CHAPTER - 3

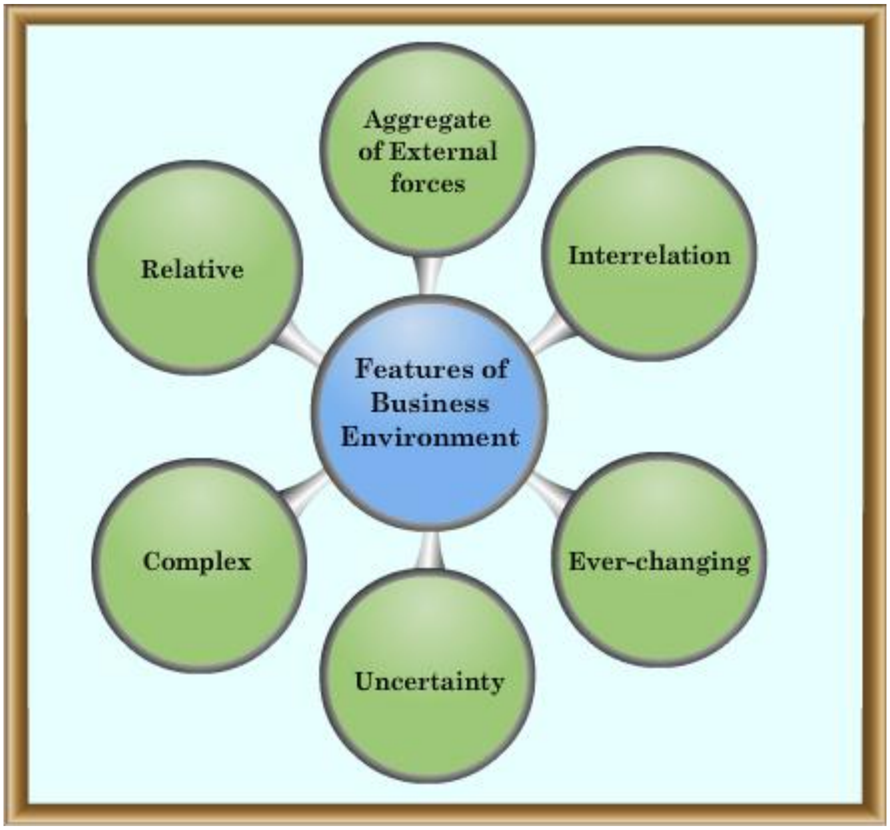
Business Environment

❖ **Meaning of Business Environment**

- Business environment refers to all the external forces— including economic, social, political, technological and legal—that affect the performance of a business organisation.
- These forces can affect the performance of the organisation either in a positive or in a negative manner. For example, a change in consumer's tastes and preferences in favour of a firm's product increases the demand for its product. On the other hand, political instability can have an adverse impact on its performance.
- External forces are outside the purview or control of an organisation but affect its performance.

❖ **Features / Characteristics of Business Environment**

The following diagram depicts the various features of a business environment.



1) ***Aggregate of external forces***: A business environment is the aggregate of all the external forces such as individuals, consumers, government and legal matters that affect the performance of an organisation either positively or negatively.
2) ***Interrelated:*** The different forces of a business environment are interrelated with one another. For example,

   $\uparrow$ in income of the consumers $\Rightarrow \uparrow$ in demand for consumer durables
3) ***Ever-changing***: A business environment is dynamic. For example, the consumer's tastes and preferences, technology, political conditions, etc., change continuously.
4) ***Uncertain***: The dynamism in the forces of a business environment implies that they are highly uncertain and cannot be predicted easily.
5) ***Complex:*** As a business environment is the aggregate of different interrelated forces, understanding it is quite difficult.
6) ***Relative***: A business environment is relative in nature and differs from

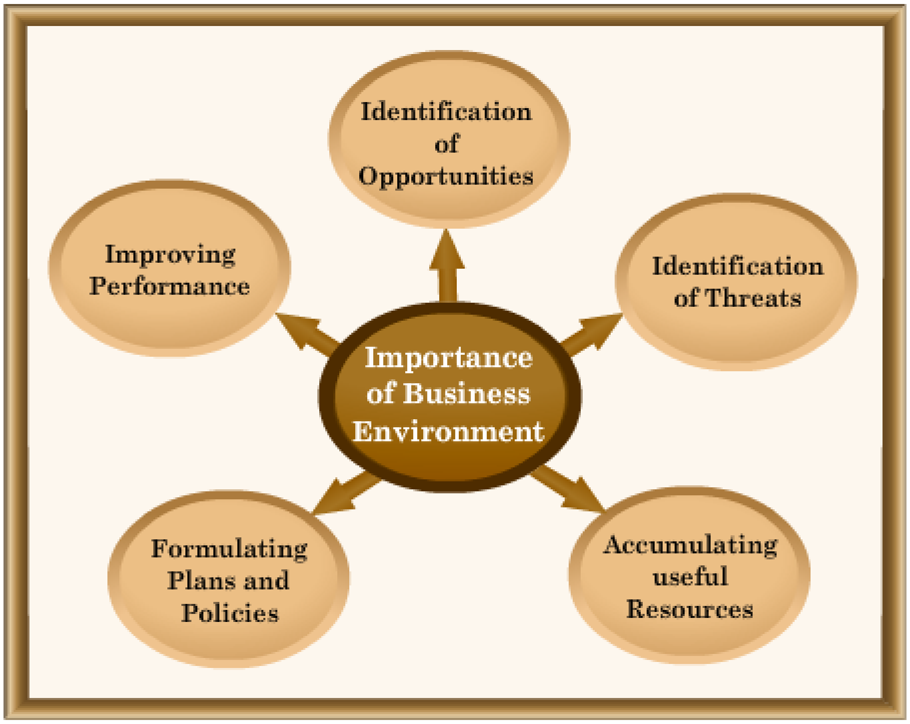
one region to another depending on various factors. For example, political conditions, religious beliefs, etc., are different in different regions.

- **Specific and General Business Environment**
    - ***Specific environment***: A specific business environment refers to a business environment in which an organisation is acted upon by external forces specific to the particular organisation and its performance is affected ***directly*** by these forces. For example, a change in consumer tastes and preferences for the products of a business enterprise directly affects the demand.

    - ***General environment***: A general business environment refers to a business environment in which general external forces affect the performance of all the organisations simultaneously. These forces affect a particular organisation only ***indirectly***. For example, a change in political conditions affects the performance of all the organisations in the region simultaneously.

- **Importance of Business Environment**

The following diagram highlights the importance of a business environment.



As an organisation is constantly affected by various external forces, an understanding of these forces is necessary for its successful functioning. The following points highlight the importance of studying the business environment.

1) ***Identification of opportunities***: An analysis of a business environment enables an enterprise to identify various positive opportunities and thereby take first advantage in its competition with other companies.
2) ***Identification of threats***: A study of a business environment can help a company analyse positive opportunities, but this study can also help it identify various threats or negative signals and take preventive measures timely and appropriately.
3) ***Accumulation of useful resources***: A business environment, on the one hand, provides an organisation various inputs required for its functioning, and on the other hand, acts a source of demand for the goods and services produced by it. Thus, it is important for an organisation to understand its environment and use those resources from it that are required for the production of the goods and services in demand.

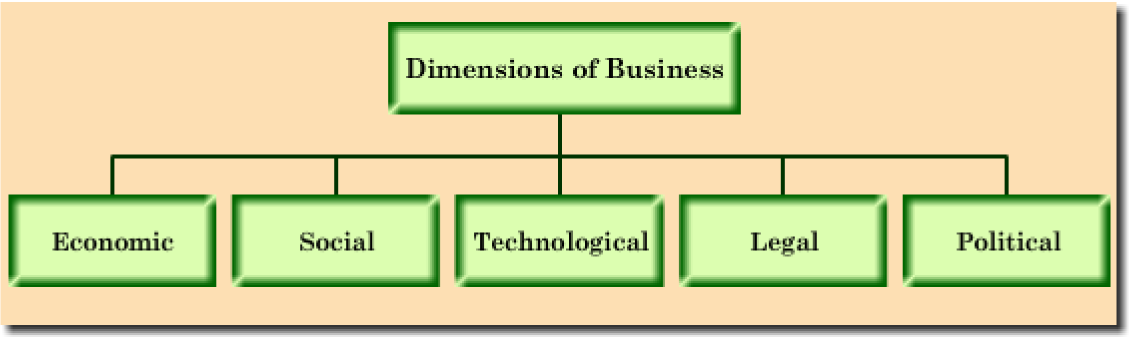
4) ***Adjustment to changes***: A careful study of a business environment helps an organisation in dealing with various changes in the external forces better.

5) ***Formulation of plans and policies***: Through a study of a business environment, an organisation can identify various threats and opportunities to it, and accordingly frame suitable plans and policies.

6) ***Improvement in performance***: Organisations that carefully study their business environments and accordingly adopt suitable plans and policies are better able to improve their performance in the long run.

❖ **Dimensions of Business Environment / Components of Business Environment / Factors Affecting Business**

The term 'dimensions' refers to the various external forces that make up a business environment. There are six broad dimensions of business.

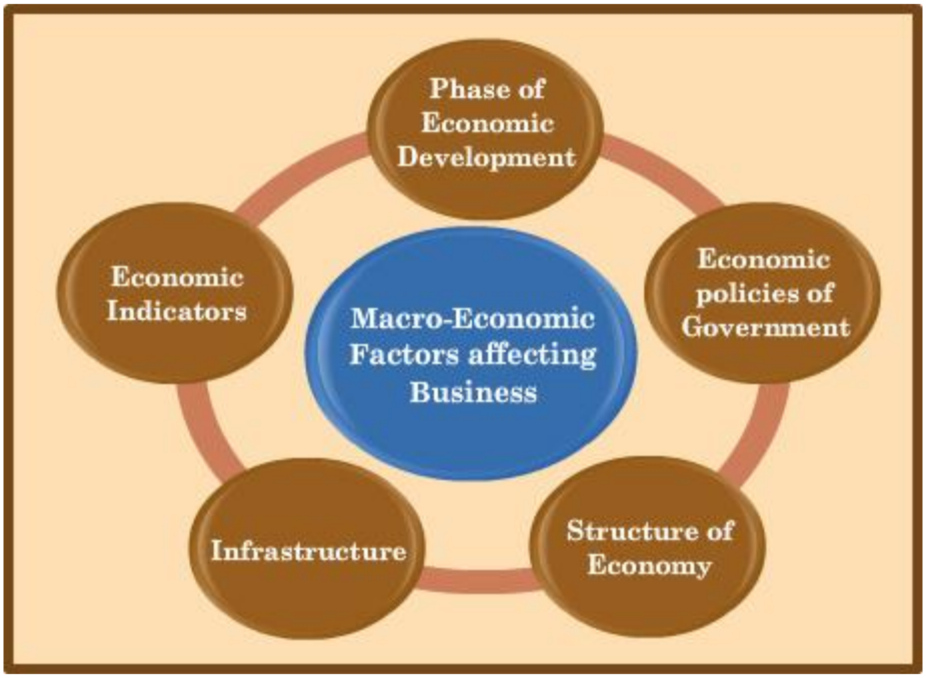


The following are the dimensions of a business environment.

Dimension	*Consists of*	*Example*
Economic	Changes in economic variables	Interest rate, income, stock market indices
Social	Social forces	Customs, traditions, religious celebrations
Technological	Technological changes and improvements	Technology used in the production of a product becoming obsolete

Legal	Laws passed by the government	Laws such as Companies Act and Trade Union Act
Political	Changes in political conditions and situations	A change in the government bringing a change in rules and policies

❖ **Macro-economic Factors that affect the functioning of Business**



1) ***Phase of economic development***: Business organisations are directly influenced by the phase of development of the economy in which they operate. The policies followed by business organisations in developed countries are different from the policies followed by companies in developing countries.
2) ***Economic policies of the government***: Economic policies such as fiscal policies and monetary policies directly affect the functioning of business organisations. For instance, liberal monetary policies (such as a reduction in interest rates) have a positive impact on business organisations.

3) ***Structure of the economy***: The type of structure, namely, capitalist, socialist or mixed economic structure, governs the business opportunities in a country.
4) ***Infrastructure***: The availability (or lack) of infrastructure facilities has a positive (or negative) impact on the functioning of a business enterprise.
5) ***Economic indicators***: Economic indicators such as national income and rate of saving and investment depict the level of economic activity and, thereby, the availability of various business opportunities.

❖ Economic Environment in India at the Time of Independence

At the time of Independence, the economic environment in India can be rightly said to have been stagnant. The following are the characteristics of the economic environment in India at the time of Independence.

1) Agriculture was the dominant economic activity.
2) Nearly 70% of the total population was employed in agriculture.
3) More than 85% of the total population lived in villages.
4) Obsolete and backward technology was used in production (in both agriculture and manufacturing).
5) There was a lack of a good public health care system.
6) Communicable diseases were widespread.

❖ Major Objectives of Development Plans in India

Development plans in India were formulated with the following four broad objectives.

i. Rapid economic growth
ii. Self-reliance
iii. Equity
iv. Development of socialist pattern

Objective	***Meaning***
Rapid economic growth	Increase in the GDP i.e., over time a continuous increase in the market value of the goods and services produced in the economy during an accounting year
Self-reliance	Discouraging imports of those goods that could be produced domestically
Equity	Equitable distribution of GDP such that the benefits of higher growth are shared by all sections of society
Socialist pattern	Focus on equality and overall welfare

Note: In accordance with these objectives, a major step taken by the government was to increase the role of the public sector while restricting the private sector. A large number of industries were reserved for the public sector. On the other hand, the operations of the private sector were highly restricted through regulations and controls such as licences and permits. However, the system did not yield a positive effect, and India faced a severe economic crisis in 1991.

❖ **Major Features of the Economic Crisis in 1991**

1) ***High fiscal deficit*** amounting to 7% of the GDP.
2) ***Increasing internal debt*** (approximately 50% of the GDP). In addition, the interest payments accounted for more than 39% of the total revenue collections of the central government.
3) ***Low production*** in the agriculture and industrial sectors.
4) ***High inflation rates*** (13-14%).
5) ***Depreciation*** in the value of the rupee against the US dollar.
6) ***Fall in the foreign exchange reserves*** to an extremely low level.

7) ***Failure to meet international financial obligations***, thereby forcing the Reserve Bank of India (RBI) and the State Bank of India (SBI) to pledge nearly 47 tonnes of gold in the international market.
8) ***Considerable fall in the country's credit-worthiness rating***, making it difficult for the country to go in for fresh borrowings.
9) ***Low gross national product (GNP) growth rate*** (1.4%).

To overcome the crisis, the Union Government introduced a host of reform measures. The most important was the introduction of the New Economic Policy, 1991.

❖ New Economic Policy (NEP), 1991

As a part of the reforms, the government introduced the New Economic Policy (NEP) in July 1991. The following are the broad features of the policy.

1) ***Delicensing***: The number of industries under compulsory licensing was reduced to only six. That is, a licence was required for the establishment of a new business in only six industries.
2) ***Dereservation***: The number of industries exclusively reserved for the public sector was reduced to only four (strategic industries).
3) ***Disinvestment***: To further minimise the role of the public sector, disinvestment was taken up in many public sector units.
4) ***Increase in foreign equity participation***: Foreign equity participation was increased, and 100% foreign direct investment (FDI) was allowed.
5) ***Liberalisation of the import of technology***: Automatic permission was granted to import foreign technology as well as to enter into technological collaborations with foreign companies.
6) ***Promotion of small-scale industries***: Various efforts were made to increase the importance of small-scale industries.

7) ***Establishment of the Foreign Investment Promotion Board (FIPB)***: To further promote FDI in India, the FIPB was set up.
8) ***Abolition of the Monopolies and Restrictive Trade Practices (MRTP) Act***: The MRTP Act was abolished, and companies were able to freely expand their area of operation or establish new units without licence.

❖ **Impact of NEP/ Essence of NEP**

The essence of NEP is seen in the form of liberalisation, privatisation and globalisation.

➢ **Liberalisation:** Liberalisation refers to the removal of controls and restrictions imposed by the government. Liberalisation in India took the following form.

1) ***Abolition of licences***: On the whole, the system of obtaining a licence for the establishment of a new unit was abolished. However, the system was retained for six industries, namely, liquor, cigarettes, defence equipment, dangerous chemicals, industrial explosives, and drugs and pharmaceuticals.
2) ***Augmentation of production***: Augmentation of production implies freedom to decide the scale and size of production as well as the price of products. The MRTP companies (companies having assets worth more than Rs. 100 crore) became free to expand the scale of their business according to the market conditions.
3) ***Removal of trade restrictions***: Restrictions regarding trade, such as customs, duties and tariff, were removed.
4) ***Encouragement to foreign direct investment:*** Emphasis was laid on increasing competition in the domestic market and attracting FDI.

- **Privatisation**: Privatisation refers to assigning a greater role to the private sector and a gradual transfer of ownership or management of state-owned enterprises to private sector enterprises. In India, privatisation took the following form.
  1) ***Disinvestment***: Disinvestment implies sale of equity and strategic sale of public sector units (PSUs) to the private sector.
  2) ***Establishment of the Board of Industrial and Financial Reconstruction (BIFR):*** The BIFR was established for the revival of the sick and loss-making public sector enterprises.
  3) ***Reduction in the Role of Public Sector:*** The number of industries exclusively reserved for the public sector was reduced to eight and then further to three (namely, railways, atomic mineral and atomic energy).
  4) ***Navratna policy:*** Under the Navratna policy, nine high-performing PSUs were awarded the status of '*Navratnas*'. This recognition encouraged these PSUs to improve their efficiency and performance.

- **Globalisation**: Globalisation refers to opening up and integrating the economy with the world economy. Globalisation in India took the following form.

1) ***Removal of trade restrictions:*** Various trade restrictions such as tariffs, custom duties and quotas were reduced considerably.
2) ***Reduction in export duty and import duty***: Export duty and import duty were reduced to promote free trade.
3) ***Encouragement to foreign capital investment***: In accordance with the objective of encouraging foreign capital investment, various steps, such as increasing the equity limit of foreign capital, setting up of special economic zones and introducing the Foreign Exchange Management Act

(FEMA), were taken.

❖ **Demonetisation**

- ***On Nov 8, 2016 notes of <u>Rs. 500 & Rs. 1,000 were 'demonetised'</u>- ceasing to be legal tender***
  - Made 86% of money in circulation invalid
  - People deposited the invalid currency in banks along with facing certain restrictions on cash withdrawals and the convertibility of domestic money and bank deposits.
  - ***Aim***: To curb corruption, illegal activities, unfair trade practices and accumulation of 'black money'

- **Features**

  i. ***Measure of tax administration***- black money holders had to declare the unaccounted wealth and pay taxes at penalty rates

  ii. ***Measure to avoid tax evasion***- indicating govt. will not tolerate tax evasion

  iii. ***Measure of channelizing savings into financial system***- by depositing money in banks

  iv. ***Create 'cash-less' or 'cash-lite' economy***- for increasing financial savings and reducing tax evasion

- **Impact of Demonetisation**

  i. ***Money/Interest Rates***: Decrease in Cash Transactions, Increase in Bank Deposits & Increase in Financial Savings

  ii. ***Private Wealth***: Decrease in Some high demonetised notes not returned

  iii. ***Public Sector Wealth***: No Effect

  iv. ***Digitisation***: Increase in Digital transactions

  v. ***Real Estate***: Decrease in Prices

  vi. ***Tax Collection***: Increase in Income tax collection

  **As per Economic Survey, 2016–17*

- **Impact of NEP/Impact of LPG/Impact of Government Policy Changes**

The following points highlight the impact of NEP on business and industry.

i. ***Increased competition***: Policies such as abolition of the licensing policy and dereservation increased the competition faced by domestic companies.

ii. ***Benefit to consumers***: To survive in the environment of increased competition, producers increasingly focussed on improving the quality of their products. This benefited the consumers.

iii. ***Change in business policies***: Business organisations altered their policies and operations as per the New Industrial Policy.

iv. ***Technological changes***: The increase in competition made firms increasingly adopt new technology to survive in the market.

v. ***Need for trained personnel***: The adoption of new and improved technology by business organisations further increased their requirement for skilled and trained personnel.

vi. ***Greater market orientation***: To survive in the market, enterprises increasingly paid attention to the market demand and produced goods as per the needs and requirements of the consumers.

vii. ***Less reliance on budgetary support among public sector enterprises***: In order to improve efficiency and productivity, public sector enterprises realised the need to reduce their reliance on budgetary support.