %	2005 est.
2007	7.80 %	92	-12.36 %	2006 est.
2008	7.20 %	89	-7.69 %	2007 est.
2009	6.80 %	85	-5.56 %	2008 est.

Source: indexmundi.com

Notes

7.3 Human Development

Human development is a multifaceted and complex process. There are many dimensions along which development occurs and there are complex interdependencies and linkages between these dimensions. (In mathematical terms, you may say that these dimensions are not mutually orthogonal.) Due to these dependencies and linkages, attaining goals is not a simple process of randomly enumerating them and then arbitrarily attempting to work on each sub goal. The enumeration of the goals itself should reveal some of the dependencies. Care must be taken to distinguish between causes and effects, between underlying causes and their symptoms.

India's Human Development goals enumerate them randomly. Indeed, the first "goal" is Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012. Poverty cannot be reduced by declaring it as a goal. If indeed it were that easy, we should reduce poverty by 100 percent, and not pussy-foot around the place with goals of reducing it by only five percentage points.

Poverty reduction is the combined effect of a number of other 'goals' that one may have. For instance, poverty will be reduced if these were to happen.

1. Control population growth.
2. Increase access to education.
3. Provide access to credit.
4. Have a rational labor and industrial policy.

If you do all the above (and more, perhaps) successfully, the outcome will be reduction in poverty. Whether that is a 5 percentage points reduction or a 50 percentage points only time will tell.

If there was an incentive for people to state realistic goals and achieve them, then we could have an honest goal setting exercise.



Example: Suppose if the goals were not achieved, those setting the goals were to lose their jobs, they would not set these goals at all.

They would then think very clearly and figure out what the factors are that, if obtained, would lead to certain results. These bureaucrats would then list out the factors and say in the end, "Don't know by how many points exactly will poverty be reduced but it will be reduced if the factors are obtained."

A partial list of factors needs to be targeted for achieving development:

1. education, primary as well as vocational
2. access to credit
3. access to markets
4. a transparent legal system and law enforcement
5. rule of law as opposed to rule by men

Monitorable Targets for the Tenth Plan and Beyond

1. Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012;

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2. Providing gainful and high-quality employment at least to the addition to the labour force over the Tenth Plan period;
3. All children in school by 2003; all children to complete 5 years of schooling by 2007;
4. Reduction in gender gaps in literacy and wage rates by at least 50 per cent by 2007;
5. Reduction in the decadal rate of population growth between 2001 and 2011 to 16.2 per cent;
6. Increase in Literacy Rates to 75 per cent within the Tenth Plan period (2002-03 to 2006-07);
7. Reduction of Infant Mortality Rate (IMR) to 45 per 1000 live births by 2007 and to 28 by 2012;
8. Reduction of Maternal Mortality Ratio (MMR) to 2 per 1000 live births by 2007 and to 1 by 2012;
9. Increase in forest and tree cover to 25 per cent by 2007 and 33 per cent by 2012;
10. All villages to have sustained access to potable drinking water within the Plan period;
11. Cleaning of all major polluted rivers by 2007 and other notified stretches by 2012.

Task Find out the facts and figures regarding the level of education, poverty, women development, infant mortality and gender equality in India.

7.4 Rural Development

Gone are the days when a rural consumer went to a nearby city to buy "branded products and services". Today, rural markets are critical for every marketer - be it for a branded shampoo or an automobile. There was a time when marketers thought van campaigns, cinema commercials and a few wall paintings would suffice to entice rural folks under their folds. Thanks to television, customers in rural areas are quite literate about myriad products that are on offer in the marketplace today. An Indian farmer going through his daily chores wearing jeans may sound idiotic. Not for Arvind Mills, though.

Did u know? When Arvind Mills launched the Ruff & Tuff kits in the rural areas, it had created quite a sensation among the rural folks within a few months of their launch.

The Indian rural market with its vast size and demand base offers great opportunities to marketers. Two-third of the country's consumers live in rural areas and almost half of the national income is generated here. It is only natural that rural markets form an important part of the total market of India. Our nation is classified into about 450 districts, and approximately 6,30,000 villages that can be sorted according to different parameters such as literacy levels, accessibility, income levels, penetration, distances from nearest towns, etc.

The Indian rural market with its vast size and demand base offers a huge opportunity that MNCs cannot afford to ignore. With 128 million households, the rural population is nearly three times the urban population. According to Mr. D. Shivakumar, Business Head (Hair), Personal Products Division, Hindustan Lever Limited, the money available to spend on Fast Moving Consumer Goods (FMCG) products by urban India is ₹ 49,500 crores as against is ₹ 63,500 crores in rural India. The importance of the rural market for some FMCG and durable marketers is underlined by the fact that the rural market accounts for close to 70 % of toilet-soap users and 38 % of all two-wheelers purchased.

Notes

About 70% of India's population lives in 627000 villages in rural areas. According to the NCAER study, there are almost twice as many 'lower middle income' households in rural areas as in the urban areas.

1. At the highest income level there are 2.3 million urban households as against 1.6 million households in rural areas.
2. Middle and high-income households in rural India is expected to grow from 80 million to 111 million by 2007.
3. In urban India, the same is expected to grow from 46 million to 59 million. Thus, the absolute size of rural India is expected to be double that of urban India.

The above figures are a clear indication that the rural markets offer the great potential. The study on ownership of goods indicates the same trend. It segments durables under three groups – (1) Necessary products – transistors, wristwatch and bicycle (2) Emerging products – B&W TV and cassette recorder (3) Lifestyle products – CTV and refrigerators. Marketers have to depend on rural India for the first two categories for growth and size. Even in lifestyle products, rural India will be significant over the next five years.

7.4.1 Problems Need to be Addressed

Despite its a vast untapped potential, it should also be recognised that it is not that easy to operate in rural markets because of several problems. Rural marketing is a time-consuming affair and requires considerable investment in terms of evolving appropriate strategies with a view to tackle the problems.

The major problems of marketing in rural India are:

1. ***Poverty:*** A large number of rural population still lives under the poverty line and even those who are above poverty line are living hand-to-mouth. Only a small segment of each village can afford anything beyond basic necessities. Thus underdeveloped people and consequently underdeveloped markets by and large characterise the rural markets. Even though about 33-35% of gross domestic product is generated in the rural areas it is shared by 74% of the population. Hence the per capita incomes are low compared to the urban areas. Vast majorities of the rural people are tradition bound, fatalistic and believe in old customs, traditions, habits, taboos and practices.
2. ***Lack of Proper Roads:*** Nearly 50% of the villages in the country do not have all weather roads. Physical communication of these villages is highly expensive. Even today most villages in the eastern parts of the country are inaccessible during the monsoon.
3. ***The Unevenly Scattered Population:*** India's rural population is scattered in more than six lakh villages. Of these only 6,300 villages have a population of more than 500. This makes the work of a marketer very cumbersome.
4. ***Many Languages and Dialects:*** Even though the number of recognised languages are only 16, more than 850 dialects thrives in the country. The number of languages and dialects vary from state to state, region to region and probably from district to district and even from village to village. Communication is thus a tough task, forcing rural markets to concentrate more on images than words.
5. ***Low Levels of Literacy:*** The literacy rate is low in rural areas as compared to urban areas. The print medium becomes ineffective and to an extent irrelevant in rural areas since its reach is poor.
6. ***Spurious Brands:*** Spurious brands are a serious problem faced by marketers. Local organizations take advantage of illiteracy among villagers and launch a multitude of

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local variants that are cheaper but look like the original product. There are many Colgates, Lifebuoys (imaginary names), etc., and their packing is similar to the original brands. These brands give a good margin to retailers so Colgate loses its sales to Colgate.

7. ***Less Retail Outlets:*** In rural markets there are few retail outlets and most villages don't even have any, except maybe a pan-bidi shop. In this situation the bargaining power of retailers increases because they play a critical role in selection of the brand by a village consumer. These retailers also keep few brands, particularly those which give them a higher margin. And their products can sometimes be fake.

8. ***Seasonal Demand:*** Demand for goods in rural markets depends upon agricultural conditions. To an extent, it depends upon the blessings of mother-nature. Even if mother nature blesses the farmer with good rains, demand is not round the year but only at the time of harvesting.

9. ***Different Way of Thinking:*** There is a vast difference between the lifestyle of the urban and rural populations. Governed by tradition and generally resistant to change the rural mind represent different paradigm of thinking.



Notes

Distinctive Features of Rural and Urban Markets

Attribute	Rural	Urban
Population Density	Low	High
Occupation	Agriculture	Trade, Industry, Service
Economy	Closed and less Monetized	Open and Monetized
Infrastructure	Poor and Weak	Abundant and Strong
Attitude to Modernization	Tradition bound	Ready for Adaptation and Change
Family Structure	Joint	Nuclear
Possession of House Hold Assets	Low	High
Mobility	Low	High
Literacy	Low	High
Exposure	Low	High
Attitude to Life	Fatalistic	Scientific
Manufacturing Activity	Low	High
Distribution Outlet	Fewer	More

Source: Dogra, B.S., Marketing Management and Rural Marketing, Commonwealth Publishers, New Delhi, 1990

7.4.2 Corporate Projects in Rural Areas

Project Shakti

Project Shakti is a Hindustan Lever Ltd (HLL) rural self-help group initiative to push the penetration of its products to reach areas of low access and low market potential.

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Concept

The project is a retail/distribution model that HLL established in late 2000 to sell its products through women self-help groups who operate like a direct-to-home team of sales women in inaccessible areas where HLL's conventional sales system does not reach.

Strategy for Success

Social Angle: Create "income-generating capabilities for underprivileged rural women by providing a sustainable micro-enterprise opportunity". To improve rural living standards through "health and hygiene awareness".

Commercial Angle: Creating opportunities to increase rural family incomes and putting more money in their hands to purchase the range of daily consumption products, from soaps to toothpastes that HLL makes. It also enables HLL access to hitherto unexplored rural markets.

Modus Operandi of Project

1. To start, the Shakti woman borrows from her SHG (Self Help Group) and the company itself chooses only one person. With training and hand-holding by the company for the first three months, she begins her door-to-door journey selling her wares.
2. A Shakti entrepreneur receives stocks at her doorstep from the HLL rural distributor and sells direct to consumers as well as to other retailers in the village.
3. Each Shakti entrepreneur services 6-10 villages in the population strata of 1,000 - 2,000 people.
4. Typically, a Shakti entrepreneur sets off with 4-5 chief brands from the HLL portfolio - Lifebuoy, Wheel, Pepsodent, Annapurna salt and Clinic Plus. Other brands which find favour with a rural audience are: Lux, Ponds, Nihar and 3 Roses tea.

The women avail of micro-credit through banks. Some of the established Shakti dealers are now selling ₹ 10,000 – ₹ 15,000 worth of products a month and making a gross profit of ₹ 700 – ₹ 1,000 a month. Each Shakti dealer covers 6-10 villages, which have a population of less than 2,000. The company is creating demand for its products by having its Shakti dealers educating consumers on aspects like health and hygiene.

A pilot project (christened Project Shakti) was launched in Nalgonda in December 2000 in a small cluster of 50 villages with 50 SHGs and 3 MACTS (Mutually Aided Co-operative Thrift Society, a federation of around 20 SHGs).

E-Choupal

"Take a remote village. Go to the smallest farmer there. Educate him in the best farming techniques. Inform him about daily whether conditions and price movements in the market. Make available to him at his doorsteps the best possible seeds, pesticides and fertilizers at the most competitive prices. And when the crop is ready, help him find the best buyer. Sounds tedious? Imagine doing all this in 30,000 villages across six states season after season, year after year, that too with profits." (India Today, Dec. 13, 2004)

One fine morning S. Sivakumar, Chief Executive of Agri-business (ITC) approached ITC Chairman Yogesh Deveshwar with an ambitious idea in 2000. Sivakumar initially requested for ₹ 50 Lakh to test the idea among Soya farmers in Madhya Pradesh. Deveshwar granted him ₹ 10 crore. The project started with a pilot in June 2000 in Madhya Pradesh with Soybean farmers.

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Currently, it covers six states, and multiple commodities like prawns, cotton and coffee with 4,000 Choupals. The rest is history. ITC's E-Choupal did in a short time what the Indian government couldn't do in 55 years, i.e., smoothing of the distribution network of agriculture produces.

In a selected village ITC installs a computer with solar-charged batteries for power and a VSAT Internet connection. A local farmer called Sanchalak (conductor) operates the computer on behalf of ITC, but exclusively for farmers. The e-choupal offers farmers and the village community five distinct services:

1. ***Information:*** Its gives daily weather forecast, information about prices of various crops, e-mails to farmers and ITC officials, news and any other information-all this in the local language, free of cost.
2. ***Knowledge:*** It provides knowledge about modern farming techniques and methods specific to each crop and region; knowledge about soil testing, expert advice that is mostly sourced from agriculture universities, etc., all for free.
3. ***Purchase:*** Farmers can buy seeds, fertilizers, pesticides, and a host of other products and services ranging from cycles and tractors to insurance policies, banks, and cafeteria to FMCGs.
4. ***Sales:*** At harvest time, ITC offers to buy the crop directly from any farmer at the previous day's closing price; the farmer then transports his crop to an ITC processing centre where the crop is weighed electronically and assessed for quality. The farmer is then paid for the crop and given a transport fee. "Bonus points," which are exchangeable for products that ITC sells, are given for crops with quality above the norm. In this way, the e-Choupal system bypasses the government-mandated trading mandis.

   Farmers selling directly to ITC through an e-Choupal typically receive a higher price for their crops than they would receive through the mandi system, on average about 2.5% higher (about US$6 per ton). The total benefit to farmers includes lower prices for inputs and other goods, higher yields, and a sense of empowerment. At the same time, ITC benefits from net procurement costs that are about 2.5% lower (it saves the commission fee and part of the transport costs it would otherwise pay to traders who serve as its buying agents at the mandi) and it has more direct control over the quality of what it buys.
5. ***Development Work:*** NGOs working for cattle breed improvement and water harvesting, and women self-help groups are also reaching villages through e-choupals. In some states, farmers can even access their village. ITC is also planning to give health services through e-choupal.

7.5 Business Ethics

Business ethics refers to the measurement of business behaviour on standards of right and wrong, rather than relying entirely on principles of accounting and management. Ethics is not merely desirable but is also essential for the smooth functioning of a business. If businesses don't follow ethics it will be difficult to build trust; and there will be no scope for business. Ethics has a role in a buyer and seller relationship, or even for a competitor relationship. Its objectives of ethics are:

1. Studying human behaviour and making an evaluative assessment about them as moral or immoral (diagnostic goal) beings.
2. Establishing moral standards and norms of behaviour.

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3. Making a judgment upon human behaviour based on these standards and norms.
4. Prescribing moral behaviour and making recommendations about how to or how not to behave (therapeutic goal).
5. Expressing opinions or attitudes about human conduct in general.



Example: Matsushita Electric Co. follows a value system of the Seven 'Spiritual' Values:

1. National Service through Industry
2. Fairness
3. Harmony and Cooperation
4. Struggle and Betterment
5. Courtesy and Humility
6. Adjustment and Assimilation
7. Gratitude

7.5.1 Characteristics of Ethics

1. Ethical decision differs with individual perspectives of different persons. Each person has its own perception and believes in ethics. Hence, ethical decisions do not have unique solutions but have a multitude of alternatives.
2. Ethical decisions affect a wide range of other situations as well. Similarly, unethical decisions do not culminate in themselves, but have widespread ramifications.
3. Most ethical decisions involve a trade-off between costs incurred and benefits gained.
4. Often, the consequences of ethical decisions are not clear. They are ambiguous in nature. Similarly, it is not clear what the consequences of an unethical decision will be either of an individual or of an organisation.
5. Ethical decisions have long-term impact. They may produce bitter results in the short term such as loss on sales, but in the long run, they reap not only good results but t benefits that will persevere for long term.
6. Such as high quality management may affect bottom line in the short run but it in long term it the product leaves a lasting impression on the mind of the prospective customer.
7. Every person is individually responsible for the ethical or unethical decisions and actions that he or she makes. But the consequences of those decisions have to be faced and borne by the whole organization.
8. Ethical decisions are voluntary human actions. A person cannot escape his personal liability by saying he committed an act because of a senior's pressure.

7.5.2 Sources of Ethics

Sources of ethics are:

1. ***Genetic Inheritance:*** There are persuasive evidence and arguments suggesting that the evolutionary forces of natural selection influence the development of traits such as cooperation and altruism, which lie at the core of ethical system. The home is the first school of ethics, and he foremost. The more ethical the parents, the higher the chances that

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their children will follow those ethics. Ethics are passed from one generation to another, and the process goes on.

2. ***Religion:*** Religion plays a critical role in deciding ethics. Before the dawn of law, it was religion that played the role of imposing restrictions on unsocial activities. Even today also, a common man tries to abide by the ethics prescribed by his or her religion. The Brihadarayaka Upanishad states about the Karmavada:

   Yathakari, Yathachari tatha bhavati

   Sadhukari sadhur-bhavati, papakari papi bhavati;

   Punyah punyena karmaan bhavati, papah papena.

   [As it does, and as it acts, so it becomes: the doer of good becomes good, and the doer of evil becomes evil; he becomes virtuous through a virtuous act and vicious through a vicious act].

3. ***Culture:*** Culture also begets ethical standards. Culture genders to rules, customs and standards transmitted from generation to generation. Though culture differs from religion to religion, its ethical standards remain the same. Different places may have different cultures but no culture believes in dishonesty, or in deceiving or harming others. There are three aspects of culture:

   (a) *Universal, trans-cultural human values and ideas:* These are universal ideals expected of everyone, In its ideal form. As in almost all culture girls leaves the home of there parents after marriage.

   (b) *Culture specific, operative human values that translate ideals into actionable conduct in a given culture:* These are the cultural values a common man believes in for his day-to-day operations. In India, for instance, the 'mother' image is the most dominant. In India, even today, a father often does not touch his daughter's body once she attains puberty.

   (c) *Culture-specific, operative human values that derive from certain altogether different human ideals:* This predisposition contributes to the purity of mind and is a check against permissiveness and incest. In India it has translated into practical conduct through the tradition of a son or a daughter bowing down and touching the feet of his/her parents or by a student doing the same to a teacher.

4. ***Philosophical System:*** The philosophical system arising of a culture also influences ethics. Philosophers like Aristotle, Pluto, Shri Aurbindo, Swami Vivekanand, Subhash Chandra Bose, Swami Dayanand, and Mahatma Gandhi have left a lasting impact on ethics with their different school of philosophies.

   But there are differences of opinion too. On the one hand there is the ideology of Karl Marx, according to which it is unethical to do business to accumulate wealth. On the other hand, Mahatma Gandhi believed in business but preached trusteeship according to which a businessman should look after the welfare of his employees.



Example: Jamna Lal Bajaj, JRD TATA, G.D. Birla who were influenced by M. Gandhi adopted this philosophy and invested heavily on the welfare of employees.

On the other hand countries like China, the erstwhile USSR, etc., were influenced by the ideology of Karl Marx and declared business to be both unethical and unlawful in their respective countries. Vivekananda has given great importance to the means of achieving results:

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"With means a right end must come… if we take care of the cause the effect will take care of itself. The realisation of the ideal is the effect. The means are the cause: attention to the means is therefore is the great secret of life."

5. ***The Legal System:*** Laws represent a rough approximation of a society's ethical standards. Thus, society regards activities such as hoarding, black marketing, cheating, giving wrong information, etc., as unethical and there exist laws to curtail such activities. There are also laws against exploitation of labour, sexual harassment, etc., and all these activities are considered unethical.

6. ***Codes of Conduct:*** Steiner and Steiner identify three primary categories of such codes. The first are company codes that work on common belief and are highly generalised.

   The second are a company's operating policies that often contain an ethical dimension. These include policies regarding customer complaints, hiring and other decisions. These serve as a guide to one's conduct and also act as a shield by which the employee can protect against unethical advances from those outside the firm.

   Third, many professional and industry associations have developed their codes of ethics, such as in Indian Association of Advertising Agencies developing a code of conduct for the advertising business.

7.5.3 Ethics and Profits

One of the Business Round tables in the US had introduced a survey report on corporate ethics, which included among others, the following pointers:

One of the myths about business is that there is a contradiction between ethics and profits. The myths are thoroughly debunked by the attitudes and action of top managers in the companies that contributed to this report. There is a deep conviction that a good reputation for fair and honest business is a prime corporate asset that all employees should nurture with the greatest care.

Ethics and profit go together. It may be possible that in the short run, an organisation steals an advantage or good profits by unethical means. But ethics are the values that last. For instance, an organisation may garner good sales initially by disseminating false messages about the product. But it will not get repeat sales and will earn a bad name in the process.



Example: In India a few years back, TUFF shoes launched an advertisement featuring Milind Soman and Madhu Sapre where both were naked, covered only by a snake and wearing TUFF shoes. This advertisement gave them instant publicity and soon TUFF shoes became a household name in India. But all this sleazy publicity was in vain as TUFF shoes failed to generate much sales. In fact this advertisement earned a bad name for TUFF shoes and even after many years, the company is struggling to obtain decent sales.

Take the case of Reliance Infocom that was launched in India with a big bang. The company initially generated good sales as it adopted every sales gimmick, like frequent changes in price and tariffs and frequent changes in policy. Even frequently changed its policy regarding its distribution network, which resulted in losses to thousands of youth who had become their distributors. All this gave them initial sales and finance but also a rotten image. This influenced their sales and profits adversely.

By the late 1990s, the Indian automobile market was totally dominated by MNCs like Hyundai, Daewoo, and Suzuki. At that time, Tata launched an indigenously developed car Indica and got a good name from day one. Even when critics did not appreciate the product, Indians, strong believers in Tata's ethics welcomed the product. This resulted in low expenditure in

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advertisements and high initial and repeat sales of the new product. This is true for any new product that Tata launches and has meant big profits over the years, not only from their existing product portfolio but with every new and prospective launch.

People prefer doing business with an honest person. This means ethical companies attract more suppliers and business contracts. GM and FORD followed a policy of many suppliers for the same product to increase their bargain power. They also used the threat of backward integration to increase their bargaining power. On the other hand, TOYOTA takes its suppliers as business partners and keeps the number of suppliers as low as possible. This helps them in R&D and in their production system. Instead of the need for bargaining power resulting only in threat, they achieved one of the lowest procurement costs in the automobile industry in the world through their cooperation.

Even dishonest people love to work for those who believe in ethics. Ethical companies attract more and good quality human resources, have low executive turnover, and less labour unrest. All this decreases cost and increases production, which results in high revenue and profits.

In totality, we can say that ethics aids in good sales, good relations with the industry and better human resources. All this, results in higher profits and long-term eminence.



Caselet

Act as an Agent and Knock out Ethics?

– Excerpt from article by C Gopinath

When companies try to balance their push for commercial success with what is acceptable professional behaviour, ethics can take a bit of a knock. Take, for example, the role of a sales agent. It is ok to pay a commission to an agent to push your product, but if the agent also happens to be an influential party in the transaction, then both the ethics of the company and that of the agent come into question.

When the agent is a legislator or a minister and the deal in question is a lucrative contract, then we will scream 'bribe' and drag people off to jail. Mr. W. Jefferson was recently sentenced to 13 years in prison in a corruption case where boxes of bribe money were found hidden in his refrigerator. A member of the US parliament at the time he was caught, he was to hand over this money to a Nigerian minister on behalf of a company that was looking for a contract in Nigeria.

What happens when the doctor behaves as an agent? That can even be as lucrative as treating patients, which incidentally gives them the leverage to act as agents. Doctors are regularly paid lavish fees by pharmaceutical companies to lecture to their peers on the benefits of a drug they endorse. In the health care reform that is being debated in the US, one of the bills under consideration requires pharmaceutical companies and medical device manufacturers to disclose the payments they make to doctors and other companies that provide continuing education to doctors. This is being hotly resisted! If transparency is a solution to prevent corruption, then any resistance to transparency must make you wonder about the intent of the action.

Source: thehindubusinessline.com



Task

Give examples of any two companies that had to suffer losses due to unethical business practices.

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7.6 Corporate Governance

Corporate governance has in recent years succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general. However, the concept of corporate governance is poorly defined because it potentially covers a large number of distinct economic phenomenon. As a result, different individuals have come up with different definitions that basically reflect their special interest in the field.

At its broadest, corporate governance comprehends the framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations. Relevant rules include applicable laws of the land as well as internal rules of a corporation. Relationships include those between all related parties, the most important of which are the owners, managers, directors of the board (when such entity exists), regulatory authorities and to a lesser extent, employees and the community at large. Systems and processes deal with matters such as delegation of authority, performance measures, assurance mechanisms, reporting requirements and accountabilities.

In this way, the corporate governance structure spells out the rules and procedures for making decisions on corporate affairs. It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring the performance of those objectives.

Corporate governance is the method by which a corporation is directed, administered or controlled. It includes the laws and customs affecting that direction, as well as the goals for which it is governed. The principal participants are the shareholders, management and the Board of Directors. Other participants include regulators, employees, suppliers, partners, customers, constituents (for elected bodies) and the general community.

7.6.1 Scope of Corporate Governance

Corporate governance covers the following functional areas of governance:

1. Preparation of the entity's (Company) financial statements
2. Internal controls and the independence of the entity's auditors
3. Review of the compensation arrangements for the chief executive officer and other senior executives
4. The way in which individuals are nominated for positions on the board
5. The resources made available to directors in carrying out their duties
6. Oversight and management of risk

7.6.2 Principles of Corporate Governance

Commonly accepted principles of corporate governance include:

1. ***Rights of, and equitable treatment of shareholders:*** Organisations should respect the rights of shareholders and help shareholders exercise those rights.
2. ***Interests of other stakeholders:*** Organisations should recognise that they have legal and other obligations to all legitimate stakeholders.
3. ***Role and responsibilities of the board:*** The board needs a range of skills and understanding to be able to deal with various business issues and to have the ability to review and

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challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.

4. ***Integrity and ethical behaviour:*** Organisations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision-making.

5. ***Disclosure and transparency:*** Organisations should clarify the role of the board and the management and the same be conveyed to the public. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organisation should be timely and balanced to ensure that all investors have access to clear, factual information. Transparency is the best principle of corporate governance.

7.6.3 Role of Corporate Governance

The role of effective corporate governance is of immense significance to the society as a whole. It can be summarised as follows:

1. Corporate governance ensures the efficient use of resources.
2. It makes the resources flow to those sectors or entities where there is efficient production of goods and services and the return is adequate enough to satisfy the demands of stakeholders.
3. It provides for choosing the best managers to administer scarce resources.
4. It helps managers remain focused on improving performance and making sure that they are replaced when they fail to do so.
5. It pressurises the organization to comply with the laws, regulations and expectations of society.
6. It assists the supervisor in regulating the entire economic sector without partiality and nepotism.
7. It increases the shareholders' value, which attracts more investors. Thus, corporate governance ensures easy access to capital.
8. As corporate governance leads to higher consumer satisfaction, it helps in increasing market share and sales. It also reduces advertising and promotion costs.
9. Employees are more satisfied in organizations that follow corporate governance policies. This reduces the employee turnover, which results in the reduction in the cost of human resource management. Only a satisfied employee can create a satisfied customer.
10. Corporate governance reduces the procurement and inventory cost. It helps in maintaining a good rapport with suppliers, which results in better and more economical inventory management system.
11. Corporate governance helps in establishing good rapport with distributors providing not only better access to the market, but also reducing the cost of production.

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Corporate Governance Performance of the Firm

In its 'Global Investor Opinion Survey' of over 200 institutional investors first undertaken in 2000 and updated in 2002, McKinsey & Co. found that 80% of the respondents would pay a premium for well-governed companies. They defined a well-governed company as one that had mostly external directors with no management ties, undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues. The size of the premium varied by market, from 11% for Canadian companies, to around 40% for companies where the regulatory backdrop was least certain. The Basel Committee has issued several papers on corporate governance, in which the importance of corporate governance is emphasised. These papers suggested the following practices to avoid governance problems in banking organizations, and are applicable to all organizations:

1. Establishing strategic objectives, setting up corporate values, and communicating them across the banking organization.
2. Setting up and enforcing a clear line of authority and responsibility.
3. Ensuring that the board members are well qualified and not subject to pressure.
4. Ensuring that the board has a clear understanding of their role in corporate governance.
5. Ensuring that there is appropriate overseeing by the senior management.
6. Effectively utilising the work done by internal and external auditors, in recognition of the important control function they provide.
7. Ensuring that the compensation approaches are consistent with the organization's ethical values, objectives, strategy, and control environment.

7.6.4 Corporate Governance in India

In India, corporate governance has matured well and today we have the privilege of the New York Stock Exchange citing Infosys Technologies, an Indian company, as a role model regarding disclosure of information to shareholders. Good corporate governance is good business because it inspires investors confidence, which is essential in attracting capital. In India corporate governance is not a new concept. The roots of Indian working ethos lie in values. India has never judged an individual's esteem according to his wealth and power, but has always valued his virtue, learning and character. Even Kautilya's Arthashashtra holds opinion on corporate governance, wherein he states:

"Only if a king himself is energetically active, do his officers follow him energetically. If he is sluggish, they too remain sluggish. And besides, they eat up his works. His enemies thereby easily overpower him. Therefore, he should dedicate himself energetically to activity. The vow of the king is energetic activity, his sacrifice is constituted of the discharge of his own administrative duties; his sacrificial fee (to the officiating priest) is his impartiality of attitude towards all; his sacrificial consecration is his anointment as king". (Arthshastra 8.2)

It is thus put forth quite obvious that Indians used to believe in high moral and social standards. In modern times Mahatma Gandhi gave the principle of "Trusteeship" which can be an ideal of corporate governance. Gandhi said that an entrepreneur is a trustee of the organization and of its employees and he should look after the organization and employees as their trustees.

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In the present scenario, India is reinventing the principles of corporate governance.



Example: Scams like the share market scams post-liberalisation in 1991, failure of banks like the Global Trust Bank, Lala Kashinath Bank, issue of the age of directors at Tatas, the UTI fiasco are examples where corporate governance in order can play a role.

Also, the option of share buyback, big remunerations and perks enjoyed by top management, instances where most of the businesses where the Chairman and Managing Director is the same person, and in cases where the son becomes the CEO, there is an urgent need of ethical Corporate Governance to protect the rights and safeguard the interest of small shareholders and other stakeholders.

In purview of this situation, the government and the industry took a step to be more accountable. Both tried at their level to make Indian business more responsible to the shareholders. The result was the constituents of various committees by the CII and SEBI. Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance (a voluntary code published by the CII), and the first formal regulatory framework for listed companies specifically for corporate governance, established by the SEBI. This resulted in the amendment in the Companies Act to introduce effective Corporate Governance in India.

7.7 Corporate Social Responsibility

The socio-economic obligation of business refers to its responsibility in preventing to prevent economic consequences of business from adversely affecting public welfare. Social-human obligation denotes to the obligation of business to nurture and develop its human resources so that employees get every opportunity to grow, develop and advance through life and their careers and to promote human values within the organization.

Keth Devis has defined social responsibility in the following words:

"Social responsibility refers to the businessman's decision and actions taken for reasons at least partially beyond the firm's direct economic or technical interest."

7.7.1 Responsibility towards Shareholders

People invest in money to make money. Milton Friedman claims that the ethical mandate of business is to increase shareholders' profit. The primary responsibility of business is to increase shareholders' wealth, to give good returns on investment, to give dividends at the proper time, to protect the interests of even small shareholders, to listen to and respect shareholders, to regularly invite shareholders to participate in decision-making.

So the basic responsibility of a business towards shareholders is to create wealth for them. Economic Value Added analysis is an effective tool to measure the increment in shareholder's wealth. Economic values added are increments in the shareholder's wealth beyond its expected return. Debt has its cost in terms of interest, but in financial terms equity does not has any cost. So in EVA, Equity costs are the risk-adjusted rate of return that investors should expect from this type of investment.

Could be met and above this it is EVA and if it is below this then company may be in profit but in terms of EVA it is decreasing shareholders wealth. These expected returns should be met and if returns are above that, EVA is positive and if it is lesser than EVA is negative. That is, the firm may be in profit but it is not meeting expectations.

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7.7.2 Responsibility towards Employees

The Success of an organization is dependent on its employees. Gone are the days when employees were the most neglected resource of the organization. Today, HRM is the Critical Success Factor for the success of all industries, be it Old Economy industries like steel, cement or FMCG or New Economy ones like BPOs and software services. Organizations have many responsibilities, towards their employees:

1. Fair treatment
2. No discrimination on the basis of sex, caste or creed
3. Fair wages
4. Fair appraisal system
5. Healthy and safe working environment
6. Establishment of fair work standards and norms
7. The provision of labour welfare facilities
8. Fair opportunity for accomplishment and promotion
9. Proper recognition, appreciation and encouragement of special skills and capabilities of the workers
10. Installation of an efficient grievances handling system
11. An opportunity for participating in managerial decisions to the extent desirable
12. Proper training and development programmes so that workers can develop themselves according to a changing environment
13. ***Family Welfare:*** That is, if workers have lesser problems in their family life, their productivity will be higher. It is for this reason that Tatas have invested a lot in family welfare of its employees. JRD Tata has also won UNESCO's world population award. JRD invested a lot in making his employees understand about family planning, which ultimately resulted in happier families among the employees.

Most of India's work force is employed in the private sector. Imagine, if every private sector pays attention on family planning, it would be a great born to the organisation, apart from benefiting the country.

7.7.3 Responsibility towards Consumer

1. Providing products of proven quality
2. Regular R&D to augment the product and to innovate
3. To ensure that product reaches the customer and to check any sort of black marketing or profiteering by middlemen and anti social elements
4. To supply goods at reasonable prices
5. To provide required after-sale services, and to ensure that spare parts should be available in the market
6. To fulfil its commitments impartially and courteously, in accordance with sound and straightforward business principles
7. To provide sufficient information about the product, including its adverse effects, risks and the care to be taken while using the product

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8. To ensure that the product supplied does not have any adverse effect on the customer
9. To hear and redress the genuine grievances of customers
10. To avoid any type of cartel formation that a attempts to reap monopoly profits.

7.7.4 Responsibility towards Community

1. To prevent environmental pollution and to prevent ecological imbalance
2. Improve the efficiency of business operations
3. Contributing to research and development
4. Development of backward areas
5. Promotion of small scale industry
6. Development of region in which they are operating
7. This includes working on development of schools, social awareness programmes, adult education, health, medical facilities, helping NGOs and the government for social causes such as the Pulse Polio Mission, etc.
8. Taking steps to conserve scarce resources and developing alternatives, wherever possible.

7.7.5 Major Social Responsibilities of a Business

1. ***Optimum Utilisation of Scarce National Resources:*** All corporations must use resources judiciously and not waste, misutilise, damage or cause to deteriorate the resources at its disposal. It is essential in an energy/power scarce country like India. Not only this, business should develop alternative sources of energy and power.



Example: ITC uses wind power for some of its projects, while Mahindra and Mahindra spends on research an alternatives fuels.

Reliance is a classical example of efficient utilisation of resources as it uses by-products and waste of one project in another. Its petrochemical plants and refineries are so integrated that they use each other's products.

2. ***Responsibility Not to Make Losses:*** A loss-making unit is a burden on society. It should not only conserve resources of the society but perform its duty towards the customer by providing better products, towards the shareholder by creating wealth, towards the society by utilising its resources well, and towards its employees by not meeting better HR standards.

   Most PSUs that make losses but are kept alive in the name of socialism and employment, are basically a burden on society. Their losses are met by taxing the society. One can say that society pays higher taxes to subsidies the inefficiencies of PSUs. The question arises, why should they?

3. ***Improved Quality of Life:*** An organization should help improve the society's standard of living, which is based on financial power and material growth.
4. ***Responsibility of Employment and Income:*** Every business should make provisions for the payment of fair wages, satisfactory working conditions, steady employment and job security, prospects for promotion, growth and development of workers, and also take adequate measures for employee welfare.

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5. ***Offering Quality Products at Fair Prices:*** Business is all about creating customers, and the customer can only be created when customers are satisfied. Customers can be satisfied when they are provided with value-added products at fair prices, after sales services, timely information, and when the product reaches the right customer, etc.

6. ***Environmental Protection:*** Industrialisation is doing much irreparable harm to the environment. It is therefore an obligation on them to not only morally, but also legally undo the damage by taking serious and responsible steps to protect the environment and to keep it healthy condition.

   They should adopt modern technology to ensure that their operations do not harm the environment. Businesses should also take actions to educate their employees and people about the environment in general.

7. ***Fair Trade Practices:*** Fair trade practices of business include:

   (a) Avoidance of formation of cartels or following monopolistic practices.

   (b) By creating shortages for the purpose of black marketing and speculation.

   (c) By exaggerating and making false statements regarding claims.

   (d) Not buying political favours to sway decisions in its favour.

   (e) Following healthy competition with competitors by not indulging in industrial espionage or other unethical means.

   (f) Not deliberately making the organization sick to avoid obligations or to escape from responsibilities.

   (g) Not to involve in insider trading or to take undue advantage of inside information.

   (h) Not bribing public servants and corrupting the democratic structure of the country.

   (i) Paying taxes, duties and other dues honestly and on time.

   (j) To provide required information to shareholders and all other stakeholders.

   (k) Making timely payment of borrowings and interest.

   (l) While dealing with suppliers, instead of using their bargaining power, corporations should invest in good relations with them. This will help suppliers maintain quality and develop new products for the organization. This may appear to be costly initially but it ultimately pays. The Japanese usually believe in establishing a good rapport with their suppliers.

   (m) Not adopting a communication strategy that is not compliant with social norms.

   (n) Business should abide by the laws of the land.

8. ***Local Development:*** Businesses use resources of the society are therefore responsible for the development of their surrounding areas. A business can perform various functions to develop its local area. In fact, if every business house takes responsibility of some villages, miracles can happen in India.



Example: Business houses like Tata Chemicals, ITC and HLL are doing so. Cooperatives like IFFCO are also following this concept. These business houses adopt some village and construct roads, spread literacy, ensure health programmes, promote family planning and other social reform programmes, help farmers in agriculture and marketing of their products, and promote the handicraft and cottage industry of the villages. HLL is giving employment and empowerment to the women of villages through its operation Shakti and ITC is revolutionising the village distribution system through its e-choupal system.

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7.7.6 Arguments for Corporate Social Responsibility

The major arguments supporting a role for the social responsibility of business are as follows:

1. ***Public Expenditure:*** There is a deep conviction within sections of the public that business has a clear obligation towards the greater good of the society.
2. ***Long Run Viability:*** If a business fails to meet this need, other groups will assume the responsibility and the power that goes with it.
3. ***Public Image:*** Socially responsible behaviour creates a positive public image for business.



Example: Tata and Birla enjoy a very good image among people because of their social welfare programmes.

4. ***Better Environment:*** Businesses can create a better environment, which will be more conducive to future business success.
5. ***Avoidance of Government Regulation:*** If business is perceived as meeting its social obligations, costly and restrictive government regulations can be avoided.
6. ***Balance of Responsibility and Power:*** Since a business already has a great deal of social power, its social responsibility should be of equal importance.
7. ***Let Business Try:*** Since other social institutions have failed to resolve many social problems, it's time to give business a try.
8. ***Business has the Resources:*** Business has a reservoir of capital and expertise that has great potential for public service.
9. ***Problems can become Profit:*** If the innovative skills of businesses can be applied to social problems, some efforts might lead to profits in the traditional business sense.
10. ***Prevention is Better than Cure:*** If there are any further delays in resolving social problems they are only going to become worse.
11. ***Shareholder Interest:*** Businesses will prosper from an improved social environment.

7.7.7 Arguments against Corporate Social Responsibility

The major arguments against assumption of broad social responsibilities include:

1. ***Loss of Profit Maximization:*** Diverting resources away from the firm to socially responsible programmes undermines the principles of the competitive market and deprives shareholders of rightful economic gain.
2. ***Cost:*** Social obligations can be very expensive and may render firm unable in going for attractive business investment; or it may even have to go out of business.
3. ***Lack of Skills:*** Most of businessmen do not have the requisite skills and training to work effectively on social issues.
4. ***Dilution of Purpose:*** The pursuit of social goals may dilute the economic productivity of the firm.
5. ***Too Much Power:*** Business can be said to already possess much power without encouraging it to increase its social influence.

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6. ***Lack of Broad Support:*** There is lack of pubic support for corporate social responsibility and this condemns it to failure.

7. ***Lack of Accountability:*** There is no way to hold a business accountable for the outcomes of its social programmes, once instituted.

(Both for and against arguments are given by Schermerhorn)

7.7.8 Social Responsibility and Profits

One of the biggest arguments against social responsibility is its cost and bearing on profitability. Organizations exist for profit and their philanthropy can reduce profits. Laura P. Hartman has rightly said:

"The problem of business and for business ethics is the equation of business money, specifically bottom line accounting profits, and the pressure to increase those profits quarterly and annually. The organization is structured, people are hired, jobs are described, managers are held accountable, raw materials are acquired, and technology engaged to increase that bottom line. Everything and everybody within the company is directed by that profit maximizing principle and expected to conform to its demands."

Laura P. Hartman (Perspective in Business Ethics, p. 243) Tata McGraw Hill 2003.

In a 1970 New York Times Magazine article, Friedman wrote his now well-known argument that a business's social responsibility is to its stockholders; therefore its main objective is to increase profits.

In 1967, Carr argued that business is a game in which there are certain rules. He held that a person should set aside personal ethics and values in order to meet the needs of the corporation. But reality is some thing else. In fact, profit is a natural end of meaningful social responsibility.

Any sales promotion technique may reap short-term profits but fulfilling social responsibility results in long term gains. Managing and performing social responsibility not only yields profit but also results in competitive advantages:

Decreasing Cost: Social responsibility helps in reducing the cost per unit and increasing their efficiency and effectiveness. Training and development of employees increases their productivity. If they are happy at home, if their children are getting good education, and if they are healthy, their productivity goes up, leading to industrial peace, which also means an overall reduction in costs.

Not only this, such organizations also attract the best available human resource for their workforce, which again provide them a strategic advantage.



Example: TISCO hardly ever faced any industrial problem, only because of its healthy HR policy. As early as in 1970, JRD Tata educated his employees at TISCO about family planning. This resulted in economic and socially content families at TISCO. Indian organizations like Infosys, Wipro, TCS, etc., have conquered the world only because of their value-based human resource policy.

These are the companies where people dream about working. Today, if these companies have any competitive advantage, it is their human resources. We thus see that managing social responsibility gives a competitive advantage and bigger profits.

Brand Loyalty and High Sales: Social responsibility has a direct impact on brand loyalty sales and profit. In fact, many organizations have successfully used social norms for boasting their sales.

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Example: Surf Excel launched its campaign for water conservation with its "2 bucket pani bachao" line. Whisper advertised that every time you purchase their product, a certain amount would go towards charity. All this resulted in more sales.

SHELL invested heavily on environment conservation, which makes its image as an environment friendly company.

It can thus be seen that while corporate social responsibility reduces costs, it also enhances sales and brand loyalty. What else does a business need?

Case Study

Narayan Murthy Committee: An Approach towards Corporate Governance

SEBI constituted a committee on corporate governance under the Chairmanship of N.R. Narayana Murthy. The committee included representatives from the stock exchange, chamber of commerce and industry, investor associations and professional bodies. They debated key issues and made recommendations as under:

1. All audit committee members should be 'financially literate'. At least one member should possess accounting or related financial management expertise.
2. Mere explanation as to why a company has followed a different accounting standard from the prescribed standards will not be sufficient.
3. Board members should be informed about risk assessment and risk minimisation procedures.
4. Board members should be trained in the business model of the company as well as the risk profile of the business parameters, their responsibilities as directors, and the best way to discharge them.
5. Use of proceeds of IPO should be disclosed to the audit committee.
6. There shall be no nominee directors when a director is to be appointed on the board and such appointment shall be made by shareholders.
7. Compensation paid to Non-executive Directors may be fixed by the Board of Directors, limiting the maximum number of stock options that can be granted to non-executive directors in any financial year.
8. The performance evaluation of non-executive board members should be made by a peer group comprising the entire Board of Directors, and excluding the director being evaluated.

The Narayana Murthy Committee has identified about the correct approach for successful corporate governance. It has said:

"*Corporate governance is beyond the realm of law. It stems from the culture and mindset of management, and cannot be regulated by legislation alone. Corporate governance deals with conducting the affairs of a company such that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. It is about openness, integrity, and accountability. What legislation can and should do, is to lay down a common framework - the 'form' to ensure standards. The*

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'substance' will ultimately determine the credibility and integrity of the process. Substance is inexorably linked to the mindset and ethical standards of management."

From the government's side there have been swift moves through law and regulations made by the Department of Company Affairs (DOC) and SEBI to hasten the process of effecting improvements in a corporation's functioning. A number of provisions regarding corporate governance have been inserted in the Companies Act through Companies (Amendment) Act 2000. Important changes to improve Corporate Governance are:

1. Providing for director's responsibility statement [Section 217 (2AA)]
2. Board to report in cases where buyback was not completed within the time specified in sub-section (4) of Section 77.
3. Small shareholders to get a representation through a director (Section 252).
4. Limitations in directorships in companies (Sections 274 & 275).
5. Constitutions of audit committees.
6. Providing for higher penalties (tenfold increase) for offences provided in various sections of the Companies Act.

Questions

1. Critically analyse the Recommendations of the Narayan Murthy Committee.
2. How can one lead to good governance system in organisations?

7.8 Summary

- Society and culture primarily govern the lifestyle of an individual.
- Poverty is one of the main issues, attracting the attention of sociologists and economists. It indicates a condition in which a person fails to maintain a living standard adequate for a comfortable lifestyle.
- Out of India's total population of more than 1 billion, 350 to 400 million people are living below the poverty line. Nearly 75% of the poor people are in rural areas, most of them are daily wagers, landless laborers and self employed house holders.
- The phenomenal increase in the city populations is the main reason for poverty in the urban areas of India. A major portion of this additional population is due to the migration of the rural families from villages to cities.
- India as a nation is facing a massive problem of unemployment. Unemployment can be defined as a state of no work for a man fit and willing to work. It is a condition of involuntary and not voluntary idleness.
- The problem of unemployment has becoming a colossal. Various problems have caused this problem. There are individual factors like age, vocational unfitness and physical disabilities which restrict the people.
- The remedial measures for reducing unemployment may lay greater emphasis on creation of opportunities for self -employment, augmentation of productivity and income levels.
- Human development is a multifaceted and complex process. There are many dimensions along which development occurs and there are complex interdependencies and linkages between these dimensions.

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- The Indian rural market with its vast size and demand base offers great opportunities to marketers. Two-third of the country's consumers live in rural areas and almost half of the national income is generated here.
- Business ethics refers to the measurement of business behaviour on standards of right and wrong, rather than relying entirely on principles of accounting and management. Ethics is not merely desirable but is also essential for the smooth functioning of a business.
- Ethical decisions are voluntary human actions. A person cannot escape his personal liability by saying he committed an act because of a senior's pressure.
- People prefer doing business with an honest person. This means ethical companies attract more suppliers and business contracts.
- Corporate governance has in recent years succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general.
- Good corporate governance is good business because it inspires investors confidence, which is essential in attracting capital. In India corporate governance is not a new concept.
- The socio-economic obligation of business refers to its responsibility in preventing to prevent economic consequences of business from adversely affecting public welfare.
- The primary responsibility of business is to increase shareholders' wealth, to give good returns on investment, to give dividends at the proper time, to protect the interests of even small shareholders, to listen to and respect shareholders, to regularly invite shareholders to participate in decision-making.
- Industrialisation is doing much irreparable harm to the environment. It is therefore an obligation on them to not only morally, but also legally undo the damage by taking serious and responsible steps to protect the environment and to keep it healthy condition.

7.9 Keywords

Business Ethics: Measurement of business behaviour on standards of right and wrong

CII: Confederation of Indian Industries

Corporate Governance: Framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations

Corporate Social Responsibility: Decision taken for reasons at least partially beyond the firm's direct economic or technical interest

Cyclical Unemployment: Result of the trade cycle which is a part of the capitalist system

E Choupal: Initiative taken by ITC to smoothen the distribution network of agriculture produces

EVA: Economic Value Added

Involuntary Unemployment: When a person is willing to work, but is not getting work

Project Shakti: Rural self-help group initiative by HUL to push the penetration of its products

Seasonal Unemployment: When production season ends, the workers are rendered unemployed

Sudden Unemployment: Happens due to completion of work or some change in firm

Unemployment: State of no work for a man fit and willing to work

Voluntary Unemployment: Person is out of job of his own desire, doesn't work on the prevalent or prescribed wages.

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7.10 Self Assessment

State whether the following statements are true or false:

1. Poverty is a state when a person is considered to be following a low standard of living.
2. According to a survey, more members in a family means more income and thereby less poverty.
3. A person who is not working because he is not in a physical state to work is also considered voluntarily unemployed.
4. According to a report, giving credit to the people could eliminate poverty.
5. Rural markets serves as the biggest market for FMCG products.
6. Project Shakti works on a direct selling basis in the rural areas.
7. For making huge profits, firms have to forego their business ethics.
8. It is in the social responsibility framework of the companies to ensure quality goods to the consumers.

Fill in the blanks:

9. In order to ensure availability of food grains to the poor people, government had introduced……..
10. ……..sector sees more people involuntarily unemployed than other sectors.
11. Many people lost jobs during the current economic downturn that hit the globe. This was a case of ……. unemployment.
12. Products like washing machines are considered as ……. products in rural areas.
13. Some companies have a code of conduct that every customer should be treated equally irrespective of their status and purchase. This type of code is known as ……. code.
14. ……deals with the issue of senior subordinate and company-shareholders relationship.
15. According to Mahatma Gandhi, the business leader is the ……. of the business and its employees.
16. ……company had launched a child care initiative wherein which one rupee went for the education of children when we purchased their cards.

7.11 Review Questions

1. "Society and culture primarily govern the lifestyle of an individual". Comment.
2. "Most organizations try to position their products around social needs" Substantiate.
3. Compare the poverty situation of India, today and a decade back. What significant changes do you notice?
4. Examine the role of Indian Government in eradicating poverty.
5. "India as a nation is facing a massive problem of unemployment". Discuss.
6. Do you believe that there can be concept like voluntary unemployment? What is difference between cyclical and seasonal unemployment?

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7. "Unemployment can be defined as a state of no work for a man fit and willing to work." Do you find this definition correct? Justify.
8. "The computerization and automation has led to technological unemployment". What do you mean by this statement?
9. "Rural markets are critical for every marketer". Justify the statement.
10. Critically examine the role of E Choupal and Project Shakti in rural development.
11. "Ethics is not merely desirable but is also essential for the smooth functioning of a business." Discuss.
12. Suppose you are the advertising manager of a firm producing skin whitening creams. You know that kind of ads that are made are unethical but very essential for sales. How will you handle the conflict situation?
13. "Corporate governance is the method by which a corporation is directed, administered or controlled". Discuss.
14. Do you believe that Corporate Governance has matured in India? Justify your answer.
15. Towards whom does a business have its most important social obligation-employees, customers, community or shareholders? Explain the rationale behind your answer.

Answers: Self Assessment

1.	False	2.	False
3.	False	4.	True
5.	True	6.	True
7.	False	8.	True
9.	Public Distribution System	10.	Agriculture
11.	Cyclical	12.	Lifestyle
13.	Company	14.	Corporate Governance
15.	Trustee	16.	ITC

7.12 Further Readings



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Unit 8: Legal Environment

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Objectives

After studying this unit, you will be able to:

- Discuss the Monopolistic and Restrictive Trade Practice (MRTP) Act
- Explain the Intellectual Property Right (IPR) and Right to Information (RTI)

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Introduction

The legal environment in India is such that the Indian judiciary is known for its independence and extensive powers. The High Court or the Supreme Court in exercise of their constitutionally conferred writ jurisdiction is empowered strike down legislation on the ground of unconstitutionality. They can and fairly routinely intervene with executive action as well on the ground of unreasonableness or unfairness or arbitrariness in State action.

8.1 Monopolistic and Restrictive Trade Practice (MRTP) Act

The Directive Principles of our constitution suggest that ownership and control of material resources should be widely distributed and there should be no concentration of wealth and means of production. With this in mind, the Monopolistic and Restrictive Trade Practice Act, 1969, was enacted so as to:

1. ensure that the operation of the economic system does not result in concentration of economic power to the common man's detriment,
2. provide the control of monopolies,
3. prohibit monopolistic and restrictive trade practices.

The Act was amended in 1974,1980,1984,1988 and in 1991. The Act placed many restrictions on companies having assets of more than ₹ 100 crores in respect of new projects, expansion, diversification, mergers, and even in the appointment of directors.

8.1.1 Scope of MRTP

Before the 1991 amendment, the MRTP law sought to control the concentration of economic power by requiring undertakings that had assets over ₹ 100 crores and/or were 'dominant undertakings' to register themselves with the Monopolies and Restrictive Trade Practices Commission. If such an undertaking wishes to expand and enter a new line of production or to participate in mergers, amalgamations and takeovers, it to seek permission from the government.

MRTP controls the following aspects of economic activity:

1. Restrictive Trade Practices
2. Unfair Trade Practices
3. Monopolistic Trade Practices
4. Concentration of Economic Power.



Notes

Pre-entry Condition after the 1991 Amendment

Pre-entry restriction on MRTP companies hindered the rapid growth of industry and in turn of the economy. For rapid industrialisation, the Act was amended in September 1991 and all entry restrictions on MRTP companies i.e. companies having group assets of over ₹ 100 crores were removed. Now, the MRTP Act concentrates only on controlling and regulating the monopolistic, restrictive and unfair trade practices and concentration of economic power to a limited extent.

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8.1.2 Restrictive Trade Practice (RTP)

A Restrictive Trade Practice is one which has, or may have, the effect of preventing, distorting or restricting competition in any manner and in particular:

1. which tends to or obstructs flow of capital or resources for production,
2. which tends to impose unjustified costs or restrictions on consumers, relating to goods and services by manipulation of prices, or by conditions of delivery or to affect supplies in market.

The deemed RTPs are as follows:

1. ***Restrictions on Buying/Selling:*** This means restricting person or persons to whom goods may be sold or from whom to be bought. Such as Trade Associations that asks their members not to deal in goods of a particular manufacturer.



Example: Manufacturers restricting its distributor to appoint a sub-distributor or dealer without prior permission. A manufacturer restricting its dealers/distributors to supply goods to particular institutions or consumers. Distributors selling goods to third party without prior permission of the manufacturer, etc.

2. ***Tie in Sales or Full Line Forcing:*** This means requiring a person to purchase something else compulsorily, along with goods he wants to purchase.



Example: Such as forcing dealers to purchase orange drinks with cola drinks, or forcing purchase of gas stoves with gas connections, requiring dealers to maintain a minimum level of stock of the full range of products of the manufacturer, schools making it mandatory to buy uniforms and books only from their own shop, etc.

3. ***Exclusive Dealing Agreement:*** It is about forcing not to deal with goods other than those of the seller. For instance dealers not to deal with similar type of products of the competitor, or buyers force manufacturers not to manufacture identical goods for any other buyer without consent of the particular buyer, producers enter into a long term contract with an artist prohibiting him from giving performances anywhere else, agreements wherein a distributor will purchase goods only from the manufacturer or from some other as may be nominated by him.
4. ***Collective Price Fixation and Tendering:*** This is a collective agreement to purchase or sell or to tender only at agreed prices or terms. This is called 'cartel'. It is also called the Knock Out Agreement.



Example: When tyre or cement manufacturers, or some trade associations increase prices or restrict supply uniformly and simultaneously, by mutual agreement.

5. ***Restriction by Association:*** This is when associations don't allow non-members to carry the goods, thereby hampering free flow of goods, resulting in imposing unjustified costs on the customer.
6. ***Discriminatory Dealing:*** Giving concessions or benefits on the basis of turnover or giving huge discount to large buyers will be considered as RTP, if such discounts are injurious to competition. However, discounts are very common in business and many discounts are not considered as discriminatory as cash discount on prompt payment, discount to different classes of customers as government and private customer, incentive to increase sales, newspapers charging different rates for different pages of newspaper, etc.

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7. ***Resale Price Maintenance:*** This means not allowing resale below certain price or not to sell above a particular price. If maximum price is indicated, the dealer should be free to charge below the indicated price.
8. ***Restriction on Output or Supply:*** This means an agreement to limit, withhold or restrict the output or supply or any goods or allocate any market or areas for disposal of goods.
9. ***Restriction on Manufacturing Process:*** This means an agreement not to use a particular method, machinery or process in the manufacture of goods.
10. ***Price Control Arrangement:*** This means an agreement to sell goods with a view to eliminate competition or any competitor.
11. ***Restriction on Buying:*** To restrict the class or number of wholesalers, producers or suppliers for whom goods may be bought is an restrictive trade practices.
12. ***Collective Bidding:*** This means an agreement among the contenders for bid to be offered at auction or not to be bid at auction.
13. ***Agreement Declared by government to be restrictive:*** The government has powers to declare any agreement as restrictive on the recommendation of the Commission.

Besides all these, many others are treated as RTP.



Example: Such as Dumping of goods, deficiency in insurance services, insisting on collection of gas cylinders from shop, accepting deposits for supply without any possibility of supply, not providing a house as promised, failure to refund deposits, wide variations in prices in different regions, etc., are treated as restrictive trade practices.

Investigation into RTP

The MRTP commission will enquire into any RTP. If it finds that the trade practice is prejudicial to public, the Commission may give the following directions:

1. the practice shall be discontinued or shall not be repeated
2. agreement relating to RTP shall be modified as may be specified by MRTP Commission.

8.1.3 Monopolistic Trade Practices (MTP)

A Monopolistic Trade Practice is one that has or is likely to have any of following effects:

1. Limiting or controlling production, supply or distribution of goods or services and thereby maintaining price of goods or charge or service at an unreasonable price.
2. Unreasonably preventing or lessening competition.
3. Limiting technical development or capital investment or allowing quality of goods or services to deteriorate.
4. Unreasonably increasing prices of goods or services.
5. Unreasonably increasing the cost of production or charges for any services.
6. Unreasonably raising the profits on production, supply or distribution of goods or services.
7. Adopting unfair or deceptive methods to reduce or prevent competition in goods or services.

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If the MRTP Commission reports that the trade practice is against public interest, the government can order the following:

1. Regulating production, supply, storage or control of goods or services and fixing terms of sale, sales price and supply.
2. Prohibiting the undertaking from resorting to such trade practice, that reduces competition.
3. Fixing quality standards for goods.
4. Declaring some type of agreements as unlawful.
5. Asking any party to cancel the whole or part of any agreement.
6. Regulate profits that may be derived from production, storage, supply, distribution or control or goods or provision or services.
7. Regulate quality of goods or services.

Initiation of Inquiry by the Commission

The Commission can enquire into any restrictive, unfair or monopolistic trade practice (a) upon receiving a complaint from any consumer or a consumers' association, (b) on reference made by Central or state government, (c) on an application made by DGIR, (d) on its own.

8.1.4 Governing Body

MRTP Commission

The Central government provides its powers under Section 5 of the MRTP Act. As per the MRTP Act Commission, it is to consist of a chairman and not less than two and not more than eight other members. The chairman should be a person who has been or is qualified to be a judge of the High Court or the Supreme Court.

One time tenure of the office of a member is fixed for 5 years subject to renewal. However, no member can hold office for more than 10 years or beyond reaching age of 65 years (section 6).

Director General

The Central government has also appointed a Director General of Investigation and Registration. The main function of the Director General is to make preliminary investigation before an inquiry by the MRTP Commission and to maintain a register of agreements required to be registered under the Act.

Powers of the Commission

The MRTP commission has the following powers:

1. Power of a civil court under the Code of Civil Procedures, 1908, with respect to:
   (a) Summoning and enforcing the attendance of any witness and examining him on oath.
   (b) Discovery and production of any document or other material object producible as evidence.
   (c) Reception of evidence on affidavits.

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(d) Requisition of any public record from any court or office.

(e) Issuing of any commission for examination of witness and

(f) Appearance of parties and consequences of non-appearance.

2. Proceedings before the Commission are deemed as judicial proceedings within the meaning of Sections 193 and 228 of IPC.

3. To require any person to produce before it and to examine and keep any books, accounts or other documents relating to the trade practice in its custody.

4. To require any person to furnish such information with respect to the trade practice as may be required, or such other information as may be in his possession in relation to the trade carried on by any other person.

5. To authorize any of its officers to enter and search any undertaking, or seize any books or papers relating to an undertaking in relation to which the inquiry is being made, if the commission suspects that such books or papers are being or may be destroyed, mutilated, altered, falsified or secreted.

6. The Commission has the power to order compensation and damage, if a person is found (after enquiry), to be indulging in unfair, monopolistic or restrictive trade practice. An application can be made to the Commission for awarding compensation for loss or damage suffered due to such trade practice.

Restriction on the Powers of Commission

The Commission cannot restrict any right attached to a patent. It cannot order in respect of conditions attached by a patent holder to his licensee in India. Firms engaged in production, supply, distribution or control of goods for export exclusively cannot be restrained by the Commission. Trade unions and government undertakings engaged in defense production do not come under the purview of the MRTP Act. Judgments of High court are binding the MRTP Commission. It has no power to impose penalties though it can only issue 'cease and desist' order and can order compensation.

The MRTP Act was implemented in keeping with India's adopted political ideology of socialism. Its basic objective was to restrict the concentration of economic power by restricting and controlling the big companies, but in reality it only restricted and controlled the growth of Indian economy. If we examine developments the development up to 1990 we will find that much of the big business was in the hands of few business houses of India as they alone could mange to garner license for manufacturing.



Caution Restrictions on expansion resulted in a low level of production that resulted in high production cost and short supply, both of which are detrimental to the consumer.

As a result, India, which was an economic power in Asia at the time of its independence, soon fell way behind much smaller economies, like Japan and South Korea, which overtook us to emerge as economic giant.

In view of this, the thrust of the 1991 liberalisation removed those sections of the MRTP Act that required large undertakings to seek permission from the government before initiating any activity. The current version of the MRTP Act merely allows for the possibility of the government dividing undertaking or serving interconnections if it feels that such an action is in the 'public interest'. The role of the MRTP Commission remains confined to providing a suitable report – if

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asked to provide one. The government introduced a Competition Bill which is more suitable in a changed scenario.


Task

In your daily routine life, what offenses to the MRTP Act do you see? Have you ever taken any action against them?

8.2 Intellectual Property Rights (IPR)

In India, Intellectual Property Rights (IPR) fall under item 49 of list - the union list of the 7th Schedule to the Constitution. The items read - patents, inventions and designs; copyright; trademark; and merchandise marks. Patent are thus is a Union subject. Patent protection was first introduced in 18th century. Formal patent protection in Indian was introduced by Patent Act, 1911.

A patent is a grant of property rights by the government to an inventor. Patents are exclusive property rights that can be sold, transferred, willed, licensed or used as collateral, much like other valuable assets. In fact, most independent inventors do not commercialize their inventions or create new products from their ideas. Instead, they sell or license their patents to others who have the resources to develop products and commercial markets.

Patent law stipulate broad categories of what can and cannot be patented and in the words of the statute, any person who "invents or discovers any new and useful process, machine, manufacture, composition or matter or any new and useful improvement thereof, may obtain a patent."

8.2.1 New Patent Law [Patent (Amendment) Ordinance, 2005]

India has allowed its pharmaceuticals makers to copy drugs patented abroad since the early 1970s as long as they use different manufacturing processes. This helped a few drugs companies like Ranbaxy, Cipla, Kopran, etc., to rise into global challenges and made medications cheaper for the poorer masses who often need them. Most multinationals such as Glaxo-Smithkline Plc, Pfizer Inc., Novartis AG and Aventis, who have been forced to watch Indian firms eat into their market share, await the new environment with cautious optimism.

But following January 2005 and with the amendment of Indian Patent Act, 1970 through a midnight ordinance on December 31, 2004, India entered in a new phase of product patents.

Companies around the world have filed applications for one million international patents since the system began in 1978, the UN agency for intellectual property said. The US currently dominates patents applications filing with 205,286 applications since 2000; Japan is in second place with 70,513, followed by Britain with 25,916 and France with 24,278.


Example: According to WIPO (World Intellectual Property Organization) among individual corporations, Dutch manufacturer Philips Electronics NV is leading the way with 9,778 applications filed between 1995 and 2003. Siemens AG of Germany is in second place with 8,981, followed by Robert Bosch GmbH with 6,069 and P&G Co of the US with 5,841.

For a flat fee of 1,400 Swiss francs ($1,100) companies can file a request for patent protection in any of the 124 countries that have signed up to the system. WIPO registers the applications, publishes them and carries out an examination to determine whether the product or process applied for appears to be new. Alternative is to go to every country individually and apply for patent protection. (The Economic Times, 16 January)

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Indian behemoth Ranbaxy and Dr. Reddy's Lab bagged the largest number of US FDA approvals for generic drugs ahead of other global generic majors like Teva, Sandoz, Mayne and Bedford. Ranbaxy has already obtained the approvals for Clarithromycin along with Andrx and Roxane. It is also the only generic company till now to have received tentative approvals for Simvastatin and Pravastatin, whose patent expired in 2006. On the other hand, DRL has already secured the EMR for Ondansetron. The company has already secured tentative approvals for Finasteride along with Teva. (The Economic Times 18 December 2004.)

After the implementation of WIPO agreement, widespread changes are taking place in the industry. In accordance with WIPO agreement, India also promulgated the Patent (Amendment) Ordinance 2004. India has complied with the WTO negotiations by amending its Patent Act, 1970 in 1999 and also through Patents (Amendment) Act, 2002. The Patent (Amendment) ordinance was a further step in this direction.

Some of the important provisions and their legal implications in respect of product patents are as follows:

1. ***Patentable Subject Matter:*** According to the new ordinance, whatever falls within the purview of the definition of 'invention' will be patentable in India. The amendment to the Act in 2002 defines invention as "A new product or process involving an inventive step and capable of industrial application".

   Thus, if a product satisfies the tests of patentability, viz., novelty, inventive step (non-obviousness) and industrial application (utility) it can be patented in India.

   The second requirement of a patentable invention is that of novelty, which requires that the invention should not have been known to the public before the patent application was lodged. The novelty of an invention is determined by the patent examiner conducting a search of literature in the relevant field to determine what the state of the art was at the time of the patent application being filed.

   The novelty requirement also necessitates that the invention should not have disclosed publicly by the person applying for the patent. An example of the application of that rule is that the application must not have offered the product for sale before applying for a patent. The requirement of novelty is not actually as strict a limitation as one might suppose. If the invention simply combines two well known pre-existing products of techniques – say a method of encryption and a method of compression the combined invention is still likely to be considered as novel.

   Such an invention may however be found to lack an 'inventive step, which is the third and final requirement that a patentable invention has to fulfil. An invention that lacks a sufficient inventive step is one that would be obvious to a suitably skilled person, such as another programmer who had access to technical literature in the field.

   This comes with a certain exception. As under Section 3(j), "Plants and animals in whole or any part thereof (other than micro organism) including seeds, varieties and species and essentially biological process for the production of plants and animals – cannot be patented". This is in line with Article 27.3 of TRIPS. Under Section 3(d) of the Act, the mere discovery of any new property or new use for a known substance is not patentable.

   (a) *Farm Sector:* The new amendment has not categorically excluded seeds developed by novel means. The third amendment has extended the product patent regime, which includes seeds developed by novel means, particularly transgenic seeds.

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(b) *Software:* Software would now be patentable if embedded with hardware. Currently, the Intellectual Property Rights (IPRs) protection with regard to software is limited to copyrights. This means that software embedded in hardware application like mobile phones, TVs and computers are patentable.

Now it is possible to patent programmes for computers that when run on a compute produce a 'technical effect'. However, if a programme does not produce a technical effect when run on a computer, it is unlikely to be patentable. A technical effect is generally an improvement in technology and needs to be in an area of technology that is patentable. So any new software that can improve the functioning of washing machines automobiles, mobile phones or even computers can be patentable, but a simple spreadsheet for writing text still falls under the copy right regime.

(c) *Micro-organism and Microbiological Process:* The TRIPs Agreement has not defined micro-organism and microbiological process. The question is whether the micro organism, existing freely, are patentable, or their mere isolation in pure form are patentable or human intervention, in establishing a level of novelty in the discovered micro-organism, is needed for patenting.

The next question is whether a product produced by a micro-organism, which is known can be patentable, or the process is patentable. In the absence of a clear definition of micro-organism and micro biological process in the TRIPs Agreement.

Lack of clarity in the third amendment, claims in gene patent applications may pertain to genes or partial DNA sequence, proteins encoded by these genes, vectors used for transfer of genes, genetically modified micro-organism, cells, plants and animals and the process of developing a transgenic product. All these may lead to multiple rights, owned by multiple actors, called patent thickets over a final product. Hence there are problems of not only patent thickets but also of royalty staking and reach through claims.

(d) "*Mere*" *new use:* Earlier 'new use for a known substance' could not be patented. However, the new ordinance provides that "mere new use for a known substance" cannot be patented. The insertion of a single word 'mere' would open the floodgates for pharmaceutical product patents. The word 'mere' restricts the scope of non-patentable subject matter and widens the scope of patentability.

(e) *Infringement:* A person who infringes a patent by making or using a patented invention without permission can be sued by the patent holder for damages. Perhaps the most distinctive feature of patents in comparison to copyright law is that it is possible to infringe a patent unintentionally and that this makes no difference to liability for damages.

2. ***Mail Box Application:*** The Mail box application for product patents that were filed from January 1, 1995 until December 31, 2004 will now be examined for grant of patents rights. Nearly 12,000 patents applications, a majority of them from multinational pharma companies, would be opened by the government as it has compiled it with WTO obligations. (The Economic Times, 28th December 2004)

Only upon the actual grant of patent will the patentee be able to prevent others from exploiting his invention. The grant of patent will typically take anywhere between 1 to 3 years from applications that depending on the backlog of work in various branches of the patent office. The products that are patented abroad but for which no corresponding patent applications were filled in India, will continue to be open for exploitation in India. A patent term of 20 years will be calculated from the date of the application and not from the day the patent was granted.

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Due to the existence of bolar provision in Section 107A of the Act, an organisation will be able to make, use, sell or import the patented product for uses related to development and submission under Indian or foreign law.

3. ***Exclusive Marketing Right (EMR):*** Product patent was also applicable to those applications, which were made since 1995 using the 'mailbox' provisions. The 'mailbox' provision was introduced in the Patent Act through the first amendment undertaken in 1999 in order to fulfil the condition imposed in Article of the TRIPs Agreement (the so-called Transitional Arrangement). The "Transitional Arrangement" required India to introduce two provisions in its Patent Act.

   Article 70.8 of the TRIPs Agreement required India to provide 'a means' by which product patent application can be filed from January 1, 1995. If the products figuring in these applications were granted a patent in any of the WTO member countries were granted marketing approvals in any of the WTO member countries, then according to Article 70.9, five years Exclusive Marketing Rights (EMR) had to be granted by India before the patent on the product was either granted or rejected in India.

   According to the new ordinance, holders of EMRs will continue to enjoy their EMR till the patent is granted or rejected.

4. ***Compulsory License:*** Article 31 of TRIPs provides the provision of compulsory license which means a situation where a government allows an agent to produce a patented product without the consent of the original patent owner. If attempts to obtain the right to produce a patented product from patentee fail and if a compulsory license is issued, then adequate remuneration will be paid to the original rights holder. These requirements are waived or diluted when these are issued for public and non-commercial use or for other circumstances of extreme urgency.

   Unit XVI of the Act deals with the provision of compulsory license in India. Section 92A allows the grant of compulsory license to manufacture and export a patented product to any country having insufficient or no manufacturing capacity in the pharmaceutical sector for the purpose of addressing public health problems, provided a compulsory license has been granted in that country. The amendment seeks to implement the agreement on Para 6 of the Doha Declaration on TRIPS and public health. This will allow Indian companies to produce and export AIDS drugs to the African and South East Asian countries.

   Due to the existence of compulsory license provisions, MNCs will be forced to work their inventions in India in case they obtain an Indian patent. In the event of the patented invention not having been worked on India for a period of more than three years, (e.g. the product is only imported and not manufactured in India) the Controller General of patents can issue a compulsory license to any one interested in exploiting the patent. Three other conditions are to be satisfied in this regard:

   (a) Reasonable requirements of the public are not satisfied;

   (b) The patented invention is not worked in the country and;

   (c) The patented invention is not available to the public at a reasonably affordable price.

   The last mentioned provision is aimed at ensuring that India has the option to export products that have been produced using the license from the patent holders. A major impact will be on the pharmaceuticals sector, where India could well emerge as a major supplier of pharmaceuticals to the developing countries that do not have adequate domestic manufacturing facilities.

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Provision of compulsory license can be implemented after payment of adequate remuneration to the patent holder. Article 31(h) of the TRIPS Agreement that provides the guideposts in this regard states that, "the right holder shall be paid adequate remuneration… taking into account the economic value of the authorisation."

*Consideration for determining remuneration for use of a patent:*In determining the reasonableness of licensing terms for the use of a patent under subsection (c), the secretary of Health and Human Services or the Federal Trade Commission (as the case may be) shall consider:

(a) the risks and cost associated with the invention claimed in the patent and the commercial development of products that use the invention,

(b) the efficacy and innovative nature and importance to the public health of the invention or products using the invention,

(c) the degree to which the invention benefited from publicly funded research,

(d) the need for adequate incentives for the creations and commercialisation of new inventions,

(e) the interest of the public as patients and payers for health care services and

(f) the public health benefits of expanded access to the invention.

Source: House of Representatives, Affordable prescription Drugs and Medical Inventions Act; (HR 1708): To amend Title 35, United States Code to provide for Compulsory Licensing of certain patented inventions relating to health, 107th congress, 1st session, May 3, 2001.

Compensation for Use of Patent: In exercising the right under subsection (a) to authorize other use of the subject of a patent, the right holder shall be paid reasonable remuneration for the use of the patent, in determining the reasonableness of remuneration for the use of a patent, the secretary of Health an Human services may consider:

(a) Evidence of the risks and costs associated with the invention claimed in the patent and the commercial development of products that use the invention;

(b) Evidence of the efficacy and innovative nature and importance to the public health of the invention or products using the invention;

(c) The degree to which the invention benefited from publicly-funded research;

(d) The need for adequate incentives for the creation and commercialisation of new inventions;

(e) The interest of the public as patients and payers for health care services;

(f) The public health benefits of expanded access to the invention;

(g) The benefits of making the invention available to working families and retired persons;

(h) The need to correct anti competitive practices; or other public interest considerations.

(***Source:*** House of Representatives, Public Health Emergency Medicines (HR 3235): To amend title 35, United States Code, to provide for compulsory licensing of certain patented inventions relating to health care emergencies, 107th congress, November 6, 2001.)

5. ***Pre-versus Post-grant Opposition:*** Before the introduction of the new ordinance, India followed a system of Pre-Grant Opposition. The erstwhile section section 25 of the Patent Act provided for initiation of proceedings for opposition the grant of a patent which could

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be launched within four months from the date of advertisement of the acceptance of complete specification. The Grant of patents could be opposed on the grounds included:

(a) the invention for which the patent has been claimed was publicly known or publicly used in India,

(b) the invention is obvious and does not involve an inventive step,

(c) the invention is not patentable under the Patent Act 1970,

(d) the complete specification wrongly mentions the source or geographical origin of biological material used in the invention, and

(e) the invention on which the patents is claimed forms part of the traditional knowledge whether in India or elsewhere.

The 2003 Amendment introduces two sets of changes to the condition relating to opposition to the grant of patents. First the pre-grant opposition of the 1970 act is proposed to be changed to a pre-grant representation and secondly the pre-grant opposition has been replaced by post-grant opposition. Post Grant opposition, which has been provided in Section 25(3) of the Patents Act 1970, allows any interested person to oppose the grant of a patent before the expiry of one year from the date of grant of patent. But while change in the system of opposition has been included, the ground for opposition has been left unchanged. The grounds for pre-grant opposition in the 1970 Act have been retained in the post-grant opposition of 2003 Amendment and two sub-clauses (j) and (k) have been added.

Pre-grant representation included in Section 25 (I) can be made to the Patent Controller after the publication of the patent application on the ground of patentability, including novelty, inventive step and industrial application.



Example: Two other grounds for this representation have been provided, viz., non-disclosure or wrongful mentioning of the source and geographical origin of biological material used in the invention and anticipation of the invention by the knowledge, oral or otherwise available within any local or indigenous community in India or elsewhere.

Section 25(2) says that person making the pre-grant representation cannot be a party to the proceedings, which would weaken the case of those making the representations. The above mentioned implies that the pre-grant opposition that the Patent Act, 1970 has provided thus far would be de facto replaced by a post grant opposition.

8.2.2 Salient Features of the Third Amendment to the Patent Law

1. Extension of product patent protection to all fields of technology (i.e., drugs, food, and chemicals).
2. Deletion of the provisions relating to Exclusive Marketing Rights (EMR) and introduction of a transitional provision for safeguarding EMRs already granted.
3. Introduction of provision for enabling grant of compulsory licence for export of medicines to countries that have insufficient or no manufacturing capacity, and to meet emerging public health situations (in accordance with Doha Declaration on TRIPS and Public Health).
4. Modification in the provision relating to opposition procedures with a view to streamlining the system by having both pre-grant and post-grant opposition in the patent office.

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5. Addition to a new provision to circumscribe rights in respect of mailbox applications, so that patent rights in respect of the mailbox shall be available only from the date of grant of patent and not retrospectively from the date of publication.
6. Strengthening the provisions relating to national security to guard against patenting abroad of dual use technologies.
7. Clarification of the provision relating to patenting of software related inventions when they have technical application to industry or are in combination with hardware.
8. Rationalisation of provision relating to time-lines with a view to introducing flexibility and reducing the processing time for patent application and simplifying and rationalising procedures.
9. The government has the power to acquire a patent for national requirement.
10. Polymorphs new forms of older drugs are patentable.
11. Parallel imports are allowed.
12. Local production is mandatory.
13. The earlier provision of 'new use' criteria is modified to 'mere new use'.
14. Transfer of cases from High Courts to the Appellate Board (S.117G.)

8.2.3 Issues of Concern

Incrementally Modified Drugs (Ever Greening): Incrementally Modified Drugs (IMDs) include new formulations, new combinations of active ingredients or new salts or esters of approved compound. In the US brand manufacturers have flooded the market with IMDs, which "in 85% of the cases, do not provide significant improvement over currently marketed therapies" (National Institute for Health Care Management, Changing Patterns of Pharmaceutical innovation: A Research Report, May 2002, p5).

In the pharmaceutical sector it is very common to file a patent application for already known molecules by claiming trivial improvements. This naturally extends their monopoly even after the expiry of the original patent. This process is often referred to as ever greening. Ever greening of pharmaceuticals patents is a problem that India would have to grapple with in the near future, when the product applications that are currently in 'mailbox' are examined.



Example: In the mailbox there are nearly 12,000 product patent applications, which would have to be examined according to the provision of the recently amended act. It is to be noted that between 1995 and 2003, only 274 new chemicals entities were granted marketing approvals by the US Federal Drug Administration (FDA).

This implies that an overwhelming majority of the applications in the 'mailbox' cover IMDs.

According to a report of the US National Institute of Healthcare and Medicines (NHCM), drug manufacturers patent a wide range of inventions connected with incremental modifications of their products, including minor features such as inert ingredients and the form, colour and scoring of tables. In some cases, these patents may discourage generic companies from trying to develop a competitive product. In others, the generic company may be able to design around the new features.

In such conditions, it is necessary for developing countries like India to limit the scope of patentability only to new chemical entities so as to ensure accessibility, availability and affordability of medicines.

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Hike in prices: The hike in cost because of patent will depend on how much more can the patentee charge of his patented drug.



Did u know? To develop and clinically test a new drug, it costs around $500-600mn and about 12 to 13 years for any MNC.

There will naturally steep hike in prices for the drugs totally new to the world and for which no alternative currently exists. Patentees seek to maximise global profits and this will certainly drive prices of patented products skywards. Prices of new generation drugs for AIDS and Cancer are going to be very high. As Cipla offers a year's dosage of AIDS drugs at $600 (₹ 26,400) compared to $ 12,000 (₹ 5,28000) of a branded manufacturer. But the prices of new generation of drugs for AIDS and cancer are certainly going to be in lakhs.

The picture is not all that grim, though. As 97% of all drugs manufactured in India are off patent and there will be no impact on them, but for the remaining 3% drugs which can be patented, there are methods and various alternatives that the government can use to ensure their availability at affordable price. Market forces also play a decisive role in determining prices. In the next four years drugs worth $50 billion will go off patent. It is a sign that when in coming years prices of new and patented drugs will be sky high the prices of drugs which will go off patent will come down every year.

Effectiveness of Compulsory Licenses: Compulsory licences in the new patent bill are not very effective. According to it, with the exception of national emergency, extreme emergency or public non-commercial use, a compulsory license is available only after three years from the date of grant of the patent. Clear and effective grounds for the issue for a compulsory license have not been provided in the legislation. The procedural requirement to issue a compulsory license is too cumbersome and does not provide any strict time frames for the conclusion of the process. There is no ceiling on the remuneration payable to the patent holder, which will inevitably lead to demands for excessive royalty and unnecessary litigations.

8.2.4 Opportunities/Benefits of the New Patent Bill

The new patent bill is a sea of opportunities. It brought numerous business opportunities for the Indian pharmaceutical industry and the industry reaping benefits from it. When India joined the WTO eleven years ago, its pharmaceutical exports were less than ₹ 4,000 crore. A decade later, its exports went up to worth rupees 14,000 crore. There are ample opportunities now because over the next few years, drugs worth $ 60 billion are going off patent and one can grab a lion's share of these off patent drugs.



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Patent Status of 10 Blockbuster Drugs

Drug	Year	Innovator
Zitromax	2005	Pfizer
Prevacid	2006	Takeda
Zocor	2006	Merck
Pravachol	2006	Bristol Myers Squibb
Zoloft	2006	Pfizer
Paxil	2006	GlaxoSmithkline

Contd...

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Norvasc	2007	Pfizer
Risperdal	2007	J&J
Effexor	2008	Wyeth
Lipitor	2010	Pfizer

1. ***Research and Development:*** As inventor is able to earn higher profits and therefore would like to invest more in R&D and drug discovery and testing. This also results in more consumer welfare. During the preparation phase 'research' becomes the buzzword. The industry has transitioned from a 1% research budget to 4-5% and is focusing on developing new and analogue molecule. But this is tough to achieve as it costs much more, both in terms of money and time and only a few players in India can follow this strategy. Indian companies may not have such skills or deep pockets required for the job.

   But they definitely do have something honed over the years: impressive reverse engineering and process chemistry skills that, relatively speaking, don't cost much. They have used those skills to make the R&D leap to discovery of either new molecules or a novel way of delivering an exiting drug.

Example: Ranbaxy's copy of Bayer's Cipro (an antianthrax drug whose patent expired) was a significant improvement in terms of dosage; Bayer's Cipro needs to be taken twice a day to be effective, whereas Ranbaxy's is a once a day formulation. In 2001, Cipla rocked Big Pharma by offering a year's dosage of AIDS drugs at $600 compared to $12,000 of branded manufacturers.

2. ***Bulk Drug Supply:*** It is a route to survival and profit for small companies like Divi's Lab, Matrix Lab, Granules India, etc. These Hyderabad-based small companies cannot invest much in R&D and in marketing of single or few drugs and therefore on bulk drug supply to the US, Latin America and Europe.

3. ***Generic:*** Once the patent on a drug expires it is termed as a generic drug. Indian companies are very strong in reverse engineering and this opens doors to the generic market in the world not only for existing molecules but also for patented ones, which have gone off patent post 2005. Some $ 50 billion worth of drugs are now off patent.

   Cost of manufacturing generic drug is low and the manufacturing only needs to prove "bioequivalence" (that is prove that the generic copy is equally effective). A generic drug manufacturer has to file an application called Abbreviated New Drug Application or ANDA with the US FDA. India has strategic advantage in 'generic' as manufacturing costs here are 40% to 50% lower than in the developed countries. Secondly, India has a deep supply chain with some of the big companies vertically integrated-doing everything from R&D to manufacture of bulk and formulation to marketing.

4. ***Contract Manufacturing:*** Due to specialty in low-cost manufacturing, Indian companies are likely to serve as contract manufacturing organisations for bigger players.

5. ***Strategic Alliances:*** Companies may also establish alliances with MNCs. Many drug companies are engaged in 'out-licensing' of molecules to foreign multinationals for further clinical trials. Alliances can also be for R&D as India is a cost effective hub for research. Indian companies have established alliances with MNCs for the distribution of their generic drugs overseas.

Example: Cipla has a tie up with the Ivax and Watson for supply of active pharma ingredients (APIs) and one with Pentech Pharma to tap the US generic market. Some have

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acquired manufacturing facilities in the US, Europe and even in Africa to access channels. As Sun Pharma hiked its stake to 63% in Detroit -based Caraco Pharma. Wockhardt has acquired three companies in Europe and Cadilla healthcare acquired Atlanta's pharma's French unit, besides Ranbaxy has also acquired few firms to access overseas market.

6. ***Consolidation, Mergers and Acquisitions:*** In view of the new law, companies will consolidate their business. Two major pharma companies, GlaxoSmithkline and Sanofi Aventis, have already consolidated their Indian business. The consolidation will bring synergy among different siblings of the pharma majors and would also give the advantage of an enhanced size. Similarly, there will be big number of M&A as small companies may choose to merge with bigger entities for the sake of survival.


Task

Find out the IPRs that are available with Coca Cola Company and Pepsi.

8.3 Right to Information (RTI)

The Right to Information Act (RTI) comes into force on the 12th October, 2005 (120th day of its enactment on 15th June, 2005). Some provisions have come into force with immediate effect viz. obligations of public authorities [S.4(1)], designation of Public Information Officers and Assistant Public Information Officers [Ss.5(1) and 5(2)], constitution of Central Information Commission (Ss.12 and 13), Constitution of State Information Commission (Ss.15 and 16), non-applicability of the Act to Intelligence and Security Organizations (S.24) and power to make rules to carry out the provisions of the Act (Ss.27 and 28).

The Act extends to the whole of India except the State of Jammu and Kashmir. [S. (12)]

According to RTI, information means any material in any form including records, documents, memos, e-mails, opinions, advices, press releases, circulars, orders, logbooks, contracts, reports, papers, samples, models, data material held in any electronic form and information relating to any private body which can be accessed by a public authority under any other law for the time being in force but does not include "file notings" [S.2(f)].

Right to Information means the right to:

1. inspect works, documents, records.
2. take notes, extracts or certified copies of documents or records.
3. take certified samples of material.
4. obtain information in form of printouts, diskettes, floppies, tapes, video cassettes or in any other electronic mode or through printouts [S.2(j)].

8.3.1 The Information you can Avail

What is not Open to Disclosure?

The following is exempt from disclosure [S.8)]

1. Information, disclosure of which would prejudicially affect the sovereignty and integrity of India, the security, strategic, scientific or economic interests of the State, relation with foreign State or lead to incitement of an offence;

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2. Information which has been expressly forbidden to be published by any court of law or tribunal or the disclosure of which may constitute contempt of court;
3. Information, the disclosure of which would cause a breach of privilege of Parliament or the State Legislature;
4. Information including commercial confidence, trade secrets or intellectual property, the disclosure of which would harm the competitive position of a third party, unless the competent authority is satisfied that larger public interest warrants the disclosure of such information;
5. Information available to a person in his fiduciary relationship, unless the competent authority is satisfied that the larger public interest warrants the disclosure of such information;
6. Information received in confidence from foreign Government;
7. Information, the disclosure of which would endanger the life or physical safety of any person or identify the source of information or assistance given in confidence for law enforcement or security purposes;
8. Information which would impede the process of investigation or apprehension or prosecution of offenders;
9. Cabinet papers including records of deliberations of the Council of Ministers, Secretaries and other officers;
10. Information which relates to personal information the disclosure of which has no relationship to any public activity or interest, or which would cause unwarranted invasion of the privacy of the individual;
11. Notwithstanding any of the exemptions listed above, a public authority may allow access to information, if public interest in disclosure outweighs the harm to the protected interests.

Can there be permission for partial disclosure? Only that part of the record which does not contain any information which is exempt from disclosure and which can reasonably be severed from any part that contains exempt information, may be provided. [S.10]

The List of those who are Excluded?: Central Intelligence and Security agencies specified in the Second Schedule like IB, R&AW, Directorate of Revenue Intelligence, Central Economic Intelligence Bureau, Directorate of Enforcement, Narcotics Control Bureau, Aviation Research Centre, Special Frontier Force, BSF, CRPF, ITBP, CISF, NSG, Assam Rifles, Special Service Bureau, Special Branch (CID), Andaman and Nicobar, The Crime Branch-CID-CB, Dadra and Nagar Haveli and Special Branch, Lakshadweep Police. Agencies specified by the State Governments through a Notification will also be excluded. The exclusion, however, is not absolute and these organizations have an obligation to provide information pertaining to allegations of corruption and human rights violations. Further, information relating to allegations of human rights valuations could be given but only with the approval of the Central or State Information Commission, as the case may be [S.24)].

8.3.2 Procedure for Request of Information

The application procedure for requesting information is such that one can apply in writing or through electronic means in English or Hindi or in the official language of the area, to the PIO, specifying the particulars of the information sought for. While applying one should mention the reason for seeking information are not required to be given. One should also submit the fees as may be prescribed (if not belonging to the below poverty line category).

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Time Limit to Get the Information

1. 30 days from the date of application.
2. 48 hours for information concerning the life and liberty of a person.
3. 5 days shall be added to the above response time, in case the application for information is given to Assistant Public Information Officer.
4. If the interests of a third party are involved then time limit will be 40 days (maximum period + time given to the party to make representation).
5. Failure to provide information within the specified period is a deemed refusal.

Fee Applicable

1. Application fees to be prescribed which must be reasonable;
2. If further fees are required, then the same must be intimated in writing with calculation details of how the figure was arrived at;
3. Applicant can seek review of the decision on fees charged by the PIO by applying to the appropriate Appellate Authority;
4. No fees will be charged from people living below the poverty line;
5. Applicant must be provided information free of cost if the PIO fails to comply with the prescribed time limit.

Grounds for Rejection

1. If it is covered by exemption from disclosure. (S.8)
2. If it infringes copyright of any person other than the State. (S.9)

8.3.3 Information Commissions

Central Information Commission

1. Central Information Commission to be constituted by the Central Government through a Gazette Notification.
2. Commission includes 1 Chief Information Commissioner (CIC) and not more than 10 Information Commissioners (IC) who will be appointed by the President of India.
3. Oath of Office will be administered by the President of India according to the form set out in the First Schedule.
4. Commission shall have its Headquarters in Delhi. Other offices may be established in other parts of the country with the approval of the Central Government.
5. Commission will exercise its powers without being subjected to directions by any other authority (S.12).

Eligibility Conditions for the Appointment of CIC/IC

1. Candidates for CIC/IC must be persons of eminence in public life with wide knowledge and experience in law, science and technology, social service, management, journalism, mass media or administration and governance.

Notes

2. CIC/IC shall not be a Member of Parliament or Member of the Legislature of any State or Union Territory. He shall not hold any other office of profit or connected with any political party or carrying on any business or pursuing any profession (S.12).
3. Appointment Committee includes Prime Minister (Chair), Leader of the Opposition in the Lok Sabha and one Union Cabinet Minister to be nominated by the Prime Minister.

Term of Office and Other Service Conditions of CIC

1. CIC shall be appointed for a term of 5 years from date on which he enters upon his office or till he attains the age of 65 years, whichever is earlier.
2. CIC is not eligible for reappointment.
3. Salary will be the same as that of the Chief Election Commissioner. This will not be varied to the disadvantage of the CIC during service (S.13).

Term of Office and Other Service Conditions of IC

1. IC shall hold office for a term of five years from the date on which he enters upon his office or till he attains the age of sixty-five years, whichever is earlier and shall not be eligible for reappointment as IC.
2. Salary will be the same as that of the Election Commissioner. This will not be varied to the disadvantage of the IC during service.
3. IC is eligible for appointment as CIC but will not hold office for more than a total of five years including his/her term as IC (S.13).

State Information Commission

1. The State Information Commission will be constituted by the State Government through a Gazette notification. It will have one State Chief Information Commissioner (SCIC) and not more than 10 State Information Commissioners (SIC) to be appointed by the Governor.
2. Oath of office will be administered by the Governor according to the form set out in the First Schedule.
3. The headquarters of the State Information Commission shall be at such place as the State Government may specify. Other offices may be established in other parts of the State with the approval of the State Government.
4. The Commission will exercise its powers without being subjected to any other authority.

The Term of Office and Other Service Conditions of SCIC/SIC

The Appointments Committee will be headed by the Chief Minister. Other members include the Leader of the Opposition in the Legislative Assembly and one Cabinet Minister nominated by the Chief Minister. The qualifications for appointment as SCIC/SIC shall be the same as that for Central Commissioners.

The salary of the State Chief Information Commissioner will be the same as that of an Election Commissioner. The salary of the State Information Commissioner will be the same as that of the Chief Secretary of the State Government (S.15).

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Powers and Functions of Information Commissions

1. The Central Information Commission/State Information Commission has a duty to receive complaints from any person:
   (a) who has not been able to submit an information request because a PIO has not been appointed;
   (b) who has been refused information that was requested;
   (c) who has received no response to his/her information request within the specified time limits;
   (d) who thinks the fees charged are unreasonable;
   (e) who thinks information given is incomplete or false or misleading; and
   (f) any other matter relating to obtaining information under this law.
2. Power to order inquiry if there are reasonable grounds.
3. CIC/SCIC will have powers of Civil Court such as:
   (a) summoning and enforcing attendance of persons, compelling them to give oral or written evidence on oath and to produce documents or things;
   (b) requiring the discovery and inspection of documents;
   (c) receiving evidence on affidavit;
   (d) requisitioning public records or copies from any court or office;
   (e) issuing summons for examination of witnesses or documents;
   (f) any other matter which may be prescribed.
4. All records covered by this law (including those covered by exemptions) must be given to CIC/SCIC during inquiry for examination.
5. Power to secure compliance of its decisions from the Public Authority includes:
   (a) providing access to information in a particular form;
   (b) directing the public authority to appoint a PIO/APIO where none exists;
   (c) publishing information or categories of information;
   (d) making necessary changes to the practices relating to management, maintenance and destruction of records;
   (e) enhancing training provision for officials on RTI;
   (f) seeking an annual report from the public authority on compliance with this law;
   (g) require it to compensate for any loss or other detriment suffered by the applicant ;
   (h) impose penalties under this law; or
   (i) reject the application (S.18 and S.19).

The Reporting Procedure

1. Central Information Commission will send an annual report to the Central Government on the implementation of the provisions of this law at the end of the year. The State Information Commission will send a report to the State Government.

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2. Each Ministry has a duty to compile reports from its Public Authorities and send them to the Central Information Commission or State Information Commission, as the case may be.
3. Each report will contain details of number of requests received by each Public Authority, number of rejections and appeals, particulars of any disciplinary action taken, amount of fees and charges collected etc.
4. Central Government will table the Central Information Commission report before Parliament after the end of each year. The concerned State Government will table the report of the State Information Commission before the Vidhan Sabha (and the Vidhan Parishad wherever applicable) (S.25).

8.3.4 Role of the Governments

Role of Central/State Governments

1. Develop educational programmes for the public especially disadvantaged communities on RTI.
2. Encourage Public Authorities to participate in the development and organization of such programmes.
3. Promote timely dissemination of accurate information to the public.
4. Train officers and develop training materials.
5. Compile and disseminate a User Guide for the public in the respective official language.
6. Publish names, designation postal addresses and contact details of PIOs and other information such as notices regarding fees to be paid, remedies available in law if request is rejected etc. (S.26).

Who has the Rule making power?: Central Government, State Governments and the Competent Authority as defined in S.2(e) are vested with powers to make rules to carry out the provisions of the Right to Information Act, 2005 (S.27 & S.28).

Who has the power to deal with the difficulties while implementing this act?: If any difficulty arises in giving effect to the provisions in the Act, the Central Government may, by Order published in the Official Gazette, make provisions necessary/expedient for removing the difficulty (S.30).

8.3.5 How to Appeal for RTI?

An appeal to the Commission shall contain the following information, namely:

1. name and address of the appellant;
2. name and address of the Central Public Information Officer against the decision of whom the appeal is preferred;
3. particulars of the order including number, if any, against which the appeal is preferred;
4. brief facts leading to the appeal;
5. if the appeal is preferred against deemed refusal, the particulars of the application, including number and date and name and address of the Central Public Information Officer to whom the application was made;

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6. prayer or relief sought;
7. grounds for the prayer or relief;
8. verification by the appellant; and
9. any other information which the Commission may deem necessary for deciding the appeal.

Every appeal made to the Commission shall be accompanied by the following documents, namely:

1. self-attested copies of the Orders or documents against which the appeal is being preferred;
2. copies of documents relied upon by the appellant and referred to in the appeal; and
3. an index of the documents referred to in the appeal.

8.3.6 Procedure in Deciding Appeal

In deciding the appeals the Commission may:

1. hear oral or written evidence on oath or on affidavit from concerned or interested person;
2. peruse or inspect documents, public records or copies thereof;
3. inquire through authorised officer further details or facts;
4. hear Central Public Information Officer, Central Assistant Public Information Officer or such Senior Officer who decide the first appeal, or such person against whom the complaint is made, as the case may be;
5. hear third party; and
6. receive evidence on affidavits from Central Public Information Officer, Central Assistant Public Information Officer, such Senior Officer who decided the first appeal, such person against whom the complaint lies or the third party.

Service of Notice by Commission

Notice to be issued by the Commission may be served in any of the following modes, namely:

1. service by the party itself;
2. by hand delivery (dasti) through Process Server;
3. by registered post with acknowledgment due; or
4. through Head of office or Department.

Personal Presence of the Appellant or Complainant

1. The appellant or the complainant, as the case may be, shall in every case be informed of the date of hearing at least seven clear days before that date.
2. The appellant or the complainant, as the case may be, may at his discretion at the time of hearing of the appeal or complaint by the Commission be present in person or through his duly authorized representative or may opt not to be present.
3. Where the Commission is satisfied that the circumstances exist due to which the appellant or the complainant, as the case may be, is being prevented from attending the hearing of

Notes

the Commission, then, the Commission may afford the appellant or the complainant, as the case may be, another opportunity of being heard before a final decision is taken or take any other appropriate action as it may deem fit.

4. The appellant or the complainant, as the case may be, may seek the assistance of any person in the process of the appeal while presenting his points and the person representing him may not be a legal practitioner.

Order of the Commission

Order of the Commission shall be pronounced in open proceedings and be in writing duly authenticated by the Registrar or any other officer authorized by the Commission for this purpose.



Case Study

Microsoft held Guilty of Breaking Antitrust Laws

A Federal judge has ruled in a landmark decision that Microsoft Corporation seriously violated US antitrust laws, exposing the software giant to harsh penalties that could even result in its break-up.

District Judge Thomas Penfield Jackson yesterday found that the Redmond, Washington based firm broke the law by abusing its monopoly power in personal computer operating systems, doing "violence to the competitive process."

Microsoft promised to appeal once the trial ends months from now and was confident it would ultimately prevail. The company's stock, down the entire day, improved slightly after verdict but was still off $ 15-3/8 at $ 90-7/8 in after-hours trading.

Judge Jackson's most serious conclusion was that Microsoft violated Section 2 of the Sherman Antitrust Act by using its might against other companies, especially Netscape Communications, its rival in the 1990s for control of the internet browser market.

Netscape's market share withered under Microsoft's attack and it sold out to America Online during the early part of the trial. "Microsoft maintained its monopoly power by anti-competitive means and attempted to monopolies the web browser market," wrote Judge Jackson in his 43-page ruling.

While it is legal to gain a monopoly through skill or lucks, it is illegal to use that power to perpetuate a monopoly by preventing competitors from springing up.

Representatives of the justice department and the 19 States that brought the case, left open the possibility that they would seek the strongest remedy available for such a serious violation – a break-up of the company. Alternatively, they could seek changes in the company's business practices.

₹ 60,000 Crore Gone as Markets Crash

The panic on the country's stock markets over the last few days today took a dramatic turn for the worse with investors losing a massive ₹ 60,000 crore in the largest meltdown in the country's stock market history since the Harshad Mehta bubble burst in the early '90s. The Bombay Stock Exchange's Sensex fell 361 points or lost over 7.2 per cent of its total value

Contd...

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today, with 55 top stocks in the 'A' group falling by 8 per cent before they hit the lower 'circuit filter' which stopped all trading in them.

In continuing with the trend of the past few days, technology firms like Infosys and Satyam were the worst hit – tech stocks have been falling on the US Nasdaq as well with investors of the view that these stocks have been hyped too much. Technology shares like Infosys, Satyam and Wipro, pharma shares like Ranbaxy, L&T, MTNL, Reliance, HFCL, VSNL and SBI plunged on sustained unloading of shares by panicky investors.

Today's bloodbath, initially triggered off by the collapse of the American Nasdaq after the US court ruled that Microsoft had indeed violated antitrust legislation, was worsened by rumours spread by interested stock market operators in the Indian markets.

One of the country's pink financial dailies carried a report this morning (April 4) that the income tax authorities were demanding taxes from Foreign Institutional Investors (FIIs) which had routed their investment through the Mauritius tax-haven, to claim tax advantages. While the report was denied by the Finance Ministry in New Delhi early enough in the morning – the income tax claims were a mere ₹ 9 crores from just 7 of the total of over 600 FIs who operate in India – operators used this to wreak havoc.

Rumours were spread that this was just the beginning of a massive income tax swoop on FIIs.

Question

State the case for and against Microsoft as a company.

Source: The Economic Times, April 4, 2000

8.4 Summary

- The legal environment in India is such that the Indian judiciary is known for its independence and extensive powers. The High Court or the Supreme Court in exercise of their constitutionally conferred writ jurisdiction is empowered strike down legislation on the ground of unconstitutionality.
- The Directive Principles of our constitution suggest that ownership and control of material resources should be widely distributed and there should be no concentration of wealth and means of production.
- Before the 1991 amendment, the MRTP law sought to control the concentration of economic power by requiring undertakings that had assets over ₹ 100 crores and/or were 'dominant undertakings' to register themselves with the Monopolies and Restrictive Trade Practices Commission.
- The Commission can enquire into any restrictive, unfair or monopolistic trade practice (a) upon receiving a complaint from any consumer or a consumers' association, (b) on reference made by Central or state government, (c) on an application made by DGIR, (d) on its own.
- The MRTP Act was implemented in keeping with India's adopted political ideology of socialism. Its basic objective was to restrict the concentration of economic power by restricting and controlling the big companies, but in reality it only restricted and controlled the growth of Indian economy.
- In India, Intellectual Property Rights (IPR) fall under item 49 of list - the union list of the 7th Schedule to the Constitution.

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- India has allowed its pharmaceuticals makers to copy drugs patented abroad since the early 1970s as long as they use different manufacturing processes.
- Incrementally Modified Drugs (IMDs) include new formulations, new combinations of active ingredients or new salts or esters of approved compound.
- The new patent bill is a sea of opportunities. It brought numerous business opportunities for the Indian pharmaceutical industry and the industry reaping benefits from it.
- The Right to Information Act (RTI) comes into force on the 12th October, 2005 (120th day of its enactment on 15th June, 2005). The Act extends to the whole of India except the State of Jammu and Kashmir.
- Only that part of the record which does not contain any information which is exempt from disclosure and which can reasonably be severed from any part that contains exempt information, may be provided., under RTI
- The application procedure for requesting information is such that one can apply in writing or through electronic means in English or Hindi or in the official language of the area, to the PIO, specifying the particulars of the information sought for.
- Order of the Commission shall be pronounced in open proceedings and be in writing duly authenticated by the Registrar or any other officer authorized by the Commission for the purpose of deciding appeals.

8.5 Keywords

Appellant: A person who appeals for information

Capital Account Transactions: Transactions that tracks the movement of funds for investments and loans into and out of a country

CIC: Central Information Commission

Collective Bidding: Agreement among the contenders for bid to be offered at auction or not to be bid at auction.

IMD: Incrementally Modified Drugs

MRTP: Monopolies and Restrictive Trade Practice

Patents: Grant of property rights by the government to an inventor

Restrictive Trade Practice: One which has, or may have, the effect of preventing, distorting or restricting competition in any manner

SIC: State Chief Information Commissioner

8.6 Self Assessment

State whether the following statements are true or false:

1. MRTP Act was introduced to check the pricing system under monopolies.
2. Under MRTP Act giving bulk discounts are under restrictive framework.
3. Coca Cola has got a patent for its tag line-thanda matlab Coca Cola.
4. Patents are not such a big issue in the FMCG sector as it is in the pharma sector.
5. The Special branches of police of some of the Union territories are not included under RTI.

Notes

Fill in the blanks:

6. ……Act was created to protect interests of the common man.
7. A group of investors decide not to go to quote any offer at an auction. It is known as……
8. ……means all the notes excluding one rupee notes.
9. If you visit abroad and shop there, that transaction would be a ……account transaction.
10. The formal patent system in India was introduced by……..
11. The Maharaja, a popular mascot, is a patented logo of……
12. ……days is time limit to get information if the information concerns someone's' constitutional rights.

8.7 Review Questions

1. "The Indian judiciary is known for its independence and extensive powers". Comment.
2. What would have happened if there was no MRTP Act? Would it affect you as a consumer?
3. Analyse the governing procedure and rules for MRTP Act.
4. "The MRTP Act was implemented in keeping with India's adopted political ideology of socialism." Discuss the validity of the statement.
5. Critically analyse the Foreign Exchange Regulation Act.
6. What do you think, which one holds good in Indian environment – FERA or FEMA? Justify.
7. Contrast between the transactions in the capital and current account. Which is most likely to involve you as a common man?
8. Discuss the relevance of the penalty system under FEMA.
9. "Patents are just as good as valuable assets for any firm". Discuss.
10. How important it is for a pharmaceutical firm to get patents? Discuss the need for patents in other industries also.
11. Earlier 'new use for a known substance' could not be patented. Why? What would happen if word 'mere' is added to it, (i.e. mere new use)?
12. Critically analyse the concept of IMD.
13. "Compulsory licenses in the new patent bill are not very effective". Comment.
14. As a citizen of India, what kind of information you can seek and what can you do if you are not getting the required information?
15. Analyse the role of government in RTI Act. How can a good citizen be an ambassador of RTI Act?

Answers: Self Assessment

Notes

1.	True	2.	True
3.	True	4.	False
5.	False	6.	MRTP
7.	Collective Bidding	8.	Indian Currency
9.	Current	10.	Current
11.	Patent Act 1911	12.	Air India

8.8 Further Readings



Books

Pandey GN, *Environment Management*, Vikas Publishing, New Delhi

Paul Justin, *Business Environment: Text and Cases*, Tata McGraw Hill, New Delhi

Saleem Sheikh, *Business Environment*, Pearson Education, New Delhi

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Unit 9: Foreign Exchange Management

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Objectives

After studying this unit, you will be able to:

- State the provisions of Foreign Exchange Regulation Act (FERA)
- Discuss Foreign Exchange Management Act (FEMA)

Introduction

In last unit you have studied about legal environment. The year 2001 has seen some major changes in the corporate sector. Increasing liberalisation has forced companies to become more competitive and adopt different strategies to survive. The Government has also responded by continuing with its liberalisation policy and further simplifying the laws & procedures. Significant changes have been made in the field of corporate laws in the last couple of years in areas such as capital market regulations, corporate governance, simplification of tax laws, rationalisation of excise and customs duty etc. We also understand that more such progressive measures such as introduction of VAT, introduction of a new Competition Act to replace the existing MRTP Act etc are in store in the near future. This unit provides you knowledge of foreign exchange management act.

Notes

9.1 Foreign Exchange Regulation Act

FERA is an Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.

9.1.1 Application of the Act

1. This Act may be called the Foreign Exchange Regulation Act, 1973.
2. It extends to the whole of India.
3. It applies also to all citizens of India outside India and to branches and agencies outside India of companies or bodies corporate, registered or incorporated in India.
4. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf.

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

9.1.2 Some Important Provisions of the Act

1. ***"Authorised dealer"*** means a person for the time being authorised under section 6 to deal in foreign exchange;
2. ***"Bearer certificate"*** means a certificate of title to securities by the delivery of which (with or without endorsement) the title to the securities is transferable;
3. ***"Certificate of title to a security"*** means any document used in the ordinary course of business as proof of the possession or control of the security, or authorising or purporting to authorise, either by an endorsement or by delivery, the possessor of the document to transfer or receive the security thereby represented;
4. ***"Coupon"*** means a coupon representing dividends or interest on a security;
5. The provisions of F.E.R. (Amendment) Act, 1993 (hereafter referred to as Act 29 of 1993) came into force on the 8th day of January 1993.
6. ***"Currency"*** includes all coins, currency notes, banks notes, postal notes, postal orders, money orders, cheques, drafts, traveler's cheques, letters of credit, bills of exchange and promissory notes;
7. ***"Foreign currency"*** means any currency other than Indian currency;
8. ***"Foreign exchange"*** means foreign currency and includes -
   (a) all deposits, credits and balances payable in any foreign currency, and any drafts, traveler's cheques, letters of credit and bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency;
   (b) any instrument payable, at the option of the drawee or holder thereof or any other party thereto, either in Indian currency or in foreign currency or partly in one and partly in the other;

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9. ***"Foreign security"*** means any security created or issued elsewhere than in India, and any security the principal of or interest on which is payable in any foreign currency or elsewhere than in India;

10. ***"Indian currency"*** means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one-rupee notes issued under section 28A of the Reserve Bank of India Act, 1934;

9.2 Foreign Exchange Management Act (FEMA)

The Foreign Exchange Management Act (FEMA), 1999, has been enacted as part of the ongoing liberalisation process. The Act was implemented w.e.f. June 1, 2000.

Foreign exchange control was first introduced in September, 1939 under the Defense of India Rules. The Foreign Exchange Regulation Act was introduced in 1947, which was replaced with the Foreign Exchange Regulation Act in 1973 and in 2000 by FEMA.

9.2.1 Differences between FERA and FEMA

The object of the FEMA Bill is to consolidate and amend the law relating to foreign exchange, with the objective of facilitating external trade and payment and for promoting the orderly development and maintenance of the foreign exchange market in India. The primary differences between FERA and FEMA are:

1. The object of FERA was to conserve foreign exchange and to prevent its misuse. The object of FEMA is to facilitate external trade and payments and maintenance of foreign exchange market in India.
2. Violation of FERA was a criminal offence whereas violation of FEMA is a civil offence.
3. Offences under FERA were not compoundable, while offences under FEMA are compoundable.
4. Citizenship was a criteria to determine the residential status of a person under FERA, while stay of more than 182 days in India is the criteria to decide residential status under FEMA.
5. Provision in respect of Basic Travel Quota (BTQ) business travel export commission, gifts, donation, etc., have been considerably enhanced in FEMA.
6. Almost all current account transactions are free, except a few.

9.2.2 Scope of FEMA

FEMA provides:

1. Free transactions on current account subject to reasonable restrictions that may be imposed.
2. RBI controls over capital account transactions.
3. Control over realization of export proceeds.
4. Dealing in foreign exchange through authorized persons like authorized dealer/money changer/off shore banking unit.
5. Adjudication of Offences.
6. Appeal provision including Special Director (Appeals) and Appellate Tribunal.

Notes

9.2.3 Export of Goods and Services

Regulations relating to the export of goods and services from India are contained in the Foreign Exchange Management (Export of Goods and Services) Regulations 2000.

Every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, shall furnish to the specified authority, a declaration in one of the forms set out in the Schedule. The declaration should be submitted with in 21 days from exports.

Such a declaration should be supported by evidence specified, containing true and correct particulars of the material:

1. the full export value of the goods or software; or
2. if the full export value is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive from the sale of the goods or the software in the overseas market, and affirms in the said declaration that the full export value of goods or the software has been or will within the specified period, be paid in the specific manner.

Every exporter of services shall furnish to the RBI or to such other authorities, a declaration in such form and in such a manner as may be specified containing the true and correct particulars of material in relation to payment for such services.

9.2.4 Possession and Retention of Foreign Currency

Under FEMA, restrictions prevail only for physical possessions and retention of foreign currency and not in respect of the foreign currency kept in permissible account with authorized dealers (banks).

Limits for possessions and retention of foreign currency or foreign Coins:

1. An authorized person can retain and possess foreign currency and coins within the scope of his authority without any limit;
2. Any person can possess foreign coins without limit;
3. A person residing in India can retain foreign currency notes, bank notes and foreign currency travellers' cheques up to a certain limit as prescribed by RBI;
4. A person residing in India but not permanently resident therein may possess without limit, foreign currency in the form of currency notes, bank notes and travelers cheques if such foreign currency was acquired, held or owned by him when he was resident outside India and has been brought into India in accordance with the regulation made under the Act i.e. after making the declaration when required.

9.2.5 Realization and Repatriation of Foreign Exchange

A person residing in India to whom any account of foreign exchange is due or has accrued, shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the RBI.

Notes

Exemption from Realization and Repatriation in Certain Cases

The provisions are not applied to the following situations:

1. Possession of foreign currency or foreign coins by any person up to such limit as the Reserve Bank may specify;
2. Foreign currency account held or operated by such person or class of persons and up to the limit which the Reserve Bank may specify;
3. Foreign exchange acquired or received before July 8, 1947 or any income arising or accruing there on, which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;
4. Foreign exchange held by a person resident in India up to such limit as the RBI may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in Clause(c) including any income arising there from;
5. Foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limit as the RBI may specify;
6. Such other receipts in foreign exchange as the RBI may specify.

9.2.6 Capital Account Transaction

Section 2(e) states that 'Capital Account Transaction' means:

1. A transaction that alters the assets or liabilities, including contingent liabilities outside India of a person residing in India.
2. A transaction that alters the assets or liabilities in India of persons residing outside India.
3. Transfer or issue of any foreign security by a person residing in India.
4. Transfer or issue of any security by a person residing outside India.
5. Transfer or issue of any security or foreign security by any branch, office or agency in India or a person residing outside India.
6. Any borrowing or lending in foreign exchanges in whatever form or by whatever name known.
7. Any borrowing or lending in rupees in whatever form or by whatever name known between a person residing in India and a person residing outside India.
8. Deposits between persons residing in India and person residing outside India.
9. Export, import or holding of currency or currency notes.
10. Transfer of immovable property outside India, other than lease not exceeding five years, by a person residing in India.
11. Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.
12. Giving of guarantee or surety in respect of any debt, obligation or other liability incurred, by a person residing in India and owed to a person residing outside India, by a person residing outside in India.

Regulation of Capital Account Transaction

Notes

Subject to the provision of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

The RBI may, in consultation with the Central government, specify:

1. any class or classes of capital account transaction that are permissible;
2. the limit up to which foreign exchange shall be admissible for such transactions.

Provided that the RBI shall not impose any restrictions on the withdrawal of foreign exchange for payments due on account of amortisation of loans for depreciation of direct investment in the ordinary course of business.

Without prejudice to the generality of the provision of sub-section (2), the Reserve Bank may, by regulations prohibit, restrict or regulate the following:

1. Transfer or issue of any foreign security by a person residing in India.
2. Transfer or issue of any security by a person residing outside India.
3. Transfer of issue of any security of foreign security by any branch, office or agency in India of a person residing outside India.
4. Any borrowing or lending in foreign exchange in whatever form or by whatever name known.
5. Any borrowing or lending in rupees in whatever form or by whatever name known between a person residing in India and a person residing outside India.
6. Deposits between persons residing in India and persons residing outside India.
7. Export, import or holding of currency or currency notes.
8. Transfer of immovable property outside India, other than lease not exceeding five years, by a person residing in India.
9. Acquisition or transfer of immovable property in India, other than a lease not exceeding five years by a person residing outside India.
10. Giving a guarantee or surety in respect of any debt, obligation or other liability incurred:
    (a) By a person residing in India and owed to a person residing outside India; or
    (b) By a person residing outside India.

A person residing in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such persons when he was residing, outside India or inherited from a person who was residing outside India.

A person residing outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was residing in India or inherited from a person who was residing in India.

Without prejudice to the provision of the section, the RBI may, by regulations prohibit, restrict or regulate establishment in India of a branch, office or other place of business by a person residing outside India, for carrying on any activity relating to such branch, office or other place of business.

Notes



Notes

Some Terms used in FEMA

Convertible Currency/Hard Currency

Some currencies are freely convertible, i.e., one can exchange these currencies with any other currency without any restriction. The major ones are: Dollars (USA), Pound Sterling, Euro, DM, Yen, Franc, Lira, etc. This are often referred to as hard currency

Rupee Trade

India has rupee trade with Nepal and Bhutan, i.e., payments in respect of trade with Nepal and Bhutan are made in Indian Rupees.

Currency

Currency includes all currency notes, postal notes, postal orders, money orders, cheques, drafts , traveller's cheques, letter of credit, Bill of Exchange and Promissory notes, credit cards or such other similar instruments as may be notified by the RBI. The RBI has notified 'debit cards', ATM cards or any other instruments by whatever name known that can be used to create a financial liability' as 'currency'.

Foreign Exchange

Foreign exchange means foreign currency and includes (i) deposits, credits, and balances payable in any foreign currency (ii) drafts, traveller's cheques, letter of credit or bill of exchange expressed or drawn in Indian currency but payable in foreign currency (iii) drafts, traveller's cheques letter of credit or bill of exchange expressed drawn by banks, institutions or persons outside India, but payable in Indian currency.

Overseas Corporate Bodies

OCB means any overseas company, partnership, firm, society, and other corporate body predominantly owned directly or indirectly to the extent of at least 60% by NRIs. It also includes overseas trusts in which at least 60% beneficial interest is irrevocably held by NRIs.

9.2.7 Current Account Transactions

FEMA has eased the regulation over transactions in foreign exchange and security. Transactions in current account have been made restrictions-free:

1. ***No restriction on current account transaction unless specified:*** Any person can sell or draw foreign exchange to or from authorized persons if such sale or withdrawal is a current account transaction. Reasonable restrictions on current account transaction can be imposed by the Central Government in public interest, in consultation with the RBI.
2. ***Current Account Transaction:*** Section 2(j) states that current account transaction means a transaction other than a capital account transaction. It includes the following:
   (a) Payment due in connection with foreign trade, other current businesses, services and short term banking, and credit facilities in the ordinary course of business.
   (b) Payment due as interest on loans as net income from investment.
   (c) Remittances for living expenses of parents, spouse and children residing abroad.
   (d) Expense in connection with foreign travel, education and medical care of patents, spouse and children.

Notes

(e) The definition is 'inclusive', i.e., besides of aforesaid expenses, any expenditure that is not a 'capital account transaction' will be a current account transaction. For examples, expenditure incurred on oneself own expenses on foreign travel, education, and medical care are covered as 'current account transaction' not specified above.

(f) Any person may sell or withdraw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction.

Foreign Currency/Security/Property by Resident

A person resident in India may hold, own transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was residing outside India or inherited from a person who was residing outside India [section 6 (4)].

Indian Currency/Security/Property by Non-resident

A person residing outside India may hold, own transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was residing in India or inherited from a person who was residing in India. [section 6 (4)].

Restrictions on Branches, Offices of Non-residents

The RBI may prohibit, restrict or regulate establishment of branch, office or other place of business by a person residing outside India; for carrying on any activity relating to such branch, office or other place of business. [Section 6 (6)]

9.2.8 Enforcement and Penalties

Directorate of Enforcement

The Directorate of Enforcement has been formed to ensure that the provisions of the Act are adhered to. In the Directorate of Enforcement, an Additional Director, a special Director and Assistant Directors of Enforcement are appointed by the Central Govt. under section 36.

These officers can investigate contraventions of FEMA. They have powers similar to those conferred on Income Tax authorities under the Income Tax Act. These powers can be exercised subject to limitations laid down under Income Tax Act. (Section 37).

The following powers are available under the Income Tax Act - powers to requisition books of accounts etc., power to call for information, power to inspect registers of companies [Sections 131 to 136 of Income Tax Act].

Penalties under the Act

An Adjudicating Authority appointed by the Central Government under FEMA can impose penalties for violating any provision of the Act or contravention of any rule, regulation, direction or order issued under the power conferred by the Act.

Notes

Departmental Adjudication

The Central Government can authorise certain officers as 'Adjudicating Authority' under Section 16(1). Their jurisdiction will be prescribed by the Central Government [Section16 (2)]. They can adjudicate cases in respect of violation of FEMA. These officers are quasi- judicial and have to follow the principle of natural justice by giving the opportunity of making representation. The Adjudicating Authority can hold an enquiry only upon receiving a complaint from an authorised officer [Section 16 (3)].

Powers of Adjudicating and Appellate Authorities

The adjudicating authority, Special Director (Appeals) and Appellate Tribunal have the following powers of the civil court:

1. Summoning witnesses and enforcing attendance of any person and examining them on oath.
2. Requiring discovery and production of any document.
3. Receiving evidence on affidavits.
4. Requisition of any public record or document or copy of such record/document from any office (subject to sections 123 and 124 of the Indian Evidence Act).
5. Reviewing its decisions.
6. Dismissing a representation of default or deciding it *ex parte*.
7. Setting aside any order of any representation for default or any order passed by it *ex parte*.
8. Any other matter as may be prescribed by the Central Government.

Penalties

If any person contravenes any provision of the Act, he shall be liable for a penalty upto thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakhs rupees where the amount is not quantifiable, and where such contravention is a continuing one. Further penalty may extend to five thousand rupees for every day after the first day during which the contravention continues.

Any Adjudicating Authority adjudging any contravention under sub-section (1) may, if he thinks fit, in addition to any penalty that he may impose for such contravention, direct that any currency, security or any other money or property in respect of which the contravention has taken place, shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

9.3 Summary

- FERA is an Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.

Notes

- The Foreign Exchange Management Act (FEMA), 1999, has been enacted as part of the ongoing liberalisation process.
- The object of the FEMA Bill is to consolidate and amend the law relating to foreign exchange, with the objective of facilitating external trade and payment and for promoting the orderly development and maintenance of the foreign exchange market in India.
- Regulations relating to the export of goods and services from India are contained in the Foreign Exchange Management (Export of Goods and Services) Regulations 2000.
- If any person contravenes any provision of the FEMA, he shall be liable for a penalty upto thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakhs rupees where the amount is not quantifiable, and where such contravention is a continuing one.

9.4 Keywords

Contact Manufacturing: A company takes up manufacturing work for another company on contractual basis

Current Account Transactions: Transaction other than a capital account transaction

Fema: Foreign Exchange Management

Fera: Foreign Exchange Regulation Act

Strategic Alliance: Two or more companies come together for common purpose

9.5 Self Assessment

State whether the following statements are true or false:

1. Under FERA, a coupon means representing dividends and interests on securities.
2. A difference between FERA and FEMA is that, violation under FERA is a civil offence and under FEMA is a criminal offence.
3. Any borrowing or lending to the persons residing outside the country are recorded as current account transactions.

Fill in the blanks:

4. Under FEMA, mostly …….account transactions are free of any charge.
5. The Foreign Exchange Management Act (FEMA), 1999, has been enacted as part of the ongoing .....
6. The Foreign Exchange Regulation Act was introduced in ....., which was replaced with the Foreign Exchange Regulation Act in 1973 and in 2000 by FEMA.
7. The object of ..... was to conserve foreign exchange and to prevent its misuse
8. Regulations relating to the ..... from India are contained in the Foreign Exchange Management (Export of Goods and Services) Regulations 2000.
9. An ..... can retain and possess foreign currency and coins within the scope of his authority without any limit

Notes

9.6 Review Questions

1. Describe the scope of FEMA and discuss the difference between the FERA and FEMA.
2. Discuss the role of the RBI in enforcing FEMA.
3. What is a Capital Account Transaction? Discuss the role of FEMA in regulating Capital and Current Account Transactions.
4. Discuss how the Directorate of Enforcement puts FEMA into effect.

Answers: Self Assessment

1. False
2. True
3. True
4. Current
5. Liberalisation process
6. 1947
7. FERA
8. Export of goods and services
9. Authorized person

9.7 Further Readings



Books

Pandey GN, *Environment Management*, Vikas Publishing, New Delhi

Paul Justin, *Business Environment: Text and Cases*, Tata McGraw Hill, New Delhi

Saleem Sheikh, *Business Environment*, Pearson Education, New Delhi

Vivek Mittal, *Business Environment*, Excel Books, New Delhi



Online links

exim.indiamart.com/act-regulations/fera-1993.html

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Unit 10: Foreign Trade

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Objectives

After studying this unit, you will be able to:

- State the foreign investment condition in India
- Describe the idea of Multinational Corporations

Introduction

In last unit you have studied about legal environment. Multi-National Corporations (MNCs) are an intriguing and, at times, quite a controversial topic. So much so, that they have attracted enormous attention from economists, sociologists, political scientists, historians, in addition to scholars of international business. There are, therefore, many different issues and questions that receive attention in the literature. In this collection, papers cover two over-riding issues. First, the process of how MNCs emerge, evolve and expand, including the different internationalization strategies adopted by different firms from diverse contexts. A second, and interrelated, issue is what happens once an MNC goes abroad: how it is managed, what kinds of tensions, issues and dilemmas can be generated, and what kinds of consequences its presence has for the host country

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as well as for the global capitalist economy. The answer of these questions depends directly or indirectly upon the way in which the firm internationalizes, that is, the way the firm was transformed into an MNC. One paper in this volume focuses squarely on the first concern, whilst the rest of the papers deal more with the second issue, though, in many of them, attention is also paid to firm internationalization strategy. In this sense, directly or indirectly, these two main issues regarding MNCs receive substantial consideration and analysis in this collection.

10.1 Foreign Investment

Foreign Direct Investment (FDI) is defined as an investment made by an investor of one country to acquire an asset in another country with the intent to manage that asset (IMF, 1993). The IMF definition of FDI includes as many as following elements: equity, capital, reinvested earning of foreign companies, inter-company debt transactions including short-term and long term loans, overseas commercial borrowings, non-cash acquisition of equity, investment made by foreign venture capital investors, earnings data of indirectly-held FDI enterprises, control premium, non-competition fee and so on.

Foreign investment and technology play an important role in the economic development of a nation and have been exploited by a number of developing countries.



Example: The economic health of transition countries in Eastern Europe, Russia, and Central Asia is smoother due to FDI.

Even communist countries like China have welcomed foreign investment to improve their economies.

Governments of developing nations are attracting FDI along with the technology and management skills that accompany it. To attract multinational companies, governments are offering tax holidays, import duty exemption, subsidised land and power and many other incentives. FDI are supposed to bring many benefits to the economy. They contribute to GDP, capital formation, balance of payment and generate employment.

10.1.1 India's FDI Policy

Multinational companies are a part of the Indian economy since the British period either as a wholly owned subsidiary or as a joint venture. They played a critical role in the development of the automobile industry, two wheeler industry, mining, petroleum, FMCG, etc. But after independence, because of government policies some like Coca Cola, IBM, etc., left the country.

Flow of substantial foreign investment began in India in the 1980s. At that time Suzuki entered India with a joint venture with the Indian Government. The then Prime Minister Rajiv Gandhi initiated the reforms and allowed FDI in certain cases and because of these liberal policies Pepsi was able to entered India.

It was in 1991, following liberalisation, that does for FDI were opened in the true sense. India welcomed direct foreign investment in virtually every sector of the economy except strategic concern such as defense, railway transport and atomic energy. Of this, automatic approval for foreign equity participation up to 51% is granted in high priority sector. Use of foreign brand names/trade marks for sale of goods in India is permitted. Foreign equity up to 100% is particularly encouraged in export-oriented units, power sector, electronics, and software technology parks.

Foreign direct investment is freely allowed in all sectors (except railways and atomic energy) including the services sector, except a few sectors where the existing and notified sectoral policy

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does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the automatic route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through, government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB).

10.1.2 Routes of Foreign Investment

Automatic Route

New Ventures: All items/activities for FDI/NRI/OCB investment up to 100% fall under the automatic route except the following:

1. All proposals that require an Industrial License which includes (1) the item requiring an Industrial License under the Industries (Development & Regulation) Act, 1951; (2) foreign investment being more than 24% in the equity capital of units manufacturing items reserved for small scale industries; and (3) all items which require an Industrial Licence in terms of the locational policy notified by government under the New Industrial Policy of 1991.
2. All proposals in which the foreign collaborator has a previous venture/tie up in India. The modalities prescribed in Press Note No. 18 dated 14.12.1998 of 1998 Series, shall apply to such cases. However, this shall not apply to investment made by multilateral financial institutions such as ADB, IFC, CDC, DEG, etc., as also investment made in the IT sector.
3. All proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor.
4. All proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted.
5. Whenever any investor chooses to make an application to the FIPB and does not want to avail of the automatic route, he or she may do so.
6. ***PSUs and EPZs:*** Investment in public sector units as also for EOU/EPZ/EHTP/STP units would also qualify for the automatic route. Investment under the automatic route shall continue to be governed by the notified sectoral policy and equity caps and RBI will ensure compliance of the same. The National Industrial Classification (NIC) 1987 shall remain applicable for description of activities and classification for all matters relating to FDI/NRI/OCB investment.

Existing Companies: Besides new companies, automatic route for FDI/NRI/OCB investment is also available to the existing companies proposing to induct foreign equity. For existing companies with an expansion programme, the additional requirements are that:

1. increase in equity level must result from the expansion of the equity base of the existing company without the acquisition of existing shares by NRI/OCB/foreign investors;
2. the money to be remitted should be in foreign currency;
3. proposed expansion programme should be in the sector(s) under automatic route. Otherwise, the proposal would need government approval through the FIPB. For this, the proposal must be supported by a Board Resolution of the existing Indian company.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic approval are that:

1. they are engaged in the industries under automatic route;

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2. the increase in equity level must be from expansion of the equity base;

3. the foreign equity must be in foreign currency.

The automatic route for FDI and/or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer/trademark agreement in the same or allied field in India.

Equity participation by international financial institutions such as ADB, IFC, CDC, DEG, etc., in domestic companies is permitted through automatic route subject to SEBI/RBI regulations and sector-specific cap on FDI.

Government Approval

For the following categories, government approval for FDI/NRI/OCB through the FIPB is necessary:

1. All proposals that require an Industrial Licence which includes (1) the item requiring an Industrial Licence under the Industries (Development & Regulation) Act, 1951; (2) foreign investment being more than 24% in the equity capital of units manufacturing items reserved for small scale industries; and (3) all items which require an Industrial Licence in terms of the locational policy notified by the government under the New Industrial Policy of 1991.
2. All proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor.
3. All proposals falling outside the notified sectoral policy/caps or under sectors in which FDI is not permitted.

For greater transparency in the approval process, the government has announced guidelines for consideration of FDI proposals by the FIPB.



Notes List of Industries for which Industrial Licensing is Compulsory Under Industries (Development & Regulation) Act, 1951

1. Distillation and brewing of alcoholic drinks.
2. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
3. Electronics, Aerospace and defence equipment: all types.
4. Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches.
5. Hazardous chemicals.
   (a) Hydrocyanic acid and its derivatives
   (b) Phosgene and its derivatives
   (c) Isocyanates and di-isocyanates of hydrocarbon, not elsewhere specified



Example: Methyl Isocyanate

6. Drugs and Pharmaceuticals (according to modified Drug Policy issued in September, 1994 and subsequently amended in February, 1999)

Notes



Notes Manufacture of SSI- reserved items by other industrial undertakings and location of industrial undertakings in relaxation of the notified locational policy will attract compulsory licensing.

Foreign Investment in the Small-scale Sector

Under the small-scale policy, equity holding by other units, including foreign equity in a small-scale undertaking, is permissible up to 24%. However, there is no bar on higher equity holding for foreign investment if the unit is willing to give up its small-scale status. In case of foreign investment beyond 24% in a small-scale unit which manufactures small-scale reserved item(s), an industrial licence carrying a mandatory export obligation of 50% would need to be obtained.

Foreign Investment Policy for Trading Activities (Export)

Foreign investment for trading can be approved through the automatic route of up to 51% foreign equity and beyond this by the government through the FIPB. For approval through the automatic route, the requirement would be that the undertaking concerned is an export house/ trading house/super trading house/star trading house registered under the provisions of the Export and Import policy in force.

Other Modes of Foreign Direct Investments

Global Depository Receipts (GDR)/American Deposit Receipts (ADR)/Foreign Currency. Convertible Bonds (FCCB): Foreign Investment through GDRs/ADRs, Foreign Currency. Convertible Bonds (FCCBs) are treated as Foreign Direct Investment. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADRs/ FCCBs.

Highlights of the Annual Supplement 2010-11 to the Foreign Trade Policy

1. Additional benefit of 2% bonus, over and above the existing benefits of 5% / 2% under Focus Product Scheme, allowed for about 135 existing products.
2. 256 new products added under FPS (at 8 digit level), which shall be entitled for benefits @ 2% of FOB value of exports to all markets.
3. Tea and CSNL Cardinol included for benefits under VKGUY @ 5% of FOB value of exports.
4. Zero duty EPCG scheme, introduced in August 2009 and valid for only two years upto 31.3.2011, has been extended by one more year till 31.3.2012.
5. Duty Entitlement Passbook (DEPB) scheme has been extended beyond 31.12.2010 till 30.06.2011.
6. ***Concessional Export Credit:*** Interest subvention of 2% for pre-shipment credit for export sectors namely, Handloom, Handicraft, Carpet and SMEs for all export sectors.
7. Exporters shall now have the flexibility to get a high value EPCG authorisation by filing their EPCG application on Annual basis.
8. Clarifications on the availability of 4% SAD refund benefit.
9. Facility of a data preparation module for Advance Authorization and Export Promotion Capital Good (EPCG) has been provided on an offline mode.

Notes

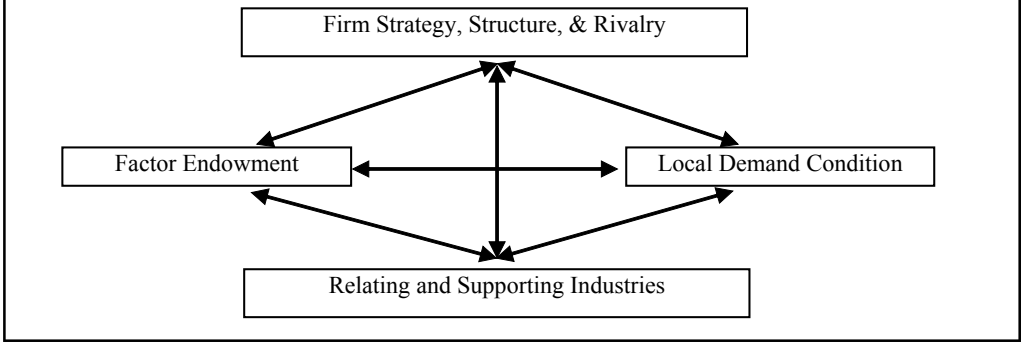
10. Finished Leather export shall be entitled for Duty Credit Scrip @ 2% under FPS.
11. Duty free import of specified trimmings, embellishments etc. shall be available on Handloom made-ups exports @ 5% of FOB value of exports.
12. Readymade Garment sector granted enhanced support under MLFPS for a period of further 6 months

10.1.3 Determinants of FDI

Liberalization is not the sole reason to attract FDI. There are many other determinant of FDI, India may lagging there. As at Kearney's FDI Confidence Audit: India, February 2001 said "India gain's in attractiveness because of its market size and its potential is diminished by negative assessment of its regulatory environment." Other important determinants are rule of law, competitive wages, labour skill, infrastructure and well developed financial institutions. Determinants of FDI can be better understood by the Porter's diamond model of international competitiveness, which has identified four major determinants:

1. Factor Conditions (i.e. factor of production)
2. Demand condition
3. Related and supporting industries
4. Firm strategy, structure a rivalry

Figure 10.1: Michael Porter's International Competitiveness Model



Factor Condition

A nation may have comparative advantage over others because of certain factors of production. Organizations will shift their production base to those countries where the critical factors of production of there industry specific is economical. India's human resources are of proven quantity as well as more economical in comparison to the US and Europe leading many countries to establish their manufacturing units here. India has the largest pool of English speaking people in Asia causing MNCs to shift their BPO, to India. India has also proven its competitive edge in R&D and Software Development, it is the reason that almost all the major software companies of the world have invested in India in software development and more and more companies like GE, NOKIA are establishing there Research center in India. But India doesn't have proved its advantage in basic research. In basic research it is the USA who has established its reputation, hence most of companies established there basic research set up in USA.

Example: Honda a Japanese company having a Core Competency in Engine technology has its research center in Engine technology in USA.

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Most of the Software companies established their Application software research center in USA and Customized Research Center in India. Italy have established its comparative advantage in terms of Industrial Design the result is that job of industrial design goes to Italy from all over world.



Example: TATA took the help of Italian firm in designing TATA Indica.

Other factors of production like availability of capital, raw material and technology also plays a decisive role. It is because of the availability of raw material that South Korean's POSCO has invested in India. Availability of capital has made the US a haven for foreign investment.

Demand Condition

This is also a significant factor in deciding the level of FDI. Higher the demand higher will the FDI. China and India are hot destinations of FDI because of their aggregate demand. In terms of PPP they are in top five countries of the world. Event the companies like P&G who don't believe in the customization of product for low income group is investing in R&D for the sake of customization of product for low income group. Most of MNCs whether it is Electronics, FMCG, Automobiles, White Goods etc. are investing in India and China and are investing in R&D in developing product for the local people only because huge demand in these countries specially in the low income and middle income group.



Example: It is level of demand only that Retail Giant Wal-Mart is very much keen to invest in India.

Related and Supported Industry

MNCs prefer to go to the destination where there is well developed supported industry (ancillaries units) for the specific industry. Infrastructure play a critical role in a selection of site. It is well said that take care of roads and electricity investment will take care of itself. Well developed ancillaries units facilitate the FDI. As now organization don't have to invest in ancillaries. Not only ancillaries but other supported industry as the availability of well developed financial market, distribution network etc. also plays role.

Rivalry and Firm Strategy

The Competitive environment in a nation also plays a critical role. Organizations like to invest in countries where there is no stiff competition.



Did u know? Pepsi invested in India when the Indian policies were not so liberal, consenting to many Indian conditions imposed on Pepsi. It did so only because here it wouldn't have to face competition from its arch rival Coca Cola.

Level of rivalry also decides the FDI. If all the above mentioned reasons are favorable to attract FDI even after that ultimately it is the Firms strategy which decides that whether it will invest in a most attractive destination or not. Few organizations are very aggressive in grabbing overseas investment opportunity on the other hand few are reluctant and follow a policy of wait and watch.

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10.1.4 Impact of FDI

FDI has a wide spread impact on a country not only economically but also socially. Foreign investment is always accompanied by superior technology and transfer of technical knows how. It has an impact on local industry as it provides them both opportunity and threat. It gives consumers a wide choice that too at reasonable price. FDI increases not only GDP but also exports and therefore results in higher per capita income and large forex reserves.

Impact on Local Industry

McKinsey studied the impact of FDI on local industry and it found that FDI unambiguously helped the receiving economy. It raised productivity and output in the sector involved thereby raising national income, while lowering prices and improving the quality and selection of services and products and consumers.

FDI nearly always generated positive spillover for the rest of economy. It generated big opportunities for local manufacturers as they become OEM to them.



Example: Hyundai and Suzuki developed ancillary units in India, Coca Cola and Pepsi developed bottling plants of world class; they gave local manufacturer an opportunity to export.

Not only an opportunity for manufacturing, FDI also give technical know how to OEM which increases the level of quality. Today's Coca-Cola' bottling plant are far better, infact of international quality then those of Parle which Coca-Cola acquired.



Example: OEMs of Maruti Suzuki don't only supplies to Suzuki but also export it. MacDonald's trained local farmers and bakers to produce product of international quality and today they are not only supplying it to MacDonald's but are also exporting it.

Simultaneously it gives impetus to service industry. FDI has a big role in the development of the BPO industry in India. The entire framework of BPO industry in India is an outcome of FDI. And today India is the most preferred nation for BPO in the world.

Impact on Employment

FDI in India has contributed in the creation of a more than $10–billion-a-year software and outsourcing industry which employees 5,00,000 people directly. Projections suggest that it will employ 2,000,000 people by 2008. These are the estimates of only one industry. FDI has created jobs in every field manufacturing, telecommunication, advertising, media, and above all services.

Impact on Consumer

Perhaps biggest beneficiary of the FDI is the Indian consumer. By the 1980 we were driving Ambassador or Premier Padmini and after the investment by Suzuki 8 new models were launched. Now we have access to many international brands. Prices have been steadily decreasing in all the segments because of FDI, like electronics, computers, ACs, automobiles, and even soft drinks, two wheelers, etc. Not only this, today consumer has wide choice as these organizations are launching new variants with improved performance every day.



Example: Recently we have seen that how HLL decreased its price as a reaction to aggressive policy of P&G. Price of ACs, Television, and Washing Machine fell by 10% in two thousand alone because of MNCs.

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Besides this there is a are macro economic impact as contribution to GDP, though it may be argued that there is not any significant growth after liberalization as compared to previous decade. But FDI has contributed a lot in transforming whole economy. Earlier we were producing substandard goods and driving cars of 1960s and today gradually we are becoming the exporting hub of telecommunication tools, software and automobile. It had not only improved Balance of Payment but also fetched Foreign Exchange for the nation because of this Forex reserve of the nation is very high. Opponents of FDI argue that it will cannibalize local industry, to a extent it is true also which may be true. But it is not the MNCs, which threaten them, in fact it is their inefficiency, which is their biggest threat.

10.1.5 Entry Strategies for Foreign Investors

A foreign company planning to set up business operations in India has the following options:

As an Indian Company

A foreign company can commence operations in India by incorporating a company under the Companies Act, 1956 through

1. Joint Ventures; or
2. Wholly Owned Subsidiaries

Joint Venture with an Indian Partner: Foreign Companies can set up their operations in India by forging strategic alliances with Indian partners. Joint Ventures may entail the following advantages for a foreign investor:

1. Established distribution/marketing set up of the Indian partner
2. Available financial resource of the Indian partners
3. Established contacts of the Indian partners which help smoothen the process of setting up of operations

As a Foreign Company

Foreign Companies can set up their operations in India through

1. Liaison Office/Representative Office
2. Project Office
3. Branch Office

1. ***Liaison Office/Representative Office:*** Liaison office acts as a channel of communication between the principal place of business or head office and entities in India. Its role is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers. It can promote export/import from/to India and also facilitate technical/financial collaboration between parent company and companies in India.
2. ***Project Office:*** Foreign companies planning to execute specific projects in India can set up temporary project/site offices in India.
3. ***Branch Office:*** Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up branch offices in India for the following purposes:
   (a) Export/Import of goods

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(b) Rendering professional or consultancy services

(c) Carrying out research work, in which the parent company is engaged.

(d) Promoting technical or financial collaborations between Indian companies and parent or overseas group company.

(e) Representing the parent company in India and acting as buying/selling agents in India.

(f) Rendering services in Information Technology and development of software in India.

(g) Rendering technical support to the products supplied by the parent/group companies.

(h) Foreign airline/shipping company.

Branch Office on "Stand Alone Basis: Such branch offices would be isolated and restricted to the Special Economic zone (SEZ) alone and no business activity/transaction will be allowed outside the SEZs in India, which include branches/subsidiaries of its parent office in India.


Task

Give examples of companies that adopted above mentioned entry strategies to enter Indian market. (Give at least one example for each strategy)

10.2 Multinational Corporations (MNCs)

MNCs are defined as an enterprise that is headquartered in one country but has operations in one or more countries. Sometimes it is difficult to know if a firm is an MNC because multinationals often downplay the fact that they are foreign held.


Example: Most of the people in India are unaware that Bata is a Canadian company, Bayer is a German company, Nestle is a Swiss company and Cadbury a British company.

10.2.1 Multinational, Global, Multi-domestic and Transnational

Multinational, Global, International and Transnational are terms which are frequently used to describe the organizations which are operating in more than one nation. Though usually these terms are used interchangeably, they have specific meanings.

1. ***Multinational Enterprise (MNE)*** is a company that takes a global approach to foreign markets and production; it is thus willing to consider market and production location anywhere in the world. The term multinational corporation (MNC) is also commonly used in the international business arena and often is a synonym for MNE. Usually, most authors prefer MNE as there are many international firms which are not organized as corporations.
2. ***Transnational Companies (TNC)*** is a term used by United Nations and most of the developing nations for multinational firms. This term is used in two contexts though some writers use this term for a company that is:
   (a) trying to achieve economies of scale through global integrations of its functional area while at the same time.

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(b) highly responsive to different locational environment (a newer name is multicultural multinational).

Business people define transnational company as a firm formed by the merger of two firms of approximately the same size that are from two different countries.



Example: Royal Dutch Shell is a company that is jointly owned in the United Kingdom and the Netherlands, and its corporate management is split between the two countries. Similarly Unilever is a Dutch and English firm, VFK-Fokker (Germany - Netherlands Aircraft Company).

Presently today this term is frequently used as synonymous for MNE/MNC. MNE as well as any other company can be categorized into two categories that is a Global Company and Multidomestic Company.

3. ***Global Company:*** The term Global Company is widely used for MNE but every MNE is not a Global MNE. A global company is one that has a global vision. It is a company which looks for opportunities worldwide, it sources it products, raw material, and financing and personnel worldwide, seeks to maintain a presence in key markets of world and look for similarities, not differences among markets. The biggest characteristic of these companies is that they look at the whole world as a single market and standardise operations and products worldwide in one or more of the firm's functional areas.

   If we go strictly by this definition then perhaps there is no global firm ever as firms carry out some alteration in their product or functional strategy according to the local condition. If overseas market is as big as India and China then certain modifications are essential.



Example: There are firms who to an extent can be classified as global firms, such as Coco Cola, Pepsi, Kellogg's, SONY, etc.

These are the companies who keep their product portfolio same and manufacture the product for the whole world considering them as a single market, though they change their functional strategy according to the local requirements.

4. ***Multi-domestic Company:*** It is a company which treats each of its units operating in different countries as an independent profit centre. It allows its foreign country operations to act fairly and independently such as by designing and producing a product or service in India for the Indian market and in China for the Chinese market.

10.2.2 Benefits of Being MNCs

Undoubtedly, firms cross national boundaries and accept the risk of operating in an unknown environment in the hope of earning more profit and increasing their shareholders wealth. Besides this, there are many other reasons such as survival, new sources of supplies, cheap human resource and even just to keep busy the nearest rival in its home country. Some of the key reasons of crossing national boundaries are as follows:

1. ***Survival:*** Most countries are not as fortunate as that of India, Russia, China or the US in terms of size, resources and opportunities. Most European nations are small in size or most Middle East and South East countries are rich in only one or very few resources. In these countries organizations are bound to do business in and with other countries to survive. Even organisations of big countries are bound to look out for new markets for their products and cheap resources to remain competitive and to survive.

2. ***Growth of Overseas Market (Sales):*** This has been the biggest reason for more and more companies expanding overseas. In the last 20 years many economies have opened their doors for the world. This resulted in a big opportunity in terms of Market. Most of the

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European nations, USA, Canada, Japan, etc., have a stagnant population growth and very low GDP growth.

All these factors led to companies searching for a new market. Emerging economies like India, China, and South East Asia form a significant market-perhaps more than 35% of the world market. This has given them opportunities and MNCs have started expanding their wings in these parts of the world.

India and China are amongst the top five countries of the world in terms of Purchasing Power Parity. All this attracted many organizations to tap new markets in emerging economies. Besides this agreements/groups like GATT, GATS, ASEAN, EU, SAPTA, NAFTA, etc., have also created huge opportunities of business for organizations and to tap these, they are going abroad.

3. ***Diversification:*** No organization wishes to keep all its eggs in one basket. Every organization wants to diversify its risk and internationalisation is a good manner to do that, along with sticking to its core competency or old business. Different countries have different trade cycles for the same product. When there is a recession in one economy, there could be a boom in the other and an organization can cover losses in one country by profits.



Example: The Ispat group has steel plants almost all over the world. It is number two in most of the countries but it is number one in terms of sales in India. Unilever which is behind P&G in USA, is much ahead of P&G in India.

Thus MNCs diversify risk through internationalisation.

4. ***Resources:*** In today's cut-throat competition, cost cutting is the key to success. Prices are controlled by consumers and the only thing which can be manipulated to increase profit is cost. Organizations go abroad in search of economical sources of supply. A truly global firm always locates its processing in the best available location in the world and outsource HR and other physical resources from the best suited place available. In fact, this is the reason that more and more companies are establishing their call centres in India.



Example: Even Wal-Mart, the biggest retailer of the world, does not have any retail shop in India but it does have a purchase office in India. Nike gets its shoes manufactured in South East Asia. Besides Nike even Nokia, IBM, Toyota, Sony, Philips, Samsung, Mitsihuta, Boeing, Airbus, Adidas, GM, Ford, etc., have their manufacturing capacities, research centres, and ancillary units at places best -suited for their purposes.

Thus, companies cross borders to have access to economical resources.

5. ***To Protect Market Share:*** Firms also become MNEs in response to increased foreign competition and a desire to protect their home market share. Using a "follow the competitor" strategy, a growing number of MNEs have now set up operations in the home countries of their own major competitors. This approach serves as a dual purpose: (1) it takes away business from their competitors by offering customers other varied choices and (2) it lets competitors know that, if they attack the MNEs home markets, they will face a similar response.

6. ***Tariff and Non-Tariff Barrier:*** Organizations establish their operation overseas to deal with tariff and non-tariff barriers. Many time countries impose tariff and non-tariff restrictions on import in such cases. Organizations establish their production unit in the host country so that it can be treated as a local company.

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Example: In the late 1970, when the US imposed some non-tariff restrictions on the automobile import of Japan, Japanese firms began establishing their units in the US so that in terms of taxes they could be treated at par with US firms, Soon, America became the playground of Japanese firms.

7. ***Technology Expertise:*** One reason for becoming an MNE is to take advantage of technological expertise by manufacturing goods directly (by FDI) rather than allowing others to do it under a license. Many MNCs feel it unwise to give another firm access to proprietary information such as patent, trademarks or technological expertise.

8. ***Access to Economical Human Resources:*** Many times companies cross borders to have access to economical human resource. Organizations which used to earlier import Human Resource from our country are now establishing their operations in India itself, only to take advantage of economical human resource. Various companies are crossing borders because the cost of human resource is rising.

10.2.3 Impact of MNCs

Multinational firms play a pivotal role in the global economy, linking rich and poor economies, and transmitting capital, knowledge, ideas and value systems across borders. Their interaction with institutions, organizations and individuals is generating positive and negative spillovers for stakeholders in host countries. As a consequence they have become focal points in the popular debate on the merits and dangers of globalisation, especially when it comes to developing countries. MNE are profit maximising, thus naturally not interested in creating benefits for others without obtaining a good price for it.

Impact on the Trade Balance

The macroeconomic effect of FDI is their impact on the trade balance. MNEs have a competitive advantage in both, accessing global markets in importing their products to local markets. The ability to produce at central locations with large economies of scale and supply markets in several countries is a core strategy of many manufacturing MNEs. Hence, they frequently export more than domestic firms, but also import a larger share of their inputs. A large share of both exports and imports is typically to or from affiliated companies, i.e., intra-firm international trade. Any analysis of trade impact of FDI has to consider their impact on both exports and imports.

Table 10.1: Impact on Balance of Payment of Selected Items

Capital Outflows	Capital Inflows
Imports	**Exports**
- Intermediate goods for local assembly and sale	- Final goods for global markets
- Machinery for local production facilities	- Intermediate goods for global markets
- Investors' global products for local sale	**Service Exports**
Service Imports	- Tourism and business travel receipts
- Fees for licenses and other services	**Capital Export**
Capital Import	- Profit remittance
- Initial equity investment	- Interest payments
- Loans from parent to affiliate	- Repayment of loans

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Promote Small Scale/Ancillary Industry

MNCs often catalyse the export of complex, technology-intensive products made by small- and medium-size firms (SMEs) located in host countries.



Example: Approximately two-thirds of consumer electronic products made in Korea and Taiwan are sold to MNCs such as GE, IBM and Toshiba on an "original equipment manufacture" basis. In India too companies like Maruti Suzuki, Hyundai, Samsung, LG, etc., do most of their purchases from India itself as it promotes ancillary industry.

Knowledge Transfer

Host countries, especially developing economies, aim to create an indigenous technological capability, that is, "skills - technical, managerial and institutional" – that allow productive enterprises to utilise equipment and technical information efficiently. Foreign investors are a potential source for knowledge at the technical and systemic level. They can contribute not only by transferring information, but also by stimulating directly or indirectly the generation of new knowledge in the host country.

Multinational firms possess some firm-specific advantages that can be profitably combined with locational advantages at a site outside their home country. Knowledge transfer raises the productivity of the subsidiary in the host economy and thus contributes to tax revenues, national income and possibly creates spillovers to the local economy.

Improves the Level of Technology of Local Firms

In the era of globalised capital markets, where overseas borrowing can be used to supplement domestic savings, the importance of FDI perhaps lies less on the quantity of capital inflow and more on its ability to transfer technology and business best practices to the domestic firms in the host country.

Transfer of technology and business best practices significantly improves the productivity of domestic firms in the recipient countries. These firms would improve their international competitiveness and the impact of this spillover effect on the economy of the recipient country is arguably much greater than the impact of the FDI itself. To maximise such benefits to local firms, governments in many developing countries have stipulated that foreign firms set up business operations in these countries in the form of joint ventures (JVs), assuming that such cooperation among multinational enterprises and their local partners would facilitate the transfer of technology and business practices.

Technology and business best practices are equally likely to be transferred from MNEs to domestic firms in developing countries by way of migration of labour from the former to the latter. The Indian software industry is a well-proven example of this. Labour and executive mobility can thus enhance productivity throughout the economy by transferring tacit knowledge that could not be other wise transferred through informal contacts between firms.

Development of Infrastructure and Economic Development

FDI is a transfer of capital across borders, which allows the receiving economy to increase investment beyond its own savings rate. Traditionally, developing economies focused on this addition to the capital stock as core contribution of foreign investment to economic development. FDI is a source of capital because it has a more long-term character than portfolio investment. It

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cannot be withdrawn quickly if the volatile environment goes through an economic downturn such as the exchange rate crises in Mexico in 1995, East Asia in 1997 or Russia in 1998.

FDI in infrastructure and business services has a direct impact on productivity on its customers. In industries such as telecommunication foreign investment leads to substantial improvement of services required by businesses; in other cases, such as accounting or IT services, foreign investors provide services previously not available locally.

For instance, foreign investment in telecom leads to major improvements in technology and competition in the sector. This ultimately reduces firms' communication costs and thus increases productivity. Similar effects arise from FDI in other utilities such as energy distribution or motorway and airport projects.

Forward and Backward Linkages

Foreign firms often purchase intermediate goods (backward integration) from domestic suppliers. These backward linkages create several effects on the domestic supplier. Foreign investors may transfer knowledge directly to local suppliers by training and even joint product development. MNEs improve the productivity of indigenous firms by providing technical assistance and training of employees to increase the quality of suppliers' products by helping in management and organization, by assisting them in purchasing of raw materials.

Moreover, the FDI may increase demand for intermediate goods, thus allowing local suppliers to realise scale economies.



Example: In India almost all the MNCs like McDonalds, Pepsi, Coco-Cola, Suzuki, Hyundai, Samsung, etc., have transferred technology and imparted training to personnel so that they can supply products of international standards. McDonalds has even appointed an agriculture engineer to help farmers improve their crop.

Foreign-owned customers (forward integration) may set higher requirements regarding product quality and service-aspects of the supply relationships such as just in time delivery, thus providing incentives for improving product quality and production processes.

Increases Employment

MNCs generates new opportunities of employment in the host country. MNCs transfers their routine jobs and non-core jobs to the destination where labour is cheap, which is the reason that lot of jobs from Europe and the US have been transferred to India in the last decade. MNCs also transfer their operations to new and economical destination which also increases the opportunity for employment. MNCs play a critical role in economic development and in raising the income level of people in turn increasing the level of employment. In the last decade, directly or indirectly, MNCs have created millions of jobs in India in almost all the sectors such as infrastructure, software, hardware, old economy industry, entertainment, media, etc.

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Caselet

MNCs have Injected Spirit of Innovation

The Indian IP landscape has gone through a huge transformation over the last few decades. Today, one can see a paradigm shift in the attitude towards protecting IP. Engineering talent in India has realised the importance of innovation, and of filing patents and protecting their innovation. One would wonder how did this consciousness come about in country where IP laws are frail and where respect for innovation is almost absent?

We certainly have the globalisation and IT boom in the country to thank for this change.

Before the influx of large corporations setting up shop here, IP protection and patent filing was sporadic at the least, and patents weakly protected at best. The arrival of MNCs has helped in two major transformations-it has injected a spirit of innovation in the R&D environment, and it has propelled the culture of patent filing in India.

A large number of MNCs have set up full-fledged R&D centres here. Over the years, these research centres have become an important and critical part of the innovation they showcase globally. As a result, our engineering talent has not only had the chance to work on many exciting, innovative and revolutionary projects, but also they have had a chance to represent their own fresh ideas, which have been promoted by their employers, through the proactive patent filing process, and eventually developed into products that are used around the world. This is a great motivation for any developer or engineer to constantly push the envelope to innovate and see his or her ideas being recognised on a global platform. The MNCs in India have provided a great stage for Indian engineers to be seen as global cerebral talent.

IPR protection or innovation was not a priority for Indian companies till recently. The reasons ranged from little R&D investment, no or limited competition from foreign players, license regime, and archaic and difficult to navigate IPR laws. Customers also had got used to the poor quality products and services being dished out on the pretext of 'self reliance' and 'made in India'. Overall, there was no market for innovation and no need for people to innovate.

This led to a culture where innovation was neither recognised nor rewarded. There was no incentive for companies to innovate or hire people who could innovate. The result was the migration of our best and the brightest to western countries where they could demonstrate their talent and creative skills.

The opening up of the Indian markets in 1991 and subsequent arrival of MNCs in India changed everything. The MNC brought about greater awareness of IPR and that forced the country and government in particular to start recognising IPR as even an issue to consider. This led to India becoming a signatory to international treaties like the agreement on Trade-Related Aspects of Intellectual Property of the WTO.

MNCs on one side created demand and aspiration for innovative products, on the other hand their engineering and R&D centres nurtured an environment where people developed the skills to innovate and got exposed to the world of IPR. In fact, some of the MNC R&D centres are producing IPR at the same rate as any other global R&D centre.

Indian employees got a chance to innovate and rapidly acquire the knowledge how to the process; and it became a showcase of the quality of Indian talent.

As the MNC R&D centres move up the value chain, we believe that this culture of innovation will only become stronger and more widespread in India.

Source: financialexpress.com

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10.2.4 Demerits of MNCs

Multinational corporations have become too powerful in absolute terms as well as relative to governments.

The enormous resources controlled by multinational corporations give them a tremendous amount of power, especially over individuals and governments. The ongoing erosion of national barriers to trade and investment enables these firms to close shop and head overseas if government, workers or NGOs place restrictions (e.g., minimum wage, taxation, labour standards, fines for pollution, etc.) on them or otherwise inhibit their ability to earn profits.

Certainly, there is a danger to any organization that controls resources and market share on par with giant conglomerates like HLL, Reliance, TATA, or AV Birla may abuse their power in ways that undermine democratic processes or hurt consumers. But these corporations earn their profits through efficiency and innovation, without which they would quickly lose market share to rivals. They employ millions of workers with competitive wages, provide relatively low-cost/ high-quality goods and services to consumers and enrich shareholders. Moreover, they must accomplish all of this without stepping beyond the boundaries of Competition/Antitrust Law/ Consumer Act in the countries in which they operate. In light of the profit motive, firms spend money to influence legislation to its favour in case doing so is likely to enhance profitability.

10.2.5 MNCs in India

"When the Bangalore-based telecom software product company Subex Systems acquired Alcatel's Fraud Management Group (FMG) it took quite a few by surprise in the industry. After all, Subex with revenues of 90 crore and Alcatel the € 25 Billion French giant were in totally different leagues. It was a part of Subex's well thought out strategy to move centre stage in the global arena of its chosen space of telecom fraud management and revenue maximisation. With this acquisition, Subex claims to be the largest vendor the world over for Fraud Management Systems, based on the number of installations. It currently has 61 customers with 105 networks spread across 37 countries." (Business India December 20, 2004 to January 2, 2005.)

"Not many know that most new generation vehicles that ply the Indian roads have Moterson's inputs-be it Toyota, Honda, Mercedes, Ford, Hyundai or even the homegrown Maruti. From wiring harnessing to cockpits, door trims to bumpers and plastic components, it chips in with its produce, not just for the cars rolled out in India but also for those rolled out in the Far East. The Group has 13 plants including at Sharjah and Ireland." (Business India, September 26-October 9, 2005.)

"If you were to ask which Indian company leads the world in a given product/segment, chances are that you would get it wrong. It is neither Reliance nor a company from the stable of TATA or the Birlas, Infosys or even Wipro of the country. The right answer is Subhash Chandra's Essel Propack (EPL), the single largest specialty packaging company in the world manufacturing laminated and seamless tubes catering to oral care, cosmetics, personal care, pharmaceuticals, food and industrial sectors.

With an estimated 32% market share in laminated tubes globally, EPL is multinational with manufacturing facilities in 13 countries through 21 plants including the US, the UK, Russia, Germany, Mexico, Colombia, Venezuela, Philippines, Indonesia, Egypt, Nepal and China, besides India. EPL was established in 1984, ventured out to become a global player in 1993 by setting its first overseas venture in Egypt. Four years later it formed a wholly owned subsidiary in Guanghou, China. In 2000 it acquired Switzerland's Propack A.G. which was then the world's fourth largest laminated tubes company. This helped Essel gain access to markets in Latin America, Indonesia, and China". (Business India, October 10-23, 2005)

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Task

List a few MNCs that have found their ground in India via merger and acquisition of Indian companies. Also list some Indian companies that have acquired foreign companies.



Case Study

FDI in India: A New Dawn

In the recent few years, the outlook of India as an investment destination has been growing. This is indicated by surveys of different consultancy groups on the outlook of different countries as a host to FDI, which are consistently upgrading the rank of India.

In JBIC surveys India has moved up with its rank increasing from 7th in 1996 to 5th in 2001. India is ahead of countries like Vietnam, Taiwan, South Korea, Malaysia and Singapore as promising destinations for FDI over the medium term but lagging behind countries such as China, US, Thailand, and Indonesia. In terms of Kearney's FDI confidence index, India is moving in the narrow range of 5th -7th position between 1998 and 20031 (1 Business Line (18.9.2003) 'India moves up in Kearney's FDI Confidence Index')

Kearny has also ranked India as the top destination for business processing. India is also the R&D base for over 100 of the Fortune 500 companies, with GE's largest R&D Centre outside the US. India is also a preferred business process outsourcing destination. 250 of the Fortune 500 companies are clients of Indian companies High quality standards in the field of IT with over 2/3rd of the world's SEI CMM Level-5 companies being Indian.

FDI approved in 2003 is US$ 3.1 billion as against US$ 4.43 billion in 2002. FDI inflows approved in the period April 1991-April 2003 stood at US$ 78 billion, of which US$ 35.5 billion has been realized. USA accounted for $ 16 billion (24.9%). The other major investor countries are Mauritius, UK, Japan, South Korea, Germany, Netherlands, Australia, France, Malaysia, Singapore and Italy in that order. Even Chinese firms have started investing in India. For example, ZTE of China is investing $ 50 million in the telecom sector. Haier is investing 200 million dollars to manufacture refrigerators and set up a Rand D facility.

Sector-wise break-up of FDI is as follows: fuels -26.7%, telecom-19.6%, electrical equipments-9.9%, transportation-7.5%, services-6.5% and metallurgical industry-5.3%

MNCs, which have invested in India include GE, DuPont, Eli Lily, Monsanto, Caterpillar, GM, Hewlett Packard, Motorola, Bell Labs, Daimler Chrysler, Intel, Texas Instruments, Cummins, Microsoft, IBM, Toyota, Mitsubishi, Samsung, LG, Novartis, Bayer, Nestle, Coca Cola and McDonalds.

Cumulative FII (Foreign Institutional Investors) investment since the equity market was opened in the early 1990s is $ 25 billion. US$ 6.5 billion of the FII funds in 2003 went into equities FIIs have 50 percent stake in one third of the 30 companies which make up the BSE-30 Index and hold about 10 percent of the stakes in public sector undertakings.

FDI also contributes to exports. As in 2001 Faber Heatcraft Industries Ltd had decided to increase the production capacity of its manufacturing facility in Pune by 4-5 times at a cost

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of ₹ 5 crore so that it could use India as the manufacturing hub for the SAARC and other Asian markets near India . (Economic Times (29.11.2001) 'India to be Faber's production hub for SAARC')

Philips plans to use India as a manufacturing base to source a range of products for international markets with an intended investment of $150 million within the next 5 years (Times of India (4.9.2003) 'Philips to make India export hub'). The company also decided to double its employees to 2000 in next three years in its Bangalore software development center (Economic Times (4.9.2003) 'Philips to hire 1,000 for B'lore operations'). Same Deutz-Fahr, the third largest tractor firm in the world also expressed its intention of using India as an export hub for international markets including North America. (Business Line (17.9.2003) 'Same Deutz-Fahr tractors to make India an export hub'). The company has already exported its tractors in small numbers to Israel, Colombia, Zambia, Sri Lanka and Chile leveraging its manufacturing facility located in Ranipet, Near Chennai with a plant capacity to manufacture 7000 tractors and 10000 engines. Hyundai, the carmakers which is already using India as a export hub is planning an additional investment of about $200 million to increase the production capacity to four lakh units annually (Business Line (18.9.2003) 'Hyundai's exports eat into domestic sales: Three-week backlog in local market')

The company had exported a total of 9000 units in 2002-03 and has set an export target of 30000 vehicles for 2003-04.

In 1998 Hyundai Motors built a $614 million auto assembly plant in Chennai in the face of deep skepticism expressed by many industry analysts about India's potential as an export platform. Many other foreign companies such as Ford Motors, Suzuki, Bosch, Timken, MICO, SKF Bearings, Daimler-Chrysler and FAG Bearings have already begun using India as an export platform.

Pohang Steel Company (Posco) of South Korea signing a landmark MoU for setting up a steel plant at Paradip with a total investment of $12 billion (₹ 51,000 crore).

Table 1 present figures on FDI actual inflows of foreign direct investment from 1992-93-2003-04. The actual flow shows fluctuating trends in different years. It an peaked at US $ 4700 million in 2002-03 and was its lowest at US $ 279.5 million in 1992-93. The trend shows an upward direction which is very significant for the country.

Table 1: FDI Inflow in India (year wise)

Year	Amount in Million US $	Share of total Inflow
1992-93	279.50	1.06
1993-94	369.00	1.41
1994-95	872.10	3.32
1995-96	1418.00	5.40
1996-97	1091.60	4.16
1997-98	3560.00	13.56
1998-99	2000.00	7.62
1999-00	2160.00	8.23
2000-01	2340.00	8.91
2001-02	3900.00	14.85
2002-03	4700.00	17.90
2003-04	3570.00	13.59
Total	**26260.20**	**100.00**

Source: Ministry of Commerce and Industry (Department Indian Policy and Promotion)

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During the post liberalization period, Mauritius and the USA are the largest sources of FDI for India. Mauritius being the tax heaven companies route their FDI through Mauritius. A part from Mauritius and USA, Japan U.K. and Netherland respectively were major contributors of FDI during 2002-03.

Country	₹ in Crore	Share in Total Investment
Mauritius	33820.73	40.68
USA	15409.92	18.54
Japan	7430.64	8.94
U.K.	6648.56	7.80
Netherland	5969.43	7.18
Germany	4512.30.	5.43
France	2656.57	3.20
South Korea	2489.66	2.99
Singapore	2348.04	2.82
Switzerland	1842.79	2.22
Total	**83128.64**	**100.00**

Source: Economic Survey 2003-04

After liberalization India couldn't attract much FDI in last decade as compared to its eastern neighbor. During 2003, FDI inflows to China were $ 53 bn and India only $4bn. But the actual difference is not so high. As both the countries follow different computation method for calculating FDI. Dr. Nirupama Bajpai observed (Business Line, 15 May 2004) that after making the necessary adjustments, FDI inflows, excluding the 'round tripping' into China during 1999 and 2000, reduces FDI net inflow from $ 40bn to $20 bn. On the on the other hand, India's adoption of a standard method of FDI computation should raise its net annual FDI inflow figures, as reported I the RBI's official balance of payment statistics, to rise from around $3 bn to about $8 bn.

To woo FDI, the government of India has taken various steps and has established various organization to support FDI as Secretariat For Industrial Assistance (SIA) , Foreign Investment Promotion Board, (FIPB), Focus Windows, Foreign Investment Promotion Council (FIPC) etc.

Questions

1. Has India truly arrived at the global platform as a lucrative market?
2. What are changes you notice in recent years in context of localizing India in the global market?

Source: Vivek Mittal, *Business Environment*, First Edition, Excel Books, New Delhi, 2007

10.3 Summary

- Foreign Direct Investment (FDI) is defined as an investment made by an investor of one country to acquire an asset in another country with the intent to manage that asset.
- Governments of developing nations are attracting FDI along with the technology and management skills that accompany it. To attract multinational companies, governments are offering tax holidays, import duty exemption, subsidised land and power and many other incentives.
- Multinational companies are a part of the Indian economy since the British period either as a wholly owned subsidiary or as a joint venture. They played a critical role in the

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development of the automobile industry, two wheeler industry, mining, petroleum, FMCG, etc.

- The automatic route for FDI and/or technology collaboration is not available to those who have or had any previous joint venture or technology transfer/trademark agreement in the same or allied field in India.
- Liberalization is not the sole reason to attract FDI. There are many other determinant of FDI, India may lagging there like demand conditions, factor conditions, supporting industries and firm strategy.
- FDI has a wide spread impact on a country not only economically but also socially. Foreign investment is always accompanied by superior technology and transfer of technical knows how.
- MNCs are defined as an enterprise that is headquartered in one country but has operations in one or more countries. Sometimes it is difficult to know if a firm is an MNC because multinationals often downplay the fact that they are foreign held.
- Firms cross national boundaries and accept the risk of operating in an unknown environment in the hope of earning more profit and increasing their shareholders wealth.
- Multinational firms play a pivotal role in the global economy, linking rich and poor economies, and transmitting capital, knowledge, ideas and value systems across borders.
- Multinational corporations have become too powerful in absolute terms as well as relative to governments. The enormous resources controlled by multinational corporations give them a tremendous amount of power, especially over individuals and governments.
- Up to the First Plan Approach towards imports was liberal. During Second Plan and aftermath policy of import restriction was adopted. Given the acute shortage of foreign exchange most of the time government opted for direct allocation of foreign exchange among different users and uses through import licences.
- During recent years, international agencies like the IMF and World Bank have been pressuring the developing countries to open up them in improving the economic efficiency of their industrial sector and compete in the international markets.

10.4 Keywords

Backward Linkage: Purchasing intermediate goods form domestic players

Diversification: Opening up to different markets with different products

FDI: Investment made by an investor of one country to acquire an asset in another country

Forward Linkage: Distribution chain connecting a producer or supplier with the customers

Global Companies: They look for similarities and not differences in markets

Joint Venture: Two or more companies join together, share resources, profits

LERMS: Liberalised Exchange Rate Management System

Liaison Office: Channel of communication between head office and branch office

Multi-domestic Company: Treats each of its units operating in different countries as an independent profit centre

Multinational Corporations: Enterprise that is headquartered in one country but has operations in one or more countries

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Multinational Enterprise: Company that takes a global approach to foreign markets and production

10.5 Self Assessment

State whether the following statements are true or false:

1. FDI would also include the loans and advances made by foreign companies to Indian companies.
2. Coca Cola was asked to leave India because they were not adhering to the rules of Indian market.
3. Companies like IBM and HP have opened their call centre in India only to exploit the cost benefits because labor is costly in their own country.
4. MNC have a positive impact on Indian economy in the sense that people now in addition to Maruti and Tata, also like to buy Hyundai, Ford and Toyota.
5. Most of the Indian public sector banks are Multinational Corporations.
6. Products like petrochemicals, fertilizers etc. were once in the canalized list.
7. One of the major reasons for setting up SEZs is to facilitate exports of a country.

Fill in the blanks:

8. Decisions regarding FDI are taken by the Indian Government with association with……
9. Wal-Mart has taken entry into the Indian market via alliance with……..
10. Companies like Swaraj Mazda, Bajaj Allianz, Mahindra Renault are types of …… companies.
11. The excess of imports over exports give negative……..
12. Using technical and human cognitive skills of one nation by another nation is called……..
13. ……..is the first Indian company to look beyond Indian market.

10.6 Review Questions

1. "The objective of the country as a whole was the attainment as far as possible, of national sufficiency. International trade was certainly to be included but we were anxious to avoid being drawn into the whirlpool of economic imperialism." What do you mean by the statement?
2. Critically analyse the FDI policies of the Indian Government before 1991.
3. Write a short note on history of MNCs in Indian market.
4. List the factors that led to the exit of Coca Cola from India. How did this step affect the Indian market? Do you think Indian Government took a wrong decision?
5. "India gain's in attractiveness because of its market size and its potential is diminished by negative assessment of its regulatory environment." Discuss.
6. "A nation may have comparative advantage over others because of certain factors of production." Comment in context of the Indian market.

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7. Why do you think that P&G which is otherwise a bigger company in other nations is much behind Unilever in India?
8. "Well developed ancillaries units facilitate the FDI". Discuss.
9. "Perhaps biggest beneficiary of the FDI is the Indian consumer". Do you agree? Justify.
10. There is a thin line that differentiates a Global company and MNE. Discuss the difference sand similarities using examples.
11. Suppose you are the MD of an Indian electronics company. Your company wants to expand its market to foreign territory. Considering the fierce competition in the industry, which five countries would you like to expand to and why?
12. With reference to the above questions, how will you use the resources of those countries to maximum advantage and what steps will you take to penetrate the market?
13. "Multinational corporations have become too powerful in absolute terms as well as relative to governments." Substantiate.

Answers: Self Assessment

1.	True	2.	False
3.	True	4.	False
5.	True	6.	True
7.	True	8.	Foreign Investment Promotion Board
9.	Bharti Group	10.	Transnational
11.	Balance of Payments	12.	Knowledge Transfer
13.	Aditya Birla Group		

10.7 Further Readings



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Unit 11: EXIM Policy

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Objectives

After studying this unit, you will be able to:

- Discuss the EXIM Policy
- Identify the purpose of Special Export Zones (SEZ)

Introduction

Indian foreign trade under colonial rule was controlled by the British for their own interests. After independence, the then government incorporated the Import and Export (Control) Act, 1947 with the objective of regulating imports and exports. At that time the Indian economy was affected by scarcity. To safeguard the domestic industry and to restrict the export of essential goods, it was essential to regulate international trade.

The National Planning Commission (NPC) has said, "The objective of the country as a whole was the attainment as far as possible, of national sufficiency. International trade was certainly to be included but we were anxious to avoid being drawn into the whirlpool of economic imperialism."

So in subsequent years, import substitution and protection of domestic industry became the main thrust of the EXIM policy for most of the period during 1950-51 to 1990-91. It was in 1991 that the Indian EXIM policy saw a drastic change in the form of liberalisation.

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11.1 EXIM Policy

11.1.1 Earlier EXIM Policy (Pre Reform Period)

Up to the First Plan Approach towards imports was liberal. During Second Plan and aftermath policy of import restriction was adopted. Given the acute shortage of foreign exchange most of the time government opted for direct allocation of foreign exchange among different users and uses through import licences.

On the side of imports, the principal policy measure taken with devaluation was the announcement of a liberal import policy for 59 priority industries under which arrangements were made to meet their requirements for raw materials, components and spares in full (initially for six months). The import policy for small-scale industrial units making the same products as the priority industries was also substantially liberalised. The import policy introduced in 1966-67 was continued in its basic essentials in the following two years. The policy for 1967-68 was made need-based and production- oriented and provided for the continuation of the preferential treatment for the 59 priority industries. The policy for 1968-69 placed 260 items or groups of items on the banned list since these commodities could be supplied in sufficient quantity from domestic production. Imports of another 197 items were allowed to actual users on a restricted basis as the domestic production of these items had increased substantially.



Caution The policy of import restriction was pursued up to 1977-78. Since 1978 and up to early 1980s policy of import substitution was followed. From 1985 onwards liberalization policy was initiated.

According to Rajesh Mehta ("Trade Policy Reforms, 1991-92 to 1995-96", EPW, April 12, 1997), "While the objectives of self-reliance and self-sufficiency influenced the trade policy formulation in the 1950s and 1960s, the factors like export led growth, improving efficiency and competitiveness of Indian industries prevailed upon the trade policy-making during the late 1970s and the early 1980s."

The period of first three Five Year Plans was characterized by an essentially passive export policy, though some steps to increase exports were undertaken in the Third Plan. To increase exports, the Government devalued rupee in June 1965. The post devaluation period was accompanied by a substantial elimination of export subsidies. During the period of 1973 to early 1980s, exports were accorded a high priority. Since late 1980s export promotion policy was initiated. Incentives for export production were enhanced.

In order to bring domestic prices in line with external prices, to restore and enhance the competitive power of exports, and to provide a solution to the country's trade and payments problems, the per value of the rupee was reduced by 36.5 per cent on June 6, 1966, involving a rise of 57.5 per cent in the price of foreign exchange in terms of Indian rupees. Along with devaluation, the existing special export promotion schemes providing import entitlements against exports and the scheme for tax credit certificates were abolished. Moreover, in order to protect the unit values of exports in terms of foreign exchange, export duties were levied on a number of commodities, mostly agricultural commodities and agriculture-based manufactures. A variety of additional measures were taken to promote exports. A liberal import policy was announced for 59 priority industries, including a number of export-oriented industries. A new import replenishment scheme enabled registered exporters to obtain raw materials, components and spares against export of specified products. It was decided to provide cash assistance for exports of selected products with a good export potential. A scheme for the supply of steel at

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international prices to exporters of engineering goods was announced. Imports of some raw materials were placed under an Open General Licence.

The import policy for 1968-69 was oriented to provide special import facilities for exporters. Units in the priority industries which had exported at least 10 per cent of 'their productions in 1967-68 were given facilities to import their requirements from sources of their choice. Ten priority industries were selected on the basis of their export potential and it was laid down that units engaged in these industries would have to export 5 to 10 per cent of their production, failing which they would be liable to cuts in their import entitlements.

In the field of export credit, the Reserve Bank of India introduced a scheme under which preferential rates of discount were provided for refinancing of pre-shipment credits granted by the commercial bank to certain categories of exporters at concessional rates. It also provided a subsidy to banks on export credit granted by them in the shape of packing and post-shipment advances.

During all these years there was absence of a long-term export strategy. During recent years, international agencies like the IMF and World Bank have been pressuring the developing countries to open up them in improving the economic efficiency of their industrial sector and compete in the international markets.

11.1.2 EXIM Policy 1992-1997

When the Eighth Plan commenced, the three-year Import-Export policy (1990-93), valid until March 1993 was in operation. With a view to reinforcing the trade policy reforms and complementing the fiscal, industrial and investment measures, the new five-year Export-Import Policy (1992-97) was introduced with effect from April 1992. For the first time, the policy was given an export bias. Earlier this policy was known as Import-Export policy; the new policy was titled Export-Import Policy (EXIM Policy). Several schemes were introduced or modified to eliminate regulatory measures and discretionary controls impinging on free trade.

Just before the launching of the EXIM Policy 1992-97, on March 1, 1992, the Liberalised Exchange Rate Management System (LERMS) was introduced. Under the LERMS, exporters were required to surrender 40 per cent of the foreign exchange earning at the official exchange rate. The Government would use the amount to import essential items such as petroleum, fertilisers and life saving drugs. The exporters were allowed to sell the remaining 60 per cent of the foreign exchange or use it to finance their own imports, which facility was not given to exporters in the pre-reform period. This system acted as a self-correcting mechanism to keep trade deficit under control. With effect from June 1992, the 15% Foreign Exchange Conservation (Travel) Tax was abolished. The travel tax had become redundant with the introduction of partial convertibility of rupee and Liberalised Exchange Rate Management System (LERMS) under which foreign exchange for travel had to be obtained at the market rate.

Along with this change in the exchange rate regime, the import licensing system was abolished for capital goods, intermediates and components; these items could be imported on Open General Licence (OGL) subject to payment of tariffs (Ministry of Commerce).

To promote investment by Non-resident Indians, a new deposit scheme was introduced in June 1992, under which accounts in Indian rupees could be opened with authorized dealers by remittance of funds in freely convertible foreign exchange from aboard or by transfer of funds from the existing on-resident (external)/FCNR accounts. No penalty was to be levied for premature withdrawal of existing non-resident deposits for the purpose of making investment in the proposed scheme. Full convertibility of rupee on trade account (current account) was introduced and dual or partial exchange rate was abolished. In March 1993, the exchange rate was unified and transactions on trade account were freed from exchange control.

11.1.3 EXIM Policy 1997-2002

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The new 5-year Export and Import for the period 1997-2002 aims at giving a major thrust to acceleration of India's exports through restructuring and revamping of various export promotion schemes and wide ranging measures for simplification and streaming of procedures with a view to making them more transparent and easy to administer.

The policy aims at consolidating the achievement made possible during the preceding 5-year EXIM Policy for 1992-97, while continuing the process of trade reforms and trade liberalisation with a view to achieving higher rate of export growth. The new EXIM Policy focused on the need to allow exporters to concentrate on the manufacture and marketing of their products globally in an environment unhindered by discretionary controls and procedural bottlenecks. The policy aims at enabling the industry to enhance its competitiveness in the global markets and to achieve its full potential in the areas of its strength.

Some of the major policy changes include (a) the threshold limit for EPCG zero duty scheme was brought down to ₹ 10 million (for agricultural and allied sectors from ₹ 50 million and for electricals, textiles, leather, gems and jewelry, sport goods and food processing from ₹200 million) and to ₹ 1 million in case of the software sector; (b) DEPB scheme was modified to neutralise not only the basic customs duty but also the special customs duty which was introduced as a temporary measure in 1998; and (c) exports of oilseeds for consumption purpose and vegetables were made free without any quantitative and licensing requirements (Ministry of Commerce). Several modifications to the earlier schemes were done mainly to boost services trade, particularly IT exports.



Example: The Export Promotion Capital Goods (EPCG) scheme for services sector has been introduced.

Under this scheme, capital goods are allowed to be imported for rendering services for which payments are received in a freely convertible currency. The scheme is applicable to professionals and other providers of services such as architects, consultants, economists, charted accountants, engineers and tour operators. Exemption was given to exports under all export promotion schemes from the applicability of the special additional duty of 4 per cent introduced in the 1998-99 budget. Promotional measures and procedural changes that were made in 1998 include facilities such as extension of holiday for EOU/EPZ to 10 years, sub-contracting facility for Domestic Tariff Area and permission to set up private software technology parks.

In order to promote trade among SAARC countries, India unilaterally removed all QRs on imports of 2300 items from SAARC countries with effect from August 1, 1998. On December 28, 1998, a free trade agreement was concluded between India and Sri Lanka which would result in zero import tariff for most commodities on both sides by 2007. Following the third round of negotiations held under SAARC Preferential Tariff Agreement (SAPT), the Revenue Department notified on August 11, 1999 concessional customs duties – ranging from 25 per cent to 60 per cent for least developed countries (Bangladesh, Maldives, Nepal and Bhutan) and 10 per cent to 50 per cent for the other three countries – covering items in 1800 tariff lines which account for 60 per cent of imports (Ministry of Finance).

On March 31, 1999, the following new schemes to boost service exports were introduced. The setting up of Special Economic Zones (SEZs) was announced with a view to providing internationally competitive and hassle free environment for exports. Together with the Foreign Direct Investment policy initiatives for SEZs, it is expected that these zones will have the potential to act as "magnets" for investments for export production from home and abroad.

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Example: As a first step, four existing Export Processing Zones (EPZs) – at Kandla, Santa Cruz, Cochin and Surat – were converted into SEZs with effect from 1st November, 2000. Setting up of new SEZs in the areas has been progressing steadily: Positra (Gujarat), Nangunery (Tamil Nadu), Kakinada-Vizag (Andhra Pradesh), Paradip (Orissa), Kulpi (West Bengal) and Bhadohi (Uttar Pradesh).

It is too early to judge their success. However, their success will depend on how effectively domestic regulations and infrastructure bottlenecks are eliminated in these zones. In order to provide an impetus to infrastructure development, deemed export benefits have been extended to infrastructure projects with a minimum investment of ₹ 100 crore.

With a view to making exports a national effort by involving all the State Governments, a Scheme has been evolved for granting assistance to the States on the basis of their export performance for development of export related infrastructure. To facilitate an equitable allocation of resources, this amount will be distributed on the basis of absolute export performance as well as on the basis of incremental one. To begin with, an allocation of ₹ 2.5 billion is proposed for 2001-02, which would be suitably increased in the subsequent years. There would be subsequent annual allocation for this Fund. The amount would be utilised by the States for complementary export related infrastructure, such as roads connecting the production centres with Ports, research and development of state specific ethnic products, development of cold chains for agro exports, development of minor ports, creation of new export promotion industrial parks, human resource development and for the purpose of developing marketing infrastructure. The units may be allowed to dispose of obsolete or unusable capital goods, spares and other goods in the Domestic Tariff Area (DTA) on payment of applicable customs duty. Such disposal shall, however, be subject to the Import Policy in force.

Under the SEZ scheme, the goods cleared from the Zone will be treated as imported goods. Therefore, in case of DTA clearances, though the duty charged will be central excise duty, this duty will be equal to the aggregate of all duties of customs (WTO). In other words, the SEZ units will have to pay full customs duty (applied duty) on their DTA clearances. The only laws which will operate within the SEZs will be those related to labour and banking.

A SEZ unit shall maintain proper account financial year-wise, of all foreign exchange inflow by way of exports and other receipts, all foreign exchange outflows on account of imports, payment of dividend, royalty, fees etc., consumption and utilisation of the materials and ale in the DTA. RBI will permit banks to open branches in the SEZ and permit transactions to be operated in dollars for all units. Most of the units within SEZ may be employing less than 1000 workers. With the recent change in the labour laws announced in the Union Budget 2001-2002 that a firm employing less than 1000 employees is not required to get the approval from the Government to layoff any employee or to close down the unit, labour laws particularly may not be a constraint. Further, the new law allows outsourcing and employing contract labour, which facilitates reducing employer-employee frictions in work places (Ministry of Finance).

With the view that agriculture is the responsibility of State Governments, the Central Government has insisted through the revised EXIM policy of 1997-2002 that the state governments should identify and develop product-specific Agricultural Export Zones (AEZ). It is expected that the states will identify product-specific AEZ for end-to-end development from a geographically contiguous area. They will also have to evolve a comprehensive package of services provided by all state government agencies, agricultural universities, and some Central institutions and agencies for 'intensive delivery' in these zones. The AEZ would have access to the Centre's proposed market access initiative, which will provide market research, warehousing and retail marketing infrastructure in select countries, and direct market promotion activities. Two AEZ exist, one in Tamil Nadu and another in Gujarat.

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Imports Liberalisation: India retained import of items under five categorisations – the prohibited list, the Special Import Licence (SIL) list, the restricted list, the canalised list and the free list. The number of items included in these lists keeps on changing. Of these, the restricted list has been freed and SIL abandoned and freed. The canalised list is being retained, but under a new nomenclature (the special list) and a new set of products. Thus, at present, the number of import lists has come down to three – the prohibited list, the special list and the free list.

The prohibited list contains only a few products prohibited on grounds of religious and cultural sensitivity and the list includes tallow, fat and oils of animal origin, animal rennet and wild animals including their parts and products and ivory. Bulk agricultural commodities that include grains excluding feed grade maize, edible oils, oilseeds, sugar, and non-agricultural products such as urea, petroleum products are in the special list that was earlier called canalised list. Imports of these items should be done by state agencies. Apart from the special list of consumer products, gold will continue to be imported through designated banks. Import of all primary products of plant and animal origin will also be subject to import permits to be issued by the ministry of agriculture after an import risk analysis based on sanitary and photo-sanitary measures and provisions. In addition, conditions have been prescribed for the import of new and second and cars for ensuring road safety. Import of foreign liquor, processed food products and tea wastes has to be made subject to already existing domestic regulations concerning health and hygiene. Rest of the commodities are in the free list. Imports of these freed items attract high tariffs with bound rates.

During 1997-98, the peak rate of import duty was reduced to 40 per cent ad valorem except for passenger luggage, alcoholic beverages, dried grapes and a few other products. The peak rates for imports of raw materials and capital goods for projects were reduced to 30 per cent and 20 per cent respectively. However, the special additional customs duty was raised from 2 per cent to 5 per cent on all imported goods except petroleum products and certain project imports. A surcharge of 10% on basic duty was introduced in 1998-99 mainly to control imports of consumer goods.

From 1st April 2001, removal of QRs became necessary in the face of India losing the case against the USA. By replacing QRs with high tariffs, India indicates that its promotion of free trade is not without restraint. In fact, high tariffs have been imposed on goods removed from QRs to protect the domestic industry from overseas competition. WTO permits tariff setting, so far as the applied rates do not surpass bound rates. India's applied rates are mostly lower than the bound tariffs.

11.2 Special Export Zones (SEZ)

The standard definition applied by international organisations states that an Export Processing Zone (EPZ) is an industrial area that constitutes an enclave with regard to customs' tariffs and the commercial code in force in the host country. Traditionally therefore the concept of EPZs evolved to compensate for anti-export-bias created by the Import Substitution Industrial (ISI) policy regime. An ISI strategy creates an incentive structure, which tends to be biased against the export sector. The over valued exchange rate coupled with high tariffs and Quantitative Restrictions (QRs) makes production for import substitution significantly profitable relative to production for exports.

India initiated the process of industrial growth in 1948 (immediately after the political independence), when it announced its first Industrial Policy Resolution, IPR 1948. The strategy adopted was one of import-substitution industrialisation across all sectors. Within an ISI policy framework, export promotion had also been a concern of the government. Thus, attempts to promote the EPZ as an export platform on the basis of economic incentives, such as the provision of better infrastructure and tax holidays became a feature of Indian development. The first zone

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was set up in 1965. The country has had four phases in the evolution of the EPZ policy since then. Following is a brief overview of the evolution of the EPZ policy in India through these four phases.



Did u know? The first zone was set up in Kandla in a highly backward region of Kutch in Gujarat as early as in 1965. It was followed by the Santacruz export processing zone in Mumbai which came into operation in 1973.

There was however no clarity of objectives that the government wanted to achieve. Kandla and Santacruz EPZs were set up with different sets of objectives (Tandon Committee, 1980). Operationally, an overall inward looking trade policy with umpteen controls and regulations influenced the EPZ policy also (Kundra 2000). The policies were rigid and the package of incentives and facilities was not attractive. Zone authorities had limited powers. There was no single window facility within the zone. Entrepreneurs had to acquire individual clearances from various state government and central government departments. Day-to-day operations were subjected to rigorous controls. Custom procedures for bonding, bank guarantees and movement of goods were rigid. FDI policy was also highly restrictive. According to the business environment rating index which rated investment climate in 43 countries on the basis of 18 independent factors, Indian, zones were placed at the bottom for FDI.

Towards the end of the 1970s, India's failure to step up significantly the volume of her manufactured exports in the background of the Second Oil Price Shock began to worry the policy makers. To provide fillip to exports, the government decided to establish four more zones in 1984. These were at Noida (Uttar Pradesh), Falta (West Bengal) Cochin (Kerala) and Chennai (Tamil Nadu). Thereafter, Visakhapatnam EPZ in Andhra Pradesh was established in 1989, though it could not become operational before 1994. All these zones with the exception of Chennai were set up in industrially backward regions. The primary objectives of the zones were still not specified and there were no significant changes in other laws and procedures pertaining to the EPZs.

In 1991 massive dose of liberalization was administered in the Indian economy.

In this context, wide-ranging measures were initiated by the government for revamping and restructuring EPZs also (See Kundra 2000 for details). This phase was thus marked by progressive liberalisation of policy provisions and relaxation in the severity of controls and simplification of procedures. The focus had been on delegating powers to zone authorities, providing additional fiscal incentives, simplifying policy provisions and providing greater facilities. The scope and coverage of the EPZ/EOU scheme was enlarged in 1992 by permitting the agriculture, horticulture and aqua culture sector unit also. In 1994, trading, re-engineering and re-conditioning units were also permitted to be set up.

11.2.1 Key Features of SEZ Scheme

Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs. Goods and services going into the SEZ area from DTA shall be treated as exports and goods and services coming from the SEZ area into DTA shall be treated as if these are being imported. SEZ units may be set up for manufacture of goods and rendering of services.

SEZ unit may import/procure from the DTA without payment of duty all types of goods and services, including capital goods, whether new or second hand, required by it for its activities or in connection therewith, provided they are not prohibited items of imports in the ITC(HS). The units shall also be permitted to import goods required for the approved activity, including

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capital goods, free of cost or on loan from clients. SEZ unit may, on the basis of a firm contract between the parties, source the capital goods from a domestic/foreign leasing company. SEZ unit shall be a positive Net Foreign Exchange earner. Net Foreign Exchange Earning (NFE) shall be calculated cumulatively for a period of five years from the commencement of production.

As per the "Special Economic Zones Rules, 2006", notified by the Department of Commerce, in case a SEZ is proposed to be set up exclusively for electronics hardware and software, including information technology enabled services, the area shall be ten hectares or more with a minimum built up processing area of one lakh square meters.

The SEZ Act 2005 envisages key role for the State Governments in Export Promotion and creation of related infrastructure. A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of Approval (BoA). The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically. All decisions of the Board of approvals are with consensus.

The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

Approval mechanism: The developer submits the proposal for establishment of SEZ to the concerned State Government. The State Government has to forward the proposal with its recommendation within 45 days from the date of receipt of such proposal to the Board of Approval. The applicant also has the option to submit the proposal directly to the Board of Approval.

11.2.2 Objectives of SEZ Scheme

The main objectives of the SEZ Act are:

1. Generation of additional economic activity
2. Promotion of exports of goods and services
3. Promotion of investment from domestic and foreign sources
4. Creation of employment opportunities
5. Development of infrastructure facilities

11.2.3 Benefits of SEZ Scheme

It is expected that this will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:

1. Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units.
2. 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
3. Exemption from minimum alternate tax under section 115JB of the Income Tax Act.

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4. External commercial borrowing by SEZ units up to US $ 500 million in a year without any maturity restriction through recognized banking channels.
5. Exemption from Central Sales Tax.
6. Exemption from Service Tax.
7. Single window clearance for Central and State level approvals.
8. Exemption from State sales tax and other levies as extended by the respective State Governments.

The major incentives and facilities available to SEZ developers include:

1. Exemption from customs/excise duties for development of SEZs for authorized operations approved by the BOA.
2. Income Tax exemption on income derived from the business of development of the SEZ in a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act.
3. Exemption from minimum alternate tax under Section 115 JB of the Income Tax Act.
4. Exemption from dividend distribution tax under Section 115O of the Income Tax Act.
5. Exemption from Central Sales Tax (CST).
6. Exemption from Service Tax (Sections 7, 26 and Second Schedule of the SEZ Act).

11.3 Summary

- When the Eighth Plan commenced, the three-year Import-Export policy (1990-93), valid until March 1993 was in operation. With a view to reinforcing the trade policy reforms and complementing the fiscal, industrial and investment measures, the new five-year Export-Import Policy (1992-97) was introduced with effect from April 1992.
- The new 5-year Export and Import for the period 1997-2002 aims at giving a major thrust to acceleration of India's exports through restructuring and revamping of various export promotion schemes and wide ranging measures for simplification and streaming of procedures with a view to making them more transparent and easy to administer.
- The standard definition applied by international organisations states that an Export Processing Zone (EPZ) is an industrial area that constitutes an enclave with regard to customs' tariffs and the commercial code in force in the host country.
- Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs.
- The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

11.4 Keywords

Canalisation: Erstwhile import of certain commodities was allowed only through specific government agency. This is called canalisation, where the import of these goods is canalised through government agency.

Import substitution: It means decreasing the dependability on imports i.e. is to produce goods that we import. It was a policy followed by India after independence.

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Liberalized Exchanged Rate Systems (LERS): It is a system under which 40% of the foreign exchange receipts were to be exchanged through RBI at the official exchange rate and rest is allowed to be converted at market exchange rate.

Open General License (OGL): Items included in the list of OGL can be imported easily without much government restriction.

11.5 Self Assessment

Fill in the blanks:

1. The ..... for small-scale industrial units making the same products as the priority industries was also substantially liberalized.
2. A scheme for the supply of steel at international prices to exporters of engineering goods was announced. Imports of some raw materials were placed under an .....
3. In the field of ....., the Reserve Bank of India introduced a scheme under which preferential rates of discount were provided for refinancing of pre-shipment credits granted by the commercial bank to certain categories of exporters at concessional rates.
4. The travel tax had become redundant with the introduction of partial convertibility of rupee and ..... under which foreign exchange for travel had to be obtained at the market rate.
5. The policy aims at enabling the industry to enhance its ..... in the global markets and to achieve its full potential in the areas of its strength.
6. Under the ....., the goods cleared from the Zone will be treated as imported goods.
7. It is expected that the states will identify ..... for end-to-end development from a geographically contiguous area.
8. The standard definition applied by ..... states that an Export Processing Zone (EPZ) is an industrial area that constitutes an enclave with regard to customs' tariffs and the commercial code in force in the host country.
9. ..... is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs.
10. EXIM policy of ……..freed the trade account transactions from the control of exchanges.
11. Special centres established by the government for promotion of farming exports are .....

11.6 Review Questions

1. Critically analyse the EXIM policy of 1992-1997 and 1997-2002.
2. "Special Economic Zone is a specifically delineated duty free enclave". Explain the statement. How does SEZ generate additional economic activity?
3. What do you understand by the new Trade Policy of 1991?
4. What do you know about the EXIM Policy 2002-07?
5. Discuss the key features of current Exim Policy.

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6. Critically analyse the EXIM policy of 1992-1997 and 1997-2002.
7. "Special Economic Zone is a specifically delineated duty free enclave". Explain the statement.
8. How does SEZ generate additional economic activity

Answers: Self Assessment

1. Import policy
2. Open General Licence
3. Export credit
4. Liberalized Exchange Rate Management System (LERMS)
5. Competitiveness
6. SEZ scheme
7. Product-specific AEZ
8. International organisations
9. Special Economic Zone (SEZ)
10. 1992-1997
11. Agricultural Export Zones

11.7 Further Readings



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Unit 12: International Monetary Fund

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Objectives

After studying this unit, you will be able to:

- Explain the role of International Organisations
- Discuss the financial of IMF

Introduction

Growing Importance of International Business Environment: In the recent past, many meanings of the word 'globalisation' have accumulated. The word 'globalise' was first attested by the Merriam Webster Dictionary in 1944. To consider the history of globalisation, some authors focus on events since 1492, but most scholars and theorists concentrate on a much more recent past.

Long before 1492, people began to link together disparate locations on the globe into extensive systems of communication, migration, and interconnections. This formation of systems of interaction between the global and the local has been a central driving force in world history.

In 325 BC Chandragupta Maurya becomes a Buddhist and combines the expansive powers of a world religion, trade, economy, and imperial armies for the first time. Greeks (Selukas) sue for peace with Chandragupta in 325 BC at Gerosia, marking the eastward link among overland routes between the Mediterranean, Persia, India, and Central Asia.

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By 1350, networks of trade which involved frequent movement of people, animals, goods, money, and micro-organisms ran from England to China, through France and Italy, across the Mediterranean to the Levant and Egypt, and then across Central Asia (the Silk Road) and along sea lanes down the Red Sea, across the Indian Ocean, and through the Straits of Malacca to the China coast.

Between 1492 and 1498: Columbus and Vasco da Gama travel west and east to the Indies, inaugurating an age of European sea-borne empires.

In South Asia, it should be noted, the Delhi Sultanate and Deccan states provided a system of power that connected the inland trading routes of Central Asia with the coastal towns of Bengal and the peninsula and thus to Indian Ocean trade for the first time.

The commodities trade continued well into the seventeenth century, concentrating on local products from each region of the Eurasian system – Chinese silk and porcelain, Sumatra spices, Malabar cinnamon and pepper, etc. – but by the 1600s, long - distance trade was more deeply entrenched in the production process. An expansion of commercial production and commodities trade was supported by the arrival into Asia of precious metals from the New World, which came both from the East and West (the Atlantic and Pacific routes – via Palestine and Iran, and also the Philippines and China).

Liberalisation of the 19th century is often called "The First Era of Globalisation". The "First Era of Globalisation" is said to have broken down in stages, beginning with the First World War, and then collapsing with the crisis of gold standard in the late 1920s and early 1930s. Countries that engaged in that era of globalisation, including the European core, some of the European periphery and various European offshoots in the Americas and Oceania, prospered. Inequality between those states fell, as goods, capital and labour flowed remarkably freely between nations.

12.1 International Monetary Fund (IMF)

The International Monetary Fund was established by an international treaty in 1945 to help promote the health of the world economy. Headquartered in Washington, D.C., it is governed by its almost global membership of 184 countries.

The IMF is the central institution of the international monetary system – the system of international payments and exchange rates among national currencies that enable business to take place between countries.

12.1.1 The Origins of the IMF

The IMF was conceived in July 1944 at an international conference held at Bretton Woods, New Hampshire, U.S.A., when delegates from 44 governments agreed on a framework for economic cooperation partly designed to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s.

During that decade, as economic activity in major industrial countries weakened, countries attempted to defend their economies by increasing restrictions on imports; but this just worsened the downward spiral in world trade, output, and employment. To conserve dwindling reserves of gold and foreign exchange, some countries curtailed their citizens' freedom to buy abroad, some devalued their currencies, and some introduced complicated restrictions on their citizens' freedom to hold foreign exchange.

These fixes, however, also proved self-defeating, and no country was able to maintain its competitive edge for long. Such "beggar-thy-neighbour" policies devastated the international

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economy; world trade declined sharply, as did employment and living standards in many countries.

As World War II came to a close, the leading allied countries considered various plans to restore order to international monetary relations, and at the Bretton Woods conference the IMF emerged. The country representatives drew up the charter (or Articles of Agreement) of an international institution to oversee the international monetary system and to promote both the elimination of exchange restrictions relating to trade in goods and services, and the stability of exchange rates.

The IMF came into existence in December 1945, when the first 29 countries signed its Articles of Agreement.

12.1.2 The IMF's Purposes

The purposes of the International Monetary Fund are:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions, which hamper the growth of world trade.
5. To provide confidence to members by making general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with an opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.



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The IMF's Main Business: Macroeconomic and Financial Sector Policies

The IMF focuses mainly on a country's macroeconomic policies—that is, policies relating to the government's budget, the management of interest rates, money, and credit, and the exchange rate—and financial sector policies, including the regulation and supervision of banks and other financial institutions. In addition, the IMF pays due attention to structural policies that affect macroeconomic performance—including labor market policies that affect employment and wage behaviour. The IMF advises each member on how its policies in these areas may be improved to allow the more effective pursuit of goals such as high employment, low inflation, and sustainable economic growth—that is, growth that can be sustained without leading to such difficulties as inflation and balance of payments problems.

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12.1.3 Organization of IMF

The IMF is accountable to its member countries, and this accountability is essential to its effectiveness.

The day-to-day work of the IMF is carried out by an Executive Board, representing the IMF's 184 members, and an internationally recruited staff under the leadership of a Managing Director and three Deputy Managing Directors – each member of this management team being drawn from a different region of the world.

The powers of the Executive Board to conduct the business of the IMF are delegated to it by the Board of Governors, which is where ultimate oversight rests.

Board of Governors

The Board of Governors are represented by all member countries and it is the highest authority governing the IMF. It usually meets once a year, at the Annual Meetings of the IMF and the World Bank. Each member country appoints a Governor – usually the country's minister of finance or the governor of its central bank – and an Alternate Governor. The Board of Governors decides on major policy issues but has delegated day-to-day decision-making to the Executive Board.

Executive Board

It consists of 24 Executive Directors, with the Managing Director as Chairman. The Executive Board usually meets three times a week, in full-day sessions, and more often if needed, at the organization's headquarters in Washington, D.C. The IMF's five largest shareholders – the United States, Japan, Germany, France, and the United Kingdom – along with China, Russia, and Saudi Arabia, have their own seats on the Board. The other 16 Executive Directors are elected for two-year terms by groups of countries, known as constituencies.

Key policy issues relating to the international monetary system are considered twice-yearly in a committee of Governors called the International Monetary and Financial Committee, (IMFC) (until September 1999 known as the Interim Committee). A joint committee of the Boards of Governors of the IMF and World Bank called the Development Committee advises and reports to the Governors on development policy and other matters of concern to developing countries.

Managing Director

The Executive Board selects the Managing Director, who besides serving as the chairman of the Board, is the chief of the IMF staff and conducts the business of the IMF under the direction of the Executive Board. Appointed for a renewable five-year term, the Managing Director is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.

IMF employees are international civil servants whose responsibility is to the IMF, not to national authorities. The organization has about 2,800 employees recruited from 141 countries. About two-thirds of their professional staff are economists. The IMF's 26 departments and offices are headed by directors, who report to the Managing Director. Most staff work in Washington, although about 90 resident representatives are posted in member countries to help advise on economic policy. The IMF maintains offices in Paris and Tokyo for liaison with other international and regional institutions, and with organizations of civil society. It also has offices in New York and Geneva, mainly for liaison with other institutions in the UN system.

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12.1.4 Financing of the IMF

The IMF's resources come mainly from the quota (or capital) subscriptions that countries pay when they join the IMF, or following periodic reviews in which quotas are increased. Countries pay 25 % of their quota subscriptions in Special Drawing Rights (SDRs) or major currencies, such as U.S. dollars or Japanese yen; the IMF can call on the remainder, payable in the member's own currency, to be made available for lending as needed. Quotas determine not only a country's subscription payments, but also the amount of financing that it can receive from the IMF, and its share in SDR allocations. Quotas also are the main determinant of countries' voting power in the IMF.

Quotas are intended broadly to reflect members' relative size in the world economy: the larger a country's economy in terms of output, and the larger and more variable its trade, the higher its quota tends to be.



Example: The United States of America, the world's largest economy, contributes most to the IMF, 17.5 % of total quotas; Palau, the world's smallest, contributes 0.001 %. If necessary, the IMF may borrow to supplement the resources available from its quotas.

Determination of Member Country's Quota

A member quota is broadly determined by its economic position relative to other members. When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members considered by the IMF to be broadly comparable in economic size and characteristics. Quotas are denominated in Special Drawing Rights (SDRs).

Functions of Quotas

A member's quota delineates basic aspects of its financial and organizational relationship with the IMF, including:

1. ***Subscriptions:*** A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full upon joining the Fund: up to 25 % must be paid in SDRs or widely accepted currencies (such as the US dollar, the euro, the yen, or the pound sterling), while the rest is paid in the member's own currency.
2. ***Voting power:*** The quota largely determines a member's voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of quota.



Example: Accordingly, the United States has 371,743 votes (17.1 percent % of the total), and Palau has 281 votes (0.013 % of the total).

3. ***Access to financing:*** The amount of financing a member can obtain from the IMF (its access limit) is based on its quota.
4. ***SDR allocations:*** A members' share of general SDR allocations is established in proportion to its quota.

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Role of IMF in Serving its Members

The IMF helps its member countries by:

1. reviewing and monitoring national and global economic and financial developments and advising members on their economic policies;
2. lending them hard currencies to support adjustment and reform policies designed to correct balance of payments problems and promote sustainable growth; and
3. offering a wide range of technical assistance, as well as training for government and central bank officials, in its areas of expertise.

1. ***Advice on Policies and Global Oversight:*** The IMF's Articles of Agreement calls for it to oversee the international monetary system, including by exercising firm "surveillance" – that is, overlooking – over its member countries' exchange rate policies. The IMF conducts its oversight in three ways:

   (a) Country surveillance, it takes the form of regular (usually yearly) comprehensive consultations with individual member countries about their economic policies, with interim discussions as needed. The consultations are referred to as "Article IV consultations" as they are mandated by Article IV of the IMF's charter. (They are also referred to as "bilateral" consultations, but this is strictly speaking a misnomer: when the IMF consults with a member country, it represents the entire membership, so that the consultations are really always multilateral.)

   (b) Global surveillance, it entails reviews by the IMF's Executive Board of global economic trends and developments. The main reviews of this kind are based on World Economic Outlook and Global Financial Stability reports prepared by IMF staff, normally twice a year, before the semiannual meetings of the International Monetary and Financial Committee (IMFC).

   (c) Regional surveillance, under this the IMF examines policies pursued under regional arrangements.



Example: This includes Board discussions of developments in the European Union, the euro area, the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Eastern Caribbean Currency Union.

IMF management and staff also participate in surveillance discussions of such groups of countries as the G-7 (the Group of Seven major industrial countries) and APEC (the Asia-Pacific Economic Cooperation forum).

2. ***Lending to Help Countries in Difficulty:*** The IMF lends foreign exchange to countries with balance of payments problems. An IMF loan eases the adjustment that a country has to make to bring its spending in line with its income so as to correct its balance of payments problem. But IMF lending is also intended to support policies, including structural reforms, that will improve a country's balance of payments position and growth prospects in a lasting way.
3. ***Technical Assistance and Training:*** The IMF shares its expertise with member countries on a regular basis by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration,

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and official statistics. The IMF provides technical assistance and training mainly in four areas:

(a) strengthening monetary and financial sectors through advice on banking system regulation, supervision, and restructuring, foreign exchange management and operations, clearing and settlement systems for payments, and the structure and development of central banks;

(b) supporting strong fiscal policies and management through advice on tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and the management of internal and external debt;

(c) compiling, managing, and disseminating statistical data and improving data quality; and

(d) drafting and reviewing economic and financial legislation.

4. ***Reducing Debt Burdens:*** In 1996, the World Bank and the IMF unveiled the HIPC Initiative to reduce the debt burdens of the world's poorest countries. This initiative was viewed as a means of helping the countries concerned achieve economic growth and reduce poverty.



Did u know? **Facts about IMF**

Current membership: 184 countries

Staff: approximately 2,700 from 141 countries

Total Quotas: $327 billion (as of 2/28/05)

Loans outstanding: $90 billion to 82 countries, of which $10 billion to 59 on concessional terms (as of 2/28/05)

12.1.5 Criticism of IMF

It is said that IMF policy makers support capitalist dictatorship, and is friendly to American and European corporations. Critics claim that financial aid from the IMF is always come bound with conditionalities, throwing the IMF's stated goals to the winds.

The IMF frequently advocates currency devaluations, criticised by proponents of supply-side economics as inflationary. Secondly, they link higher taxes under "austerity programmes" with economic contraction.

It is believed that IMF interventions aggravate poverty and the debts of developing nations. Argentina, which had been considered by the IMF to be a model country in its compliance to policy proposals by the Bretton Woods institutions, experienced a catastrophic economic crisis in 2001, generally believed to have been caused by IMF-induced budget restrictions – which undercut the government's ability to sustain national infrastructure even in crucial areas such as health, education, and security – and privatisations of strategically vital national resources. The crisis added to widespread hatred of this institution in Argentina and other South American countries, with many blaming the IMF for the region's economic problem.

India's Relations with the International Monetary Fund

India and the IMF have a positive relationship. The IMF has provided financial assistance to India, which has helped in boosting the country's economy. The IMF praised the country for it was able to avoid the Asian Financial Crisis in 1999 and was also able to maintain the average

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rate of growth of its economy. The Managing Director of International Monetary Fund Rodrigo De Rato visited India in May 2005. In 2005, the IMF said that the budget of India is very positive for it points that the economy of the country will grow at the rate of 6.7%.

International Monetary Fund said that the reasons behind the economy growth of India are that the RBI has been able to control inflation and has also handled its monetary policies very skillfully. The IMF has suggested that India can become a financial super power by bringing in more reforms in its economic policies that will increase its growth rate to 8%.

The loans provided by IMF to India:

1. SDR 3,260,405,000 in 1992
2. SDR 3,584,905,000 in 1993
3. SDR 2,763,180,833 in 1994
4. SDR 1,966,633,125 in 1995
5. SDR 1,085,250,003 in 1996
6. SDR 589,791,667 in 1997
7. SDR 284,916,664 in 1998
8. SDR 38,500 in 1999

The Current Relationship between IMF and India

The relationship between the IMF and India has grown strong over the years. In fact, the country has turned into a creditor to the IMF and has stopped taking loans from it. India and IMF must continue to boost their relationship this way, as it will prove to be advantageous for both.



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Transcript of Conference Call by a Senior Official of the International Monetary Fund on the IMF's Sale of Gold to the Reserve Bank of India

Washington, D.C., Monday, November 2, 2009

SENIOR IMF OFFICIAL: Good evening, everyone.

Let me say a few words just as background to the announcement this evening. As I'm sure you all know, in mid-September, on September 18, the IMF's Executive Board approved a limited gold sale to finance the Fund's New Income Model, and also to help boost the Fund's concessional lending capacity, and the sale was strictly limited to 403.3 metric tons.

And at the time, we noted that the Board approved two broad modalities for the sale. One was direct off-market sales to official purchasers, if there was interest from official purchasers. And the second was on-market sales which would be conducted in a phased manner consistent with the approach followed by central banks that participate in the Central Bank Gold Agreement.

So, today we are announcing the sale of 200 metric tons of gold to the Reserve Bank of India. That's just under half the total amount that was approved for sale by the Executive Board.

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As is laid out in the Press Release, this sale was phased over a period of two weeks, ending last Friday, October 30, and each sale was conducted based on the prevailing market prices on the day of the sale, with total proceeds equivalent to about $6.7 billion, or about 4.2 billion SDRs.

We are making the announcement tonight, consistent with the approach that we have indicated we would take, of being very transparent with the sales, and reporting regularly on the progress.

I think those are the main points. I'll stop there. Happy to take any questions.

QUESTIONER: Thank you. I have a question about the market price of gold. Obviously, you are very lucky; what's your sense on this.

SENIOR IMF OFFICIAL: Obviously, you know the price has recently been fluctuating a bit over $1,000 an ounce, and we'll only know the average price once settlement is completed. We're in the process of finalizing now, but probably (the average price will be) just under $1,045 per ounce.

QUESTIONER: Thank you. When you planned this sale, you planned on $850/oz price. Now it's more than $1,000. Do you have a feeling that you couldn't have been more lucky?

SENIOR IMF OFFICIAL: Obviously, it's a good price relative to the original assumptions. You might recall, as part of the agreement on stepping up our financing to low-income countries, we had already agreed that part of the proceeds from the sale would be used to generate resources for concessional lending. So this certainly helps with that.

Of course, this is only half the sale that we have completed, so we don't want to get ahead of ourselves. We still have another half to go. I hope we'll still be lucky.

QUESTIONER: I was wondering how soon after the agreement in September did India come forward to buy the gold? And I was wondering if you've got any potential buyers lined up for the remaining 203 tons of gold?

SENIOR IMF OFFICIAL: I don't recall exactly when India came forward. We've been in discussions for a while. Obviously it's a sale for a large amount, so it's taken a little while to finalize the details. So we've been in discussions for a while leading up to the sale. And, as I mentioned, it took place over a period of two weeks.

I can't really comment on other potential interests. Obviously, as we indicated back in September, we stand ready to sell the gold directly to central banks or other official holders if there's interest. But I wouldn't want to comment beyond that at this point.

QUESTIONER: And I was wondering why the sales-this is just for my knowledge-take place over two weeks?

SENIOR IMF OFFICIAL: Well, given its size, I think both from the Fund's point of view and also the Reserve Bank of India, this was a really to give some protection against short-term fluctuations in the price. Obviously this is an off-market sale, but we do it based on the price prevailing on the day. The price can fluctuate up and down for various reasons on a day-to-day basis. So we felt it would give some protection against short-term fluctuations to do it on a phased basis over two weeks, rather than just all at the price prevailing on one day.

QUESTIONER: Given the good price you got for this gold, would you consider putting more than previously planned for help for countries, given that there are not many donor countries ready to step forward and help-especially for lower rates?

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A second question, just technical-so does India pay you in SDRs for this transaction?

And finally, are you optimistic you won't need to go to the market to sell all of the gold?

SENIOR IMF OFFICIAL: On the first question-well, the decision to sell is very clearly limited to 403 tons. That's the decision taken by the Board. And so far the Board has also decided that a certain amount, which was roughly SDR 500 to 600 million of resources linked to the sale would be provided for concessional subsidies for concessional lending. So those are the decisions that have been taken so far.

As I said, we haven't yet sold all the gold, so we don't yet know whether, at the end of the day, we will have more than we were originally anticipating, or how much more. So I think it's probably too early to speculate on that.

In terms of payment, the payments are in currencies, not in SDRs. So the payment will be settled in the major currencies that make up the SDR basket.

The third question was-sorry, I missed the third question.

QUESTIONER: Whether you're optimistic that you won't need to sell on the market.

SENIOR IMF OFFICIAL: Well, again, this depends whether there's further interest from the official sector. If not, we would still proceed as we've planned previously. And we have indicated that before we start any on-market sales we would inform the market that we are beginning those sales.

Again, it's probably too early to tell, but we are certainly proceeding with our original plans, and we'll see if there's more off-market demand or we'll begin the on-market sales.

QUESTIONER: You'd said that you plan to be transparent and provide the public with announcement of the progress. And I'm wondering why the decision was made not to make an announcement during hours when the market's open for trading. You know, it's six o'clock now. The market's kind of closed.

SENIOR IMF OFFICIAL: Well, the markets are always open somewhere … and the market will be opening, I guess, in Asia pretty soon. So I don't think there's any particular good time to make these announcements.

As I said, the transactions were only concluded on Friday, and we wanted to get the announcement out as quickly as possible.

Source: imf.org

12.2 International Bank for Reconstruction and Development (World Bank)

The World Bank is one of the world's largest sources of finance and knowledge to its member countries to improve the condition of health centres, provide water and electricity, fight disease, and protect the environment. The World Bank is not a "bank" in the common sense. The World Bank is an international organization owned by the 184 countries both developed and developing that are its members. Since inception in 1944, the World Bank has expanded from a single institution to a closely associated group of five development institutions.

In June 1944, 17 countries met in Atlantic City, USA to prepare the agenda for the Bretton Woods conference, and 44 countries which signed the final agreement established the Bank. India was one of the 17 countries and one of the 44 countries which signed the agreement. It was India which suggested the name "International Bank for Reconstruction and Development" (IBRD) to

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the drafting committee. The Indian delegation was led by Sir Jeremy Raisman, Finance Member of the Government of India and included Sir C. D. Deshmukh (Governor of the Reserve Bank of India, later to become India's Finance Minister), Sir Theodore Gregory (the first Economic Advisor to the Government of India), Sir R.K. Shanmugan Chetty (later independent India's first Finance Minister), Mr. A.D. Shroff (one of the architects of the Bombay Plan) and Mr B.K. Madan (later India's Executive Director in IMF).

IBRD is made up of two unique development institutions owned by 184 member countries – the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Each institution plays a different but supportive role in our mission of global poverty reduction and the improvement of living standards. Besides, it also has three affiliates named:

1. The International Finance Corporation (IFC),
2. The International Centre for Settlement of Investment Disputes (ICSID),
3. The Multilateral Investment Guarantee Agency (MIGA).

All five of these institutions together make up the World Bank Group.



Notes Total member countries in each institution:

1. The International Bank for Reconstruction and Development (IBRD) - 184
2. The International Development Association (IDA) - 165
3. The International Finance Corporation (IFC) - 178
4. The Multilateral Investment Guarantee Agency (MIGA) - 167
5. The International Centre for Settlement of Investment Disputes (ICSID) - 142

12.2.1 Purpose of Organization

The purposes of the Bank as described in its articles:

1. The main purpose of the bank is to assist economies in the reconstruction and development by facilitating the investment of capital for productive purposes, it also helps in reconstruction of economies destroyed or disrupted by war, and it encourages the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.
4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with the first.

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5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

12.2.2 Activities of IBRD

The World Bank's two closely affiliated entities-the International Bank for Reconstruction and Development (IBRD) and The International Development Association (IDA) - provide low or no interest loans and grants to countries that have unfavourable or no access to international credit markets.

Fund Generation

IBRD finance is lending by selling AAA-rated bonds in the world's financial markets. While IBRD earns a small margin on this lending, the greater proportion of its income comes from lending out its own capital. This capital consists of reserves built up over the years and money paid in from the bank's 184 member country shareholders. IBRD's income also pays for World Bank operating expenses and has contributed to IDA and debt relief.

IDA, the world's largest source of interest-free loans and grant assistance to the poorest countries, is replenished every three years by 40 donor countries. Additional funds are regenerated through repayments of loan principal on 35-to-40-year, no-interest loans, which are then available for re-lending. IDA accounts for nearly 40% of our lending.

Loans

IBRD offers two basic types of loans and credits.

Investment loans are made to countries for goods, works and services in support of economic and social development projects in a broad range of economic and social sectors.

Development policy loans (formerly known as adjustment loans) provide quick-disbursing financing to support countries' policy and institutional reforms.

The Bank may guarantee, participate in, or make loans to any member or any political sub-division thereof and any business, industrial, and agricultural enterprise in the territories of a member.

Each borrower's project proposal is assessed to ensure that the project is economically, financially, socially and environmentally sound. During loan negotiations, the bank and borrower agree on the development objectives, outputs, performance indicators and implementation plan, as well as a loan disbursement schedule. The Bank ensures that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.

Grants

Grants are given for development projects by encouraging innovation, co-operation between organizations and local stakeholders' participation in projects. In recent years, grants have been used for numerous purposes. Some of them are:

1. Relieve the debt burden of heavily indebted poor countries
2. Improve sanitation and water supplies

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3. Support vaccination and immunisation programs to reduce the incidence of communicable diseases like malaria
4. Combat the HIV/AIDS pandemic
5. Support civil society organizations
6. Create initiatives to cut the emission of greenhouse gasses

Analytic and Advisory Services

IBRD also provides analysis, advice and information to member countries. IBRD does this in several ways – through economic research on broad issues such as the environment, poverty, trade and globalisation and through country-specific economic and sector work, where it evaluates a country's economic prospects by examining its banking systems and financial markets, as well as trade, infrastructure, poverty and social safety net issues.

IBRD has a big knowledge bank which contains wealth of contacts, knowledge, information and experience that it has acquired over the years, country by country and project by project. Through its knowledge bank it educates clients so that they can solve their development problems and promote economic growth.

Following are some more ways through which it provides analyses, advice and knowledge to members:

1. Poverty Assessment
2. Social and Structural Reviews
3. Public Expenditure Reviews
4. Sector Reports
5. Country Economic Memoranda
6. Knowledge Sharing

12.2.3 Organisation of World Bank

Board of Governors

The World Bank is like a cooperative, where its 184 member countries are shareholders. The shareholders are represented by a Board of Governors, who are the ultimate policy makers at the World Bank. Generally, the governors are member countries' ministers of finance or ministers of development. They meet once a year at the Annual Meetings of the Boards of Governors of the World Bank Group and the International Monetary Fund. Board of Governors are responsible for key decisions such as admission of new members, increase or decrease of capital stock, suspension of member, cooperation with other international organizations, suspension of working of bank, distribution of income of bank, etc.

Executive Directors

Because the governors only meet annually, they delegate specific duties to 24 Executive Directors, who work on-site at the Bank. Before November 1, 1992, there were 22 Executive Directors, 17 of whom were elected. In 1992, in view of the large number of new members that had joined the Bank, the number of elected Executive Directors increased to 19. The two new seats, Russia and a new group around Switzerland, brought the total number of Executive Directors to its present

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level of 24. The five largest shareholders France, Germany, Japan, the United Kingdom and the United States appoint an executive director, while other member countries are represented by 19 executive directors.

The President of the World Bank chairs meetings of the Boards of Directors and is responsible for overall management of the Bank. By tradition, president of the Bank is a national of and is nominated by the largest shareholder in the bank, the United States. He is elected by the Board of Governors for a five-year, renewable term.

The World Bank operates under the leadership and direction of the president, management and senior staff, and the vice presidents in charge of regions, sectors, networks and functions.

There are four Boards of Executive Directors representing the four institutions of the World Bank Group: International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA). The Executive Directors serving on these boards are usually the same.

Vice Presidents

They are the principle managers of the Bank and look after its operations. Vice Presidents are appointed for different functions such as VP Finance, VP Network, VP Regions (South Asia, Africa, Latin America etc.) VP Audit, VP Controller, VP Strategy, Finance and Risk Management, VP Human Resource, VP External Affair, etc.



Did u know? **Basic Facts about World Bank**

Established on: July1, 1944, Bretton Woods, New Hampshire

Headquarters: Washington DC

President: Paul Wolfowitz

Membership: 184

Affiliates: IDA, IFC, MIGA, ICSID

International Development Association (IDA)

The IDA is the soft loan section of the World Bank established in 1960. Its loans are different from World Bank loans in several manners. It provides concessional loans which have a maturity of up to 40 years compared with 15 to 25 years' maturities of IBRD. The IDA can also grant grace period of 10 years before repayment of principal or interest begin, whereas the grace period of World Bank usually does not exceed 5 years.

International Finance Corporation (IFC)

The IFC's main function is to assist in the economic advancement of LDCs by promoting growth in the private sector of their economies by helping to mobilize domestic and foreign capital for this purpose. It was established in July 1956 to help strengthen the private sector in developing countries, through the provision of long-term loans, equity investments, guarantees, standby financing, risk management and quasi-equity instruments such as subordinated loans, preferred stock and income notes, through advice and technical assistance to business and government.

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Multilateral Investment Guarantee Agency (MIGA)

The Multilateral Investment Guarantee Agency, established in 1988, with an objective to create an attractive investment climate and to encourage equity investment and other direct investment flows to developing countries. MIGA offers investors guarantees against non-commercial risks (political risk), advices developing member governments on the design and implementation of policies, programmes, and procedures related to foreign investment and sponsors a dialogue between the international business community and host governments on investment issues. To promote FDI, MIGA provide three key services:

1. ***Political Risk Insurance:*** To promote foreign investment in developing countries.
2. ***Technical Assistance:*** To promote and create conducive climate for foreign investment and to establish new investment opportunities in developing countries.
3. ***Dispute Mediation:*** It provides dispute mediation services to remove obstacles and to unlock bottlenecks in the way of foreign investment.

International Centre for Settlement of Investment Disputes (ICSID)

The International Centre of Settlement of Investment Disputes came into existence in 1966 with an objective to work as a facilitator in settlement of investment disputes between governments and foreign investors. ICSID has an Administrative Council and Secretariat. The President of World Bank is also the Chairperson of Administrative Council. All the members of ICSID are also the members of World Bank. ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries.

Asian Development Bank (ADB)

The ADBs equivalent of the World Bank's concessionary-finance arm IDA is called the Asian Development Fund (ADF) and the Bank is known as Asian Development Bank. ADB is a multilateral development finance institution dedicated to reducing poverty in Asia and the Pacific region. ADB was established in 1966, and now has 4 members, mostly from the region. The headquarters is in Manila and it has 26 other offices around the world.

ADB's development work is aimed at improving the welfare of the people of Asia and the Pacific, especially of the 690 million poor living on less than a dollar a day.

ADB has the following objectives:

1. Economic Growth
2. Human Development
3. Gender and Development
4. Good Governance
5. Environmental Protection
6. Private Sector Development



Task Collect recent news about the IMF and the World Bank.

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South Asian Association for Regional Cooperation (SAARC)

The South Asian Association for Regional Cooperation was established on December 8, 1985. It involves seven states of the Indian sub-continent – Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The objective of the Association is to promote the welfare of the people of South Asia and to improve their quality of life through accelerated economic growth, social progress and cultural development in the region.

The Secretariat of the Association is at Katmandu, Nepal. Summits, which are the highest authority in SAARC, are to be held annually. The country hosting the Summit holds the Chair of the Association. The Council of Ministers comprising Foreign Ministers of member nations, meets at least twice a year. Its functions include formulating policy, reviewing progress of regional cooperation, identifying new areas of cooperation and establishing additional mechanisms that may be necessary. The Governors of the Central Banks of Member States under the auspices of SAARC FINANCE meet regularly to consider cooperation in financial matters.

Beyond official linkages, SAARC also encourages and facilitates cooperation in private sector through the SAARC Chamber of Commerce and Industry (SCCI), which is a SAARC Apex Body. Other such bodies are SAARC LAW and the South Asian Federation of Accountants (SAFA). In addition, professional groups in South Asia have been given status of SAARC Recognized Bodies. These bodies include: Architects, Management Development Institutions, University Women, Town Planners, Cardiologists, Dermatologists, Teachers, Writers, Insurance Organizations, Diploma Engineers, Radiological and Surgical Care Societies.

The SAARC Secretariat is based in Katmandu. It coordinates and monitors implementation of activities, prepares for and services meetings, and serves as a channel of communication between the Association and its member states as well as other regional organizations.

AREAS of Cooperation

SAARC seeks cooperation in the following thrust areas:

1. Agriculture and Rural Development
2. Health and Population Activities
3. Women, Youth and Children
4. Environment and Forestry
5. Science and Technology and Meteorology
6. Human Resources Development
7. Transport
8. Information and Communications Technology
9. Biotechnology
10. Intellectual Property Rights
11. Tourism
12. Energy

Notes

Association of Southeast Asian Nations (ASEAN)

The Association of Southeast Asian Nations is a primary multinational trade group of Asia. The goals of this group are economic integration and cooperation through complementary industry programmes; preferential trading, including reduced tariff and non tariff barrier; guaranteed member access to markets throughout the region; harmonised investment incentives.

Today, ASEAN economic cooperation covers the following areas: trade, investment, industry, services, finance, agriculture, forestry, energy, transportation and communication, intellectual property, small and medium enterprises, and tourism.

ASEAN was established on August 8, 1967 in Bangkok by the five original member countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei Darussalam joined on January 8, 1984, Vietnam on July 28, 1995, Laos and Myanmar on July 23, 1997, and Cambodia on April 30, 1999.

The ASEAN region has a population of about 500 million, a total area of 4.5 million square kilometres, a combined gross domestic product of US$737 billion, and a total trade of US$ 720 billion.

The Treaty of Amity and Cooperation (TAC) in Southeast Asia, signed at the First ASEAN Summit on February 24, 1976.

The TAC stated that ASEAN political and security dialogue and cooperation should aim to promote regional peace and stability by enhancing regional resilience. Regional resilience shall be achieved by cooperating in all fields based on the principles of self-confidence, self-reliance, mutual respect, cooperation, and solidarity, which shall constitute the foundation for a strong and viable community of nations in Southeast Asia.

South Asian Preferential Arrangement (SAPTA)

South Asian Preferential Arrangement was signed by the SAARC members on April 11, 1993 and came into force in December 1995. The objective of the SAPTA is the creation of trade among the SAARC countries through the reduction of tariffs and on preferential basis. It thus seeks the economic development of all the SAARC nations. The biggest argument in favour of SAPTA is that there is geographical proximity (a big scope for cross border railway and road link) among the member nations and nations are also culturally close to each other.

The basic principles underlying SAPTA are:

1. overall reciprocity and mutuality of advantages so as to benefit equitably all contracting states, taking into account their respective level of economic and industrial development, the pattern of their external trade, and trade and tariff policies and systems;
2. negotiation of tariff reform step by step, improved and extended in successive stages through periodic reviews;
3. recognition of the special needs of the Least Developed Contracting States and agreement on concrete preferential measures in their favour; and
4. inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms.

Notes

12.3 Summary

- The International Monetary Fund was established by an international treaty in 1945 to help promote the health of the world economy.
- The IMF is the central institution of the international monetary system-the system of international payments and exchange rates among national currencies that enable business to take place between countries.
- One of the major functions of IMF is to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- The day-to-day work of the IMF is carried out by an Executive Board, representing the IMF's 184 members, and an internationally recruited staff under the leadership of a Managing Director and three Deputy Managing Directors – each member of this management team being drawn from a different region of the world.
- The IMF's resources come mainly from the quota (or capital) subscriptions that countries pay when they join the IMF, or following periodic reviews in which quotas are increased.
- The IMF shares its expertise with member countries on a regular basis by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics.
- It is said that IMF policy makers support capitalist dictatorship, and is friendly to American and European corporations. Critics claim that financial aid from the IMF is always come bound with conditionalities, throwing the IMF's stated goals to the winds.
- The World Bank is one of the world's largest sources of finance and knowledge to its member countries to improve the condition of health centres, provide water and electricity, fight disease, and protect the environment.
- The main purpose of the World Bank is to assist economies in the reconstruction and development by facilitating the investment of capital for productive purposes, it also helps in reconstruction of economies destroyed or disrupted by war, and it encourages the development of productive facilities and resources in less developed countries.
- World Banks works towards generation of funds, raising loans, grants, advisory services, etc. It includes bodies like IFC, Asian Development Bank, ICSID, MIGA and IDA.
- The South Asian Association for Regional Cooperation (SAARC) was established on December 8, 1985. It involves seven states of the Indian sub-continent-Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.
- The Association of Southeast Asian Nations (ASEAN) is a primary multinational trade group of Asia. The goals of this group are economic integration and cooperation through complementary industry programmes.
- South Asian Preferential Arrangement (SAPTA) was signed by the SAARC members on April 11, 1993 and came into force in December 1995. The objective of the SAPTA is the creation of trade among the SAARC countries through the reduction of tariffs and on preferential basis.

12.4 Keywords

ACP: African, Caribbean and Pacific Group

ASEAN: Association of South East Asian Nations

Notes

Dumping: Selling the product at below the on-going market price

GATS: General Agreement on Trade in Service

IBRD: International Bank for Reconstruction and Development

ICSID: International Centre of Settlement of Investment Disputes

MFN: Most Favoured Nation Treatment

MIGA: Multilateral Investment Guarantee Agency

12.5 Self Assessment

State whether the following statements are true or false:

1. IMF at its inception had 28 members who sign its agreement.
2. IMF has a role to play in helping the nations to correct the negative balance of payments.
3. India gave World Bank the name, International Bank for Reconstruction and Development.
4. Any country that cannot afford costly vaccinations can also avail grants from the World Bank for this very purpose.
5. Maldives is a part of SAARC but not ASEAN.

Fill in the blanks:

6. ……..aims at developing an equilibrium between income and employment.
7. IMF was established in New Hampshire and is headquartered at……
8. ……, a body of World Bank, covers all the nations of any type of risks in their investments.
9. ……became a member of ASEAN in the year 1995.
10. ……has the full authority to take any decisions relating to international trade.

12.6 Review Questions

1. Trace the journey of IMF since its inception. What are the major changes that have taken place since inception?
2. Explain the hierarchy at IMF. Compare it with the organisation of World Bank and WTO.
3. "Quotas also are the main determinant of countries' voting power in the IMF". Discuss.
4. Critically analyse the role of IMF in development of its member nations.
5. "IMF supports capitalist dictatorship, and is friendly to American and European corporations". Comment.
6. "The World Bank is not a "bank" in the common sense." Substantiate.
7. Why do you think the World Bank is called International Bank for Reconstruction and Development or vice-versa?
8. What is the difference between all the member bodies of the World Bank? Do they do separate work from the World Bank?
9. Explain the rationale behind the formation of SAARC and ASEAN.

Notes

Answers: Self Assessment

1.	True	2.	True
3.	True	4.	False
5.	False	6.	IMF
7.	Washington DC	8.	MIGA
9.	Vietnam	10.	Ministerial Conference

12.7 Further Readings



Books

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Online links

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www.southasia.net/index.php?category

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Unit 13: World Trade Organization

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Objectives

After studying this unit, you will be able to:

- Discuss the functions and organisations of WTO
- Describe advantages of World Trade Organisation

Introduction

The 20th century was also governed by economic nationalism. Most of the European nations followed this policy. After the Second World War economic nationalism became the key for most nations in Asia and Europe. Even nations like the US and France were not untouched with the phenomenon of economic nationalism.

When the US started losing jobs because of globalisation it reacted sharply. Not only this, in the 20th century itself it took various measures to protect its domestic industry like automobiles and motorcycles. It imposed quantitative restrictions on the imports of automobiles from Japan. Similarly, when in 2006 a Britain-based NRI made a bid for Europe's largest steel maker France reacted sharply.

Economic nationalism is a term used to describe policies which are guided by the idea of protecting domestic consumption, labour and capital formation, even if this requires the imposition of tariffs and other restrictions on the movement of labour, goods and capital. It opposes globalisation in many cases, or at least it questions the perceived benefits of unrestricted

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free trade. Economic nationalism may include such doctrines as protectionism and import substitution.

13.1 World Trade Organisation (WTO)

The first half of the 20th century was marked by a major worldwide economic depression that occurred between the two world wars and that all but destroyed most of the industrialised nations. International trade got a set back when after the First World War countries erected high tariff walls and raised other tariff barriers to intolerable heights. International trade was stalled along with most economies. All this resulted in the great depression. This was also one of the fundamental reasons of the World War II.

After the Second World War, world leaders created General Agreement on Tariffs and Trade (GATT), to avoid the repetition of the same. GATT was a forum for member countries to negotiate a reduction of tariffs and other barrier to trade. Countries including India signed the GATT. The original agreement provided a process to reduce tariffs and created an agency to serve as a watchdog over world trade. In general, the agreement covers three basic elements:

1. trade shall be conducted on a non-discriminatory basis,
2. protection shall be afforded to domestic industries through customs tariffs, not through such commercial measures as import quotas,
3. consultation shall be the primary method used to solve global trade problems.



Notes

The GATT Trade Rounds

Year	Place/ name	Subjects covered	Countries
1947	Geneva (Switzerland)	Tariffs	23
1949	Annecy (France)	Tariffs	13
1951	Torquay (UK)	Tariffs	38
1956	Geneva	Tariffs	26
1960–1961	Geneva (Dillon Round)	Tariffs	26
1964–1967	Geneva (Kennedy Round)	Tariffs and anti-dumping measures	62
1973–1979	Geneva (Tokyo Round)	Tariffs, non-tariff measures, "framework" agreements	102
1986–1994	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc	123

13.2 Function of WTO

Instead of calling it Word Trade Organization it should be called World Trade of Opportunities. WTO gives an opportunity to the nations to sit together and talk trade. It gives them the forum where nations can negotiate with the objective of a win-win situation. WTO administers the 28 agreement contained in the final Act and a number of plurilateral agreements and government

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procurement through various councils and committees. It enforces the multilateral trade rules. In a nutshell, WTO performs the following functions:

Helping Developing and Transition Economies

Developing countries make up about three quarters of the total WTO membership. The role of WTO increases as most of these developing countries are in transition phase as they are shifting from planned economic system to market based economic system.

The WTO Secretariat's Training and Technical Cooperation Institute organizes a number of programmes to train government officials and negotiators. Besides Geneva these programmes also take place in the country concerned. Various number of programmes are organized jointly with other international organizations.

WTO provides data of tariff and trade to developing nations to help them in their export.

Specialised Help for Export

In 1964 the WTO established the International Trade Centre to help develop countries in their exports. It is jointly operated by the WTO and the United Nations. It provides information and advice on export markets and marketing techniques. It assists in establishing export promotion and marketing services, and in training personnel required for these services.

The WTO in Global Economic Policy Making

WTO cooperates with the International Monetary Fund, the World Bank and other multilateral institutions to achieve greater coherence in global economic policy-making. A separate ministerial declaration was adopted at the Marrakesh Ministerial Meeting in April 1994 to underscore this objective.

Taking Information

WTO takes regular information from the member countries regarding their policies and tariffs. According to many agreements, the government has to notify the WTO about the modified trade measures like safety standards, technical standards, anti - dumping and countervailing duties, etc. In this way it keeps itself updated regarding developments but also it disseminates information to the member countries, which help them in increasing their exports.

Giving Information to Public

It also disseminates information to the public about the developments in WTO through its publication and its websites.

Encouraging Development and Economic Reform

GATT allows for special assistance and trade concessions for developing countries. WTO agreements give them transition periods to adjust to the more unfamiliar and, perhaps, difficult framework. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them.

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13.3 Rules of WTO (Agreements)

WTO agreements include goods, services and intellectual property. It has an objective of reducing tariffs to zero. It enables liberalisation and allows limited exemption regarding duties. It establishes a system to resolve disputes and ensures transparency regarding the trade policy of government. The present WTO system is based on the Uruguay Round Agreements, which are as follows:

Binding and Cutting of Tariff

This includes commitment to cut and 'bind' custom duty rate on import of goods. In some cases, tariff is being cut to zero. There is significant increase in the bound tariffs.

Developed countries' tariff cut were for the most part phased in over five year from January 1, 1995.

On March 26, 1997, 40 countries which account for more than 92% of the old trade in information technology products, agreed to eliminate import duties and other charges on the product by 2000 (by 2005 in a handful of case).

More Bindings

Developed countries increased the number of import whose tariff rate are "bound" (committed and difficult to increase) from 78% of product line to 99%. For developing countries, the increase is considerable: from 21% to 73%.

Tariff on Agriculture

Tariff on all agricultural products are now bound. Almost all import restrictions besides tariffs have been converted to tariffs, a process known a "tariffication". The first step in "tariffication" is to replace these restrictions with a tariff that represents about the same level of protection. Then, over six years from 1995 to 2000, the tariff gradually reduced (the reduction period for developing countries end in 2005). In addition, it includes countries' commitment to reduce domestic support and export subsidies on agricultural product.

Standard and Safety

Article 20 (GATT) allows governments to make necessary arrangements to protect human, animal or plant life or health, provided they do not use it to discriminate or use it as tool to protectionism. In WTO, there are specific arrangements regarding food, safety and animals.

Textiles

From 1974 until the end of the Uruguay Round, trade was governed by the quota system (Multifibre Arrangement). This is against the spirit and principle of GATT. Since 1995, WTO has replaced the Mulltifibre Arrangement with the Agreement on Textile and Clothing (ATC). By January 1, 2005, the sector is to be fully integrated into the normal GATT rule. That is, the quota will come to an end, and importing countries will no longer be able to discriminate among exporters. The Agreement on Textile and Clothing itself no longer exists.

Services

The General Agreement on Trade in Service (GATS): (GATS) is the first and only set of multilateral rules governing international trade in service. Negotiated in the Uruguay Round, it was

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developed in response to the huge growth of the service economy over the past 30 years and the greater potential for trading service brought about by the communication revolution.

Trade Related Intellectual Property Rights

The WTO Agreement on Trade-Related Aspect of Intellectual Property Right (TRIPS), negotiated in the 1986-94 Uruguay Round, introduced intellectual property rule into the multilateral trading system for the first time. The WTO TRIPS Agreement is an attempt to narrow the gap in the way rights are protected around the world, and to bring them under common international rules.

As GATT and GATS, TRIPS also works on the principle of treating national and foreigner players equally and giving equal treatment to nationals of all trading partners in the WTO. TRIPS agreement has an additional important principle of intellectual property protection, that it, it should contribute to technical innovation and the transfer of technology. It says that both producer and user should benefit, and economic and social welfare should be enhanced.

TRIPS provide adequate protection of intellectual property in the following categories:

1. Copyrights
2. Trademarks
3. Geographical Indications
4. Industrial Designs
5. Patents
6. Layout Design for Integrated Circuit
7. Undisclosed Information and Trade Secrets
8. Curbing Anti-competitive Licensing Contracts
9. Transition Arrangements

Anti-dumping Measures and Countervailing Duties

Dumping means selling the product at below the on-going market price and/or at the price below the cost of production. Usually, when the organization in an exporting country has some product in excess then it dumps that amount of production. It prices the excess production on the basis of marginal costing and charges only variable cost plus profit, thus fixing the price below the full manufacturing cost. Dumping hurts the industry of importing countries because they cannot compete with the low priced imported product.

13.4 Organization of WTO

The WTO is run by its member-governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once ever two years) or by their ambassadors or delegates (who meet regularly in Geneva). Decisions are normally taken by consensus. WTO is a member-driven, consensus-based organization.

Highest Authority: The Ministerial Conference

WTO belongs to its members. The countries make their decisions through various councils and committees, whose membership consists of all WTO members. Topmost is the ministerial conference which has to meet at least once ever two years. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.

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Second Level: General Council in Three Guises

Day-to-Day work in between the ministerial conferences is handled by three bodies:

1. The General Council
2. The Dispute Settlement Body
3. The Trade Policy Review Body

The General Council acts on behalf of the Ministerial Conference on all WTO affairs. The General Council has other organs - Dispute Settlement Board and the Trade Policy Review Board to oversee procedures for settling disputes between members and to analyse members' trade policies.

Third Level: Councils for each Broad Area of Trade, and More

Three more councils, each handling a different broad area of trade, report to the General Council:

1. The Council for Trade in Goods (Goods Council)
2. The Council for Trade in Services (Services Council)
3. The Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council)

The three are responsible for the workings of the WTO agreements dealing with their respective areas of trade. Again, they consist of all WTO members.

Fourth Level: Down to the Nitty-gritty

Each of the higher level councils has subsidiary bodies. The Goods Council has 11 committees dealing with specific subjects (such as agriculture, market access, subsidies, anti-dumping measures and so on). Again, these consist of all member countries. Also reporting to the Goods Council is the Textiles Monitoring Body, which consists of a chairman and 10 members acting in their personal capacities, and groups dealing with notifications (governments informing the WTO about current and new policies or measures) and state trading enterprises.

The Services Council's subsidiary bodies deal with financial services, domestic regulations, GATS rules and specific commitments.

At the General Council level, the Dispute Settlement Body also has two subsidiaries: the dispute settlement "panels" of experts appointed to adjudicate on unresolved disputes, and the Appellate Board that deals with appeals.

HODs': The Need for Informality

Besides formal meetings there are informal meetings also to resolve the matter such as those of Head of Delegation (HOD). The practice is that the chairperson of a negotiating group tries to attempt to build a compromise by holding consultations with delegations individually, in twos or threes, or in groups of 20-30 of the most interested delegations. In the end, decisions have to be taken by all members and by the consensus.

How to Join the WTO: The Accession Process

Any state or customs territory having full autonomy in the conduct of its trade policies may join ("accede to") the WTO, but WTO members must agree on the terms.

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The accession process has four stages:

1. ***First,*** the government applying for membership has to describe all aspects of its trade and economic policies that have a bearing on WTO agreements. This is submitted to the WTO in a memorandum which is examined by the working parties dealing with the country's application. These working parties are open to all WTO members.
2. ***Second,*** when the working part has made sufficient progress on principles and policies, parallel bilateral talks begin between the prospective new member and individual countries. The talks determine the benefits (in the form of export opportunities and guarantees) other WTO members can expect when the new member joins.
3. ***Once*** the working part has completed its examination of the applicant's trade regime, and the parallel bilateral market access negotiations are complete, the working party finalises the terms of accession. These appear in a report, a draft membership treaty ("protocol of accession") and lists ("schedules") of the members to-be's commitments.
4. ***Finally*** the report, protocol and lists of commitments, is presented to the WTO General Council or the Ministerial Conference. If a two-thirds majority of WTO members vote in favour, the applicant is free to sign the protocol and to accede to the organization.

13.5 Regional Groups in WTO

Many groups operate in the WTO. Some are for economic integration – custom unions, free trade areas, and common markets, such as the European Union, ASEAN, NAFTA and MERCOSUR. These groups of countries, when they adopt common positions, can reach a consensus more easily. Sometimes specific groups are created to compromise and break a deadlock. But there are no hard and fast rules about the impact of groupings in the WTO.

The largest and most comprehensive group is the European Union and its 15 member states for legal reasons known officially as the "European Communities" in WTO business. The European Commission alone speaks for the EU at almost all WTO meetings. The EU is a WTO member in its own right as are each of its member states.

Association of South East Asian Nations (ASEAN) members also coordinate positions among themselves and speak with a single voice in the WTO. The role of a spokesman rotates among ASEAN members and can be shared according to the topic.

There are many other groupings which occasionally present unified statements: the African Group, the least-developed countries, the African, Caribbean and Pacific Group (ACP) and the Latin American Economic System (SELA).



Task

Find out facts related to establishment of WTO. What factors were responsible for its emergence, what were initial issues etc.

13.6 Advantages/Benefits of WTO

The WTO has proved its worth in the past years. After its inception with only 23 members, it now has more than 150 members. Its members include even communist countries like China, and more countries like Vietnam and Laos are eager to gain its membership because it gives many advantages to member countries. It is a forum where everybody wins by making others win. A few distinct advantages of the WTO are:

1. The system helps promote peace

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2. Disputes are handled constructively
3. Rules make life easier for all
4. Freer trade cuts the costs of living
5. It provides more choice of products and qualities
6. Trade raises incomes and stimulates economic growth
7. Free trade reduces the manufacturing cost
8. Governments are shielded from lobbying
9. The system encourages good government

13.7 Dispute Settlement

There is no use having rules and procedures and multilateral agreement unless and until there is a proper body to resolve disputes. The objective of WTO is to harmonize international trade, and it is not possible without having a proper dispute settlement process.

In WTO, the Dispute Settlement Body consists of all its members. This body appoints a panel of experts to consider the case. It has the authority to accept or reject the findings of the panel. It monitors the implementation of the rulings and recommendations, and has the power to authorize retaliation when a country does not comply with a ruling. The dispute settlement process has the following stages:

First Stage: Consultation (up to 60 days)

In the first stage countries in dispute talk with each other and try to solve the issue mutually and if they fail to do so they can seek the mediation of WTO director-general to get help in resolving issue.

Second Stage

The panel (up to 45 days for a panel to be appointed, plus 6 months for the panel to conclude). In case consultation fails, the complaining countries can ask for appointment of the Panel.

If the panel decides that the disputed trade measure does break a WTO agreement or an obligation, it recommends that the measure be made to conform with WTO rules. The panel may suggest how this could be done.

The report becomes the Dispute Settlement Body's ruling or recommendation within 60 days unless a consensus rejects it. Both sides can appeal against the report.

The report of the panel can be rejected by consensus in the Dispute Settlement Body, so its conclusions are difficult to overturn. The panel's findings should be based on the agreements cited.

The panel's final report should normally be given to the parties to the dispute within six months. In cases of urgency, including those concerning perishable goods, the deadline is shortened to three months.

Notes



Caselet

India and WTO Deal: India for all Round Talks

–by Prabhankar Sinha

In order to expedite progress on the Doha Development Agenda (DDA) under WTO (World Trade Organisation), India proposed simultaneous negotiations in services along with issues on agriculture and non-agriculture market access (NAMA).

Addressing a two-day mini-ministerial meeting on Re-Energising Doha A commitment to Development, commerce and industry minister Anand Sharma said, "Since time is of the essence and in order to maintain a balance within the single undertaking, we can consider moving the other issues on the agenda forward." He asked the member delegates whether parallel negotiations in services and other areas can be taken on board in a more proactive member.

The inclusion of negotiation on services along with the other contentious topics like agriculture and NAMA will help countries like India in the bargain, giving them greater maneuverability in trading off gains in one area against concessions they may have to yield in other areas.

Under the Hong Kong ministerial meeting in 2005, an understanding was reached between member countries that a sequential approach would be adopted with negotiations on agriculture and NAMA being prioritized. But to complete the Doha Round of negotiation by 2010, Sharma asked ministers from 35 countries who have come to Delhi whether they would be willing to deviate from the "tried and tested process."

"While we follow the established process of multilateral negotiations, we also need to look at various approaches to feed the multilateral process to reach a satisfactory conclusion," Sharma said, adding that concluding the Doha round of negotiations is vital for strengthening world trade.

The two-day informal meeting of trade ministers of 35 WTO-member countries is deliberating on the timeline to conclude negotiations on the Doha development agenda by 2010 and not trying to resolve the contentious issues. Various issues in agriculture and NAMA are yet to be sorted out. "This will take time and needs to be factored in when we decide on a schedule for the ensuing months to determine when agriculture/NAMA modalities can meaningfully concluded," Sharma said.

In the meeting, according to a statement by Indian government, there was a unanimous affirmation of the need to expeditiously conclude the Doha round, particularly in the present critical global economic situation. All agreed that there was a need to resume talks in Geneva to conclude the round.

Initiating the discussions in the meeting, WTO DG Pascal Lamy said the conclusion of the Doha Round was an urgent requirement as per the signals emanating from world leaders.

However, he acknowledged that these signals had not created negotiating dynamics at the ground level, which is essential for the conclusion of the Round.

The Chairs of the WTO negotiating groups on Agriculture, NAMA (industrial goods) and Services provided an overview of the status of negotiations in their respective areas and outlined their work plans in the ensuing months.

Contd...

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WTO negotiations have been facing a roadblock since December 2008, when Lamy made a strong push for convening another ministerial in Geneva to finalize modalities for agriculture and NAMA following the failure of talks at ministerial meeting in July last year at Geneva. On December 6 last year, WTO brought out revised draft modalities for agriculture and NAMA. As the texts are yet to be discussed at the WTO, the DG decided against convening a ministerial. Lamy proposed resumption of negotiations early in 2009, using the revised draft as a starting point.

But the negotiations have not resumed since then. It was in this context that India took the initiative to restart the process again. The Delhi meeting is the first occasion since July 2008 when the ministers representing practically all major blocs such as the group of 10 (G-10), G-33, G-20, NAMA 11, Least Developed Countries, Small and Vulnerable Economies, African Group, Cotton 4 and others are participating.

The meeting is being attended by the ministers from the US, European Commission, Brazil, South Africa and China among others.

Source: timesofindia.indiatimes.com

13.8 Impact of WTO on India

In the new WTO environment, the buzzwords would be efficiency and productivity. "Success will lie with those who exhibit competitiveness in price and quality." P.K. Kaul , Former Indian Ambassador to USA.

The Indian economy experienced a major transformation during the decade of the 1990s. Apart from the impact of various unilateral economic reforms undertaken since 1991, the economy has had to reorient itself to the changing multilateral trade discipline within the newly written GATT/WTO framework. The unilateral trade policy measures have encompassed exchange-rate policy, foreign investment, external borrowing, import licensing, custom tariffs and export subsidies. The multilateral aspect of India's trade policy refers to India's WTO commitments with regard to trade in goods and services, trade related investment measures, and intellectual property rights.

The multilateral trade liberalisation under the auspices of the Uruguay Round Agreement and the forthcoming WTO negotiations is aimed at reducing tariff and non-tariff barriers on international trade.

India is a founding member of the GATT (1947) as well as of the WTO, which came into effect from January 1, 1995. By virtue of its WTO membership, India automatically avails of Most Favoured Nation Treatment (MFN) and National Treatment (NT) from all WTO members for its exports and vice versa. Its participation in this increasingly rule-based system is aimed towards ensuring more stability and predictability in its international trade.

The Uruguay Round resulted in increased tariff binding commitments by developing countries. India bound 67% of its tariff lines compared to 6% prior to this round. The government has simplified the tariff, eliminated quantitative restrictions on imports, and reduced export restrictions. It plans to further simplify and reduce the tariff.

All agricultural tariff lines and nearly 62% of the tariff lines for industrial goods are now bound. Ceiling bindings for industrial goods are generally at 40% ad valorem for finished goods and 25% on intermediate goods, machinery and equipment. The phased reduction to these bound levels is to be achieved during the 10-year period commencing in 1995. Tariff rates on equipment covered under the Information Technology Agreement are to be brought down to zero by 2005.

Notes

Quantitative Restrictions (QRs) on imports are maintained on Balance-of-Payments (BOP) grounds but nation is reducing it QR gradually.

India has fulfilled its commitment by reducing tariff and eliminating QR, it had also implemented the TRIPS measures by implementing new patent laws and presently, Indian patent law is at par with international patent law following a product patent and that too for 20 years. India has also implemented Trade Related Investment Measures (TRIMs) and General Agreement on Trade and Services (GATS).

The Indian economy has grown rapidly over the past decade, with real GDP growth averaging some 6% annually, in part due to the continued structural reform, including trade liberalisation, according to a WTO Secretariat report on the trade policies and practices of India. Social indicators such as poverty and infant mortality have also improved during the last ten years.



Case Study

Dispute Settlement

On 23rd January 1995, Venezuela complained to the Dispute Settlement Body that the United States was applying rules that discriminated against gasoline imports, and formally requested consultations with the United States. Just over a year later (on 29th January 1996) the dispute panel completed its final report. (By then, Brazil had joined the case, lodging its own complaint in April 1996. The same panel considered both complaints.) The United States appealed. The Appellate Body completed its report, and the Dispute Settlement Body adopted the report on 20th May 1996, one year and four months after the complaint was first lodged.

The United States and Venezuela then took six and a half months to agree on what the United States should do. The agreed period for implementing the solution was 15 months from the date the appeal was concluded (20th May 1996 to 20th August 1997).

The case arose because the United States applied stricter rules on the chemical characteristics of imported gasoline than it did for domestically-refined gasoline.

Venezuela (and later Brazil) said this was unfair because US gasoline did not have to meet the same standards — it violated the "national treatment" principle and could not be justified under exceptions to normal WTO rules for health and environmental conservation measures. The dispute panel agreed with Venezuela and Brazil. The appeal report upheld the panel's conclusions (making some changes to the panel's legal interpretation. The United States agreed with Venezuela that it would amend its regulations within 15 months and on 26 August 1997 it reported to the Dispute Settlement Body that a new regulation had been signed on 19 August. (www.wto.org)

Question

Do you think US was right in doing what it did?

Ans. No, US was not right in doing what it did. Considering the international business environment, US should apply same or similar policies for every nation and every transaction. In this case, US was following a discriminated policy towards import of gasoline under which they applied different rules for imported gasoline and domestically refined gasoline. Venezuela and Brazil were correct in their approach. If US has to apply a strict standards test for imported gasoline, it should also apply the same for its own domestically produced gasoline or relax the rules from the imported gasoline also.

Source: Vivek Mittal, *Business Environment*, First Edition, Excel Books, New Delhi, 2007

Notes

13.9 Summary

- WTO gives an opportunity to the nations to sit together and talk trade. It gives them the forum where nations can negotiate with the objective of a win-win situation.
- WTO agreements include goods, services and intellectual property. It has an objective of reducing tariffs to zero. It enables liberalisation and allows limited exemption regarding duties.
- The WTO is run by its member-governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once ever two years) or by their ambassadors or delegates (who meet regularly in Geneva).
- Many groups operate in the WTO. Some are for economic integration – custom unions, free trade areas, and common markets, such as the European Union, ASEAN, NAFTA and MERCOSUR.
- In WTO, the Dispute Settlement Body consists of all its members. This body appoints a panel of experts to consider the case. It has the authority to accept or reject the findings of the panel.
- India is a founding member of the GATT (1947) as well as of the WTO, which came into effect from January 1, 1995. By virtue of its WTO membership, India automatically avails of Most Favoured Nation Treatment (MFN) and National Treatment (NT) from all WTO members for its exports and vice versa.

13.10 Keywords

GATT: General Agreement on Tariffs and Trade

SAARC: South Asian Association for Regional Cooperation

SAPTA: South Asian Preferential Arrangement

SELA: Latin American Economic System

TRIMS: Trade Related Investment Measures

TRIPS: Trade-related Aspects of Intellectual Property Rights

13.11 Self Assessment

State whether the following statements are true or false:

1. If we sell any product below its cost of production it's known as dumping.
2. TRIPS cover the patents of a company but not the facility outlay.
3. Any dispute between the trading organisations of the WTO can be presented before the Dispute Settlement Body which works autonomously of WTO.
4. All the protection measures for investments made by the nations is under TRIPS.
5. In second stage of the dispute settlement, the parties can seek mediation of the governing bodies.

Notes

Fill in the blanks :

6. ..... cooperates with the International Monetary Fund, the World Bank and other multilateral institutions to achieve greater coherence in global economic policy-making.
7. ..... allows for special assistance and trade concessions for developing countries.
8. The WTO ..... Agreement is an attempt to narrow the gap in the way rights are protected around the world, and to bring them under common international rules.
9. ..... means selling the product at below the on-going market price and/or at the price below the cost of production.
10. The ..... acts on behalf of the Ministerial Conference on all WTO affairs.

13.12 Review Questions

1. "Instead of calling it Word Trade Organization it should be called World Trade of Opportunities". Do you agree? Justify.
2. Are the rules of the GATT agreement binding on all member countries? What are the special protection measures do the agreement offers?
3. If any country wants to become a member of the World Trade Organisation, what it should do? Why would any nation be willing to join WTO?
4. "The process of harmony amongst nations can't be complete without proper dispute redressal". Discuss.
5. Discuss the association of WTO and India. How has India benefited by this association?

Answers: Self Assessment

1.	True	2.	False
3.	False	4.	False
5.	False	6.	WTO
7.	GATT	8.	TRIPS
9.	Dumping	10.	General Council

13.13 Further Readings



Books

Bedi Suresh, *Business Environment*, Excel Books, 2006

Mittal Vivek, *Business Environment*, Excel Books, 2007

Starling, Grower, *The Changing Environment of Business*, Cincinnati, OH, South-Western College Publishing, 1996

Notes



Online links

www.aseansec.org

www.imf.org

www.saarc-sec.org

www.southasia.net/index.php?category

www.worldbank.org

www.wto.org

Unit 14: Changes in Business Environment

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Objectives

After studying this unit, you will be able to:

- Discuss the role technological advancement
- Assess the impact of globalisation

Introduction

At least three major developments have occurred that have changed dramatically the business environment. First, technology has been developed that has made information preparation and dissemination inexpensive. This technology has taken the form of low cost, high-speed digital and cable video and data transmission, hardware that produces information quickly and easily, and the development of software that makes preparation, data, and communication tools available to individuals who previously did not have access to needed information. With these technology developments, time, space, and other temporal constraints to information have been reduced and, in many cases, eliminated.

A second major development that has significantly impacted business has been globalization. Faster methods of transportation, together with instantaneous information, have allowed the world to become one giant marketplace.

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14.1 Technological Advancement

Technology is rapidly changing our world. It is bringing us advantages beyond our grandparents' wildest dreams. It seems that with each year the pace of change quickens. Each new process or invention makes even further advances possible.



Example: Such 19th and 20th century inventions such as the telephone, the phonograph, the wireless radio, the motion picture, the automobile, and the airplane only to enhanced served only to add to the nearly universal respect that society in general felt for technology.

With the development of assembly-line mass production of automobiles and household appliances, and the building of ever taller skyscrapers, acceptance of innovations became not only a fact of everyday life but also a way of life in itself. Society was being rapidly transformed by increased mobility, rapid communication, and a deluge of available information from mass media. Since the 1950s, technology in R&D activities has also advanced significantly.

There are numerous factors that have contributed to these changes. Rothwell and Zegveld (1985) (Reindustrialization and Technology, Longman, London) identify three important factors:

1. ***Technology Explosion:*** Both authors surmise that 90% of our present technical knowledge has been generated during the last 55 years.
2. ***Shortening of the Technical Cycle:*** The technology cycle includes scientific and technological developments prior to the traditional products life cycle. These cycles have been slowly shortening, forcing companies to focus their efforts on product development. As a result, the market life of a model of a motor cycle has reduced drastically. Earlier, a model proved to be a cash cow for an organization for years. But today companies are launching new models every next year, sometimes even within the same financial year.
3. ***Globalization of Technology:*** Countries of the Pacific Rim have demonstrated the ability to acquire and assimilate technology into new products. This has resulted in a substantial increase in technology transfer in the form of licensing and strategic alliances.

14.1.1 Application of Technology

There was a time when the United Kingdom begged the maximum number of Nobel Prizes while Japan was getting wealthy. During this Japan was not giving any significant emphasis on basic research. Thus, wealth lies not in inventing and discovering technology but in its application. Application of technology requires a set of specific capabilities. These capabilities are different in nature from those involved in innovation or invention.

Technology also requires the ability to make effective use of technological knowledge. Technological capabilities require better application of technology including the ability to acquire, use, assimilate, adapt, change and create technology. Four different kinds of technological capabilities are identified: acquisitive, operative, adaptive, and innovative. While operative capabilities pertain to production know-how, adaptive and innovative capabilities relate to technological efforts that are central to the effective assimilation of technology and to simultaneous as well as subsequent adaptation to fit local circumstances better.



Example: Two examples of market innovations based on existing technology:

1. The walkman - the invention of the walkman meant no new technologies, only a new application of technology.

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2. The breakthrough of the Internet in the mid-90s; at that time this particular technology was already old. The breakthrough was a result of a convincing constellation of applications.

Changes in technology affects (i) physical devices (such as machines, tools, instruments and equipment); and (ii) techniques and working methods. Thus technology usually influences:

1. Employee training needs
2. The nature of employees' tasks
3. Organizational structures
4. Employee job satisfaction and attitudes towards work.



Notes

Nineteenth Century Economic Development Fuelled by Technological Innovations

Innovation	Innovator	Date
Steam Engine	James Watt	1770-80
Iron Boat	Isambard Kingdom, Brunei	1820-45
Locomotive	George Stephenson	1829
Electromagnetic Induction Dynamo	Michael Faraday	1830-40
Electric Light Bulb	Thomas Edison & Joseph Swan	1879-90

14.1.2 Technological Literacy

Technological Literacy can be described as the intellectual processes, abilities and dispositions needed to understand the link between technology, individuals and society in general. Technological Literacy is concerned with developing awareness of how technology is related to the broader social system, and how technological systems can never be divorced from the political, cultural and economic frameworks that shape them. In order to achieve an informed, balanced and comprehensive analysis of the technological influences on their lives and then be able to act on the basis of their analysis, students require certain levels of knowledge, skills and abilities. These include:

1. understanding that technology includes hardware, know-how, cultural needs and desires, and economic and political decision making;
2. understanding how technology shapes and is shaped by society;
3. understanding that technological issues involve conflicting assumptions, interpretations and options;
4. having the necessary data collection and decision making skills to make intelligent choices;
5. having the ability and desire to take responsible actions on social issues.

14.1.3 Technology: The Key to Competitiveness

The cold truth today is that a company can hold its competitive edge and stay ahead of change only through innovation. Innovative companies are those that keep their collective eyes and ears open to change and opportunity, and respond with ideas and actions that keep them growing

Notes

and profitable. Companies that compete through innovation know that new (or borrowed) ideas apply not only to products, but also to quality, productivity, service, financial discipline, employee attitudes and renewal. All are critical elements in a company's competitive ability.

In recent years, the ability of firms to innovate is creating significant differences between the best and the rest.



Example: A study of over 200 companies entitled "Winning New Products" conducted by the Kellogg Graduate School of Management shows that successful innovative firms were more likely to generate growth rates of 20% or more, compared with the less successful ones.

There are mainly two options for achieving competitive advantage and forging ahead in the race. Either to achieve product/service differentiation or cost differentiation, and if possible, both. Each success in such differentiation is again short - lived. Hence innovation is the call of the day to remain ahead with the differentiation.

Technology provides an edge over competitors on all the Four Ps of marketing: Product, Price, Place, Promotion.

1. ***Product:*** According to Philip Kotler, success doesn't lie in merely satisfying the customer but in delighting him/her. If an organization doesn't delight the customer then someone else will do so, and the organization will lose the customer. Even under the best of circumstances, staying competitive today is more difficult than ever before because the conditions that determine competitive advantages change at an unparalleled speed.

   Today's hot product may be tomorrow's flop; technological advances and increased competition today rack the secure, stable market. Investment in technology can deliver new and augmented products every time.



Example: Bajaj is classic example of this as it recently launched new models at short intervals where each new model cannibalized its old model because if they didn't do it, someone else would have.

The result was phenomenal as the company's sales surged rapidly. Successes such as LG, Samsung, Hyundai and others have invested in a reasonable amount of product innovation.

2. ***Price:*** Price is a decisive factor in today's marketing warfare. We are living in an era of value maximisation. Value can be maximized by making a value added product at a competitive price. This can be done only through technology. Technology not only helps in producing augmented products but also reduces manufacturing costs.

   Today, every firm in India is investing in R&D to reduce its manufacturing costs. Prof. C.K. Prahlad has said that in India, wealth lies at below the pyramid, i.e., a lower income people.



Example: This is the reason that HLL did R&D for a whole year and developed a new technology and launched an ice cream of international quality at ₹ 5.

Extensive R&D is also going on among hardware companies in India to launch a computer at less than ₹ 10,000 in the country. Today national wide companies provide shampoos, eatables, etc. at Re. 1. All this is possible because of technology. Thus it is because of technology that even the lower income groups in India can enjoy a product of international quality.

Notes

3. ***Promotion:*** Technology has today enabled all national, international and regional producers to reach out to consumers in the remotest of areas via the electronic media and other forms of mass communication. It is because of technology that today a wide variety of promotional media and options are available to organizations.

   If companies today wish to launch a product at the regional level, they don't have to spend at the national level.



Example: In the last fifteen years, we have seen a great surge in several regional brands (Ghari, Priyagold, Ujala, Kavin Care, etc.) graduating to become national brands and giving a tough fight to established national brands.

All this is possible because of the new promotional media, which they can afford.

4. ***Place:*** "Jo dikhta hai woh bikta hai" is a popular and true maxim of sales and distribution management. HLL is the emperor of the FMCG market only because of its distribution network. Coca Cola acquired Parle not because of its brands like Thumbs Up but because of its distribution network. Distribution network is a critical success factor for all products.

14.1.4 Technology and India

Science and technology have been an integral part of Indian civilization and culture over the past several millennia. Few are aware that India is the fountainhead of important foundational scientific developments and approaches. These cover many great scientific discoveries and technological achievements in mathematics, astronomy, architecture, chemistry, metallurgy, medicine, natural philosophy and others. A great deal of this scientific knowledge reached distant louds from India.

Equally, India also assimilated scientific ideas and techniques from elsewhere, with open-mindedness and a rational attitude, characteristic of a scientific ethos. India's traditions have been founded on the principles of universal harmony, respect for all creation and an integrated holistic approach. This background is likely to provide valuable insights for future scientific advances. During the century prior to Independence, there was an awakening of modern science in India through the efforts of a number of outstanding scientists. They were responsible for great scientific advances of the highest international calibre.

Thousand of years ago, many industries flourished in Harrapan towns (ancient Indian civilization), such as bead making, copper smelting, shell, pottery, jewellery and seal making. Metallurgical processes and technology of a higher order became known in India in around 1000 BC. India became renowned for making what came to be known as Damascus Steel, later used in making swords of the finest quality. High carbon steel was first produced near Hyderabad as early as the forth and fifth centuries BC.



Example: The Iron Pillar at Delhi and iron beams used in the Konark Temple are classic and live examples of Indian technology of yore.

Also to India's credit goes the discovery and extraction of zinc. Ancient India gave the world the decimal system and the concept of the zero, even as it developed many advanced mathematical formulae. Medicine, astronomy, metallurgy, hydraulics, navigation and food processing developed in India in the earliest ages.

Notes

Some of the remarkable achievements in the field of science and technology over last 50 years are listed as below:

1. India's own satellites have soared into space on rockets developed by Indian scientists indigenously.
2. Indian super-computers confront the most complex strategic and civilian challenges. Biotechnologists have produced the first leprosy vaccine.
3. Alternative energy technologies are transforming life in isolated villages.
4. When India initiated a space research programme, the world scoffed, and critics declared that such research had no relevance in a poor and underdeveloped country.

   India is, today, one of only seven nations in the world with its own satellite launch capabilities.
5. Development of remote sensing and communication satellites that encompasses
   (a) Mastery of solid propulsion fuels
   (b) Development of cryogenic engines
   (c) Development of closed loop control and guidance system
   (d) Development of strap-on staging satellite launch technologies.
6. Satellite monitoring of earth-atmosphere-ocean systems has revolutionised the forecasting and management of natural disasters. High speed computers run sophisticated mathematical models to forecast extremes of weather, saving thousands of lives every year.
7. Atomic research in India dates back to the 1940s, and by 1956 it bore fruit in Asia's first nuclear reactor, Apsara. Today, India has an installed capacity of 1,840 megawatts of atomic power, and possesses the potential for setting up a thorium based generating capacity of 200,000 Gigawatt years of electric energy. In the process, Indian atomic scientists have successfully mastered the entire atomic fuel cycle and production of atomic materials.
8. India has developed three indigenous diagnostic kits for the detection of AIDS.
9. A sophisticated liposome delivery system for drugs to cure fungal infections.
10. Diagnostic kits for tuberculosis, Hepatitis-B, A & C, kala azar, and Japanese Encephalitis in an advanced state of development.
11. A wide range of bio-fertilizers and biological control agents to supplement and reduce the use of harmful chemical pesticides and fertilizers. Developments in drugs, therapeutics, medicine and the wider field of health services have resulted in the doubling of life expectancy since Independence.
12. Dreaded diseases such as smallpox have been completely eradicated.
13. Defence research organisations have excelled in the development of missiles, and India is more secure because of the wide range of tactical missiles now available to the defence forces.
14. A sophisticated low-level warning radar, Indra, has been developed
15. Multi-barrel rocket system Pinaka has been developed.
16. India has its own battle tanks: Arjun and Ajeya.

Notes

17. India also has, to its credit, the development of fourteen new drugs, many of which are now being exported.

18. Compound rate of growth of IT industry has been 55% over the last five years. India commands over 16% of the world market for customised software services.

19. India is now poised to emerge as a major manufacturing base and an exporter of telecom equipment in the world. A number of world-class facilities for electronic component manufacture have been established, and India now produces integrated circuits and other components with the latest device geometry.



Example: Many MNCs like GE have established R&D centres in India, the first outside of the US. Besides, organizations like Intel, Motorola, Microsoft, Oracle, HP, etc., have their R&D and manufacturing centres here. Nokia too is planning to establish its manufacturing unit in India.



Task

Enlist some the major latest innovations made by Indian scientists. Also make a note of Indian Nobel winners that whose inventions affected business environment.

14.2 Globalisation

People around the globe are more connected with each other than ever before. Information and money flow more quickly than ever. Goods and services produced in one part of the world are increasingly available in all parts of the world. International travel is more frequent. International communication is commonplace. This phenomenon has been titled "globalisation."

It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labour) and knowledge (technology) across international borders.

Globalisation is a modern term used to describe the changes in societies and the world economy that result from dramatically increased international trade and cultural exchange. It describes the increase of trade and investment due to the opening of barriers across borders and the interdependence of countries. In economic contexts, it is often understood to refer almost exclusively to the effects of trade, particularly trade liberalisation or "free trade".

The International Monetary Fund defines globalisation as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology." (IMF, World Economic Outlook, May, 1997).

The World Bank defines globalisation as the "Freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries".

Impact of Globalisation

Corporations are today changing their strategies and are reorganizing their functions to cope up with the changed scenario. Whether it is their production process or location, Product strategy, Marketing, Finance, HR policies etc. Organizations have incorporated the following changes:

Notes

Designing in Global Environment

If managing product development processes was a challenge before, it is not getting any easier as companies continue to adopt global design strategies. Global designing has cost benefits that are very attractive to today's manufacturer, but it also adds new Product Lifecycle Management (PLM) challenges and intensifies existing problem areas like that of protecting intellectual property.

Production Location Selection

Jeffrey Immelt of GE Medical Systems (GEMS), pushed for acquisitions to build up scale because for leading global competitors, an R&D-to-sales ratio of at least 8 percent represents a significant source of scale economies. But he also implemented a production strategy that was intended to arbitrage cost differences by concentrating manufacturing operations – and, ultimately, other activities – wherever in the world they could be carried out most cost effectively. By 2001, GEMS obtained 15 percent of its direct material purchases from, and had located 40 percent of its own manufacturing activities in, low-cost countries.

Rationalised Production

Companies produce different components or different portions of their product line in different parts of the world to take advantage of low labour costs, capital, and raw materials. This is rationalised production. In a new, global world, rationalised production is easier. Now organizations can outsource or can establish their own production units in those areas where it is more economical.



Example: GE, for instance, used Mexico as a manufacture base for labour-intensive operations. Today, Japanese are selling their cars made in America to the American consumers, while Americans are selling American cars made in Japan. Not only this, British firms are selling English cricket bats which are made in India. Asia manufactures sports shoes for almost all the major shoe manufacturers.

Much of the production of motherboards for PCs is located in Taiwan. Japanese brands have less than a 50% share of the US market for microwave ovens but over 70% of the manufacturing is done by Japanese companies. After liberalisation in the economies of India and China, a great shift in location is going on as more and more organizations are shifting their labour-intensive operations to these locations.

Thailand, Vietnam, Indonesia, Malaysia, Philippines, Singapore and Brunei Darussalam are small countries by themselves. But as they became members of ASEAN, the whole region became attractive from a business point of view and more and more companies started establishing their manufacturing units there to take the advantage of low cost and vast markets. Today this region is one of the most active business hubs.

Vertical Integration: Vertical Integration is a company's control of the different stages in a value chain of production – from raw material to production to final distribution of the product. As international trade barriers are becoming less relevant organizations can combine resources located in more than one country.



Example: Like Indian petroleum companies who have world class refining capacities import petrol. But under the new system they are allowed to invest abroad and are acquiring oil wells overseas to ensure regular supply of oil in future. Similarly, Shell acquired oil wells the world over and has refineries across the globe.

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Companies are vertically integrating themselves. Recently, Videocon acquired the picture tube manufacturing capacities of Thomson and got access to picture tube manufacturing in many countries, including Europe. Asian Paints also has its operations in more than 27 nations. Ranbaxy and Dr. Reddy's Lab are also taking locational advantage with horizontal integration like acquiring generic pharmaceutical organizations in the US, Europe, Israel and other nations.

Product Strategy: It was a Coke's CEO, the late Roberto Goizueta, who declared in 1996: "The labels 'international' and 'domestic'… no longer apply." His globalisation program, often summarised under the tagline "think global, act global," had included an unprecedented amount of standardisation. By the time he passed away in 1997, Coca-Cola derived 67 % of its revenue and 77 % of its profits from outside North America. To cross borders, organizations have to face a very critical question that is Product Standardisation vs. Product Adaptation.

Standardisation provides advantages in the production and distribution of products and services. Cost is the decisive factor for most commodities. Through economies of scale and through standardisation, an organization can fulfil the demand of many nations through one plant.

Even in consumer good economies, standardisation works at least at regional levels. Like in India, Chinese toys took the advantage of reduction of tariff barriers and successful captured the Indian market. Similarly, in industrial goods like Processors, RAM, Chemicals, etc., standardisation can save millions of Dollars. Globalisation also helps in establishing world-class plants, which is a win-win situation as organisations reduce the cost and the customer gets the product at an economical price. Standardisation is not possible in all the goods, specifically in most of the consumer goods.

In many goods product adaptation is essential to meet the local conditions or preferences. Sometimes adaptation is mandatory because of the government's regulations, Local Standards (as Electrical), Measurement Standards and Product Standards and Systems. Sometimes product modification is done only to make it fit for specific distribution channel.



Example: Like in India Coca Cola is distributed in glass bottles that are reused. On the other hand, they use Tin cans in USA, which are not recollected from the outlet.

Product adaptation increases the cost. Sometimes, when the product is new to the market, the issue of adaptation and standardisation become crucial. Sales volumes do not justify the adaptation and the standard product doesn't suit the local requirement. This happened a few years back when the electric shaver came to the Indian market.

But organizations have to choose a trade off between standardization and product adaptation. Besides, globalisation has influenced all aspects of organizations: Sales Promotion, Research, Market Research, Distribution Strategies, Product Development Strategies, etc.

After the implementation of GATS (General Agreement on Trade and Tariffs) and the clause of free movement of labour in most of the regional trade agreements, HR policies have seen a significant change. More and more organizations are adopting international HR standards because:

1. Job-hopping may increase after new opportunities will be available.
2. When an MNC follows international standards in a new territory, the local industry also learns and follows international HR standards.
3. Because of free movement of capital and goods, competition increases. Because of FDI and imports in this situation, a business unit can survive only by providing a world-class product. And to provide world-class products, it must have HR practices of international standards and it has to invest in its nourishment.

Notes

4. When the cost of HR is a significant cost of production as in case of the software or service industry, the new trend is to shift the location of the unit where HR is available in abundance. This is the reason that more and more software companies are coming to India.



Case Study

Technology and Innovation at Asian Paints

It would be appropriate to undertake a study of Asian Paints in this unit, for its use of technology through the years to gain a competitive edge in the marketplace. " Today, the company has formulated an entire range of decorative coatings through homegrown technology. It has always given emphasis to R&D and continuously made investments in this development of Information Technology. It has used IT as a tool to bring efficiencies and streamline operations. The use of IT and R&D will continue to be important in the future and Asian Paints will not hesitate in making investments in these areas to gain advantages for the organization."

Continuous reconfiguration of activities in the value chain is a key task of all companies aiming to remain competitive and to achieve the highest value-cost leverages. Given this requirement, what were the key initiatives taken by Asian Paints during the last 5 years?

In last five years, reconfiguration of value chain activities to increase competitiveness has been one of the major focus areas for Asian Paints. In fact, Asian Paints has transformed as an organization. The sales and profit figures will reflect the strong financials of the company. But most have important have been initiatives undertaken in all areas of operations to increase efficiencies. Some of the key initiatives undertaken are:

1. Initiatives in manufacturing to reduce losses at factory
2. Sourcing efficiencies
3. Introduction of new technology to boost efficiencies and increase productivity
4. Implementation of a new supply chain solution
5. Implementation of an ERP solution

Besides the above, it has focused on continuously improving environment management standards at our plants. Today, all Asian Paints manufacturing facilities are accredited with the ISO 14001 certification for environment management standards. These systems have enabled the company to reduce effluence from the manufacturing facilities. The introduction of the new supply chain solution has transformed functions like management of inventory and forecasting demand. A new solution that helps centralise demand forecasting has brought significant benefits for the company through reduction of working capital. It has changed the manner of functioning of the supply chain division.

Question

Critically analyse technological progress at Asian Paints.

Source: Ashwin Dani,Vice Chairman, (Adapted from website of General Management Review) Asian Paints (India) Limited.

Notes

14.3 Summary

- At least two major developments have occurred that have changed dramatically the business environment – technology and globalisation.
- Technology has been developed that has made information preparation and dissemination inexpensive.
- With technology developments, time, space, and other temporal constraints to information have been reduced and, in many cases, eliminated.
- Application of technology requires a set of specific capabilities. These capabilities are different in nature from those involved in innovation or invention.
- Technological Literacy can be described as the intellectual processes, abilities and dispositions needed to understand the link between technology, individuals and society in general.
- Innovative companies are those that keep their collective eyes and ears open to change and opportunity, and respond with ideas and actions that keep them growing and profitable.
- Science and technology have been an integral part of Indian civilization and culture over the past several millennia. Few are aware that India is the fountainhead of important foundational scientific developments and approaches.
- Globalisation refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labour) and knowledge (technology) across international borders.
- Corporations are today changing their strategies and are reorganizing their functions to cope up with the changed scenario. Whether it is their production process or location, Product strategy, Marketing, Finance, HR policies etc.
- After the implementation of GATS (General Agreement on Trade and Tariffs) and the clause of free movement of labour in most of the regional trade agreements, HR policies have seen a significant change.

14.4 Keywords

ASEAN: Association of South East Asian Nations

Differentiation: Separating one product/brand form other

GATS: General Agreement on Trade and Tariffs

GEMS: General Electric's Medical System

Globalisation: Growing interdependence of countries

Job-Hopping: Frequent changes in jobs

Rationalized Production: Distributing tasks of production and distribution to various parts of world to gain economies

Standardization: Provide similar kinds of products all across

Technological Literacy: Intellectual processes, abilities and dispositions needed to understand the link between technology, individuals and society

Vertical Integration: Company's control of the different stages in a value chain of production

Notes

14.5 Self Assessment

State whether the following statements are true or false:

1. Globalisation refers to only economic interdependence of the nations.
2. With advent of technology the life of a product has increased but the market life has decreased.
3. Adaptive capabilities refers to knowledge the production processes and adapting to the same.
4. Technological literacy also includes the cultural framework of the group within the countries.
5. Product of Mahindra -XYLO is not selling well due to lack of product innovation.
6. Most of the companies have R&D centres of their own and India is a hot destination for such R&D activities.
7. Nike gets its shoes stitched and polished in Africa. It is known as rational production.
8. McDonalds follow standardization in quality but customization in offerings in different nations.
9. With increase in globalisation, there is constant switch over of jobs which can affect the organisations adversely.
10. One of the negative impacts of globalisation is that it reduces employment opportunities.

Fill in the blanks:

11. Panasonic, a company which is considered high in technological innovation belongs to…….
12. When a company acquires another company which produces intermediary products for the company. It is known as……
13. Opening up of multi-million, BPO industry is a part of …… production practice.
14. ……was India's first ever nuclear reactor.
15. ……..refers to the efforts to effectively assimilate technology.

14.6 Review Questions

1. "With the technology developments, time, space, and other temporal constraints to information have been reduced and, in many cases, eliminated". Discuss.
2. "Each new process or invention makes even further advances possible." Comment.
3. Has technology completely taken over our lives? Does it have negative implications also?
4. Suppose you are the CEO of a FMCG company. Your company is not bale to keep up with other companies and it has reach limited to major cities. What can you do to revive your company?
5. "Application of technology requires a set of specific capabilities." Substantiate.
6. Take an example of any automobile company and discuss how it has used technology to move ahead of competition.

Notes

7. Do social issues come under the purview of technological growth? How?
8. Only those companies that keep their eyes and ear open are able to survive. Comment.
9. Discuss the role of technology in growth of Indian economy.
10. "People around the globe are more connected with each other than ever before." Discuss.
11. Discuss the idea behind rationalised production. Give suitable examples to support your answer.
12. When and why do concepts of standardization and customization work for certain products?
13. Why do organizations have to choose a trade off between standardization and product adaptation?
14. Discuss the importance of HR in growing world economy.

Answers: Self Assessment

1.	False	2.	True
3.	False	4.	True
5.	False	6.	False
7.	True	8.	True
9.	True	10.	False
11.	Japan	12.	Vertical Integration
13.	Rationalised	14.	Apsara
15.	Innovation		

14.7 Further Readings



Books

Paul Justin, *Business Environment: Text and Cases*, Tata McGraw Hill, New Delhi

Saleem Sheikh, *Business Environment*, Pearson Education, New Delhi

Vivek Mittal, *Business Environment*, Excel Books, New Delhi



Online links

globalisation-and-the-environment.blogspot.com

www.businessweek.com/technology

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www.legalserviceindia.com/articles/glob_is.htm

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