Master of Business Administration

(Open and Distance Learning Mode)

Semester – I

Business Environment

Centre for Distance and Online Education (CDOE)

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MODULE 1 BUSINESS ENVIRONMENT

1.1 Learning Objectives

In this module, you will learn about:

- Meaning of environment
- Meaning of business environment
- Features of business environment
- Importance of business environment
- Components of business environment
- Process of environmental analysis
- Techniques of environmental analysis

1.2 Meaning of Environment

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)

Environment refers to all the external forces or factors which have a bearing or impact on the working 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 government"

1.3 Meaning of Business Environment

"Business Environment" means the sum total or aggregate of all individuals or institutions and other forces that are outside the control of a business enterprise but that may affect_its performance.

- Forces = economical, social, political, technological, legal etc.
- Institutions = suppliers, customers, competitors etc.

It includes all those constraints and forces which are external to a business within which it operates.

Therefore,

- The firm must be aware of these external forces and institutions and

• The firm must keep in mind these forces and institutions so that the organisational objectives are achieved.

Thus, the economic, social, political, legal and technological forces which operate outside a business enterprise are part of its environment.

Here, is the table showing changes in business environment and its effect on performance of business environment:

Changes in Business Environment	**Effect on Performance of Business Enterprise**
1. Increasing rates of taxes	Increased cost of production, hence things become expensive to buy.
2. Increased competition in the market	Reduction in profit margin.
3. Changes in fashion and tastes of consumers	Shift in market demand from existing products to new ones.
4. Technological improvements and innovations	Render existing products obsolete for e.g LCD TVs become obsolete with introduction of LED TVs .
5. Political uncertainty	Creates fear in the minds of investors to invest in long term projects.

1.4 Features of Business Environment

1. Totality of external forces

Business environment is the sum total of all the forces/factors which are external to a business firm.

2. Specific and general forces

Business environment includes both specific and general forces. Specific forces include investors, competitors, customers etc. who influence business firm directly. Specific forces affect only one individual firm only. General forces include social, political, economic, legal and technological conditions which affect a business firm indirectly. General forces affect all the firms.

3. Inter-relatedness

Various elements or components of business environment are closely inter-related to each other. For example, increased life expectancy of people and increased awareness for

healthcare have increased the demand for many health products and services like diet Coke, organic food and roasted snacks, gym services etc. New health products and services have, in turn, changed people's life style (social environment) because their income is rising (economic environment).

4. Dynamic in nature

Business environment is dynamic in nature which keeps on changing with the change in technology, consumer's fashion and tastes or entry of new competition in the market etc, political uncertainty etc.

5. Uncertainty

Business environment is uncertain (which is not certain) which means it is very difficult to know future happenings, trends or events or changes, especially when environment changes are taking place too rapidly. For example: in the case of information technology or fashion industries.

6. Complexity

Business environment is a complex phenomenon which is easy to understand in parts or separately, but it is difficult to understand in totality. For example, to know the extent of the relative impact of the social, economic, political, technological or legal factors on change in demand of a product in the market may be difficult to predict. The resultant change in demand can be due to various factors.

7. Relativity

Business environment is a relative concept whose impact differs from country to country, region to region and firm to firm. For example, demand of sarees will be low in France as compared to India, political conditions in China would differ from USA.

1.5 Importance of Business Environment

1. Identification of opportunities to get first mover advantage

Opportunities refer to the positive external trends and changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps the firm to be the first to exploit them instead of losing them to competitors. For example, Apple being the first company which made iOS phones in mobile phone sector.

2. Identification of threats and early warning signal

Threats refer to the negative external trends and changes that will hinder a firm's performance. Besides opportunities, environment happens to be the source of many threats. Awareness of the environment can help managers to identify different threats on time and serve as an early warning signal. For example, if an Indian enterprise finds that a foreign multinational is entering the Indian market with new substitutes, it should act as a warning signal. Based on this information, the Indian firms can prepare themselves to face the threats by adopting various measures such as improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on.

3. It helps in tapping useful resource

Environment is a source of different resources for running a business. To involve in any type of activity, a firm collects different resources known as inputs such as finance, machines, raw materials, power and water, labour, etc., from its environment including financiers, government and suppliers. The firm supplies the environment with its outputs such as goods and services for customers, payment of taxes to government, return on financial investment (shares and bonds) to investors and so on. Because the firm depends on the environment for the source of inputs or resources and offers outputs in return, the enterprise formulates policies that allow it to get the resources that it needs so that it can convert those resources into outputs that the environment desires.

4. It helps in coping with rapid changes

Now, business environment is getting increasingly dynamic where changes are taking place at a fast pace. All sizes and all types of enterprises are facing increasingly dynamic environment. Changing market conditions, less brand loyalty, divisions and sub-divisions of markets, more demanding customers, rapid changes in technology and intense global competition are just a few of the examples used to describe today's business environment. To cope with these significant changes, managers must understand and examine the environment and develop suitable courses of action.

5. It helps in improving performance

It is important to know and understand the business environment that how much it impacts the business. The firm that continuously monitor their environment and develops suitable course of action not only improve their present performance, but also continue to succeed in the market for a longer period. For example, Companies like Microsoft and Apple keeps on improving their performance by keeping a regular check on the business environment and makes suitable courses of action to improve their present as well as future performance.

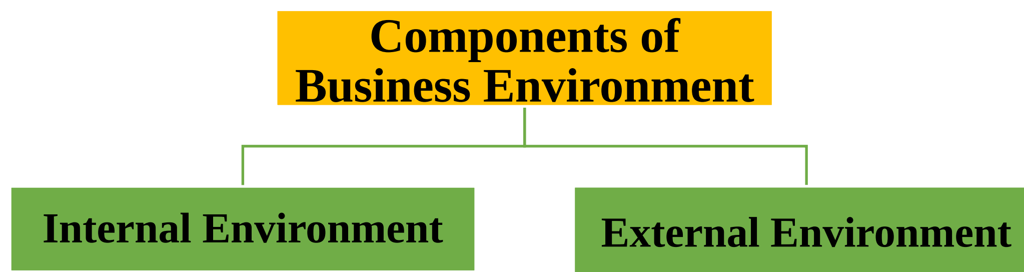
6. It helps in assisting in planning and policy formulation

Since business environment is a source of both opportunities and threats for a business firms, its understanding and analysis can be the basis for deciding the future course of action(planning) or training guidelines for decision making (policy). For instance, entry of new firms in the market, which means more competition may make a firm think afresh about how to deal with the situation.

1.6 Components of Business Environment

The 2 major components of business environment are:

1. Internal environment
2. External environment



Internal Environment

Internal environment is internal to the organisation and is inside the control of the business. For example: its employees, culture, management etc. In short important internal factors are as follows:

1. Culture and Value System

Organizational culture can be seen as a system of shared values and beliefs that shapes a company behavioural norms and standards. Value means the ideas, thoughts or belief system which a company or person follows or holds in high esteem. Whereas value system means a set of values adopted and/or evolved by a person, organization, or society as a standard to guide its behaviour in preferences in all situations. The value system of an organisation has a great and lasting influence on the organisation's success, failure and behaviour of employees. Value system not only influences the operations and behaviour it also influences the choice of business.

2. Mission and Objectives

Every business organisation has certain mission and objectives whether it's a profit making or non-profit making such as schools NGO hospitals etc. The mission and objectives of the company defines the direction of development, business philosophy, and business policy.

3. Management Structure and Nature

Structure is the method in which the tasks and sub tasks are related. Structure tells us about the hierarchical relationship, span of management, relationship between different functional areas or departments, structure of top management, authority and decision making policy, pattern of shareholding etc.

4. Human Resource

Human resource department mainly focuses on the elements like manpower planning, recruitment and selection and development, compensation, communication, and appraisal. Strength of employees is an important internal business factor. For example, if employees are motivated, hard-working and talented, then they will produce better results compared to an unmotivated and less talented workforce. The processes and relationships between and within departments can also improve effectiveness and efficiency. Besides this internal environment includes corporate resources, production/operation of goods and services, finance and accounting system and methods, marketing and channels of distribution.

External Environment

External Environment is also known as general or macro environment. It consists of factors which are external to the business that may have great impact on the firm's strategies.

Six broad dimensions/components of External Environment

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 and are considered relevant for decision-making and improving the performance of an enterprise.

By being aware of these dimensions every management can benefit themselves.

A brief discussion of the various factor constituting the general environment of business is given below:

DIMENSIONS OF BUSINESS ENVIRONMENT

1. Economic Environment

The economic environment consists of the economic factors that can affect management practices factors that can affect management practices in a business enterprise, such as:

- Interest rates
- Inflation rates
- Changes in disposable income of people
- Stock market indices
- Value of a currency

Examples of Economic Environment affecting the functioning of a business enterprise:

1. Short and long term interest rates significantly affect the demand for product and services.
2. Low rates of interest result in increased spending by consumers for buying homes and cars on loans.
3. A rise in the disposable income of people creates increasing demand for products.
4. High inflation rates generally result in restrictions on business enterprises as that will increase the cost of inputs such as the purchase of raw materials or machinery and payment of wages and salaries to employees resulting in increased cost of production and market prices of the product.

Activity I

1. Economic Environment

Read the newspapers of the past fifteen days and note the changes in any five economic policies made by the government. Analyse their impact on the working of business enterprises.

2. Social Environment

The social environment of business includes the social forces or factors like

- Customs and traditions
- Values
- Social trends
- Society's expectations from business

Examples of social environment affecting the functioning of the business enterprise:

1. Customs and traditions define social practices that have lasted for decades or even centuries. For example, the celebration of different festivals in a country provides significant financial opportunities for greetings card companies, sweets or confectionery manufacturers, tailoring outlets and many other related businesses.
2. Values refer to concepts that a society holds in high esteem. In USA, individual freedom, social justice, equality of opportunity and national integration are examples of major values cherished by the society. In business terms, these values translate into freedom of choice in the market, responsibility towards the society and non-discriminatory employment practices.

3. Social trends present various opportunities and threats to business enterprises. For example, the health-and-fitness trend has become popular among urban societies, which led to an increase in demand for products like organic food, diet soft drinks, gyms, bottled (mineral) water and food supplements. However, this trend has harmed business in other industries like dairy processing, tobacco and liquor.

Activity 2

Contact any ten families known to you. Find out the changes in their consumption habits over the last five years. Analyse the impact of these changes on the working of an enterprise.

3. Technological Environment

Technological environment includes forces relating to

- scientific improvements and innovations,
- new ways of producing goods and services,
- new methods and techniques of operating a business.

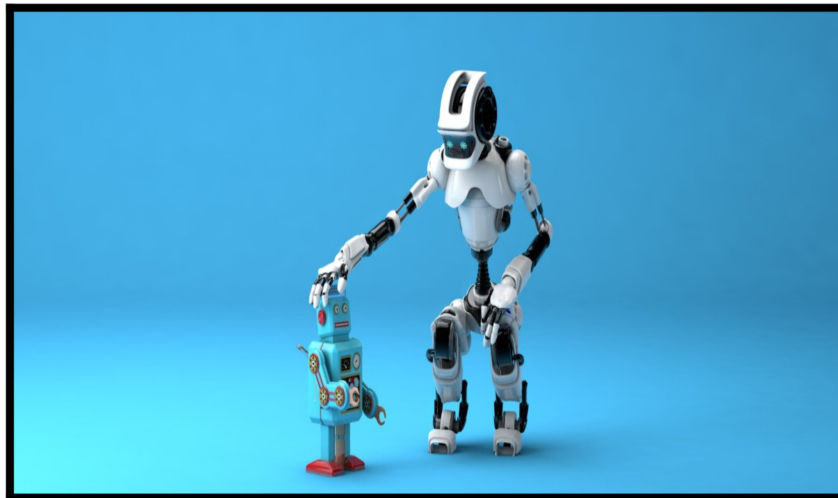
Examples of technological environment affecting the functioning of the business enterprise:

- Recent technological advancement in computers and electronics have modified the ways in which companies advertise their products. For example, it is common now to see CD-ROMs, computerised information kiosks, and Internet/World Wide Web multimedia pages highlighting the virtues of products
- Airline companies have Internet and World Wide Web pages where customers can look for flight times, destinations and fares and book their tickets online.
- Innovations in scientific and engineering fields such as lasers,
  - robotics,
  - biotechnology,
  - food preservatives,
  - medicine,
  - telecommunication and
  - synthetic fuels have provided numerous opportunities and threats for many different enterprises.

For example: Shifts in demand

- from vacuum tubes to transistors,
- from steam locomotives to diesel and electric engines,
- from fountain pens to ballpoint,

- from propeller air planes to jets, and
- from typewriters to computer based word processors.



4. Political Environment

Political environment includes political conditions such as

- General stability of the government
- Peace in the country
- Attitudes that elected government representative's hold towards business.

Examples of political *environment affecting the functioning of the business enterprise:*

- Political stability builds up confidence among business people to invest in the long term projects for the growth of the company. But political instability can shake that confidence.

- The attitudes of government officials towards business may have either positive or negative impact upon business. For example, if the government provides subsidy in the manufacturing of cotton garments, it will have positive impact on cotton textile businesses.

5. Legal Environment

Legal environment includes legal conditions such as:

- Various legislations passed by the Government
- Administrative orders issued by government authorities
- Court judgements
- Decisions rendered by various commissions and agencies at every level of the government-centre, state or local.

It is compulsory and vital for the management of every enterprise to obey the law of the land. Therefore, an adequate knowledge of rules and regulations framed by the Government is a pre-requisite for better business performance. Non-compliance of laws can enter the business enterprise into legal problems.

Impact of legal environment can be illustrated with the help of government regulations to protect consumer's interests.

Examples of legal environment affecting the functioning of the business enterprise:

- The advertisement of alcoholic beverages is prohibited.
- Advertisements, including packets of cigarettes carry the statutory warning 'Cigarettes smoking is injurious to health'.
- Advertisements of baby food must necessarily inform the potential buyer that mothers' milk is the best.

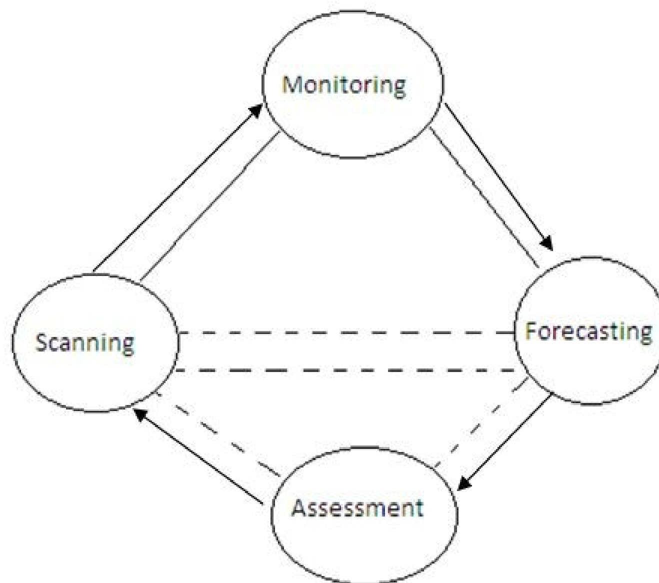
All these regulations are required to be followed by advertisers.

1.6 Process of Environmental Analysis

Environmental analysis is a challenging, time consuming and expensive work.

This analysis includes of 4 sequential steps:

- Scanning
- Monitoring
- Forecasting
- Assessment



1. Scanning

Environmental scanning is one of the essential components and first step in the process of environmental analysis.

Environmental scanning means the study and interpretation of the political, economic, social and technological events and trends which influence a business.

Scanning helps in continuously detecting the environmental change that is already in an advanced stage.

Environmental scanning is a *continuous process an*d organizations are always polishing the way their particular company or business passes through the process.

Environmental scanning makes productive strategic plans and policies that can be implemented to get the maximum benefit from the business environment in which they operate that can be implemented. Environment offers both strengths and weakness of a business. Environmental scanning helps in identifying both strengths and weaknesses of competitors, identifying new markets, potential customers and upcoming technological platforms and devices that can be best used to sell/market the product or service.

In the times of risk environmental scanning helps a business to improve their decision-making process keeping in mind the external and internal environment of the business.

2. Monitoring

Monitoring involves checking the environmental trends, sequences of events, or events of activities. It involves following the signals or indicators undiscovered during environmental scanning.

The purpose of monitoring is to collect sufficient data to find out whether certain trends and patterns are emerging or not.

Three outcomes of monitoring are:

(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.

3. Forecasting

Forecasting deals with the developing projections of directions, scope, speed and intensity of environment change.

Some examples of forecasting are:

- Are current lifestyle trends likely to continue?
- How long it will take the new technology to reach market place?
- Will people like the changing tastes in food products?

4. Assessment

Assessment involves identification and evaluation of how and why current and projected environmental change will affect strategic management of an organization.

In assessment, the steps start 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 in the organization.

Assessment helps in finding answer to the questions such as what the key issues are presented by the environment, and what are the implications of such issues for the organisation.

1.7 Techniques of Environmental Analysis

1. SWOT Analysis

What is SWOT Analysis?

SWOT analysis is a structure or framework which is used to evaluate a company's competitive position to know its strengths, weaknesses, opportunities and threats. SWOT analysis is a basic assessment framework that assesses what an organization can and cannot do, and its potential opportunities and threats.

SWOT stands for:

S-Strengths,

W- Weaknesses,

O- Opportunities and

T- Threats.

Elements of a SWOT Analysis

While using SWOT analysis an organisation must keep in mind the good and bad points. The organization has to keep the analysis specific by avoiding weak areas and analysing in contrast to real-life contexts.

For example, how are the organization's own products and services, as compared to those of the competing firms? For example: Coke and Pepsi are two leading competitive brands in soft drinks industry.

While conducting SWOT analysis, a business must keep these points in mind:

- it should be short and simple,
- it should avoid complexity and
- over-analysis as most of the of the information is subjective.

Thus, companies should use it as a guide and not as a prescription. It helps manger to formulate policies and plans based on it. It also helps top management in decision making.

a) Strengths

Strengths describes in which areas an organization excels at and_differentiates from the competitor. Strengths of an enterprise can be a strong brand, loyal customer base, a strong balance sheet, unique technology, quality of its products and services, after sales services etc.

b) Weaknesses

Weaknesses acts as a barrier in an organizations performance and hinders from performing at its optimum level. Weaknesses describes an enterprise where they are lacking and where they have to improve to remain competitive. Weaknesses of an enterprise can be higher-than-industry-average turnover, high levels of debt, an inadequate supply chain or lack of capital.

c) Opportunities

Opportunities refer to the positive external trends and changes that will help a firm to improve its performance. In other words, opportunities help an organization to use it to give it a competitive advantage.

d) Threats

Threats refer to the negative external trends and changes that will hinder a firm's performance. Other common threats include things like rising costs for inputs, increasing competition, tight labour supply, increasing competition in the market, changes in tastes and preferences of the consumer.

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

Strengths

i. India has huge pool of labour force.
ii. There are high percentage of cultivable land.
iii. Diversified nature of the economy.
iv. It has huge English speaking population, availability of skilled manpower.
v. A stable economy remains unaffected by external changes.
vi. High growth rate of economy.
vii. Rapid growth of IT and BPO sector bringing valuable foreign exchange.
viii. Abundance of natural resources.

Weaknesses

i. Large number of workforces involved in agriculture which contributes only 23% of GDP.
ii. Around a quarter of a population below the poverty line.
iii. High unemployment rate.
iv. Stark inequality in prevailing socio economic conditions.
v. Poor infrastructural facilities.
vi. Low productivity.
vii. Huge population leading to scarcity of resources.
viii. Low level of mechanization.
ix. Red tapism, bureaucracy.
x. Low literacy rates.
xi. Unequal distribution of wealth.
xii. Rural-urban divide, leading to inequality in living standards.

Opportunities

i. Scope for entry of private firms in various sectors for business.
ii. Inflow of Foreign Direct Investment is likely to increase in many sectors.
iii. Huge foreign exchange earning prospect in IT and ITES sector.
iv. Investment in R&D, engineering design.
v. Area of biotechnology.
vi. Huge population of Indian Diaspora in foreign countries (NRIs).
vii. Area of Infrastructure.
viii. Huge domestic market: Opportunity for MNCs for sales.

ix. Huge natural gas deposits found in India, natural gas as a fuel has tremendous opportunities.
x. Vast forest area and diverse wildlife.
xi. Huge agricultural resources, fishing, plantation crops, livestock.

Threats

i. Global economy recession/slowdown.
ii. High fiscal deficit.
iii. Threat of government intervention in some states.
iv. Volatility in crude oil prices across the world.
v. Growing import bill.
vi. Population explosion, rate of growth of population still high.
vii. Agriculture excessively dependent on monsoons.

2. PESTLE Analysis

PESTLE analysis (previously known as PEST analysis) is a framework or tool used to evaluate and monitor the macro-environmental factors that may have a great impact on an organisation's performance. This tool helps while starting a new business, launching a new product line, or entering a foreign market business.

PESTLE analysis plays a very crucial role in the business organisation. PESTLE analysis is a useful tool for understanding the "big picture" of the environment, in which an organisation is operating, and the opportunities and threats that operate within it. It is mostly used within a strategic SWOT analysis.

PESTLE stands for:

- P – Political
- E – Economical
- S – Social
- T – Technological
- L – Legal
- E – Environmental

PESTLE Analysis on an HR Department or other Internal Function

While the PEST or PESTLE analysis is primarily focused at looking at the external environment of an organization, many HR courses ask students to use the PEST or PESTLE analysis model to keep a check at their own function. Factors to include in the analysis may include the following:

a. Political

i. What is the culture of the organization?
ii. How is the HR function viewed by other functions?
iii. Who are the political champions of HR (or its adversaries)?
iv. Shareholder views

b. Economic

i. What is the budgetary position of the department?
ii. Is more money available?
iii. Are our customers likely to spend more or less money on the services we offer?
iv. What is happening to the financial status of the organization?
v. Interest rates
vi. Inflation
vii. Salary trends in the sector

c. Social

i. Other departmental attitudes to HR
ii. Population shifts (age profile)
iii. Education
iv. Fads (Fads include diets, clothing, hairstyles, toys, and more.)
v. Diversity
vi. Immigration/emigration
vii. Health
viii. Living standards
ix. Housing trends
x. Fashion & role models
xi. Age profile
xii. Attitudes to career

d. Technological

i. What changes may be coming our way?
ii. What new technology/systems?
iii. How do we record attendance, performance? how might this change?
iv. Use of and encourage home working?
v. Communications technologies
vi. Changes of technology that will increase/reduce the need for recruitment
vii. Changes to HR software

e. Legal

i. What is happening in our sector that will impact what we do?
ii. Minimum wage,
iii. Working time,
iv. Food stuffs,
v. Under 18 working,
vi. Occupational/ industrial Training etc.
vii. What changes will impact the services of the organization?

f. Environmental

i. Staff morale
ii. Staff engagement
iii. Need to reduce storage needs
iv. Management attitudes (inside dept/ function)
v. Organizational culture

3. Social, Legal, Economic, Political and Technological (SLEPT) Analysis

Before creating business plans or when evaluating existing ones, it is vital to 'scan' the external environment. Performing this convert in to 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.

a. Social factors

It relates to the set of behaviour, tastes, trends and lifestyles. A major component of this is a change in consumer behaviour which is a result of changes in fashions and styles. The age group of the population also alters over time (currently we have an ageing population). To a give a better outline to your business it is better to have a good knowledge of the social factors around you. The legal factors i.e. law especially the government policy and amendments 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, labour laws etc., which are continually revised in a wide range of areas. For example, changing food and clothing habits of people.

b. Economic factors

These are affected with every change in the social ones. There are multiple fluctuations associated with general booms and slumps in an economy.

During boom period all the organisations will get the benefit and during recession period most of the organisations loose out.

Various other economic changes that affect business include changes in the

- interest rate of loans,
- wage rates, and
- the rate of inflation (i.e. general level of increase in prices).

When the economic conditions of a country are right and stable then businesses will be more encouraged to expand and diversify their businesses and take risks e.g. low interest rates and rising demand.

Let's take another example: due to low interest rates of loans the demand for cars and houses have increased.

c. Political changes

It relates to changes in government policies, rules and regulations etc. In recent years these changes have been particularly important 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 the legal changes.

d. Technological changes

It has also become particularly important in the post-millennium world. The creation of data bases and electronic communications have enabled greater 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 so that they can cope with the changes in the market and can grow and survive in the long run. For example: pen drive, LED television, automatic washing machines, smart-phones, are all result of technological changes in the market.

SUMMARY

1. The term "Business Environment" means the sum total of all individuals or institutions and other forces that are outside the control of a business enterprise but that may affect its performance.
2. Features of business environment are interrelatedness, specific and general forces, dynamic, uncertainty, relativity, complex.
3. Importance of business environment: identification of opportunities to get first mover advantage, identification of threats and early warning signal, it helps in

tapping useful resources, it helps in improving performance, it helps in assigning planning and policy formulation.

4. The framework of business environment is divided into 2 broad dimensions: Internal Environment and External Environment
5. Internal environment is internal to the organization and which can be controlled by the business. The important internal factors are as follows: culture and value system, Human resource, mission and objectives, and nature and structure of management.
6. External or Macro or General Environment consists of factors external to the industry that may have a great impact on the firm's strategies. It consists of six broad dimensions: Demographic, Socio-cultural, political/legal, technological, economic and global.
7. Process of environmental scanning includes: 1 scanning 2 monitoring 3 forecasting 4 assessment.
8. The process by which organization monitors their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.
9. Monitoring involves checking the environmental trends, sequences of events, or events of activities. It involves following the signals or indicators unearthed during environmental scanning.
10. Forecasting deals with the developing projections of directions, scope, speed and intensity of environment change.
11. Assessment involves identification and evaluation of how and why current and projected environmental change will affect strategic management of an organization.
    - SWOT analysis
    - PESTLE analysis and
    - SLEPT analysis
12. Techniques of environmental scanning includes:
13. SWOT analysis is a structure which is used to evaluate a company's competitive position to know its strengths, weaknesses, opportunities and threats. SWOT analysis is a basic assessment framework that assesses what an organization can and cannot do, and its potential opportunities and threats.

14. PESTLE analysis (previously known as PEST analysis) is a framework or tool used to evaluate and monitor the macro-environmental factors that may have a great impact on an organisation's performance. This tool helps while starting a new business, launching a new product line, or entering a foreign market business.

15. SLEPT analysis 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.

SELF ASSESSMENT

LONG ANSWER TYPE QUESTIONS

1. What is business environment? How it affects a firm?
2. What are the features of business environment? Explain.
3. What is the importance of business environment? How it helps a firm to become successful?
4. What are the 2 major components of business environment? Explain.
5. Explain external environment and internal environment?
6. What are the components or dimensions of external business environment?
7. Explain the process of business environment.
8. Define environmental scanning? How it impacts a business?
9. Define monitoring? What are the outcomes of monitoring?
10. Define forecasting. Does a shopkeeper also have to do the forecasting?
11. Define assessment. What it involves?
12. Explain SLEPT analysis.
13. Explain PESTLE analysis.

REASON BASED QUESTIONS

1. The relation between a business and an environment is not a one way affair". Comment.
2. "Environment is dynamic and multi-faceted". Discuss.
3. A good strategist always keeps an eye on development in environment." Comment.
4. Do a SWOT analysis of the Indian Tourism industry?
5. 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?

6. Environmental scanning should provide inputs for "strategic discussion making".

FURTHER SUGGESTED READINGS

1. Business Environment by Vaishali and Shruti Aggarwal
2. Business Environment by Justin Paul

MODULE 2

ECONOMIC TRENDS IN INDIA- NEP

2.1 Learning Objectives

In this module you will learn about:

- Meaning of New Economic Policy of India,1991
- Rationale for reforms
- Reason of launching New economic policy
- Main Objectives of New Economic Policy – 1991
- Main Measures Adopted in the New Economic Policy
- Economic reforms in India – Liberalisation, Privatisation, Globalisation
- Liberalisation
- Steps taken under the Liberalisation reform

2.2 Meaning of New Economic Policy of India,1991

It refers to ongoing economic liberalisation or relaxation initiated in 1991 of the country's economic policies. It was introduced with the aim of making the economy more market-oriented and expanding the role of the private sector and attraction of foreign investment. In 1991, Mr. Narsimha Rao, the prime minister of India at that time, took certain concrete steps to take the economy out of economic crisis and therefore, is credited as the first designer of India's NEP.

2.3 Rationale for reforms

1. The introduction of free market principles will enhance competition and reduce cost.
2. The economy will be more competitive.
3. Reduction in domestic controls will increase foreign investment in terms of capital and finance.
4. Enhanced rate of economic growth will bring increased prosperity and well-being to the people through trickle -down effect and poverty will automatically reduce.
5. Market reforms will make it possible to generate certain civic amenities and public utilities such as water supply, food, education, and health services at a lower cost and all these will benefit the people.

The year 1991 is an important landmark in the economic history of post-Independent India. The country went through a severe economic crisis triggered by a serious Balance of Payments situation. The crisis was converted into an opportunity to introduce some fundamental changes in the content and approach to economic policy.

The response to the crisis was to put in place a set of policies aimed at stabilisation and structural reform. While the stabilisation policies were aimed at correcting the weaknesses that had developed on the fiscal and the Balance of Payments fronts, the structural reforms sought to remove the rigidities that had entered into the various segments of the Indian economy.

Since 1991, Government of India has introduced diverse economic reforms to pull the country out of economic crisis and to accelerate the rate of growth.

These reforms are often described as the New economic policy (NEP) or policy of LPG.

LPG stands for:

L for liberalisation

P for privatisation

G for globalisation

2.4 The reason of launching New Economic Policy were: -

1. Increase in fiscal deficit.
2. Mounting adverse balance of payment.
3. Gulf crisis.
4. Fall in foreign exchange reserve.
5. Rise in prices.
6. Poor performance of public sector undertaking.

2.5 Main Objectives of New Economic Policy – 1991

The main objectives behind the introduction of the New Economic policy (NEP) in 1991 by the union are stated as follows:

The NEP intended:

1. To spree Indian economy in to the arena of 'Globalisation and to give it a new picture on market orientation.
2. To bring down the rate of inflation and to remove imbalances in payment.
3. To move towards higher economic growth rate and to build sufficient foreign exchange reserves.
4. To achieve economic stabilisation and to convert the economy in to a market economy by removing all kinds of unnecessary restrictions and controls.
5. To permit the international flow of goods, services, capital, human resources and technology, without many restrictions.
6. To increase the participation of private players in all the sectors of the economy. That is why the reserved numbers of sectors for government were reduced to 3 as of now.

2.6 Main Measures Adopted in the New Economic Policy

Earlier to the NEP, the Indian economy had various restrictions and controls due to which the economy became defective. The entrepreneurs were unwilling to build new industries (because laws like MRTP Act 1969 de-motivated entrepreneurs).

These controls resulted into increased:

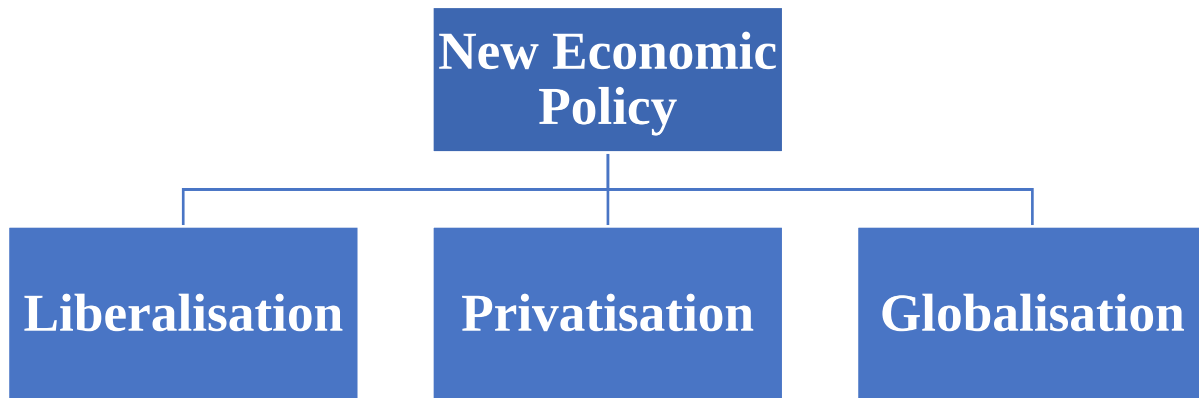
- Corruption,
- Undue delays and
- Inefficiency.

Rate of economic growth of the economy decreased. In those times it became urgent to launch economic reforms to reduce the restrictions imposed on the economy.

Thus, NEP launched LPG. LPG stands for:

1. Liberalisation;
2. Privatisation;
3. Globalisation

Branches of New Economic Policy



2.7 Economic Reforms in India- Liberalisation, Privatisation, Globalisation

1. Liberalisation

Liberalisation means freedom from direct physical controls and restrictions imposed by the government.

Licensing is now not required in all the businesses, except in only six industries.

Industries licensing is necessary for these 6 following industries:

i. liquor;
ii. cigarettes;
iii. defence equipments;
iv. industrial explosives;
v. dangerous and hazardous chemicals;
vi. drugs and pharmaceuticals.

2. Privatisation

"Privatisation" is a process of involving private sector in the ownership or operation of a state owned enterprise. It also means increasing the role of private sector in an economy.

It may happen in 3 ways: -

1. Sale of shares of PSUs
2. Disinvestment of PSUs
3. Minimisation of PSUs

3. Globalisation

"Globalisation" integrates the economy of a country with the other economies across borders. Thus, LPG policies has a positive impact on the economy. It has resulted now into a vibrant and vast economy. There has been a significant increase in government's revenue and there has been check on the rate of inflation. Now the consumers have a wider access and reach to greater variety of products and not just domestic products but international products as well.

2.8 Liberalisation

Liberalisation means eradication of superfluous and unnecessary controls and restrictions in the form of licence, quotas, and permits. India started liberalisation in 1991.

Liberalisation of the Indian industry includes

1. Abolishing licensing requirement in most of the industries except few
2. Freedom in deciding the scale (small scale, medium scale or large scale) of business activities i.e., no restrictions on expansion or contraction of business activities
3. Removing restrictions on the movement of goods and services
4. Freedom to fix the prices of goods and services
5. Reduction in tax rates and removing the unnecessary controls over the economy
6. Simplifying procedures for imports and exports, and
7. To make it easier to attract foreign capital and technology to India

2.9 Steps taken under the Liberalisation reform

1. Free determination of interest rate by the commercial banks

Under the policy of liberalisation interest rate of the banking system no longer would be determined by RBI. Now all the commercial banks are free and independent to determine the rate of interest.

2. Increase in the investment limit for the Small Scale Industries (SSIs)

Investment limit of the small scale industries has been increased to INR 1 crore. Now, Small Scale Industries (SSIs) can upgrade their capital budgeting requirements such as land, building, machinery etc. This will help in improving their efficiency. With the increase in investment level, SSIs has benefited in many ways like increased level of production, increased turnover, increased profits, efficiency and effectiveness.

3. Freedom to import capital goods

Indian industries will be free to buy machines and raw materials from foreign countries to do their comprehensive development. Now, there can be an easy exchange and transfer of resources. Freedom of import of capital goods has not just helped Indian economy to increase their level of economic growth rate but GDP as well. When India imports technical goods and machinery in Indian market and apply into their operations and businesses it helps them to produce goods effectively and efficiently. It helps them to improve their operations and methods of production resulting into benefits such as: increase in the level of production, increase in the level of turnover, increase in the level of profits, improved ways of packaging goods, better quality of goods, reduced cost of production etc.

4. Freedom for expansion and production to Industries

With the introduction of liberalisation, now the Industries are free to diversify their production capacities, operations and products. This will reduce the cost of production. Earlier government used to fix the maximum limit of level of production and each industry has to follow that norm. But now the industries are free to decide their production levels by their own on the basis of the requirement and demand of the markets.

5. Abolition of Restrictive Trade Practices

According to Monopolies and Restrictive Trade Practices (MRTP) Act 1969, all those companies which have assets worth INR 100 crore, or more were called MRTP firms and were subjected to several restrictions. Now these firms have not to take prior approval of the government to take investment decision.

2.10 SUMMARY

1. NEP refers to ongoing economic liberalisation or relaxation initiated in 1991 of the country's economic policies. It was introduced with the aim of making the economy more market- oriented and expanding the role of the private sector and attraction of foreign investment.

2. Rationale for reforms:

- The introduction of free market principles will enhance competition and reduce cost.
- The economy will be more competitive.
- Reduction in domestic controls will increase foreign investment in terms of capital and finance.
- Enhanced rate of economic growth will bring increased prosperity and well-being to the people through trickle -down effect and poverty will automatically reduce.
- Market reforms will make it possible to generate certain civic amenities and public utilities such as water supply, food, education, and health services at a lower cost and all these will benefit the people.

1. These reforms are often described as the New economic policy (NEP) or policy of LPG where:

L for liberalisation;
P for privatisation;
G for globalisation

2. The reason of launching New Economic Policy were: -

- Increase in fiscal deficit.
- Mounting adverse balance of payment.
- Gulf crisis.
- Fall in foreign exchange reserve.
- Rise in prices.
- Poor performance of public sector undertaking.

1. The main objectives behind the introduction of the New Economic policy (NEP) in 1991 by the union are stated as follows:

The NEP intended:

- To spree Indian economy in to the arena of 'Globalization and to give it a new picture on market orientation.
- To bring down the rate of inflation and to remove imbalances in payment.

- To move towards higher economic growth rate and to build sufficient foreign exchange reserves.
- To achieve economic stabilization and to convert the economic in to a market economy by removing all kinds of unnecessary restrictions.
- To permit the international flow of goods, services, capital, human resources and technology, without many restrictions.
- To increase the participation of private players in the all sectors of the economy. That is why the reserved numbers of sectors for government were reduced to 3 as of now.

India introduced economic reforms in India – Liberalisation, Privatisation, Globalisation.

1. Liberalisation means freedom from direct physical controls and restrictions imposed by the government.
2. Privatisation is a process of involving private sector in the ownership or operation of a state owned enterprise.
3. Globalisation integrate the economy of a country with the other economies across borders.

2.11 SELF ASSESSMENT

1. Give the meaning of New Economic Policy of India,1991.
2. What is the rationale behind New Economic Policy of India,1991?
3. What is the reason behind launching New economic policy?
4. What are the objectives of New Economic Policy?
5. What are the main measures adopted in the New Economic Policy?
6. Explain the economic reforms in India.
7. Define liberalisation.
8. Define privatisation.
9. Define globalisation.
10. What are the steps taken under the Liberalisation reform? Explain.

2.12 FURTHER SUGGESTED READING

1. Business Environment by B.N. Ghosh
2. Business Environment by Vaishali and Shruti Aggarwal

MODULE 3
PRIVATISATION

3.0 Learning Objectives

In this module you will learn about:

- Meaning of privatisation
- 10 applicable connotations
- Modes of Privatisation
- Motives for Privatisation
- Reasons for Privatisation
- Difference between Privatisation and Nationalisation
- Advantages of Privatisation
- Disadvantages of Privatisation
- Steps taken for Privatisation
- Types of privatisation

3.1 Meaning of Privatisation

Privatisation is the process of giving greater role to the private sector in the development of a nation and giving lessor role to the public sector.

Due to the New Industrial Policy of 1991, the government of India redefined the role of the public sector and adopted the policy of planned disinvestments of the public sector. It simply means transferring assets from the government to the private sector. Privatisation process leads to the change in ownership.

Disinvestments means transferring the public sector enterprises to the private sector. It results in dilution of stake of the Government in the public firm. When there is dilution of Government ownership beyond 51 percent, that result in transfer of ownership and management of the enterprise to the private sector.

3.2 10 applicable connotations

1. Divestment or sale of government corporate assets including land and property.
2. At least 50 per cent of government shares being sold to private share -holders.
3. Commercialisation, that is, application of the laws of the market.
4. Corporatisation, that is, changing the legal status of a government organisation to that of a limited liability company (LLP).
5. Sale of a government company either partly or wholly in term of equities.

6. Privatisation of financing of public goods- the construction and maintenance, of any overhead bridges to be entrusted to private companies, which will change the user fees or levies on the consumers.

7. Contracting out services to private companies.

8. Grating of licences and franchises to private companies for production and /or distribution.

9. Private sector participation in the production, financing, or distribution of state control enterprises.

10. Deregulation and liberalisation of process and procedures.

3.3 Modes of Privatisation

There are many modes of privatisation including:

- Divestment
- Outright sales of public enterprises
- Joint venture
- Management buying out
- Catering out services
- Private financing
- Leasing
- Franchising and so on

However, a few general observations from the ASEAN countries can be briefly presented as follows:

1. Privatisation mainly came in to those public sector enterprises which were sick units, or which were running into heavy losses, and they generally regarded as liabilities. The financial health of the public sector enterprises was not good as the liabilities was more than its assets. To revive from this critical situation, they decided to sell their shares to private sector. The mode chosen is generally divestment or outright sale.

2. Divestment has been chosen as the most suitable mode for those enterprises which involve negligible social welfare considerations and minimum legal impediments or problems.

3. Liquidation and sale have often been practised in the cases which are not strategic, or which are unimportant from the point of view of national security.

4. New areas of development or experimentation in cases, such as transportation and highways, involving huge lump sum investment have often entrusted entirely to the private sector. However, the government often resorts to modes, such as catering out, licensing, management buy-out, or financing from the private sector mainly for:

(i) enhancing efficiency

(ii) reliving its financial burden

In the early 1980s, when the wave of privatisation surcharged the ASEAN economies, many governments became very cautious economically and politically to introduce privatisation.

3.4 Motives for Privatisation

There are at least 5 major factors promoting privatisation in different countries which are following:

1. Privatisation would increase efficiency, lower costs and prices, and raise the standard of living of the people.
2. Privatisation was a reaction against the management, higher prices, uncertain supply position, sluggish performance, and service deterioration and delays of the public enterprises. In many counties, these enterprises were not economically viable and sustainable. They were running into huge losses, and an alternative was essential.
3. The growth and success of industrial capitalism in the western countries based on the principle of marketisation provided an additional incentive for the introduction of privatisation in many developing countries.
4. The pressure for privatisation came from many interest and pressure groups, both internally and externally. Internal pressure came from new entrants and loss from the groups who would stand to benefit from deregulation and privatisation. External pressures were exerted by multinational companies, foreign investors and also by the world bank and the international capitalist institutions, which championed the expansion of capitalism and private sector hegemony.
5. The states in many developing countries, particularly, in South East Asia, wanted to decrease the administrative and financial burden of the governments by privatisation.

The states were eager to accelerate the speed of economic development by increasing efficiency through the introduction of more and more competition. Privatisation was regarded as an instrument for ensuring efficiency and growth.

Why Privatisation?

3.5 Reasons for Privatisation

There are various reasons for Privatisation.

These reasons can be classified mainly into 2 categories:

(i) Economic and

(ii) Non economic

The basic idea of privatisation in the ASEAN states has introduced because of various factors such as:

- Economic inefficiency
- Exorbitant running expenditure of public enterprises
- Lower productivity
- Higher cost of per capita output
- Surplus labour, and the like

Privatisation could be helpful for generating:

- Economic efficiency
- Reducing cost and surpluses for economic development and growth.

In few cases, not only the governments wanted to decrease the financial burden and responsibilities, but also wanted to have lessor participation in the management of the economy. Thus, the philosophy underlying the role of the state drastically changed from one of a powerful and strong participatory state to a state of minimal participation, though not complete laissez faire.

3.6 Difference between Privatisation and Nationalisation

Here in the image difference is given between privatisation and nationalisation.

	Privatisation	Nationalisation
Ownership	Firm owned by private sector	Firm owned and managed by government
Incentives	Profit motive acts as incentive for owners and mangers	Workers *may* feel motivated if they feel company belongs to them.
Externalities	Private firm may ignore external costs (pollution) and external benefits	Government can put social benefits above profit motive.
Efficiency	Incentive to introduce new technology and increase labour productivity	Nationalised firms may find it hard to sack surplus workers
Knowledge	Private firms employ managers with best skills.	Politicians may interfere based on political motives
Natural monopolies	Private monopolies, e.g. water / trains may charge high prices.	Government can set prices based on social factors.
Depends on industry	Worked well for BT, BA	Natural monopolies, like trains /water. Non-profit services like health care.

3.7 Advantages of Privatisation

The advantages of privatisation are following:

1. Financial Resources

The main advantage of privatisation is to generate financial resources for the government in order to generate resources disinvestment of public sector enterprises.

2. Optimum Utilisation of Resources

The public sector has failed in the optimal utilisation of national resources. The private sector uses resources in such way that it maximises its efficiency. They use resources effectively and efficiently. They focus on maximum utilisation of resources and minimum wastage of resources.

3. Increased competition

Most of the public enterprises enjoy the status of monopoly. Due to which it results in inefficiency and losses.

For example:

1. Indian railways - Their cost is more than its revenue. Privatization fosters the spirit of competition for public enterprises thereby they are forced to improve their efficiency.
2. Electricity and gas -there is now more competition in telecoms and distribution of gas and electricity. However, privatisation doesn't necessarily increase competition; it depends on the nature of the market.
3. Water - there is no competition in tap water because it is a natural monopoly. There is also no competition in railway industry.

4. Reduces Fiscal Burden

Privatisation reduces the fiscal burden of the state by relieving it out of the losses of the public enterprise. Private enterprises aim at profit maximisation. Due to large and ample resources and technology they earn huge profits and thereby helps public enterprises to revive back to normal profits. It also helps in reducing the size of the bureaucracy.

5. Economic Democracy

Privatisation helps in controlling and reducing the government monopoly. It helps to attract more resources from the private sector. It appeared as economic democracy by private participation in economics sphere.

6. Reduction in Political Interferences

The process of privatisation leads to less political interferences in the public sector enterprises by giving more autonomy to the private sector in the management of public enterprises.

7. Reduction in Bureaucracy

Public Enterprises become synonyms to bureaucracy. It can result into bureaucracy by the process of privatisation.

8. More Productivity

The private sector may improve productivity by maintaining efficiency in its operations. The private sector uses its resources in the best possible manner. They focus on effectiveness and efficiency. This leads to reduced cost of production and increased profits. In private sector, level of production has increased which resulted into increase in GDP of an economy.

9. Economical

The process of privatisation maintains the economy in the operations, whereas the operations of public enterprises are costly. Privatisation is in economical in nature. The cost of production per unit of output is low in private sector.

10. Individual Motivation

The success of private sector lies in the sole objective of earning maximum profits. Privatisation encourages the managers to bring out the efficiency in the operations of the enterprise so that it can earn maximum profits. The main of private sector enterprises is maximisation of profits.

11. Government will raise revenue from the sale

Selling state-owned assets to the private sector raised great amount of money for the UK government in the 1980s. However, this is a one-off benefit. It also means we lose out on future dividends from the profits of public companies.

3.8 Disadvantages of Privatisation

The disadvantages of privatisation are following:

1. Problem of regulating private monopolies

Privatisation results into creation of private monopolies, such as the water companies and rail companies. These need regulation to prevent misuse of monopoly power and autonomy. Therefore, there is still need for government regulation, similar to under state ownership.

2. Opposition from Employees

Disinvestment leads to political opposition from employees in an organisation because they fear of losing their jobs. Losses of jobs is a result of liquidation. Employees fears because of the fact that if privatisation will come, they may lose their jobs as private sectors uses capital intensive technology and they will replace labour with capital. Capital intensive technology saves times, money and efforts.

3. Problem of Finance

In the developing countries under the developed capital market sometimes makes it difficult for the government to float shares and for individual buyers to finance the large purchase.

4. Improper Working

The private sector does not focus on cost reduction and quality improvement. There are many unfair practices in which many businesses involve in often resulting in the generation of black money and corruption. Sometimes private sector also fails to generate enough revenue and turnover due to may factors such as: improper management, lack of finance and capital etc.

5. Independence on Government

There has been an excessive regulation and control of the private sector by the government. This has prevented and competition from becoming a generalised phenomenon of the economy.

The private sector has also become too much dependent on the government for meeting its imports requirement, output sale, finances etc. It has resulted in a situation where private sectors are not independent.

6. High-Cost Economy

Private sector sells goods and services at a high price to earn maximum profits, which creates a situation of inflation. Most of the private sectors enterprises are inefficient in serving consumers at large.

The cost of production is high because of the poor technology inefficient management. The two other factor of higher costs are the high costs of raw materials and inputs and the higher rate of indirect taxes levied by the government.

7. Concentration of Economic Power

The private sector leads to formation of monopoly and the concentration of economic power in the hands of few. The dominance of some business groups in terms of capital and assets is an economic and social problem.

The private sectors main aim is maximisation of profits and creation of the monopoly market. It is harmful for the consumers and society as a whole.

8. Bad Industrial Relations

There is a feature of private sector which is recurrence industrial disputes which hinders the smooth functioning of the private sector. Due to industrial disputes the production levels have reduced and raised the cost of production as well.

The harmful results are work stoppages leading to the nation utilization of capital equipment, idle labor, wastage of manpower, loss of production, law and order problems etc.

9. Widespread Sickness

The private sector Industries such as Textiles, engineering, Chemicals, iron, and steel and people are facing from the problems of industrial sickness. These industries are facing continuous losses. It adversely affects the industrial environment.

10. No Guarantee of Success

Privatisation does not guarantee success of an individual unit. It has been observed that many private sector units make huge losses.

3.9 Steps taken for Privatisation

The following steps are taken for privatisation:

1. Sale of shares of PSUs

Indian government has started selling shares of PSU's to public and financial institution. For example: government sold shares of Maruti Udyog Ltd. Now the private sector will acquire ownership of these PSU's. The share of private sector has increased from 45% to 55%.

2. Disinvestment in PSU's

The government has initiated the process of disinvestment in those PSU's which had been running into losses. It means that government has been selling out these industries to private sector. Government has sold enterprises worth Rs. 30,000 crores to the private sector.

3. Minimisation of Public Sector

Previously, Public sector was given the importance with a view to help in building industrialisation and eradication of poverty. But due to huge losses, these PSU's was not able to achieve this objective and policy of contraction of PSU's was followed under new economic reforms.

Number of industries reserved for public sector was reduced from 17 to 3. The industries are following:

(a) Transport and railway

(b) Mining of atomic minerals

(c) Atomic energy

3.10 Types of Privatisation

Privatisation are of 4 types:

1. Ownership Measures
2. Organisational Measures
3. Operational Measures
4. De reservations

1. Ownership Measures

The degree of privatisation is judged by the amount of ownership transferred from the public enterprise to the private sector. It can emerge in the following ways:

(a) Total Denationalisation

Total Denationalisation is a complete transfer of a public enterprise to the private sector.

Example:

- BALCO, which was acquired by Sterlite industries.
- Modern Foods was acquired by Hindustan Lever.

(b) Joint Venture

This indicates partial start of private ownership. The range of private ownership can change, 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 stakeholder.

(c) Liquidation

Liquidation is the process of selling off assets of a company to repay creditors and distributing the remaining assets to the owners.

Liquidation is defined as the process of winding up a business, to pay off creditors, and to give the investors whatever is left over. It is an event that usually occurs when a company is insolvent and cannot pay its obligations such as the repayment of loans and interest on loans, creditors, borrowings from bank etc. when they come due.

(d) Workers Co-operative

In this type, the ownership of the enterprise is transferred to workers which may form a co-operative to run the enterprise. It is owned and self-managed by its workers.

2. Organisational Measures

A number of organisational measures are captured to limit state control. They include:

(a) A Holding Company Structure:

Here, the organization is decentralised, and sufficient authority of decision making is given at the operative/supervisory level, but the government still controls and participates in

decision making made at the apex level. Due to which decentralisation arises in management.

(b) Leasing

Here, the assets are transferred from government to private bidders for a certain period. In the leasing agreement the bidder should ensure about profit sharing between the State and bidder. This is a type of tenure ownership.

(c) Restructuring:

Restructuring is of two types:

1. Financial and
2. Basic restructuring.

Financial restructuring is the process of reshuffling or reconstructing the financial structure of a company, which basically includes equity capital and debt capital. Financial restructuring can emerge because of either compulsion or as part of the financial strategy of the company. This financial restructuring can be either from the assets side or the liabilities side of the Balance sheet. If one is changed, the other will be adjusted accordingly.

The two components of financial restructuring are:

1. Debt Restructuring and
2. Equity Restructuring

The main purpose of reconstructing is to improve the financial health of the enterprise and basic restructuring is said to occur when the public enterprise decides to lose some of its activities or functions to be taken up by ancillaries or small scale units.

3. Operational Measures

The motive of operational measures is to improve efficiency of the organisation.

Operational measures contain the following measures:

(a) Granting 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 ways of privatisation; it is a privatisation of ownership through the sale of equity. It means selling stock to the public. Divestiture is also known as disinvestment.

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

Focus of New Economic Policy (NEP)

The new industrial policy announced by the government in July 1991 focused on the following four majors are as 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 for sick public sector enterprises is same as that for private sector.

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

4. De reservations

The 1991 industrial policy reduced the number of industries reserved for the public sector from 17 to 4.

The reserved sectors are as follows:

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

(b) Atomic Energy.

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

(d) Railway Transport.

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

3.11 SUMMARY

1. Privatisation is the process of giving greater role to the private sector in the development of a nation and giving lessor role to the public sector.

2. *Disinvestments* means transferring the public sector enterprises to the private sector. It results in dilution of stake of the Government in the public firm. When there is dilution of Government ownership beyond 51 percent, that result in transfer of ownership and management of the enterprise to the private sector.

3. There are 10 connotations which is applicable to privatisation.

4. Modes of Privatisation- There are many modes of privatisation including

- divestment
- or outright sales of public enterprises,
- joint venture,
- management buying out,
- catering out services,
- private financing,
- leasing
- franchising and so on.

1. Reasons for Privatisation- There are various reasons for Privatisation.

These reasons can be classified mainly into 2 categories:

(i) economic and

(ii) non-economic.

2. The basic idea of privatisation in the ASEAN states has introduced because of various factors such as:

- economic inefficiency,
- exorbitant running expenditure of public enterprises,
- lower productivity,
- higher cost of per capita output,
- surplus labour, and the like.
- There are various advantages and disadvantages offered by the privatisation.
- Privatisation of four types: operational measures, organisational measures, ownership measures and de- reservation.
- Divestiture is one of the ways of privatisation; it is a privatisation of ownership through the sale of equity. It means selling stock to the public. Divestiture is also known as disinvestment.

3.12 SELF ASSESSMENT

1. What is privatisation?
2. What is disinvestment?
3. What are the 10 connotations of privatisation?
4. What are the modes of privatisation? Explain

5. What is the motive behind privatisation? Explain
6. Explain the reasons behind introducing privatisation.
7. Do privatisation lead to change in the ownership? Comment.
8. What are the advantages of privatisation? Explain.
9. How many types of privatisation are there? Name them.
10. Explain all the types of privatisation in detail.
11. Define De reservations
12. Explain the focus of NEP.

3.13 FURTHER SUGGESTED READINGS

1. Business Environment by Vaishali and Shruti Aggarwal
2. Business Environment by B.N. Ghosh

MODULE 4

GLOBALISATION

4.0 Learning Objectives

In this module you will learn about:

- Meaning of Globalisation
- History of Globalisation
- Features of Globalisation
- Steps taken for Globalisation
- Advantages of Globalisation
- Disadvantages of Globalisation
- Obstacles to Globalisation
- Impact of Globalisation on business and trade
- Impact of Globalisation on India

4.1 Meaning of Globalisation

The OECD defines globalisation as

"The geographic dispersion of industrial and service activities, for example research and development, sourcing of inputs, production and distribution, and the cross-border networking of companies, for example through joint ventures and the sharing of assets."

Globalisation means the integration of one economy with the world economy.

Globalisation is the process of rapid integration of countries through greater foreign trade (exports and imports) and foreign investment (FDI & FII).

In other words, it is the process of international integration arising from the interchange of world views, products, technology, opinions and services, ideas and other aspects of culture. Till 1991, the Government of India had followed a policy of strictly regulating imports in value and volume terms. These regulations were with respect to:

(a) Licensing of imports

(b) Tariff restrictions and

(c) Quantitative restrictions.

Globalisation involves an increased level of interaction and interdependence among the different nations of the global economy. This has been made possible by the rapid advancement in technology and liberal trade policies made by the Government of India. Due to the policy of 1991, the government of India led the country to this globalisation pattern.

4.2 History of Globalisation

The word 'globalise' was first attested by the Merriam Webster Dictionary in1944. 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.

4.3 Features of Globalisation

There are various features of Globalisation which are stated a follow:

1. The basic idea of globalisation s to extract surplus through various means including trade, investment and aid.

2. It is a means to extract surplus though the exploitation of cheap labour, HQM, and the resources of the developing countries.

3. The neo-liberal globalisation ties to integrate all the nations, states, and individuals into a common set of market relations, which are binding and have their own philosophy and distinctive laws of motion.

4. The modern system of globalisation is designed in such a way that it will hugely benefit the capitalist to prop up their sagging economies and sustain a higher rate of economic growth and employment.

4.4 Steps taken for Globalisation

(i) Decrease in tariffs

In India, to make Indian economy attractive to the global investors they have gradually decreased their custom duties and tariffs levied on imports and exports.

(ii) Long term Trade Policy

Trade policy was enforced for longer time period.

Main features of the policy are:

(a) Liberal policy

(b) All controls on foreign trade have been removed

(c) Open competition has been encouraged

(iii) Partial Convertibility of Indian currency

Partial convertibility refers to converting Indian currency (up to specific extent) in the currency of other countries. For example, converting INR to US dollar.

Partial convertibility adopted so that the flow of foreign investment in terms of Foreign Institutional Investment (FII) and foreign Direct Investment (FDI) can be increased.

This convertibility valid for following transaction:

(a) Remittances to meet family expenses

(b) Payment of interest

(c) Import and export of goods and services

(iv) Increase in Equity Limit of Foreign Investment

Equity limit of foreign capital investment has been raised from 40% to 100% percent. In 47 high priority industries foreign direct investment (FDI) to the extent of 100% will be allowed without any restriction. In this regard Foreign Exchange Management Act (FEMA) will be enforced.

4.5 Advantages of Globalisation

1. Increases efficiency

Globalisation helps to increase the long run average growth rate of the economy of the country by:

(a) Improvement in the allocative efficiency of resources;

(b) Increase in labour productivity; and

(c) Reduction in capital-output ratio.

2. Greater specialisation

Globalisation helps in removing inefficiency in the production system of domestic firms. With the introduction of globalisation domestic firms has achieved has cost effectiveness in their functions and operations. Now, they are focusing on their core competencies and achieving success at a faster rate. Specialisation also helps to save resources and promote exports of the country.

3. Higher production

Globalisation has resulted into spreading of manufacturing facilities in different counties. Firms which have worldwide connections and networks can outsource funds, technology, distribution and other functions from anywhere in the world. They can negotiate subcontracting so that they can focus on the areas of their core competence. International outscoring and subcontracting help to improve operational efficiency and to reduce costs.

4. Attracts entry of foreign capital

Globalisation helps in attracting entry of foreign capital and foreign updated technology thereby which improves the quality of production of the domestic firms.

5. Higher standards of living

Lower prices, better quality, and higher income helps to enhance consumption and living standards of people specially in developing countries. Increased economic development and economic growth helps the government of these countries to provide better welfare facilities like education, health, sanitation, etc. this helps in all over increase in welfare and prosperity of public.

6. Increase in employment and income

Due to upcoming MNCs in the host countries it helped the host counties to solve the problem of unemployment. Globalisation has created number of employment opportunities in many sectors such as manufacturing and service sector. Due to increased employment it has increased the incomes of people and standard of living.

FDI has cured the chronic problem of unemployment in developing counties like India. Globalisation provides consumer goods industries to expand faster so that to meet the growing needs of consumers which would result in faster expansion of employment opportunities over a period of time.

7. World peace

Globalisation promotes cultural exchange and mutual understanding among different nation. International cooperation and brotherhood contribute to peace and prosperity in the world. It has made nations to come closer to each other and build respect, integrity and compression for each other.

8. Enhances efficiency in different sectors

Globalisation enhances the efficiency of the banking, insurance and financial sectors. It has also helped to increase foreign capital, foreign banks and insurance companies.

9. Wider market

Globalisation helps in the free flow of capital and technology between countries. Global enterprises can acquire finance t lower cost of capital. Free flow of capital and technology from advanced countries help the developing nations to increase their industrialisation. Industrialisation of developing countries leads to balanced development of all the countries.

10. International economic cooperation

Globalisation improves economic cooperation between nations in the forms of trade agreements, investment treaties standardization of commercial procedures, and avoidance of double taxation, intellectual property protection and so on international cooperation also helps counties to harmonies their macroeconomic policies for their mutual benefit.

11 Price stabilisations

Globalisation may reduce price differences between counties. Free trade and international competition help to equalize price levels in international markets. Countries which have high degree of specialisation, can attract greater foreign investment which provides domestic funds, brings in foreign exchange and improves balance of payments.

4.6 Disadvantages of Globalisation

1. Inequality

Globalisation is responsible for the rising inequalities in income and wealth. The proof of this situation is the growing rural–urban divide in countries such as China, India and Brazil. This has resulted in to political and social tensions and financial instability that will decrease growth. Many of the poor sections of the world do not have access to basic technologies and public goods. They are excluded from the benefits.

2. Inflation

Increasing demand for food and energy has caused a major rise in commodity prices. Food price inflation (known as agflation) has thrown millions of the world's poorest people at great risk.

3. Drain of basic resources

Globalisation has led to exploitation of natural resources and basic raw materials in developing counties. These counties are often the sellers of agricultural and other inputs and buyers of finished products. Those nations who offer better career growth in terms of pay and status, the talented human resources from developing nations get transferred to developed nations which is a great loss to the developing nations economic underdevelopment of poor countries is the result of exploitative character of international trade.

They exploit resources in such a manner that it creates various threats such as irreversible damage to ecosystems, land degradation, deforestation, loss of biodiversity and the fear of a permanent shortage of water affecting the nations as a whole.

4. Trade Imbalances

Due to globalisation, not just global trade has increased but global trade imbalances also. Developing nations as a result choosing the option dumping as a solution. Dumping refers to the selling excess output at a price below the unit cost of supply. Thereby, resulting into fiscal deficit of a country.

5. Unemployment

Globalisation leads to restricting of industry. Technology up graduation and focus on areas of comparative advantage create unemployment and underemployment among low skilled workers. As a result, income inequality, poverty, social unrest may increase. Concern has been expressed by some that capital investment and jobs in advanced economies will drain away to developing countries as firms switch their production to countries with lower unit labour costs. This can lead to higher levels of structural unemployment.

6. Threat to domestic industry

Globalisation has been responsible for loss of economic and cultural diversity as huge firms and global multinational brands dominate domestic markets in many countries. They pose a threat to developing nations as they are huge in their size, capital, investment etc.

7. Technological dependence

Globalisation offers ready-made technology and technological goods due to which it discourages domestic research and development. It restricts creativity and innovation in domestic firms. Foreign technologies are available at a high cost and are often adaptable to local communities. Developing countries have become technology dependent on developed countries.

4.7 Impact of Globalisation on Business and Trade

The policy of liberalisation, privatisation and globalisation of the Government has made a huge and important impact on the working of various enterprises in business and industry. The Indian corporate sector has come face-to-face with various challenges due to government policy changes. The impact on business and trade are as follows:

(i) Increasing competition

Due to changes in the rules of industrial licensing such as liberal trade laws and entry of foreign firms i.e. multinational companies' competition for Indian firms has increased especially in service industries like telecommunications, airlines, banking, insurance, etc. which were earlier a part of the public sector.

(ii) More demanding customers

Customers today have become more demanding because they have all the information. Increased competition in the market gives the customers wider choice in purchasing better

quality of goods and services. Customises keep various points in mind while buying any goods and services such as greater deals, quality quantity, price, colour, other competitors in the market offering the same goods and services.

(iii) Rapidly changing technological environment

Nowadays technology is changing at a very fast pace. Due to Increased competition in the market, it forces the firms to develop new methods to survive and grow in the market. New technologies help to improve machines, process, functions, procedure, route of production, products and services. The rapidly changing technological environment pose difficult challenges before smaller firms.

(iv) Necessity for change

In a regulated environment of pre-1991 era, the firms could have relatively stable policies and practices. After 1991, the market forces have become unstable as a result of which the enterprises have to continuously modify their operations. With the changing forces in the environment it became necessary for the firms to adopt those changes to survive and grow in the market. Due to which the enterprise spends a lot on research and development.

(v) Need for developing human resource

Due to inadequately trained personnel Indian enterprises have suffered for long while. The new market conditions require people with higher competence and greater commitment. Hence, there Is a need of trained, competitive, innovative and creative personnel in the market. Employees with greater zeal and able to deal with the changing market conditions and who can wise and rational decisions and judgements which a helps a firm to earn good profits in the market.

(vi) Market orientation

Earlier firms used to produce first and go to the market for sale later. In other words, they had emphasised on production oriented marketing operations or production philosophy. In a fast changing world, there is a shift to market orientation in as much as the firms have to study and analyse the market first and produce goods accordingly. Now the firms in the market first gathers and analyses the information from the market I.e. to know and understand the needs and wants, tastes and preferences of the consumer and based on that starts producing the product.

(vii) Greater Number of Jobs/ increasing employment

The arrival of foreign companies in Indian market and growth in economy has led to job creation. However, these jobs are focused more in the services sector and this has led to rapid growth of service sector but creating problems for individuals who have low level of education. The last decade came to be known for its jobless growth as job opportunities was not proportionate to the level of economic growth.

4.9 Impact of Globalisation on India

1. Trade

The most important objective of globalisation is to increase the trade of goods and services i.e exports and imports between nations. The exports and imports of goods only is known as merchandise. India's share in world merchandise exports has improved lightly from 0.52 per cent in 1990 to 0.76 per cent in 2002. Under service sector exports increased 15 per cent annum during the same period. Trade deficit has declined.

2. Foreign investment flows

Between approved FDI and actual inflows. India received only 0.8 per cent of FDI.

3. Employment

In the era of globalisation, the employment situation has deteriorated. The rate of growth in employment declined from 2.04 per cent per year during 1983-94 to 0.98 per cent in 1994-2000.

4. Poverty and inequality

With the introduction of globalisation, poverty In India has decreased from 36.0 per cent in 1993-94 to 20.1 per cent in 1990-00. Globalisation has played a pivotal role in reducing the poverty in India. In India there is a huge between the rich sections and poor sections of the society. This gap is known as the economic divide. Due to globalisation the economic divide has increased. The inequalities in the distribution of income and wealth have increased.

Obstacles to Globalisation

1. Bureaucracy

Government policies and procedures are still complex and cumbersome. Despite economic reforms and liberalisation, smooth and efficient approvals are not coming. Bureaucratic mindset delays projects and their implementation.

2. High cost

In India, the cost of production and distribution is comparatively high because of operational inefficiency and absence of economies in scale. High cost decreases the international competitiveness.

3. Poor quality

The quality of some of the Indian brands is not up to mark and poor. Due to which the image of these Indian brands is also not good in the eyes of public leading to decrease in brand loyalty and goodwill in the market. In addition to this the supply of goods and services is also not adequate and sufficient in the market.

4. Poor infrastructures

In India, the industrial infrastructure is inadequate and inefficient. Shortage of power, lack of good roads, obsolete machinery, shortage of port facilities hampers the growth of the business as compared to international standards.

5. Obsolete technology

Till now, most of the Indian firms uses obsolete technology in their distribution and production process, which leads to high cost of production. The goods and services they offer are expensive due to this reason they are not able to compete with the multinationals. Thereby they are slagging in the market.

6. Resistance to change

In India, still labour intensive technology is used at a large scale to cure the problem of unemployment. This is the reason they discourage capital intensive techniques. Modernisation and rationalisation are resisted due to fear of unemployment. Government of India has not been able to introduce a policy due to strong opposition from public. Trade unions are not open for changes and do not adopt modern technology and modern ways of production due to fear of losing jobs.

7. Limited research and development

In India, research and development and marketing research is very limited. They don't indulge themselves into R&D due to less resources and finance. As a result, they are facing difficulties in competing with multinational corporations. Even government doesn't provide opportunities to promote R&D in most of the public sector undertakings. Hence, innovation and creativity are restricted.

8. Trade barriers

In India, there are certain trade barriers such as import restrictions and increased traffic and quota's etc. trading blocks restricts globalisation of Indian business.

Factors that have enabled Globalisation

Rapid improvement in technology has been one of the major factors that has increased the pace of the globalisation process. For example: from the past fifty years we have seen various huge improvements in transportation technology. This has resulted into much faster delivery of goods across long distances that too at lower costs. There are more remarkable improvements in developments in information and communication technology (ICT). Recently, technology in the fields of telecommunications, computers, Internet is changing rapidly. Telecommunication facilities (telegraph, telephone including mobile phones, fax) are used to contact one another around the world, to access information instantly, and to communicate from remote areas. This has been facilitated by satellite communication devices. You might be aware of computers; computers have now entered almost in every field of activity. Now with the help of internet, you cancan obtain and share information on almost anything you want to know. Internet also allows us to send instant electronic mail (e-mail) and talk (voice-mail) across the world at negligible costs.

SUMMARY

1. Globalisation means the integration of one economy with the world economy.
2. Globalisation came up with some regulations were with respect to:

a) licensing of imports,

b) tariff restrictions and

c) quantitative restrictions.

1. There are various features of Globalisation which are stated a follow:

a) The basic idea of globalisation s to extract surplus through various means including trade, investment and aid.

b) It is a means to extract surplus though the exploitation of cheap labour, HQM, and the resources of the developing countries.

c) The neo-liberal globalisation ties to integrate all the nations, states, and individuals into a common set of market relations, which are binding and have their own philosophy and distinctive laws of motion.

d) The modern system of globalisation is designed in such a way that it will hugely benefit the capitalist to prop up their sagging economies and sustain a higher rate of economic growth and employment.

1. Steps taken for globalisation.

2. There are various advantages and disadvantage posed by globalisation.

3. India also offered various obstacles to globalisation which resulted into slow economic growth of Indian economy.

4. Decrease in tariffs, Long term Trade Policy, partial convertibility of currency.

5. There is a vast impact of globalisation on India which are as follows: trade, foreign investment flows, employment and poverty and inequality.

6. There's a huge impact of globalisation on India's business and trade which are as follows: Increasing competition, more demanding customers, rapidly changing technological environment, necessity for change, need for developing human resource, market orientation, greater number of jobs/increasing employment.

SELF ASSESSMENT

1. What is meant by globalisation?
2. Define globalisation.
3. Describe the history of globalisation.
4. What are the steps taken to initiate globalisation?
5. What are the features of globalisation?
6. State the advantages of globalisation
7. State the disadvantages of globalisation
8. What are the various obstacles of globalisation posed by India?
9. Enumerate the factors responsible for globalisation.

10. What is the impact of globalisation on India? Explain. What is the impact of globalisation on Indian business and trade? Explain.

11. What bad effects has been produced by India due to globalisation. Explain.

FURTHER SUGGESTED READINGS

1. Business Environment by Vaishali and Shruti Aggarwal
2. Business Environment by B.N. Ghosh

MODULE-5
FOREIGN INVESTMENT

5.0 Learning Objectives

In this module you will learn about:

- Meaning of investment
- Types of investment
- Meaning of foreign investment
- Types of foreign investment

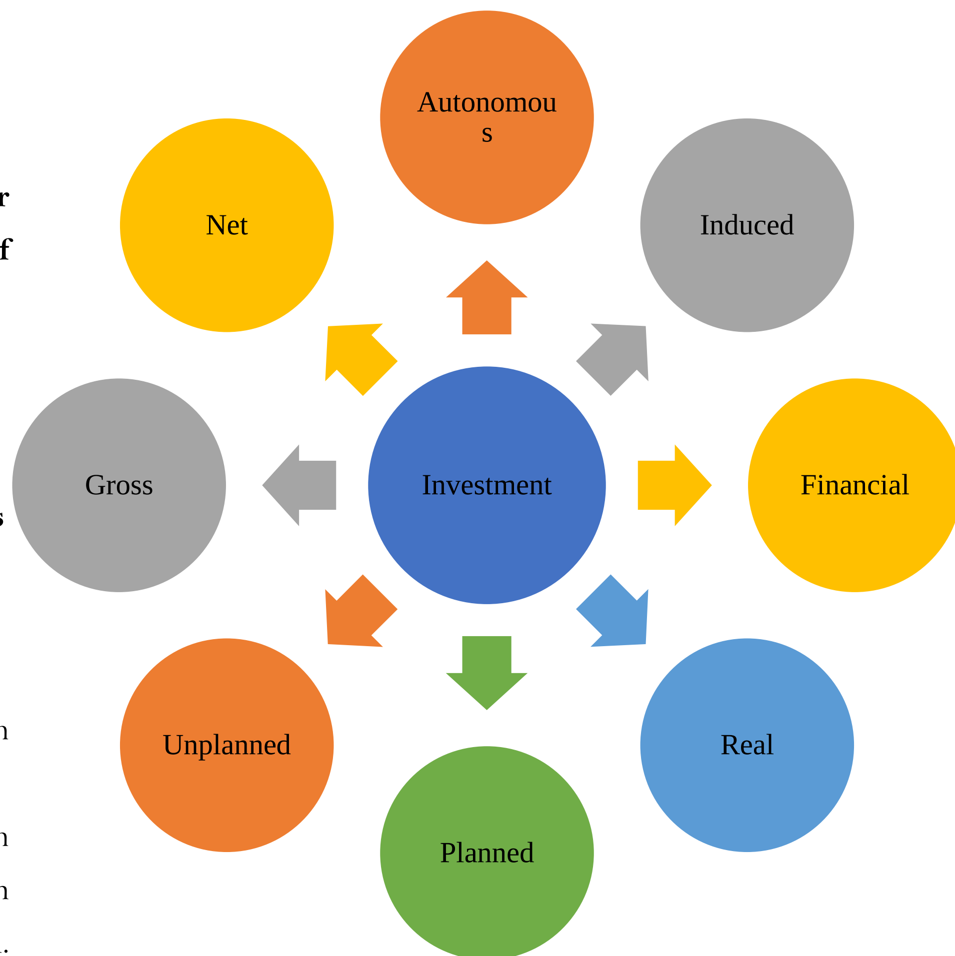
5.1 Meaning of Investment

An investment is an asset procured with the aim of generating income. It is a monetary asset purchased with the aim that the asset will produce higher benefits or income.

In a larger sense, investment can be done in fixed assets such as land, building, plant and machinery etc. or financial assets such as stock and bonds.

5.2 Types of Investment

Different types or kinds of investment are as follows



1. Autonomous Investment

Autonomous investment means which remains constant with the change in income level. In other words, Autonomous Investment remains constant or same irrespective of income level. Therefore, even if the income level is low the investment remains the same or constant. It includes the investment made on houses, roads, public buildings and other parts of infrastructure. The government usually makes such a type of investment.

2. Induced Investment

Induced investment means which changes with the change in the income level. Induced investment is directly proportional to the income level. When the levels of income of entrepreneurs are high then they will invest more and vice-versa. When the income increases, the consumption expenditure also increases and vice versa and this leads to an increase in investment of capital goods, in order to produce more consumer goods.

3. Financial Investment

Financial investment means the investment made in financial securities such as shares bonds and debentures. However, the money used for purchasing existing financial instruments such as old bonds, old shares, etc., cannot be considered as financial investment. It is a just transfer of a financial asset from one individual to another.

4. Real Investment

Real investment means acquiring or purchasing new plant, building, public utilities such as roads, railways, schools etc. It is an investment in new machine tools, plant and equipments purchased, factory buildings, etc. increases employment, production and economic growth of the nation. Thus, real investment leads to a direct impact on employment generation, economic growth, etc.

5. Planned Investment

Planned investment means which is intended or planned. Planned Investment is also known as Intended Investment because an investor while making investment make a concrete plan of his investment.

6. Unplanned Investment

Unplanned investment means which does not involves any plan. In unplanned type of investment, investors do not make any concrete or fixed plans and do investment randomly. Therefore, it is also known as Unintended Investment. In this type of investment, the investor may not consider the specific objectives while making an investment decision.

7. Gross Investment

Gross investment means the total addition to capital stock. It is the total expenditure made on new capital assets in a time period.

8. Net Investment

Net investment means gross investment less depreciation or capital consumption during a period of time.

9. Ex-post investment

The actual or realized investment is known as ex-post investment

10. Ex-ante investment

The investment, which is intended or planned, is knowns as ex-post investment.

5.3 Meaning of Foreign Investment

Foreign investment is when a company or individual from one nation invests in assets or ownership stakes of a company based in another nation.

Foreign investment involves capital flows from one country to another, granting extensive ownership stakes in domestic companies and assets.

5.4 Types of Foreign Investment

Foreign investments are divided into direct and indirect investments.

Direct investments refer to investment into physical investments and purchases in buildings, factories, machines, and other equipment outside of their home country.

Indirect investments refer to investment when companies or financial institutions purchase positions or stakes in companies on a foreign stock exchange.

In India, there are two kinds of foreign investment:

1. Foreign direct investment (FDI)
2. Foreign financial investments/foreign portfolio investments (FII/FPI)

Meaning of FDI

Foreign Direct Investment is the investment by foreign companies in real or fixed assets such as building factory machinery, land, plant, building etc. FDI also means setting up a new business in a country other than home country.

Meaning of Foreign Portfolio Investment

Foreign portfolio investment is the investment by foreign financial assets such as stocks and bonds that do not involve a transfer of management control.

SUMMARY

1. An investment is an asset procured with the aim of generating income.
2. An investment is a monetary asset purchased with the aim that the asset will produce higher benefits or income.
3. There are 10 types of investment. There are different types of investment which are as follows: gross investment, net investment, autonomous investment, induced investment,

financial investment, real investment, planned investment, unplanned investment, ex-post investment, ex-ante investment.

4. Foreign investment is when a company or individual from one nation invests in assets or ownership stakes of a company based in another nation.

5. Foreign investments are divided into direct and indirect investments.

6. Direct investments refer to investment into physical investments and purchases in buildings, factories, machines, and other equipment outside of their home country.

7. Indirect investments refer to investment when companies or financial institutions purchase positions or stakes in companies on a foreign stock exchange.

8. Foreign Direct Investment is the investment by foreign companies in real or fixed assets such as building factory machinery, land, plant, building etc. FDI also means setting up a new business in a country other than home country.

9. Foreign portfolio investment is the investment by foreign financial assets such as stocks and bonds that do not involve a transfer of management control.

SELF ASSESSMENT

1. What is investment?
2. What are different types of investments? Explain
3. Define foreign investment.
4. How many types of foreign investments are there?
5. Define direct investments.
6. Define indirect investment.
7. Define foreign portfolio investment (FPI)
8. Define foreign direct investment (FDI).

FURTHER SUGGESTED READING

1. Business Environment by B.N. Ghosh

MODULE 6
FOREIGN DIRECT INVESTMENT

6.0 Learning Objectives

In this module you will learn about:

- Meaning of Foreign Direct Investment
- Methods of Foreign Direct Investment
- Forms of Foreign Direct Investment
- Types of Foreign Direct Investment
- Advantages of Foreign Direct Investment
- Advantages of Foreign Direct Investment in India
- Disadvantages of Foreign Direct Investment
- Impact of Foreign Direct Investment

6.1 Meaning of FDI

Foreign Direct Investment is the investment by foreign companies in real or fixed assets such as building factory, machinery, land, plant, building etc. FDI also means setting up a new business in a country other than home country.

Foreign direct investments are different from portfolio investments in where an investor purchases equity of foreign-based companies.

In other words, Foreign Direct Investment is that investment, which is made to serve the business interests of the investor in a company, which is in a different nation distinct from the investor's country of origin.

According to Wikipedia

A **foreign direct investment**(**FDI**) is an investment in the form of a controlling ownership in a business in one country by an entity based in another country. It is thus distinguished from a foreign portfolio investment by a notion of direct control.

The origin of the investment does not impact the definition, as an FDI: the investment may be made either "inorganically" by buying a company in the target country or "organically" by expanding the operations of an existing business in that country.

According to the definition of the IMF

It 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.

6.2 Methods of Foreign Direct Investment

Foreign direct investments are carried out in different manner, which includes:

- the opening of a subsidiary
- associate company in a foreign country
- acquiring a controlling interest in an existing foreign company
- by means of a merger or joint venture with a foreign company

6.3 Forms of Foreign Direct Investment

On the basis of type of activities, Foreign direct investments are commonly categorized as being:

1. Horizontal
2. Vertical
3. Conglomerate

1. Horizontal

In Horizontal FDI, investment refers to the investor establishing the same type or method of production or business operation in a foreign country as it operates in its home country. In other words, the production in the host country is an extension of the home production; it is a replica. By applying the same formula by the foreign firms in this way gains the competitive advantage in the host country.

For example: the production of Japanese car by Toyota.

2. Vertical

Here, each stage of production is performed in a country where the cost of production is the lowest. Vertical FDI is intended to produce the inputs in foreign countries for use in the home country or for another subsidiary.

3. Conglomerate

Here, the FDI produces a product in the host country, which is entirely new and it does not produce such product in the home country. The basic objective of such a type of production is to capture the market and have control over a particular type of product, which is in high demand in the host country.

6.4 Types of FDI

Generally, FDI is of 3 types which are as follows:

1. Greenfield investment
2. Mergers and acquisitions
3. Horizontal foreign investment

1. Greenfield Investment

In economics, a greenfield investment (GI) refers to a type of **FDI** where a company establishes operations in a foreign country. In a greenfield investment, the company

constructs new facilities (sales office, manufacturing facility, etc.) cross-border from the ground up.

According to the <u>Bureau of Economic Analysis (BEA)</u>

A greenfield investment is a project "where foreign investors establish a new business or expand an existing business on U.S. soil."

Greenfield investments are the primary target of a host nations promotional efforts because they create new production capacity and jobs, transfer technology and know-how and can lead to linkages to the global marketplace. However, it often does this by crowding out local industry; multinational is able to produce goods in a more cheap way (because of advanced technology and efficient processes) and uses up resources (labour, intermediate goods) etc.

Example of a Greenfield Investment

Company A is based in Europe and is looking to expand its operations internationally. The company wants to penetrate the US market with a new innovative product. Upon completing market research, Company A realizes that there are little to no competitors in the United States.

Thus, there are no acquisition opportunities available to the company to establish a "base." In addition, the United States previously imposed tariffs on all European imports, causing the selling price of the company's product to be very high.

Company A decides to create a sales office and manufacturing facility on US soil with the goal of bypassing existing US import tariffs and also to penetrate into the domestic market with its new product. The company's CEO deems establishing a foreign subsidiary crucial as they are able to exert complete control over overseas business operations and brand image.

Advantages of a Greenfield Investment

There are various advantages of a greenfield investment, including:

- High level of control over business operations
- High quality control over the manufacturing and sale of products and/or services
- High control over brand image and staffing
- Economies of scale and economies of scale can be achieved in terms of marketing, research and development, and production
- Bypassing trade restrictions
- Creating jobs for the economy where the greenfield investment is taking place

Disadvantages of a Greenfield Investment

There are various disadvantages of a greenfield investment, including:

- An extremely high-risk investment – a greenfield investment is the riskiest form of foreign direct investments
- Potentially high market entry cost (barriers to entry)
- Government regulations that may prevent foreign direct investments
- High fixed costs involved in establishing a greenfield location

2. Mergers and Acquisitions

Mergers and acquisitions (M&A) are defined as consolidation of companies.

Mergers is the combination of two companies to form one.

A merger is defined as a transaction where one entity is combined with another so that at least one initial entity loses its distinct entity. Thus, a full integration of 2 firms takes place and control over a single entity can easily be exercised.

In other words,

Mergers is when two companies join hands together. These kind of activities takes place between two businesses that have the same size, and which recognise advantages the other offers in terms of increasing sales, efficiencies, and capabilities.

Acquisitions is one company taken over by the other. An Acquisition is a transaction where one firm purchases a controlling stake of another firm without combining the assets of the firms involved.

In other words, acquisitions arise when one company buys another company and uses it into its operations.

Mergers & Acquisitions can take place:

- by purchasing assets
- by purchasing common shares
- by exchange of shares for assets
- by exchanging shares for shares

3. Horizontal Foreign Direct Investment

In Horizontal *Foreign Direct Investment*, investment refers to the investor establishing the same type or method of production or business operation in a foreign country as it operates in its home country. In other words, the production in the host country is an extension of the home production; it is a replica. By applying the same formula by the foreign firms in this way gains the competitive advantage in the host country.

For example: the production of Japanese car by Toyota

6.5 Advantages of FDI

1. Economic growth

This is one of the major sectors, which most benefited from foreign direct investments. A remarkable inflow of FDI in different industrial units in India has increased the economic status of a country. FDI has accelerated the rate of economic growth in a country. FDI has played an important role in increasing GDP of an economy.

2. Trade

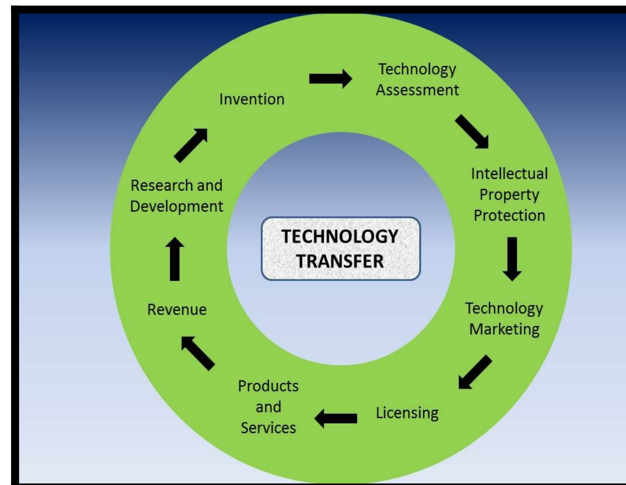
Foreign direct investments have opened a wide range of opportunities in the trading of goods and services in India in terms of imports and exports. Various industries in India produces goods of superior quality due to which it earns greater amount of exports and leads to greater amount of FDI inflows in the country.

3. Employment and skill levels

With the introduction of FDI, in developing nations the problem of unemployment has been solved. They provide a number of employment opportunities in various sectors of an economy such as manufacturing and service sector etc. In recent years employment level have been increased.

4. Technology diffusion and knowledge transfer

FDI basically helps in the transfer of technology and technical know-how from developed countries to developing countries. FDI helps in the outsourcing of knowledge from India especially in the information technology (IT) sector. It helps in developing the technical know-how in India in terms of increasing the advancement in India.



5. Linkages and spill over to domestic firms

Different foreign firms are now occupying a position in the Indian market through joint ventures and collaboration concerns. The huge amount of profits gained by the foreign firms comes through these joint ventures and is spent on the Indian market.

6. Transfer of improved technology

One of the most important advantage of FDIs is the transfer of new and improved technology. Foreign investors have helped developing nations in the transfer of sophisticated and better technologies. The new or improved type of technology can increase production, reduce the cost per unit of output, and may check the tendency towards diminishing returns.

7. Improved balance of payments

FDIs has helped in improving the state of BOP in the country. The state of BOP has significantly increased. The FDI has contributed positively to solve the problem of balance

of payments and also increases the foreign exchange reserves. FDIs even helped in increasing the export of goods of developing nations.

8. Increased levels of productivity

FDIs has helped in improving the levels of production. In recent years, the levels of production of developing countries has significantly improved. With the entrance of MNCs of the state of production of host countries has significantly been increased. The increase in state of production is been a result of many factors such as improved and better technology, new ways of producing goods, capital intensive technology, innovative and creative ideas, better management etc.

9. Better infrastructure

FDI has resulted into better social infrastructure in the developing nations. As MNC has emerged into various different sectors such as service, manufacturing, retail, Telecom due to which many backward and underprivileged areas have been improved. Infrastructure has improved in various ways such as better connectivity, roads, banks, electricity etc. Countries like India has established Special Economic Zone SEZs to invite MNCs and made India a better and lucrative place to attract FDI in India. It stimulated foreign investors to invest in India.

10. Easy international trade

A country has its certain own import tariff, rules and regulations, laws due to which trade becomes difficult. But now most of the countries has made these rules liberal. With FDI, international trade has been made easier.

6.6 Advantages of FDI in India

Advantages of foreign direct investments in India are following:

1. Promotion of investment in key areas

Due to introduction of FDI, India can promote investment in key areas such as infrastructure development as a result of which there will be more production of capital goods. For example, investment in power generation can generate more electric power which will enable the growth of more industries.

2. Increase in capital inflow

FDI promotes more capital inflow into the country especially in key and core sectors. Developing nations have shortage of capital, money and resources. FDIs will fill this gap and in this way, this will speed up the economic growth in the country.

3. Increase in exports

The introduction of FDI, has increased the ratio and amount of the exports of many underdeveloped countries. The developing nations has created some Special Economic Zones (SEZ) due to which it has resulted into promotion of 100% export oriented units (EOUs) and have also helped FDIs in increasing their exports from other countries.

4. Promotion of employment opportunities

FDIs has played an important role in decreasing the unemployment. With the entrance of MNCs they have created ample number of employment opportunities in developing nations. The FDI in developing nations has promoted the service sector. There has been a significant increase in the employment specially in these sectors advertising and marketing technologies. This provides more scope for employment opportunities. Educated unemployment to some extent is reduced by the FDI as they have given employment to Indian work force in a large way. To solve the problem of unemployment in Indian economy and to develop India into a skilled nation the government of India launched a policy: Make in India.

The "Make in India" initiative

Make in India was launched on 25 September 2014 with the objective of job creation and skill enhancement in 25 sectors of the economy, and "to transform India into a global design and manufacturing hub". The paradigm 'meant not just rapid growth of manufacturing, but rather to provide for a lead role manufacturing assumes in India's growth process'

Make in India, a type of Swadeshi movement covering 25 sectors of the economy, was launched by the Government of India on 25 September 2014 to encourage companies to manufacture their products in India and enthuse with dedicated investments into manufacturing. As a strategy it is the road map to respond to glocal (global + local) challenges through preparations for a World class manufacturing status & knowledge infrastructure that should create further knowledge for stepping on to global competitiveness.

After the launch, India received investment commitments worth ₹16.40 lakh crore (US$230 billion) and investment inquiries worth₹1.5 lakh crore (US$21 billion) between September 2014 to February 2016. As a result, India emerged as the top destination globally in 2015 for foreign direct investment (FDI), surpassing the USA and China, with US$60.1 billion FDI.As per the current policy, 100% Foreign Direct Investment (FDI) is permitted in all 25 sectors, except for Space industry (74%), defence industry (49%) and Media of India

(26%).Japan and India had also announced a US$12 billion "Japan-India Make-in-India Special Finance Facility" fund to push investment.

In line with the Make in India, individual states too launched their own local initiatives, such as "Make in Odisha", Vibrant Gujarat, "Happening Haryana" and "Magnetic Maharashtra". India received US $60 billion FDI in FY 2016-17.

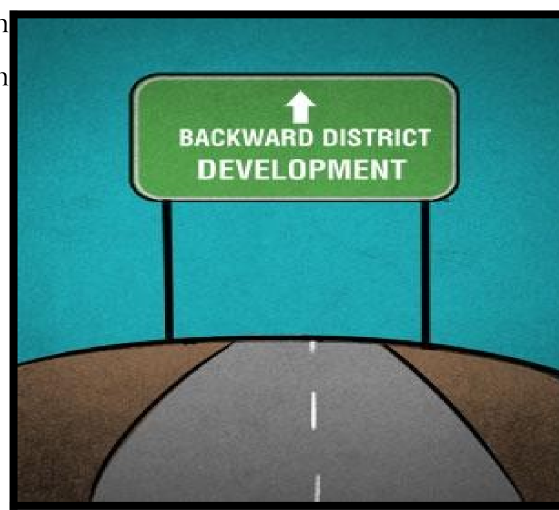
(Source: Wikipedia)

With this initiative of government of India, FDI has increased in many sectors of Indian economy, hence employment opportunities have increased.

5. Development of Backward Areas

Foreign direct investments have played a vital role in the development of backward areas. They started various industries in backward areas and underprivileged areas as a result of which these areas have developed into industrial centres.

Some of the backward regions have utilised the services of FDIs for starting industries in backward areas. For example: Hyundai and Ford car units started at Sriperumbudur and Maraimalai nagar in India. Maruti Suzuki started their venture in Manesar, Gurugram.



6. Utilisation of natural resources

The natural resources in the country which was earlier underutilised especially in country like India have been utilised in the best manner with the FDI. The examples are Saint Gobain glass company and manufacture of paper and newsprint.

7. Change in the lifestyle of people

With the FDIs, it has changed the life-style pattern of people. The purchasing power of consumers have been increased. There is an increase in the demand of goods such as TV, fridge, auto mobiles because of easy hire purchase system. The increasing number of auto mobiles in most of the cities is a standing example for the change in the life-style. People have now wider choices and access goods with greater quality, prices and features. It has increased the standard of living of people. For example: McD, KFC, Subway.

6.7 Disadvantages of FDI

1. Absence of Effective Transfer of Technology

The developed nations have advanced means of producing goods and sophisticated technology and technical know-how. These developed nations do not share their modern or original technologies with the developing nations. Rather they increase the technological dependence of less developed nations such as India. Even if they share or transfer some technology, it is only out- dated, out- mode technology, which is of no value to a developing country. Their R&D activities remain in their home countries or some other industrialized

industries. In many cases the transfer only capital intensive technology which is a threat and no use to labour intensive technology countries resulting into problem of unemployment. Foreign investors have failed to develop skill technology suitable for host country.

2. Transfer of Profits to Home Country

Foreign investors send a large amount of profit to their home countries and do not generate a significant value added in the host country. Thereby creating no benefits for the host countries as they drain out all the profits from the host country to home country.

3. Dishonest Practices

Foreign investors, especially the MNCs, are involved in various dishonest practices such as bribery, corruption and so forth in the host country. This results in losses to the host country.

4. Creation of Monopoly

In the countries where foreign investors work in the host country, the domestic competitor are often crowded out and competition is curbed. So, it is very clear that a monopoly like situation is created by foreign countries. They pose a great threat to the domestic producers. They seem to be a tough competition for domestic producers due to their features such as huge in size, large resources and latest technology.

5. Unemployment

FDI may not create adequate job opportunities as their method of production is capital intensive and not labour intensive. These foreign enterprises bring capital intensive technology, which is not fruitful for the labour intensive technology nations. As some of the developing nations still use labour intensive technology to solve the chronic problem of unemployment. If they employ capital intensive technology, then the people will lose their jobs and resulting into increase in unemployment rate. Unemployment rate in developing nation significantly increases which in result decrease the economic growth rate and GDP of a country.

6. Imbalances in balance of payments

BOP provides inflow of foreign exchanges resources and removes the limitation on balance of payment in initial stages. If capital is purchased from inside the host country the debate is that, FDI helps the host country in its balance of payments (BOP) problems, losses much

of its logical basis. The transfer of a large amount of money in the form of royalty, profits, dividend, and so on out of the host country. This may increase the problem of BOP. Foreign investors may buy a lot of expensive inputs from the other countries and in that case, the BOP problem may increase.

7. Lack of capital

Foreign enterprises may raise the capital i.e finances or national resources from inside the host country. In that case, it would be difficult for the domestic industries and the government in case when finances are needed. The developing nations who already lack resources or have scare resources, have to lose all the resources at the cost of FDI.

8. Political Imbalance

Foreign enterprises may try to influence national policies and politicise many industrial issues. They may interfere in the political issues and governmental issues.

9. Undermines Importance of National Autonomy and Control

Most of the times, the main interest of the host country can be in risk by foreign investors who hold key positions in IT industry and supply the software for the industry. They may undermine the importance of national autonomy and control.

10. Trade Deficit

The introduction of TRIPs (Trade Related Intellectual Property Rights) and TRIMs (Trade Related Investment Measures) has restricted the production of various products in other nations. For example, India cannot manufacture certain medicines without paying royalties to the country which has originally invented the medicine. The same norm is applicable to agricultural sector also, for example: seeds which are used in agriculture. Thus, the developing countries are pushed to either import the products or produce them by FDIs at a higher cost. WTO (World Trade Organization) is in favour of FDIs.

The inflow of FDI is shown in table here:

FDI inflows to selected world countries (US dollar billion)

Countries	**2010**	**2011**
Developed	1289.7	1508.6
UK	51.8	77.1
USA	228.2	210.7
China	114.7	124.0
India	24.6	34.0
Thailand	5.8	7.7
Latin America & Caribbean	160.8	216.4
Africa	54.7	54.4
Indonesia	13.3	19.7
Malaysia	9.1	11.6
Singapore	38.6	41.0

Source: World Investment Report (2011).

The UNCTAD report on the world inflow of FDI (2011) points out that developing and transitional economies capture half of the global inflow of FDI in 2011. The FDI inflows to developing Asia increased by 11% in 2011. The FDI inflows to developing Asia increased by 11% in 2011, despite slowing down in the later part of the year. In spite of global turmoil, the world FDI flow rose by 17% in 2011, surpassing the pre-crises average. The UNCTAD hopes that in the near future, the FDI is likely to grow further.

6.8 Impact of FDI

FDI has a vast impact on a country economically and socially as well.

Foreign investment is always associated with the superior technology and transfer of technical know-how.

It has an impact on local industry as it offers them both opportunity and threat. It gives consumers a ample choice that too at affordable price. FDI not only increases GDP but exports as well and hence results in higher per capita income and large forex reserves.

1. Impact on local industry

FDI has made a huge positive impact on Indian local industries in many ways. With the introduction of new technology and capital assets Indian industry has grown in leaps and bounds. FDI always generated positive impact on the rest of economy. It generated big opportunities for local manufacturers because they become OEM (original equipment manufacturer) 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.

It is not only an opportunity for the manufacturing sector. FDI also give technical know-how to OEM which

increases the level of quality of their products. Today's Coca-Cola' bottling plant are far better, infact of international quality than those of Parle which Coca-Cola acquired.

Example:

- OEMs of Maruti Suzuki not only supplies to Suzuki but also export it.

- MacDonald's trained local farmers and bakers produce products of international quality and standards and today they are not just serving it to MacDonald's but are also exporting it.

FDI not only impacted manufacturing sector, it served as a catalyst to the service industry. FDI has a great role in the development of the BPO (business process outsourcing) industry in India. The whole structure of BPO industry in India is a result of FDI. Today India is the most preferred nation (MFN) for BPO in the world.

2. Impact on employment

FDI in India has contributed in the creation of more than $10–billion-a-year software and outsourcing industry which employees 5,00,000 people directly. Projections estimates that it will employ 2,000,000 people by 2008. These are the estimates of only one industry. FDI has created jobs in every area such as manufacturing, telecommunication, advertising, media, and above all services.

3. Impact on consumer

The biggest beneficiary of the FDI is the Indian consumer. Till 1980 we were driving Ambassador or Premier Padmini in India and after the investment by Suzuki, 8 new models were launched.

Now we have reach to many international brands. Prices have been slowly decreasing in all the segments because of FDI, like electronics, computers, ACs, auto mobiles, food products, clothes, shoes and even soft drinks, two wheelers, etc. Today consumer has a wide choice as these organisations are launching new variants with improved performance, quality, features and standards every day.

Example:

- Recently HUL 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 the entrance MNCs in Indian market.

Besides this there are macro-economic impact as contribution to GDP, though it may be argued that there is not any significant growth after liberalisation 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 auto-mobile. 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 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.

6.9 SUMMARY

1. FDI is the investment by foreign companies in real or fixed assets such as building, factory machinery, land, plant, building etc. FDI also means setting up a new business in a country other than home country.
2. Foreign direct investments are different from portfolio investments in where an investor purchases equity of foreign-based companies.
3. Methods of Foreign Direct Investment: Foreign direct investments are carried out in different manner, which includes: the opening of a subsidiary or associate company in_a foreign country, acquiring a controlling interest in an existing foreign company, or by means of a merger or joint venture with a foreign company.
4. On the basis of type of activities, Foreign direct investments are commonly categorised as being:

- Horizontal,
- Vertical or
- Conglomerate.

1. There are various types of FDI:

- Greenfield investment,
- Mergers and acquisitions,
- Horizontal FDI

1. There are various advantages and disadvantages of FDI.
2. FDI has a vast impact on a country economically and socially as well.
3. The FDI has put an impact on local industry, employment, and consumer.

6.10 SELF ASSESSMENT

1. What is FDI?
2. Define FDI according to IMF.
3. What are the different methods to carry out FDI?
4. What are the various types of FDI? Explain
5. State the advantages of FDI.
6. Do India got benefited from FDI? State.

7. State the disadvantages of FDI.

8. Explain the impact of FDI.

9. "Perhaps biggest beneficiary of the FDI is the Indian consumer". Do you agree? Justify.

10. Critically analyse the FDI policies of the Indian Government.

11. FDI has made a positive impact on employment of a country. Do you agree? Explain

12. Does FDI has created a negative impact on local industries in India. Comment.

13. With the introduction of FDI, the number of jobs has been increased or not. Comment.

14. How can FDI increased the economic growth of a country? Explain.

15. Does FDI leads to economic growth? Explain with examples.

16. Why does investment not flow from rich to poor countries in large amount? Elucidate.

17. What are the different forms of FDI?

6.11 FURTHER SUGGESTED READINGS

1. Business Environment by B.N Ghosh

2. Business Environment by Ashish Bhalla

MODULE 7

MULTINATIONAL CORPORATIONS

7.0 Learning Objectives

In this module you will learn about:

- Meaning of multinational corporations
- Definitions of Multinational corporations (MNCs)
- Meaning of Transactional corporations (TNCs)
- Meaning of Multinational enterprise (MNE)
- Characteristics of MNCs
- Merits of MNCs
- Limitations of MNCs from the Viewpoint of Host Country
- Limitations from the Viewpoint of the Home Country
- Indian MNCs (List of acquires of firms abroad)
- Impact of MNCs

7.1 Meaning of Multinational Corporations (MNCs*)*

The term MNCs means an enterprise which has its headquarters in one country but has operations in one or more countries.

A multinational corporation (MNC) or worldwide enterprise is a corporate organisation which owns or controls production of goods or services in at least one country other than its home country.

7.2 Definitions of Multinational Corporations (MNCs)

According to an ILO report, "the essential nature of multinational enterprises lies in the fact that its managerial headquarters are located in one country (home country) while enterprises carries out operations in number of other countries as well (host countries).

Neil H. Jacoby defines a multinational company as follows:

"A multinational corporation owns and manages business in two or more countries."

MNC has different names:

A multinational corporation can also be referred to as:

- a multinational enterprise (MNE),
- a transnational enterprise (TNE),
- a transnational corporation (TNC),
- an international corporation, or
- a stateless corporation.

MNCs are also known as global companies, extra-national enterprises, multinational enterprises etc. It the most generic name to explain corporations operating around the world.

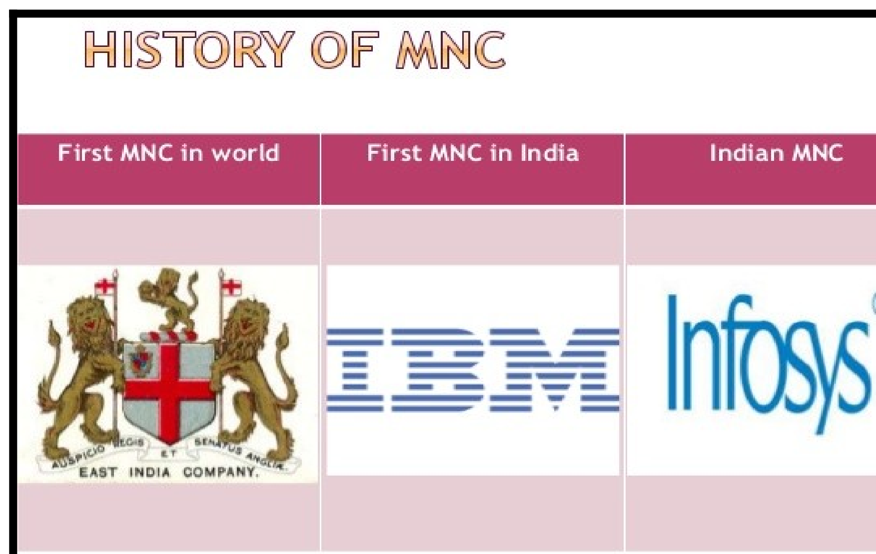
Let us know some company's origin with the help of few examples*:*

- Bata is a Canadian company,
- Bayer is a German company,
- Nestle is a Swiss company,
- Cadbury a British company and
- Coca cola is an American company.

Some of the examples of MNCs

Some of the famous example of MNCs are given below:

Foreign Multinational	**Indian Affiliate/Subsidiary**
Bata Corporation	Bata India
Cadbury	Cadbury India
Coca-Cola Corporation	Coca Cola India
Unilever	Hindustan Lever
Timex	Timex Watches
Colgate Palmolive	Colgate India
Pepsi Corporation	Pepsi India
Philips	Philips India
Sony Corporation	Sony India
Suzuki	Maruti Suzuki
GEC	GEC Alsthom
ABB	ABB India



Transactional Corporations (TNCs)

A transnational corporation (TNC) is "any enterprise that undertakes foreign direct investment, owns or controls income-gathering assets in more than one country, produces goods or services outside its country of origin, or engages in international production" (Biersteker 1978).

Transnational corporations are formal business organizations that have spatially dispersed operations in at least two countries.

One of the most "transnational" major TNCs is Nestlé, the Swiss food giant; 91 percent of its total assets, 98 percent of its sales, and 97 percent of its workforce are foreign-based.

A transnational corporation, also known as a multinational corporation, is a corporation that has a home base, but is registered, operates and has assets or other facilities in at least one other country at one time. These corporations have headquarters in more than one country.

As the companies transcend or operate across national borders , some experts use the term corporation or TNC.

TNC is a term which is favoured by the United Nations and has created a research centre for the study of transactional corporations

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.
- Unilever is a Dutch and English firm, VFK-Fokker (Germany - Netherlands Aircraft Company).

Multinational enterprise (MNE)

A multinational enterprise (MNE) is a company that has a worldwide access to markets, production and/or operations in different countries.

They are international enterprises which are state-owned enterprise, rather than corporations. They are not organised as corporations. MNE is mostly used as synonym for MNCs.

(MNE) is a business entity which conducts business operations in various countries with its subsidiaries and affiliates. MNEs possess considerable and wide human resources, finance, expertise and technology as well as enjoy substantial competitive advantage.

Characteristics of MNCs

1. MNCs are huge in size.
2. MNCs employ advanced and sophisticated technology.

3. MNCs have huge assets (fixed and financial assets) and turnover.

4. MNCs earn large profits.

5. MNCs operates through a network of branches, subsidiaries and affiliates in host countries. For example, McDonalds.

6. MNCs have a trained and qualified management.

7. MNCs offers greater variety of goods and services with different prices and assured quality.

8. MNCs engage themselves in aggressive advertising and marketing.

Merits of MNCs

1. Generates Employment

MNCs generates large amount of employment in host countries in different sectors of an economy such as manufacturing, tertiary and service sector. Thereby reducing the rate of unemployment in the host country. Due to the deceasing rate of unemployment, poverty levels have also decreased in the host country. Another advantage of this is that it has increased the standard living of people and purchasing power as well.

2. Increases Investment Level

MNCs helps to increase the investment level & hence the income and employment level to host country also increases.

3. Improves Standard of Living

MNCs helps to improve the standard of living of people of host countries by providing greater variety of goods and services with different prices and assured quality. They give consumers a wider choice and thereby improving their consumption habits.

4. End of Local Monopolies and Increased Competition

Due to the entrance of MNCs the competition levels have increased in the host countries thereby posing a threat to host companies. Due to which local monopolies of host countries either started improving their products or reduced their prices. It is a threat to the host countries; they have to formulate strategies and policies to cope up with the MNCs. In order to survive and grow in the market, most of the host countries adopts different strategies such as aggressive advertising, better quality or huge discounts. Thus, MNCs ends the exploitative practices of local monopolists. MNCs forces domestic companies to improve

their efficiency and quality. In India, many Indian companies acquired ISO-9000 quality certificates, because of fear of competition posed by MNCs.

5. Inflow of Foreign Capital

The entry of MNCs have attracted foreign capital in host countries. MNCs brings capital for the rapid development of the host country and there is automatic inflow of foreign capital.

6. Improvement in Balance of Payment Position

MNCs assists the host countries to increase their exports. They help the host country in improving their Balance of Payment position. When a country's exports are more than its imports it means favourable BOP.

7. Proper Use of Idle Resources

MNCs have advanced technical knowledge hence, MNCs utilise idle physical and human resources of the host country. Due to proper utilisation of resources the national income of the host country increases.

8. Increases GDP

MNCs produces goods and services on a large scale due to increased level of production in a host country it helps to increase the level of GDP.

9. Technical Development

MNCs help in transfer of technology or technical know-how to host country. Thereby improving the method of production, level of production or packaging of products.

10. Promotion of International Brotherhood and Culture

MNCs integrate one economy of different nations with the world economies. Through international dealings, MNCs promote international brotherhood and culture; and pave way for world peace and prosperity.

There are various limitations of MNCs which are:

- Limitations of MNCs from the Viewpoint of Host Country.
- Limitations from the Viewpoint of the Home Country.

Limitations of MNCs from the Viewpoint of Host Country

Few of the limitations of MNCs from the viewpoint of host country can be:

1. Danger for Domestic Industries

Due to the vast economic power of MNCs, they pose a danger to domestic industries which are still in the process of development. Domestic industries cannot face challenges and threats posed by MNCs. Many domestic industries result in winding up or liquidating.

2. Repatriation of Profits

Repatriation of profits means sending profits to their home country. MNCs earn large amount of profits. Repatriation of profits by MNCs adversely affects the foreign exchange reserves of the host country which means that large amount of foreign exchange drains out of the host country.

3. Poor section is ignored

MNCs caters only to richer sections of the society as they produce only those goods and services, which are used and can be afforded by the rich. Poor section of the country do not get any benefits from MNCs.

4. Danger to independence

Initially MNCs help the Government of the host country, in a number of ways and then slowly start interfering in the political affairs of the host country. In the long-run there is an implicit danger to the independence of the host country.

5. Disregard of the national interests of the host country

MNCs invest in most profitable sectors and do not take in consideration the national goals and priorities of the host country. They do not focus on the development of backward regions and don't take any steps to solve chronic problems of the host country like unemployment and poverty. Their main objective is to earn maximum profits. They do not promote social welfare of an economy.

6. Misuse of Mighty Status

MNCs are powerful and strong economic enterprises. They can easily bear losses for a long while, in the hope of earning huge profits-once they have ended local competition and achieved monopoly. This can be the clever strategy of MNCs to wipe off local competitors from the host country.

7. Careless Exploitation of Natural Resources

MNCs exploits the natural resources of the host country. They do not take the concept of sustainable development in mind thereby leading to losses for future generations. They cause rapid depletion of some of the non-renewable natural resources of the host country. In this manner, MNCs poses a permanent damage to the economic development of the host country.

8. Selfish Promotion of Alien Culture

MNCs tend to promote alien culture in host country to sell their products. They influence people about their own fashion and tastes due to which people forget about their own cultural heritage. In India, e.g. MNCs have created a taste for synthetic food, soft drinks, packaged foods etc. It has changed the lifestyle of people which is a great harm to their health. With the introduction of this type of foreign culture or lifestyle by MNCs it is injurious to the health of people also.

9. Exploitation of People, in a Systematic Manner

MNCs join hands with big business houses of host country and appears as powerful monopolies. This results in to concentration of economic power only in a few hands. Slowly and steadily monopolies take the advantage to exploit poor people and benefit themselves at the cost of the poor working class.

Limitations from the Viewpoint of the Home Country

Few of the limitations of MNCs from the viewpoint of home country can be:

1. Loss of employment

There may be loss of employment in the home country, due to spreading manufacturing and marketing operations in other countries. MNCs retard growth of employment in home country.

2. Different cultural diversity

MNCs face serious problems of managing cultural diversity. Due to which may distract managements' attention from main business issues, causing loss to the home country.

3. Large competition from bigger MNCs

MNCs may face serious competition from bigger MNCs in international markets. Their main focus is on doing wasteful counter and competitive advertising which involves huge finances resulting in higher marketing costs and lesser profits for the home country.

Indian MNCs (List of acquires of firms abroad)

- Tata motors took over Daewoo in South Korea for $118 million.
- Ambanis took over flag international for $211 million.
- Ranbaxy to takeover RPG Aventis a France based firm.
- Workhardt acquired CP pharmaceutical and Walls Laboratories -both of Britain.
- Hindalco took over mount garden and Nifty-copper mines in Australia.
- Sundram fasteners has acquired Dana spicer Europe , the British arm of an MNCs .
- Amtek auto has acquired the GWK group I the UK.
- Kirlosker brothers took over SPP pumps,UK.

Impact of MNCs

Multinational firms play an important role in the global economy, which links rich and poor economies, and transfers capital, knowledge, technology, ideas and value systems between nations. There is a negative and positive impact for stakeholders in the host country due to the interaction with institutions, organisations and individuals. As a result, they have become focal points in the popular debate on the merits and dangers of globalisation, especially when it comes to developing countries. MNEs main objective is profit maximisation they do not create products without profits.

1. Improves Trade Balance

The macroeconomic impact of FDI is on the trade balance. MNEs have a competitive advantage in both, accessing global markets and in importing their products to local markets.

The core strategies of many manufacturing MNCs are:

- the ability to produce at central locations,
- with large economies of scale and

- supply markets in several countries

They import a larger share of their inputs, and frequently export more than domestic firms. A large share of both exports and imports is basically 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.

2. Increases Employment

MNCs generates a large number of new opportunities of employment in the host country. MNCs shifts their routine jobs and non-core jobs to the places or countries where labour is cheap and easily available and that's why lot of jobs from Europe and the US have been shifted to India in the last decade. MNCs also shifts their operations or business to new and economical places or countries which also increases the opportunity for employment. MNCs play a vital role in economic development and in raising the income level of people I.e. disposable income or purchasing power of the people, in turn increasing the level of employment. In the last decade, directly or indirectly, MNCs have contributed largely in creating millions of jobs in India in almost all the sectors such as infrastructure, software, hardware, old economy industry, manufacturing, service, entertainment, media, etc.

3. Promote Small Scale/Ancillary Industry

MNCs usually research about 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 manufacturer" 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.

SUMMARY

1. MNCs means an enterprise which has its headquarters in one country but has operations in one or more countries
2. Characteristics of MNCs are as follows:

➢ MNCs are huge in size

➢ MNCs employ advanced and sophisticated technology

➢ MNCs have huge assets (fixed and financial assets) and turnover

➢ MNCs earn large profits

- MNCs operates through a network of branches, subsidiaries and affiliates in host countries. For example, McDonalds
- MNCs have a trained and qualified management
- MNCs offers greater variety of goods and services with different prices and assured quality
- MNCs engage themselves in aggressive advertising and marketing

- MNC has certain merits which are as follows: Generates employment, Increases investment level, Improves standard of living, End of local monopolies and increased competition, Inflow of foreign capital, Improvement in Balance of Payment Position, Improvement in Balance of Payment Position, Proper Use of Idle Resources, Increases GDP ,Technical Development, Promotion of international brotherhood and culture.
- MNC has certain limitations which poses or hinders an economy.
- Limitations of MNC are of 2 types: from the point of view of host country and home country.

SELF ASSESSMENT

1. Define MNC. Give some examples of MNC.
2. Define TNC. Give some examples of TNC.
3. Define MNE. Give some examples of MNC.
4. Discuss the characteristics of MNC.
5. What are the merits of MNC?
6. What are the limitations of MNC from the point of view of host country?
7. What are the limitations of MNC from the point of view of home country?
8. What is the impact of MNC? Explain
9. Give names of some Indian MNC.
10. Does MNCs has created a positive impact on an economy? Explain
11. Does MNC has helped in increasing the GDP of a country?

FURTHER SUGGESTED READINGS

1. Business Environment by Ashish Bhalla
2. Business Environment by B.N. Ghosh

MODULE 8
SOCIAL RESPONSIBILITY OF BUSINESS

Learning Objectives

In this module you will learn about:

- Meaning of Social responsibility of business
- Definitions of Social responsibility
- Types of Social Responsibilities
- Need for Social Responsibility of Businesses

Meaning of Social Responsibility of Business

Social responsibility of a business is the responsibility of business enterprises, undertaken with an aim of achieving social welfare.

In other words, social responsibility is the ***obligation*** of an enterprise, carried out in such a manner with which an enterprise not just achieve their own objectives but fulfil the needs of society.

Social responsibility means that individuals and companies have a duty to behave ***ethically*** and ***ideologically*** to serve the environment and society as a whole.

To behave ***ethically*** and ***ideologically*** means to use the natural resources of the environment in the best possible manner I.e. there should be no exploitation of resources.

Business enterprises exist to fulfil the needs of the society. It is the society that offers them the inputs and serves as the market for the goods and services they offer. All business enterprises are dependent on the society.

Therefore, they should ensure that they keep the interest of the society as their most pivotal factor in all their decisions and actions.

The basic conditions expected in this matter are:

- trust,
- honesty,
- integrity,

- transparency and
- compliance with the laws of the land.

It is the commitment of a business to behave ethically and also contribute to the economic and social development by improving the quality of life and standard of living of people.

It focuses on achieving social welfare as a whole.

Definitions of Social Responsibility

1. According to Samuel Webb

The basic purpose of social responsibility is to serve the need of society to the satisfaction of society (Webb 1976).

2. According to Howard R. Bowen

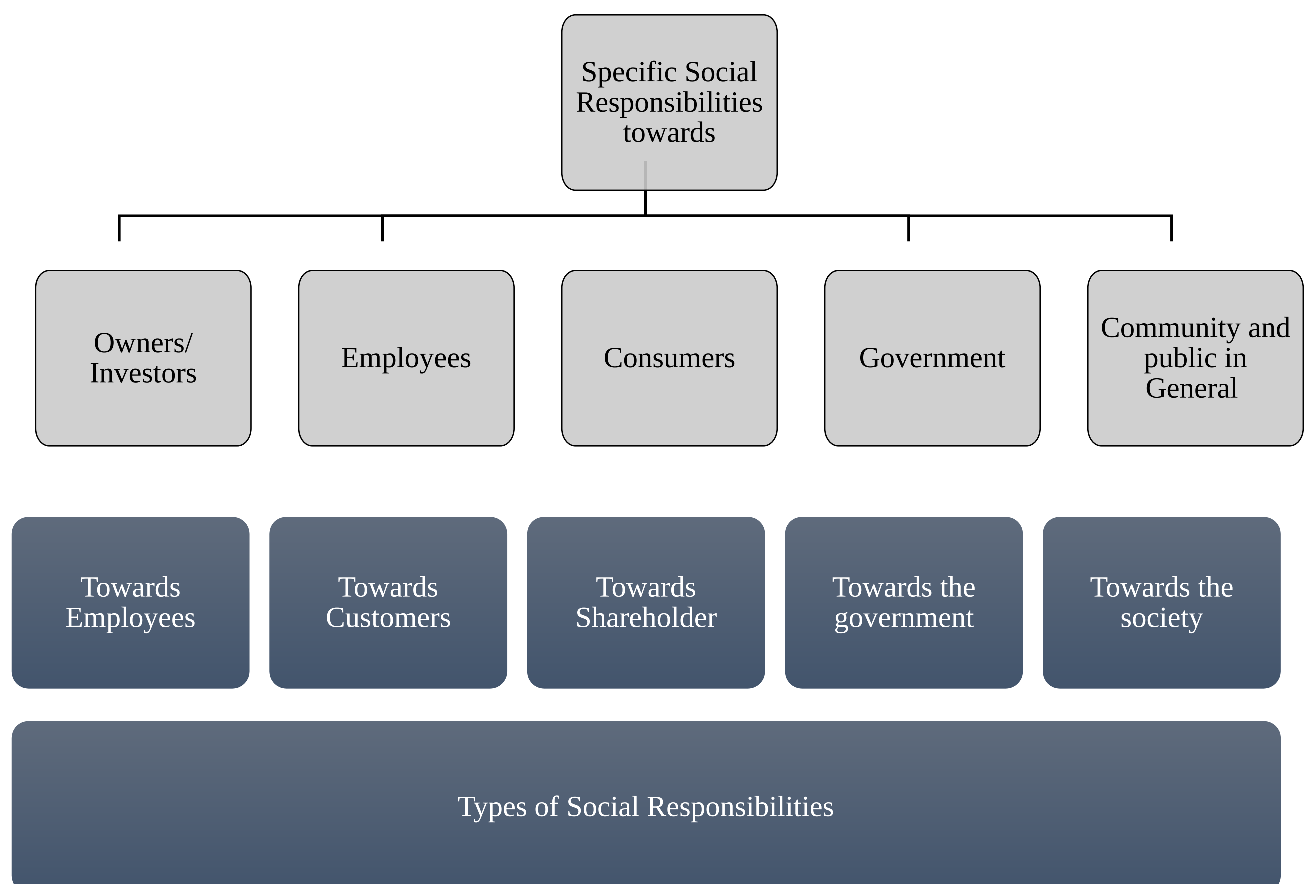
Bowen (1953) defines social responsibility as the obligations of a business person to pursue those activities and take those decisions and policies, which are consistent with the objectives and values of a society.

3. According to Keith Davis

Social responsibilities refer to the businessman's decisions and actions taken to reasons at least partially beyond the firm's direct economic or technical interests."

Types of Social Responsibilities

Social responsibility of business works at different levels and planes. Based on these, we will study the following types of responsibilities with the help of the following chart:



(1) Responsibilities towards Owners/Investors/Shareholders

Social responsibilities of business towards owners are following:

(i) To pay an appropriate rate of dividend or interest as a reward/return investment made by them.

(ii) To ensure the safety of funds invested by owners in the business.

(iii) To give owners a true and fair account of the functioning, profitability and financial health or position of the company.

(iv) To ensure the growth of the company.

(v) To protect and promote the rights of investors.

(vi) To stop the unfair trade practices like speculation and price rigging.

(vii) To avoid activities such as not to mislead the prospective investors, by any means, whatsoever, to invest in the company.

(viii) To maintain transparency and accountability of its financial statements.

(2) Responsibilities towards employees

Social responsibilities of business towards employees are:

(i) To pay adequate and timely wages to the employees.

(ii) To provide healthy and free work environment.

(iii) To provide adequate industrial safety devices.

(iv) To grant job security and job safety.

(v) To provide opportunities for promotion and advancement.

(vi) To provide perquisites and benefits like – subsidized housing, free medical care, leave with pay, entertainment and recreational facilities, day care facilities and educational facilities to the kids of the employees etc.

(vii) To ensure reasonable workers participation in management of the organisation.

(viii) To provide workers their due share in the excess profits of the business.

(ix) To treat each and every employee with integrity and respect. There should be no discrimination on account of sex, colour, caste, creed etc.

(x) To handle and resolve the grievances of the workers.

(3) Responsibilities towards consumers

Social responsibilities of business towards consumers are:

(i) To supply goods and services of good quality and at reasonable prices.

(ii) Avoid in indulging in unfair trade practices like:

- Supplying lesser weight,
- Defective packaging of goods,
- Black-marketing, hoarding and profiteering,
- Adulteration etc.

(iii) To provide full and adequate information to the consumers about the product.

(iv) Not to indulge in false, misleading and vulgar advertising.

(v) To maintain customer grievance cell for speedy redressal, if any.

(vi) To provide non-hazardous and safe goods.

(vii) To provide standardised goods.

(viii)To provide satisfactory after sales services.

(4) Responsibilities towards the State or Government

Social responsibilities of the business towards the State (i.e. the government) are:

(i) Payment of taxes on time.

(ii) To co-operate with the government in the implementation of its economic and social policies.

(iii) To provide timely and reasonable information to government departments.

(iv) To refrain from corrupt public servants and departments of public sector undertakings.

(v) To follow the rules and regulations enacted by the government.

(5) Responsibilities towards Community and Public in General

Social responsibilities of business towards community and public in general are:

(i) To ensure better utilisation of the scarce resources of the society.

(ii) To generate maximum employment opportunities to each and every section of the society without any discrimination.

(iii) Take measures to control and reduce environmental pollution.

(iv) To prevent urban congestion.

(v) To undertake programmes for the development of backward and rural areas.
(vi) To provide free facilities such as medical dispensary, education to underprivileged children and recreational facilities in society.
(vii) To innovate and implement schemes for the upliftment of the society.

Need for Social Responsibility of Businesses

1. To fulfil the needs of consumers

Social responsibility is helpful for all social classes of people. The motive for the existence of any business is to satisfy consumer needs at a profit. Consumers are important part of the society. For any business, that needs to survive in the long run must fulfil and provide goods and services as per the needs, tastes and preferences of the consumers. It is helpful for all social classes of people.

2. To build harmonious relationship between consumers and business

The society offers inputs to business such as land, labour, capital, machinery etc. and simultaneously serves as the market for the goods and services of business. There are four factors of production: land, labour, capital and entrepreneurship offered by the household sectors known as factor services. Business converts these inputs in the form of interest, rent, wages etc. known as factor payments, and earns profits by selling the output to the society. In this way, business and society enjoy a harmoniums relationship and fulfils the demand of each other. Business should protect and promote society's welfare to survive and prosper in the market. A prosperous and harmonious society is a prerequisite for profitable business.

3. To build goodwill and reputation in the market

Social responsibility of business helps in improving public image of the company. Businesses spend huge amount of resources in brand building and strengthening their public image of the company. It is helpful in building considerable goodwill that will have it pay- offs both in the short and in the long run. A company which is socially responsible enjoys a good reputation in the society. It results in increased sales, profitability, attraction of talent and sustained growth.

4. To ensure business growth

A socially responsible business helps in growth of the business. A healthy and flourishing society enjoys higher purchasing power parity. The higher purchasing power leads to higher

demand for products and services. This increased demand results in to higher sales and profit growth for businesses.

5. To avoid government regulation

If businesses are exploitative in nature and avoid society's interests, then the government has to interfere. Government will formulate restrictive rules and regulations. Then such restrictive rules and regulations would hinder the freedom and growth of businesses. In order to avoid government regulation and intervention, businesses should be socially responsive.

6. To create a pollution -free corporate environment

Problems such as environmental pollution, contamination of water resources, depletion of the ozone layer is been a result of businesses. The result of this is poor health of the community and made survival difficult for human species. Therefore, businesses should take measures to solve the problems which have been created due to negligible activities of the business. They must ensure that their activities do not result into such problems in the future.

7. Internalize the negative externalities

Social responsibility of business helps in creating a pollution free environment. It is way of internalizing the negative externalities. These externalities imply harmful effects produced by some companies. For example: a riverside factory may contaminate and pollute the river by throwing away the effluence to the water. As a result, the water will be undrinkable, and the fish may die. This will decrease the supply of fish and increase its market price. This will be a social cost, which may be absorbed by the factory. This is called internalization of negative externalities. However, this is possible for only environment-friendly manufacturing firms.

8. To create better social environment

Social responsibility of business creates a better social environment and is grounded on the basis of ethics. There is no contradiction between profit maximisation and social responsibility of business. It focuses on creating better and healthy environment by following practices such as producing eco-friendly products, better utilisation of resources, conserving natural resources etc.

SUMMARY

1. Social responsibility of a business is the responsibility of business enterprises, undertaken with an aim of achieving social welfare.
2. Types of Social Responsibilities are towards owners, consumers, employees, government, Community and Public in General
3. Need for Social Responsibility of Businesses are:

- To fulfil the needs of consumers.
- To build harmonious relationship between consumers and business.
- To build goodwill and reputation in the market.
- To ensure business growth.
- To avoid government regulation.
- To create a pollution -free corporate environment.
- To internalize the negative externalities.
- To create better social environment.

SELF ASSESSMENT

1. What do you mean by social responsibility of a business?
2. What are the types of social responsibilities of a business?
3. What are the needs for social responsibility of business? Discuss
4. Give Definitions of social responsibility according to Bowen.
5. What are your suggestions for making the Indian companies more socially responsible?
6. Why should business care about society while producing goods and services?

FURTHER SUGGESTED READING

1. Business Environment by B.N. Ghosh

MODULE 9
BUSINESS ETHICS

Learning Objectives

In this module you will learn about

- Meaning of ethics
- Meaning of business ethics
- Definition of business ethics
- Nature of business ethics
- Need for business ethics
- Characteristics or features of business ethics
- Importance of business ethics
- Companies with best ethical corporate policies worldwide

Meaning of Ethics

Ethics relates to a system of moral principles – which explains about a sense of right and wrong and goodness and badness of actions and their motives and consequences.

Ethics is the branch of philosophy that deals with morality. Ethics is concerned with differentiating between good and evil in the world, between right and wrong human actions, and between virtuous and non-virtuous characteristics of people.

Each and every society have some certain ethics to follow which govern their actions I.e. what is right and what is wrong.

Examples of societal ethical behaviour can include such things as

- Respect for another's property,
- Refraining from violence against another,
- Treating others with respect and integrity,
- Helping people who are in need.

In simple words, ethics is a system of moral principles. They affect how people make decisions and lead their lives. Ethics is concerned with what is good for individuals and society and is also described as moral philosophy.

Meaning of Business Ethics

Business ethics is the form of applied ethics, which studies ethical principles, morals and problems that take place in the business environment. It is the integration of day to day morals and ethical norms to business and applies to all types of business.

In simple terms, it means the good or bad, right or wrong behaviour, in pursuing business, determined on the basis of expected behaviour governed by the society.

Examples of Business Ethics

- Charging reasonable and fair prices from customers,
- Just and fair and equal treatment to workers,
- Earning a legitimate profit,
- Providing a good and healthy environment to employees, etc.

Ethical behaviour proves to be good for business and involves respect for key moral principles that consist

- honesty,
- fairness,
- equality,
- dignity,
- diversity and
- individual rights.

Business ethics means the application of ethics in the field of business, trade, and transactions.

Business ethics deals with moral principles and practices that reveals that whether a particular business is concerned about the society and is running its business in a morally right or wrong manner.

There are certain cognitive ethical principles.

In the light of cognitive ethical principles, the subject of Business ethics forms a

- systematic analysis,
- descriptions and
- prescription.

In business, industry, commerce, trade and other related activities, institutions, beliefs, and practices.

Business ethics is based on recognised standard ethical rules and principles, which are imperative to evaluate, guide, and prescribe normative ethical direction to all business activities.

Business ethics are the set of principles and practices, that determines acceptable behaviour in the business organisation. It gives direction to the managers and other executives in taking everyday business actions and decisions. It stresses on the impact of the business decision on the stakeholders, such as employees, consumers, government, society, investors, shareholders and so on.

Definition of Business Ethics

According to Andrew Crane,

"Business ethics is the study of business situations, activities, and decisions where issues of right and wrong are addressed."

According to Raymond C. Baumhart,

"The ethics of business is the ethics of responsibility. The business man must promise that he will not harm knowingly."

According to Wikipedia,

"Business ethics (also corporate ethics) is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations."

Nature of Business Ethics

Business ethics is mainly a ***normative science*** which includes various ethical norms and standard practices as popular in a particular country.

In terms of ***naturalist approach***, business ethics follows some established natural laws, natural religion, and nomological (religion -based) principles that are prevalent in natural system.

Natural laws are laws that are based on natural phenomenon that are based on *observations* and are *universal* in nature.

Business ethics is ***relative in nature*** which means its impact can be different in relation to area to area and region to region.

Therefore, some values may be ethical in a particular context or country but may not be ethical in another situation or country.

Business ethics is

- diagnostic,
- evaluative, and
- prescriptive.

It's important purpose in business is to set the moral standard in the business such as its guiding principle that has to be followed in all its dealings or interactions with the public, employees, government, suppliers, and consumers.

Need for Business Ethics

- To stop any business malpractices,
- To protect and promote the consumer's rights,
- To gain confidence of customers and improve public image in the society,
- For the survival and growth of business in the long run,
- To create goodwill and reputation in the eyes of public,
- To promote healthy competition in the market,
- To enhance consumer satisfaction,
- To build strong and harmonious relationship with customers and clients.

ETHICS IN BUSINESS

Characteristics or features of Business Ethics

The characteristics or features of business ethics are following: -

1. **Code of conduct**

Business ethics is a code of conduct. It outlines what to do and what not to do keeping the aim in mind. The aim of business ethics to achieve welfare of the society. All businessmen must follow this code of conduct.

2. Based on moral and social values

Business ethics is based on moral and social values. It includes moral and social principles (rules) which a business has to follow in its normal course of routine.

Some of the examples of business ethics are:

- self-control,
- consumer protection and welfare,
- service to society,
- fair and equal treatment to social groups,
- avoiding exploitation of consumers or employees, etc.

3. Gives protection to social groups

Business ethics mainly focuses on the protection and provides protection to different social groups such as consumers, employees, small businessmen, government, shareholders, creditors, etc.

4. Provides basic framework

Business ethics provide a basic framework or basic structure for running business. It formulates social cultural, economic, legal and other dimensions of business. Business must be conducted within these dimensions.

5. Voluntary

Business ethics is voluntary in nature. It is not mandatory for every business organisation to follow. It depends on the will of the business. The businessmen must accept business ethics willingly. Business ethics must act like a like self-disciplinary force. It must not be enforced by law.

6. Requires education and guidance

Before the introduction of business ethics in an organisation, businessmen must be given proper training, education and guidance. The businessmen must be motivated to apply business ethics in their activities. They must be informed about the benefits of using business ethics. Trade Associations and Chambers of Commerce must also play an active role in this matter.

7. Relative Term

Business ethics is a relative term, which means it changes from one business to another. It also changes from one country to another. Therefore, some values may be ethical in a particular context or country but may not be ethical in another situation or country. ***For example***: What is considered as good in one country may be taboo in another country. Its impact can be different in relation to area to area and region to region.

8. New concepts

In today's scenario, business ethics is a new concept. Developed countries strictly follow this concept. Poor and developing countries do not follow this concept.

Importance of Business Ethics

1. Generates sense of empowerment and security

It helps in generating sense of empowerment and security among its employees and stakeholders. It also helps in building a sense of commitment and security among employees and stakeholders. Resulting in to the satisfaction of stakeholders.

2. Gains confidence and trust of all stakeholders

A company that follows business ethics in their business gains confidence and trust of all stakeholders including suppliers, employees, customers and the public. It helps the companies to raise capital from investors. Investors will willingly and freely invest in these types of companies.

3. Reduces conflicts

A company that follows principles of business ethics can easily avoid or solve mutually various types of in -house or outside conflict. It is possible because company runs on the basis of justice, fairness, and righteousness. All the ethical principles and acts save the firm from exploitation, injustice, and unfairness and harm and injury to others.

4. Builds social image

A company that is based on ethical principles and norms can improve its social image. If company builds social image, the company will enjoy benefits such as a better goodwill or return on investment, increased profit, brand loyalty and trust, and financial leverage.

5. Fulfils Basic Human Needs

An individual will associate with an organisation where they can get respect and be proud of, because they perceive it to be ethical. Everyone wants to be associated with an organisation which the society respects as a honest and socially responsible organisation. The HR managers have to fulfil this basic need of the employees as well as their own basic need that they want to direct an ethical organisation. The basic needs of the employees as well as the managers compel the organizations to be ethically oriented

6. Better Decision Making

An organisation which formulate policies and strategies based on ethical norms and principles helps them to avoid personal bias and prejudices. This is because as ethics is taken as the bias, there will be no scope of personal value judgements, fear or favour. Ethical principles are in a sense neutral. Therefore, respect for ethics will force a management to take various economic, social and ethical aspects into consideration while taking the decisions. Decision making will be better if the decisions are in the interest of the public, employees and company's own long term good.

7. Profitability

Being ethical does not mean only social welfare or not making profits. Every organisation has a responsibility towards itself and economic objectives to fulfil also i.e., to earn profits. Ethical companies gain success and earn more profits in the long run, while in the short run they can lose money. Application of ethical norms and practices in business helps to improve profitability ratio.

8. Protection of Society

Ethics can save the society in a better way than the legal system of the country. Where law fails, ethics always succeed. The government cannot regulate all the activities that are harmful to the society. A company that is based on ethical principles and norms can protect and promote the interest of the society as a whole. They will not indulge them into exploitive practices such as black marketing, hoarding, offering adulterated goods etc. they use practices such as making eco-friendly goods, using solar panels to save electricity, using renewable sources of production etc.

Relation between Ethics and Business Ethics

There are many interrelations between ethics and business ethics, in both theoretical and empirical sense. Several standard rules and regulations of ethics are used in business, therefore in one sense business ethics is the practical application of the principles and the theories of ethics.

There are four interrelations between ethics and business ethics:

First, ethics is the source of all the theories and principles that are used in business ethics. All the important conceptual inputs, framework for development for business ethics is provided by pure ethics. Business ethics uses the core concepts of ethics like ethical intensity, ethical absolutism, ethical relativism, utilitarianism, natural law, professional ethics among others.

Second, when the business professionals are faced with contradictory circumstances or any other problem, they seek solution from the given ethical laws, principles and theories in order to solve the problems in the right way. For this purpose of action and policy making in business, the ethical principles are really useful in providing morally sound ideas, analytical guidelines and norms for reference and comparison. In order to use the principles of ethics in business, it is the necessary pre condition that the managers have the necessary knowledge of the pure ethical principles.

Third, the making of the ethical frameworks and models go a long way in assisting the managers to comprehend the ethical intensity, ethical base, and superstructure of the company etc. in order to solve the ethical dilemmas, preparing ethical audits, and at last in making ethical decisions in business.

The fourth and last interrelation between ethics and business ethics is that many functional areas and professional codes, rules, and values in business ethics are taken from the pure ethics. If we look at it from the empirical point of view there are many similarities between the pure ethics and business ethics, along with interactions and integration. In

order to find solution to many ethical problems in business and pure ethics, pure ethics always comes to aid as a point of reference.

In the nutshell we can say that the branch of pure ethics is completely independent of business, however the branch of business ethics borrows its crucial features from pure ethics.

Factors Determining Ethical Environment in Business

The ethical environment in a business depends on a number of factors like mission and the vision of the company, ethical leadership, degree of ethicality of the employees, the system of reward and punishment, motivation on the part of the company, past performance in terms of ethical achievement, organizational culture, pressures either from inside or outside force.

There are a number of factors which determine the ethical decision making in the company, but we shall here look into then in two categories –

1. Organizational factors
2. Individual factors

Organizational and Value Premise

According to a study conducted by the Ferrell and Ferrell in 2001, has depicted that the organizational factors and culture are more decisive and crucial in the ethical decision making rather than the individual and personal factors. An organization has many different people belonging to different backgrounds, culture and family situations. If a group is involved any decision making, then usually the idealistic view gets the upper hand. This happens because group's psychology is different from the individual psychology and it has been seeing that when a group takes a decision then it is fairer reasonable and ethical in nature.

However, it is important to understand that the nature of decision making by a group in a company is subject to several factors like the level of ethical orientation, ethical intensity of the problem and the moral rectitude of the company. We can understand the moral or the ethical orientation of the company from the statements of its mission and vision. It is quite understood that the corporate culture of a company founded on the moral principles, value premises and corporate objectives are more or less permanent in nature. A study by the Weber and Seger has found that there is certainly a correlation between the corporate culture and the ethical culture in a company. Both are interdependent and mutually interrelated.

Ethical Intensity, Ethical Grounding and Superstructure

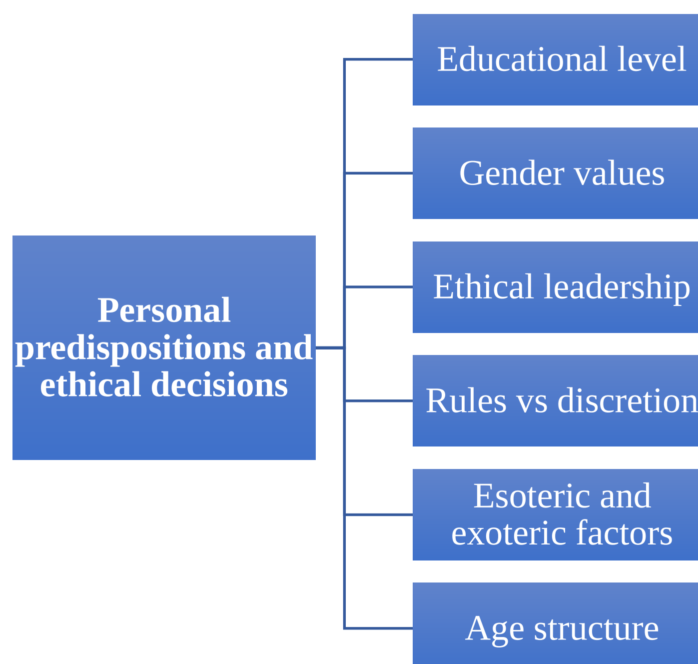
McDevitt and VanHise (2002) have attached great significance to ethical intensity and grounding in making ethical decisions. But before going forward we shall try to understand the concept of ethical intensity.

Ethical intensity

Ethical intensity is the degree of significance of the ethical issue related to case and also in the decision making. Karl Marx's idea that the growth of the superstructure depends on the base is fully applicable to the ethical base and superstructure. Only if the ethical base is strong, the ethical superstructure can expand and grow. Those organizations which attach great importance to the principles of ethics and morality shall make the decisions more judicious and just. The moral dispensation to a great deal depends on the manager or the CEO of the company because if the manager has sound ethical background and is a person of strong determination and will power then he shall fight to overcome all the hurdles, pressures, temptations, and influences in order to arrive at right moral decision.

Personal Predisposition and Proclivities

The personal predispositions and the proclivities have a key role to play in the nature of ethical decisions. At the individual level the significance of any ethical problem or dilemma will depend on different factors like the predispositions, proclivities, family background, Upbringing, ethical predisposition of parents etc.



There are several factors that have an influence on the ethical decision making process of the individual.

1. Education Level

Education along with enlightening the mind also helps us in developing the ability to differentiate between good and evil. The purpose of education should also be to train the mind and build the character. The right kind of education is based on the fundamentals of morality and ethics. One can say that there is a positive correlation between education and moral values because sometimes we see that a highly educated man does not want to do something which is unacceptable and wrong for the society. It has been observed that when a person is truly educated then he develops a spiritual sense that empowers him to make ethical decisions. In a study by O' Fallon and Butterfield it has been observed that the business professionals who are educated and rational are more ethical than the students who are in the process of learning.

2. Gender Values

Study has found that women who are more kind hearted and sensitive than men are found to be more ethical than them. As a result of this the women managers are more ethical than men and are expected to make more ethical decisions than them.

3. Age Structure

It is a common factual reality that the older managers are more concerned about the ethical issues and morality than people of younger generation. It is seen that the young managers care less about ethics and morality while taking a decision. This can attribute to the fact that as one ages, they realize the futility and the temporary nature of human existence and turns towards spirituality to seek real meaning and the purpose of life. All these factors lead to the growth of ethical consciousness with age. There can be several exceptions to this general rule but there has been no study which gives any proof contradicting this belief.

The general belief is that the elderly is more mature and sensitive to the ethical considerations thus they are more likely to make ethical decisions. However, we should be extra conscious while generalizing such beliefs. There are a few scholars who believe that that the older people may not be wiser or morally conscious. Therefore, the issue of relation

between age and morality and age is very complicated and convoluted and we should not take the risk of generalization.

4. Ethical Leadership

While taking business decisions one should not only consider the age, gender, and education rather one must also focus on the quality and the nature of ethical leadership. All the managers cannot have the same background, proclivity, and perspective thus we also cannot expect the same type of decision making from all of them. In some cases, the ethical decision making may not have much ethical intensity or content. This is one of the reasons why people highlight the importance of ethical decision making at the leadership level.

5. Rules Vs Discretion

The question of rules versus discretion comes into picture when any manager has to take any decision in an ethical manner. While engaging in such decision making should the manager give priority to the rules and the precedents set by the senior managers or should he rely on his own discretion? There is no clear cut answer to that question. In some circumstances the manager may go by the rule book in order to save his own skin. If the decision making is done according to the rules and principles and if the rules are unethical then there is a risk that the decision shall also be unethical. On the other hand of the decision making process is left to the manager then also we cannot always expect them to always do the right decision making. It therefore becomes really difficult to decide which one is better- rules or discretion. There cannot be unique answer to the question as it depends on several internal and external factors. The managerial discretion can be both favourable or unfavourable to ethical decision making process.

6. Esoteric and Exoteric factors

There are many esoteric and exoteric factors which affect the ethical decision making process. The esoteric or the internal factors can be listed as level of profit, ethical background, an ethical rooting of the company, the mission and the vision statements of the company among other things play a vital role in the ethical decision making process. There is mostly a strong correlation between the level of the profit of the company and the ethical decision making on the part of the company. However, this general rule is subject to several terms and conditions and may not be true in all circumstances. There are many exoteric factors that also impact the ethical decision making process of the company like the

pressures from outside, externalities (external influence) legal framework of the country and so on.

Personal Values in Decision Making

Several factors like managerial decision making on the personal prejudices, proclivities and the preferences of the managers affect the decision making process. There are some personal qualities of a manger which go a long way in ensuring the right kind of decision making they have been listed here:

- Personal commitment and preferences
- Ethical rooting and intensity
- Sense of duty
- Nature of the personality traits
- Commitment to perform social responsibilities
- Love for fairness, justice and righteousness
- Sense of trusteeship
- Eagerness to have good citizenship

How to Make Good Ethical Decisions in Business

There cannot be any one solution for making correct ethical decisions in all circumstances. There is uniqueness in all ethical dilemmas and problems therefore there cannot be any one solution to all the problems. All the ethical problems are not of equal importance from the ethical point of view. There are some ethical problems that are short term in nature and are less important, whereas some of these problems may have long term effects and have wide ranging implications. There is a need for a framework for the ethical conduct in the business and that framework has the specific guidelines which can be followed by the company. We shall study this ethical framework in detail here, but it is important to note that the business has a necessary ethical background and that it is prepared to solve any ethical problems that a company is confronted with.

With the help of following points, the framework has been explained:

1. The first step is to thoroughly study and analyse the case so that the case can be fully comprehended. The case should not only be read on the surface rather in a deep way.
2. A deep study of the case is followed by the analysis that how far the case is important for the company or what is the ethical intensity of the case. We are supposed to

find that is there a contradiction between the ethical issue and the objectives of the company.

3. After it has been ensured that there is no such contradiction between the case and the objectives of the company then we can move towards finding a solution through the right ethical model. The proposed solution model must be in line with the ethical base and the culture of the company.

4. This is followed by a feasibility test which actually determines that whether the solution is a feasible one in the context of the available resources. Once this has been ensured then the solution can be taken forward.

5. Before applying the solution, it is important to first take the opinion and suggestions from the senior bosses of the company.

6. The implications of the case have to be understood deeply. If the case is solved, what will be the benefits of the company whereas if the case is not solved what will be the losses? A firm may take decision keeping cost benefit analysis in mind.

7. Then the manager should give a thought on the alternative solution for the case and each of these different solutions shall have a different impact on the company in terms of costs and benefits.

8. In solving any ethical problems there are many ethical dilemmas, conflicts and contradictions. But then the question arises that what to do in case of such dilemma? Then one need to point out that there is an acceptable trade- off and the opportunity cost involved.

9. In the end the final step is that the solution to the case is taken and it is impossible to make everyone happy with that solution. Here it is important to keep in mind that those who matter will not mind and those who mind do not matter.

10. After taking the decision, the next step is to implement that. Like it is commonly said that justice delayed is justice denied, which points out the importance of the timely implementation of the solution. In case of any delay the company shall face the loss of time, increasing cost, uncertainty and sacrifice, all of which are negative for a company's growth.

Relationship between Ethics and Religion

Religion is one of the foremost sources of inspiration for ethics. There are almost 100,000 religions across the globe but cutting across these religious sects the there is a common belief that ethics in the end is an expression of the divine that shall reveal the nature of right and wrong in all areas of the life including business. When we look deeply, we find that all the religions agree on the basic principles which are similar to the building blocks of secular ethical doctrine. In all major religions like Hinduism, Buddhism, Christianity, Islam, Judaism, and Confucianism there is a common belief on the principle of reciprocity. All these religions also point out the importance of an orderly social system and focuses on social responsibility in a way that it contributes to the general welfare. Such rules form the foundation of many other rules in the business ethics. All the major religions of the world in way or the other disapprove the unethical conduct on anyone's part even in life including the business activities. Religion represents one of the more often recognized determinants of the moral values that underpin ethical standards. The most important global religions have moral teachings and they state, in different manners, disapproval of unethical conducts. Most of them preach that an omniscient God sees human actions and holds people responsible for their conducts. Thus, it is logical to consider that adherents to a religion would not be too tolerant of unethical conduct.

Business ethics follow all these in their business

Companies with Best Ethical Corporate Policies Worldwide

1. Google

Although some may criticize the company, Google (NASDAQ:GOOG) regularly makes good on its motto: "Don't be evil." Through its Google Green Program, the company has donated over $1 billion to renewable energy projects and has decreased its own footprint by using energy efficient buildings and public transportation. The company is also a staunch advocate of free speech, which can be observed from its frequent conflicts with the Chinese government. Google is also an open supporter of gay rights. Yet all this pale in comparison to Google's status as a paragon for employee benefits. Just to name a few, Google employees have access to free health care and treatment from on-site doctors, free legal advice with discounted legal services, a fully stock snack pantry and on-site cafeteria (staffed by world-class chefs, no less), and a free on-site nursery. With such a stellar record of social awareness and positive employee relations, Google is easily the best example of ethics in the corporate world today.

2. Microsoft

Microsoft was started by Bill Gates, one of the America's most generous philanthropists, it follows that Microsoft (NASDAQ:MSFT) would do well in following his example. The tech company and its employees donate over $1 billion yearly to charities and non-profit organizations. If that wasn't enough, Microsoft's management and employees have also decided to tackle America's IT professional's shortage through its TEALS program. Through the TEALS program, Microsoft employees are encouraged to volunteer at local schools to instruct students in computer science, in the hopes that it will inspire them to enter the technology industry. It's only natural that Microsoft employees would be generous people; in addition to being among the highest paid employees in America, they also enjoy a plethora of perks, including 100% coverage on their health care premiums.

Bill & Melinda Gates Foundation

Microsoft has initiated its own foundation known as Bill & Melinda Gates Foundation. Bill & Melinda Gates Foundation is the largest private foundation in the world, founded by Bill & Melinda Gates.

The primary aim of the foundation is globally, to enhance healthcare and reduce extreme poverty and expand educational opportunities and access to information technology.

Bill & Melinda Gates Foundation tackle problems in following areas:

Global development

1. Water, sanitation, hygiene
2. Vaccine delivery
3. Agriculture & nutrition

Global health

1. HIV
2. Malaria
3. Tuberculosis

Avahan is an initiative sponsored by the BMGF to reduce the spread of HIV in India reduce hunger and poverty for millions of farming families by increasing agricultural productivity.

3. Intel

Since 1988, the computer chip manufacturer Intel (NASDAQ:INTC) has been trying to bolster its reputation through its efforts to strengthen the technological education. Through the Intel Foundation, the company hosts the Intel Science Talent Search and the international Science and Engineering Fair to help encourage STEM (science, technology, engineering, and mathematics) education for young people. Intel is also interested in making these areas more diverse; the company has many donation funds and programs to encourage girls and underprivileged minorities to study in these fields. Employees of Intel also experience the company's dedication to education through a very strange corporate perk — the company promotes or reassigns them to different fields and areas every 16 to 24 months, in the interest of making sure that workers never become bored with their roles and enc to
you

30 YEARS ANNIVERSARY CELEBRATION

INTEL FOUNDATION

For the past 30 years, the Intel Foundation has been committed to improving lives around the world. From investing in STEM programs, providing disaster relief and amplifying the philanthropy of Intel employees, it has followed a vision inspired by the words of Intel co-founder Robert Noyce, **"don't be encumbered by history, go off and do something wonderful."**

The other companies which are best in practising business ethics worldwide are:

- Patagonia,
- NuStar Energy,
- SAS Institute,
- Ultimate Software,
- Goldman Sachs,
- Starbucks and
- Salesforce.com.

Two Indian companies among most ethical in the world:

1. TATA Steel- Csr activity of Tata group

- Curative and preventive health services were rendered to 295,075 community members
- Scholarships for higher studies were awarded to 891 students
- School infrastructure was developed for 100 schools
- Vocational training was imparted to 1048 youth
- Technical training was provided to 1542 youth
- Green cover was increased by planting 290,850 trees.
- Potable water solutions with support from the Sumant Moolgaonkar Development Foundation (SMDF) provided to 100 villages.
- Donations (including donation of vehicles) to help 52 NGOs for various social programmes: 2,90,60,279.

2. Wipro Limited

- Wipro Cares- "Wipro Cares" strives hard to address major issues responsibly. From community relief and rehabilitation in times of disasters to education

opportunities, health and wellness programs for the needy, we make sure that our social initiatives touch every level of society that needs our help.

- Wipro care is an initiative by the wiproites.
- Wipro care contributes through two prolonged strategy- learning enhancement and disaster rehabilitation.

SELF ASSESSMENT

1. Define ethics?
2. Define business ethics?
3. Give some definitions of business ethics.
4. Explain the nature of business ethics.
5. Why there is a need of business ethics in an organisation?
6. Explain the features of business ethics.
7. Why these days the importance business ethics have increased?
8. Name the companies that follows business ethics in the world and in India.
9. How business ethics will help an organisation to build goodwill in the market
10. Critically examine the effect of business ethics in the market.

FURTHER SUGGESTED READING

1. Business Environment by B.N. Ghosh

MODULE 10

CORPORATE GOVERNANCE

Learning Objectives

In this module you will learn about:

- Meaning of Corporate governance
- Definition of Corporate Governance
- Characteristics of Corporate Governance
- Principles of Corporate Governance
- Scope of Corporate Governance
- Importance of Corporate Governance
- Corporate Governance in India
- Main features of Corporate Governance system in India
- Provisions for improvements as per the department of company affairs in 2000.
- Seven major defects of Corporate Governance system in India

Meaning of Corporate Governance

Corporate governance means set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled so that it can fulfil its goals and objectives in a manner that adds to the value of the company. The purpose of Corporate governance to create maximum benefit for all stakeholders in the long term. Stakeholders include board of directors, management, shareholders, customers, employees and society.

Corporate governance is the method by which a corporation is directed, administered or controlled. It includes the laws and customs that affects the direction, as well as the goals for which it is governed. It includes certain rules and regulations that create an atmosphere of transparency and accountability of a business corporation.

Corporate Governance means the rules, processes or laws by which businesses are operated, regulated and controlled. Corporate governance means the idea of carrying proper management of companies through the institutions and mechanisms available to the shareholders.

Corporate governance promotes:

- corporate fairness,
- transparency,
- and accountability.

Definition of Corporate Governance:

The OECD Principles of Corporate Governance states:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

According to Catherwood

Corporate governance means that company managers its business in a manner that is accountable and responsible to the shareholders. In a wider interpretation, corporate governance includes company's accountability to shareholders and other stakeholders such as employees, suppliers, customers and local community."

According to Milton Friedman

"Corporate governance is to conduct the business in accordance with owner or shareholders desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs".

According to Cadbury Committee (U.K)

"Corporate governance is the system by which companies are directed and controlled".

A good corporate Governance must have:

1. Transparency of operations,
2. Accountability towards of shareholders and
3. Fairness in dealings.

Characteristics of Corporate Governance

1. Transparency
2. Discipline
3. Accountability
4. Independence

Principles of a good Corporate Governance

1. Accountability

A Good corporate governance ensures that stakeholders must be aware about the company's mission, values, short and long term strategic goals. They must be aware about their roles they will be performing, and that will help the company to accomplish the organisational goals. An effective board of directors will make sure a company's senior leadership is leading the company in the right direction. A senior -subordinate relationship is created, levels of management will be defined so that to carry out the strategies.

2. Transparency

Transparency is the key principle of a good corporation. Stakeholders needs reassurance that weather the company is operating as per the laws and that business is being conducted that is ethically and fairly. Transparency in an organization can be achieved by following ways such as providing an annual report, a corporate retreat to discuss direction and

strategy, or in the form of documented policies, procedures or best practices that give entry-level employees an understanding of how the company operates.
Organisations must clearly state the role of board of directors. An organisation must disclose all the material matters and facts concerning the organisation and it should be timely presented and balanced, to ensure that all investors have access to clear and factual information.

3. Policies and Procedures

Policies are general statements that define an organisation's objectives. Policies and procedures help an organisation to achieve the desired organizational objectives. Documented policies and procedures help all the employees in an organization to understand how the company functions. To gain clarity on processes and expectations both private and public companies frame policies and procedures. When policies and procedures are documented, it helps employees that the company is in compliance with all legal and regulatory requirements, establishing a framework through which the organization can operate seamlessly and successfully.

4. Sound Decision-Making

A Good corporate governance helps in achieving higher profits and returns through sound decision-making. Employee and customer surveys, market analysis reports and managerial and departmental meetings are all sources through which a company's executive leadership team can collect data and insight to inform their decisions. For a company's board of directors, the interest of shareholders and stakeholders are always a primary concern. The board has the ultimate authority regarding the company's management and must have sufficient information to approve annual budgets, determine executive compensation and authorize the hire or release of the company's chief executive officer.

5. Builds social goodwill and reputation

A good corporate governance is engaged in creating social goodwill and reputation. It aims at creating corporate citizenship through its better work and performance. It tries to become role model for others.

6. Achieves sustainable development

Sustainable development is the heart of a good organisation. It orders to achieve this; the corporation becomes very judicious in using natural resources. It follows environmental-friendly policies under all situations. They do not exploit natural resources.

7. Adopts righteousness, justice and fairness

In achieving its objectives and in dealing with its employees and customers, it follows righteousness, justice and fairness in every matter.

8. Focuses on social welfare

Investments made by a company also include social welfare, as these are based on justice and fairness. These kind of companies makes socially desirable and responsible investments. They aim at maximising shareholders wealth.

9. Financial disclosure

The achievement of financial stability is the core Principle of a good corporation. Financial disclosures to the stakeholders strengthen public image and confidence in the company.

10. Economic efficiency

The attainment of economic efficiency is the top priority of a good company, but it does not adopt immoral and illegal means to achieve it.

Scope of Corporate Governance

Corporate governance includes 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.

Importance of Corporate Governance

A good corporation of international must have:

- competence,

- contest-ability,
- competitiveness.

The major points of importance of Corporate Governance are as follows:

1. Ensuring accountability and transparency

The fundamental basis of importance of CG lies in accountability and transparency. In case of less developed countries, these factors play an important role in building confidence in investors. This results into a major determinant of an investment climate of that particular country.

2. Ensuring social welfare and justice

With the strategic implementation of CG norms efficiency, corporate functionality and productivity can be increased. These may include social responsibility carried out by an organisation in good faith to ensure social welfare and justice.

3. Enhancing financial stability

When an organisation properly implements the rules and norms of CG, then that results in to less corrupt practices in an organisation. As a result, it enhances financial stability of the organisation.

4. Strengthening sustainable development

A focused organisation with an efficient system of CG can strengthen sustainable development as an aid towards environment protection.

5. Successful and expansionary global adventure

An efficient CG is a pre-requisite for a successful and expansionary global adventure because it ensures lowest possible cost, international product quality and competitive prices of products.

6. Ensuring allocative efficiency

A corporate which is well governed can ensue competitive factor and product markets. They achieve allocative efficiency in the use of scarce resources. Allocative efficiency is obtained when no extra gain is possible through the reallocation of available resources. They make better and optimum utilisation of resources and thereby resulting into saving of time, money and efforts. Hence, there will be no wastage of resources and specialisation of resources.

7. Better public image of business

A good system of CG creates better public image of business, raises public confidence and enhances national prestige. A good corporate governance helps in increasing the GDP of a country. Good corporations are not just corporations they are national asset that not only contributes to industrial development but can also increases the level of confidence of foreign investors to participate more actively in the national development of a particular country. It helps in increasing and attracting foreign investment in a particular country.

Thereby resulting into increase in employment opportunities, social development, reducing poverty etc.

Corporate Governance in India

Due to the introduction of liberalisation in 1991, it has opened the Indian economy to the outside world in a much broader and bigger way. It resulted into 2 important developments:

1. Need for a strong and efficient systems of CG

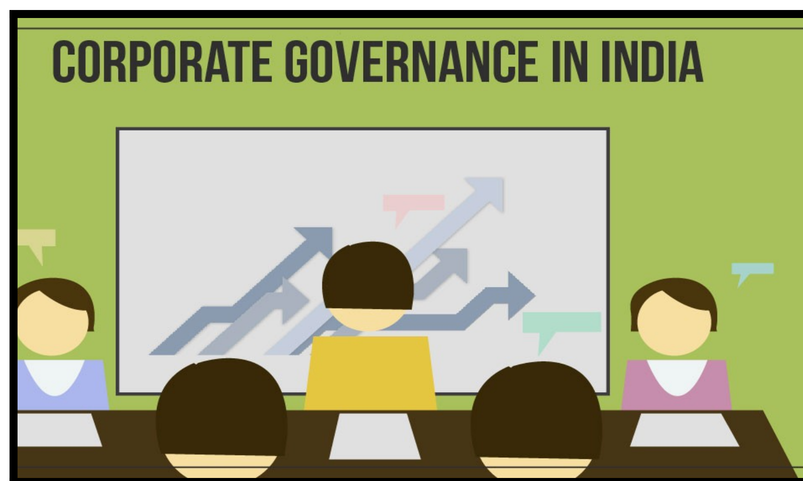
The LPG reforms created more interactions with Indian companies with their foreign counterparts, which led to an urgent need for a strong and efficient system of CG.

2. Indian CG system

The failure of many countries around the world, especially in countries like UK and USA, made the government of India and responsible corporate houses more concerned for a through refurbishment of the Indian CG system.

The above reasons compelled to review and revise the system of CG. To reform the CG system in India, some of the organisation unified themselves such as SEBI, CII and Kumar Mangalam Birla report (2000) with the changing passage of time.

In 2003, the government of India set up the National Foundation for corporate governance (NFCG) in India to address the problem faced by the existing system of CG. The establishment of this foundation was indeed a landmark in the way of CG reforms in India.



Main features of Corporate Governance system in India

In many respects, the CG system in India follows the models of UK and Japan but does not adopt the model of Germany.

In the Indian system, there is a predominance of family based insider ownership where most of the equity holdings are controlled by families. The Indian CG system has to work under many constraints.

Some of these constraints include:

- Underdeveloped capital and stock markets,
- Internal and somewhat inadequate sources of finance,
- Insignificant contributions of commercial banks and
- The right of minority investors and creditors are not properly safeguarded

In view of all these attempts have been made from time to time to improve the CG system in India. SEBI made some new provisions in clause 49 for the listing of companies with the hope that the compliance of such a clause will improve the system.

Provisions for improvements as per the department of Company Affairs

The department of company affairs in 2000 made following provisions for improvement in the performance of the system of CG:

- Introduction of more transparency in matters of accounting and public disclosers
- A proper system of public disclosures of important and critical information
- A very stringent standard of performance and operation of the listed companies
- A code of conduct for all the public sector units
- Non-executive directors and independent directors are to be given more responsible roles for better performance of the system of CG

Seven major defects of Corporate Governance system in India

- Accounting practices are not of international standard (loopholes exit).
- Shareholders do not participate very actively or very frequently.
- There is no active role of institutional investors.
- Bond and stock markets are underdeveloped.
- Independent directors are ot independent in actual practices. Politics play its role in their selection.
- It is difficult to practice "whistle blowing", there are many practical constraints.
- In many cases, the directors are not very professional.

SUMMARY

This chapter throws light on corporate governance. Corporate governance means set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled so that it can fulfil its goals and objectives in a manner that adds to the value of the company. The purpose of Corporate governance to create maximum benefit for all stakeholders in the long term. Stakeholders include board of directors, management, shareholders, customers, employees and society.

1. The OECD Principles of Corporate Governance states:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the

structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

2. Characteristics of Corporate Governance

- Transparency
- Discipline
- Accountability
- Independence

In this module you have learnt about some principles of corporate governance. Corporate governance is based on some principles.

1. Principles of a good corporate governance are as follows:

- Accountability,
- Transparency,
- Policies and Procedures,
- Sound Decision-Making,
- Builds social goodwill and reputation,
- Achieves sustainable development,
- Adopts righteousness, justice and fairness,
- Focuses on social welfare,
- Financial disclosure Economic efficiency.

Corporate governance has a wider scope.

Here is the, Scope of Corporate Governance:

1. Corporate governance includes the following functional areas of governance:

- Preparation of the entity's (Company) financial statements.
- Internal controls and the independence of the entity's auditors.
- Review of the compensation arrangements for the chief executive officer and other senior executives.
- The way in which individuals are nominated for positions on the board.
- The resources made available to directors in carrying out their duties.
- Oversight and management of risk.

Corporate Governance plays very important role in the development of the company.

1. Importance of Corporate Governance

- Ensuring accountability and transparency,
- Ensuring social welfare and justice,
- Enhancing financial stability,
- Strengthening sustainable development,
- Successful and expansionary global adventure,
- Ensuring allocative efficiency,
- Better public image of business,
- Strengthening sustainable development.

In India, the need for Corporate Governance is rising and it is benefiting the Indian companies

1. Corporate Governance in India

- Need for a strong and efficient systems of CG: The LPG reforms created more interactions with Indian companies with their foreign counterparts, which led to an urgent need for a strong and efficient system of CG.
- Indian CG system: The failure of many countries around the world, especially in countries like UK and USA, made the government of India and responsible corporate houses more concerned for a through refurbishment of the Indian CG system.

1. Seven major defects of Corporate Governance system in India

- Accounting practices are not of international standard (loopholes exit).
- Shareholders do not participate very actively or very frequently.
- There is no active role of institutional investors.
- Bond and stock markets are underdeveloped.
- Independent directors are to independent in actual practices. Politics play its role in their selection.
- It is difficult to practice "whistle blowing", there are many practical constraints.
- In many cases, the directors are not very professional.

SELF ASSESSMENT

1. What do you mean by corporate governance? Explain.
2. What is the main objective of corporate governance?
3. What does corporate governance promote?
4. Does corporate governance include any rules and regulations?
5. Give the definition of corporate governance?

6. Explain the characteristics of corporate governance?
7. Explain in detail the principles of a good corporate governance?
8. Give the major points of stating importance of Corporate Governance.

REASON BASED QUESTIONS

1. How good corporate governance helps in achieving sustainable development?
2. Does corporate governance focus on social welfare? Comment.
3. Why it is important to adopt corporate governance in a business? Enumerate.
4. Explain the concept of corporate governance.
5. State the features of corporate governance system in India.
6. State the provisions for improvements in the performance of system of CG as per the department of Company Affairs.
7. State the seven major defects of Corporate Governance system in India.

FURTHER SUGGESTED READING

1. Business Environment by B.N. Ghosh.