

BUSINESS ENVIRONMENT

3

CHAPTER

The soft-drinks giants, Pepsico and Coca-Cola, suffered a decline in sales of colas in India in the beginning of the year 2006 after an environmental group, Centre for Science and Environment (CSE) claimed to have found pesticides in their drinks upto 50 times the permissible health limits. These companies issued a number of press statements and conducted many publicity campaigns in India claiming that their beverages were perfectly safe. The Union Health Ministry's expert committee also observes that Coke and Pepsi were safe. CSE, in turn, criticised the expert committees findings and said that 1 l of Coke and Pepsi drinks contained average pesticide levels that were 24 times higher than the limits agreed by the Indian government. Despite health ministry's clean chit to colas, several States continue to ban or restrict Coke and Pepsi. However, the pesticide controversy adversely affected the sales of both Coke and Pepsi as consumers started watching their diet more closely. Organic food products suddenly became popular as the healthier option. By definition, organic means fruits, vegetables, foodgrains and processed products that have been produced with no pesticide or inorganic fertilisers. Meanwhile the soft drinks giants have been continuously advertising and trying to convince the consumers about the safety of their products.

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Explain the meaning of business environment;
- Discuss the importance of business environment;
- Describe the various elements of business environment; and
- Examine the economic environment in India and the impact of Government policies on business and industry.

The Pepsi Cola controversy raises an interesting question: Why are soft drinks giants, Coca-Cola and Pepsico putting in so much effort on publicity campaigns in India after the decline in their sales? The answer lies in the fact that their success is dependent not merely on their

internal management, but also on many external forces as, for example, decisions and actions of governments, consumers, other business firms and even non-government organisations (NGOs) like CSE. In this chapter, we shall identify certain important external forces (or environmental

conditions) and their impact on the operations of business enterprises.

MEANING OF BUSINESS ENVIRONMENT

The term 'business environment' means the sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but that may affect its performance. As one writer has put it— "Just take the universe, subtract from it the subset that represents the organisation, and the remainder is environment". Thus, the economic, social, political, technological and other forces which operate outside a business enterprise are part of its environment. So also, the individual consumers or competing enterprises as well as the governments, consumer groups, competitors, courts, media and other institutions working outside an enterprise constitute its environment. The important point is that these individuals, institutions and forces are likely to influence the performance of a business enterprise although they happen to exist outside its boundaries. For example, changes in government's economic policies, rapid technological developments, political uncertainty, changes in fashions and tastes of consumers and increased competition in the market — all influence the working of a business enterprise in important ways. Increase in taxes by government can make things expensive to buy. Technological improvements may render existing products obsolete. Political uncertainty may create fear in the minds of investors. Changes

in fashions and tastes of consumers may shift demand in the market from existing products to new ones. Increased competition in the market may reduce profit margins of firms.

On the basis of the foregoing discussion, it can be said business environment, has the following features:

- (i) **Totality of external forces:** Business environment is the sum total of all things external to business firms and, as such, is aggregative in nature.
- (ii) **Specific and general forces:** Business environment includes both specific and general forces. Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working. General forces (such as social, political, legal and technological conditions) have impact on all business enterprises and thus may affect an individual firm only indirectly.
- (iii) **Inter-relatedness:** Different elements or parts of business environment are closely inter-related. For example, increased life expectancy of people and increased awareness for health care have increased the demand for many health products and services like diet Coke, fat-free cooking oil, and health resorts. New health products and services have, in turn, changed people's life styles.
- (iv) **Dynamic nature:** Business environment is dynamic in that

it keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

- (v) **Uncertainty:** Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.
- (vi) **Complexity:** Since business environment consists of numerous interrelated and dynamic conditions or forces which arise from different sources, it becomes difficult to comprehend at once what exactly constitutes a given environment. In other words, environment is a complex phenomenon that is relatively easier to understand in parts but difficult to grasp in its totality. For example, it may be difficult 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.
- (vii) **Relativity:** Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the USA, for instance, differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

IMPORTANCE OF BUSINESS ENVIRONMENT

Just like human beings, business enterprises do not exist in isolation. Each business firm is not an island unto itself; it exists, survives and grows within the context of the element and forces of its environment. While an individual firm is able to do little to change or control these forces, it has no alternative to responding or adapting according to them. A good understanding of environment by business managers enables them not only to identify and evaluate, but also to react to the forces external to their firms. The importance of business environment and its understanding by managers can be appreciated if we consider the following facts:

- (i) **It enables the firm to identify opportunities and getting the first mover advantage:** Opportunities refer to the positive external trends or changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognise the need for small cars in an environment of rising petroleum prices and a large middle class population in India.

- (ii) **It helps the firm to identify threats and early warning signals:** Threats refer to the external environment trends and changes that will hinder a firm's performance. Besides opportunities, environment happens to be the source of many threats. Environmental awareness can help managers to identify various threats on time and serve as an early warning signal. For example, if an Indian firm finds that a foreign multinational is entering the Indian market with new substitutes, it should act as a warning signal. On the basis of this information, the Indian firms can prepare themselves to meet the threat by adopting such measures as improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on.
- (iii) **It helps in tapping useful resources:** Environment is a source of various resources for running a business. To engage in any type of activity, a business enterprise assembles various resources called inputs like finance, machines, raw materials, power and water, labour, etc., from its environment including financiers, government and suppliers. They decide to provide these resources with their own expectations to get something in return from the enterprise. The business enterprise supplies the environment with its outputs such as goods and services for customers, payment of taxes to government, return on financial investment to investors and so on. Because the enterprise depends on the environment as a source of inputs or resources and as an outlet for outputs, it only makes sense that the enterprise designs policies that allow it to get the resources that it needs so that it can convert those resources into outputs that the environment desires. This can be done better by understanding what the environment has to offer.
- (iv) **It helps in coping with rapid changes:** Today's business environment is getting increasingly dynamic where changes are taking place at a fast pace. It is not the fact of change itself that is so important as the pace of change. Turbulent market conditions, less brand loyalty, divisions and sub-divisions (fragmentation) of markets, more demanding customers, rapid changes in technology and intense global competition are just a few of the images used to describe today's business environment. All sizes and all types of enterprises are facing increasingly dynamic environment. In order to effectively cope with these significant changes, managers must understand and examine the environment and develop suitable courses of action.
- (v) **It helps in assisting in planning and policy formulation:** Since

environment is a source of both opportunities and threats for a business enterprise, 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 players in the market, which means more competition may make an enterprise think afresh about how to deal with the situation.

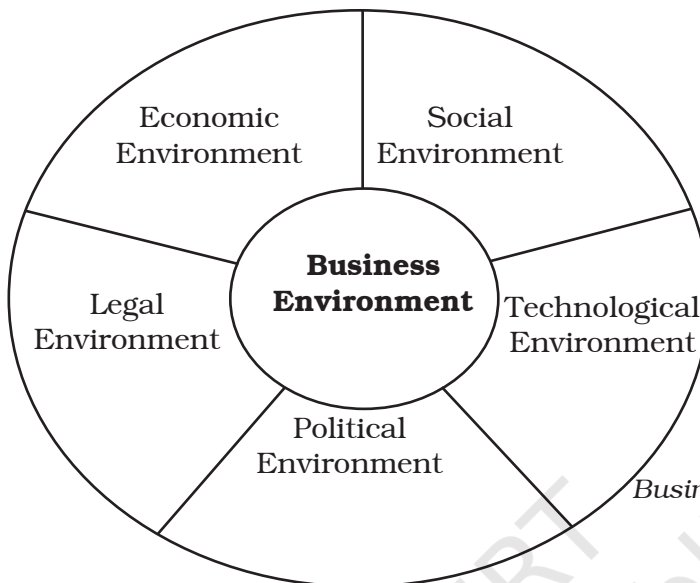
- (vi) **It helps in improving performance:** The final reason for understanding business environment relates to whether or not it really makes a difference in the performance of an enterprise. The answer is that it does appear to make a difference. Many studies reveal that the future of an enterprise is closely bound up with what is happening in the environment. And, the enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period.

DIMENSIONS OF BUSINESS ENVIRONMENT

Dimensions of, or the factors constituting the business environment include economic, social, technological, political and legal conditions which are considered relevant for

decision-making and improving the performance of an enterprise. In contrast to the specific environment, these factors explain the general environment which mostly influences many enterprises at the same time. However, management of every enterprise can benefit from being aware of these dimensions instead of being disinterested in them. For instance, scientific research has discovered a technology that makes it possible to produce an energy efficient light bulb that lasts at least twenty times as long as a standard bulb. Senior managers in the lighting divisions at General Electric and Phillips recognised that this discovery had the potential to significantly affect their unit growth and profitability. So they have carefully followed the progress on this research and profitably used its findings. A brief discussion of the various factors constituting the general environment of business is given below:

- (i) **Economic Environment:** Interest rates, inflation rates, changes in disposable income of people, stock market indices and the value of rupee are some of the economic factors that can affect management practices in a business enterprise. Short and long term interest rates significantly affect the demand for product and services. For example, in case of construction companies and automobile manufacturers, low longer-term rates are beneficial because they result in increased spending by



*Elements of
Business Environment*

consumers for buying homes and cars on borrowed money. Similarly, a rise in the disposable income of people due to increase in the gross domestic product of a country creates increasing demand for products. High

inflation rates generally result in constraints on business enterprises as they increase the various costs of business such as the purchase of raw materials or machinery and payment of wages and salaries to employees.

Components of Economic Environment

- Existing structure of the economy in terms of relative role of private and public sectors.
- The rates of growth of GNP and per capita income at current and constant prices
- Rates of saving and investment
- Volume of imports and exports of different items
- Balance of payments and changes in foreign exchange reserves
- Agricultural and industrial production trends
- Expansion of transportation and communication facilities
- Money supply in the economy
- Public debt (internal and external)
- Planned outlay in private and public sectors

(ii) **Social Environment:** The social environment of business include the social forces like customs and traditions, values, social trends, society's expectations from business, etc. Traditions define social practices that have lasted for decades or even centuries. For example, the celebration of Diwali, Eid, Christmas, and Guru Parv in India provides significant financial opportunities for greetings card companies, sweets or confectionery manufacturers, tailoring outlets and many other related business. Values refer to concepts that a society holds in high esteem. In India, individual freedom, social justice, equality of opportunity and national integration are examples of major values cherished by all of us. In business terms, these values translate into freedom of choice in the market, business's responsibility towards the society and non-discriminatory employment practices. Social trends present various opportunities and threats to business enterprises.

For example, the health-and-fitness trend has become popular among large number of urban dwellers. This has created a demand for products like organic food, diet soft drinks, gyms, bottled (mineral) water and food supplements. This trend has, however, harmed business in other industries like dairy processing, tobacco and liquor.

(iii) **Technological Environment:** Technological environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business. For example, recent technological, advances in computers and electronics have modified the ways in which companies advertise their products. It is common now to see CD-ROM's, computerised information kiosks, and Internet/World Wide Web multimedia pages highlighting the virtues of products. Similarly, retailers have direct links with suppliers who replenish stocks when

Activity I

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.

RBI is a key regulator of the country's economic environment since it:

- Influences the interest rates
- Controls the flow of money in the economy
- Regulates the working of banks

needed. Manufacturers have flexible manufacturing systems. Airline companies have Internet and World Wide Web pages where customers can look for flight times, destinations and fares and book their tickets online. In addition, continuing innovations in different 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. Shifts in demand from vacuum tubes to transistors, from steam locomotives to diesel and electric engines, from fountain pens to ballpoint, from propeller airplanes to jets, and from typewriters to computer based word processors, have all been responsible and creating new business.

- (iv) **Political Environment:** Political environment includes political conditions such as general stability and peace in the coun-

try and specific attitudes that elected government representatives hold towards business. The significance of political conditions in business success lies in the predictability of business activities under stable political conditions. On the other hand, there may be uncertainty of business activities due to political unrest and threats to law and order. Political stability, thus, builds up confidence among business people to invest in the long term projects for the growth of the economy. Political instability can shake that confidence. Similarly, the attitudes of government officials towards business may have either positive or negative impact upon business. For example, even after opening up of our economy in 1991, foreign companies found it extremely difficult to cut through the bureaucratic red tape to get permits for doing business in India. Sometimes,

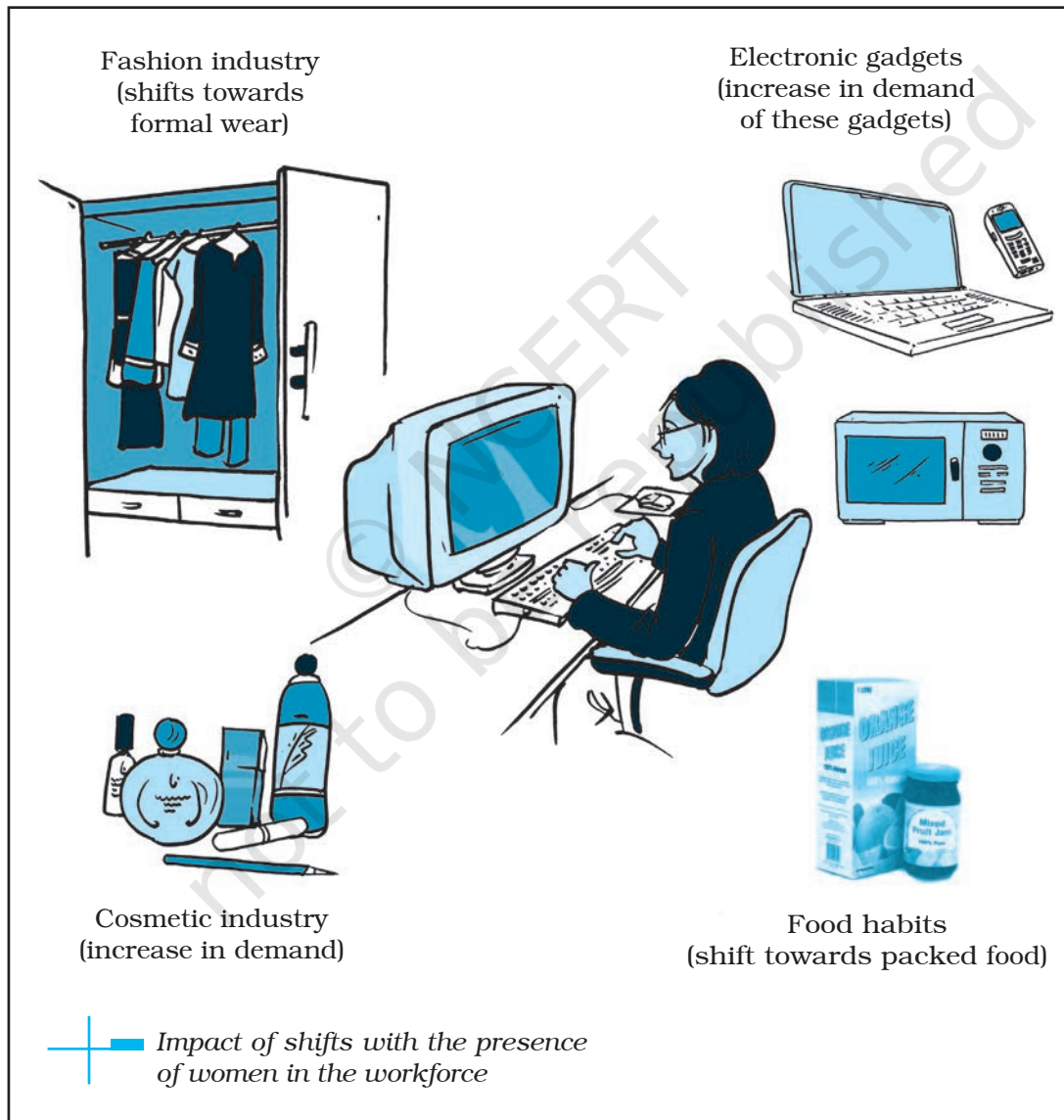
Major Elements of Social Environment

- Attitudes towards product innovations, lifestyles, occupational distribution and consumer preferences
- Concern with quality of life
- Life expectancy
- Expectations from the workforce
- Shifts in the presence of women in the workforce
- Birth and death rates
- Population shifts
- Educational system and literacy rates
- Consumption habits
- Composition of family

Activity II

SOCIAL ENVIRONMENT

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 business enterprises.



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- Register as an individual. Registration is FREE.
- Login by entering your user name and password.
- The 'Plan my travel and Book tickets' page appears.
- Use 'HELP' option for any help required to book tickets.

Plan My Travel and Book Ticket

* Mandatory

From *

To *

Date * 24 Dec 2006

Class *

Ticket Type * ☐ i-ticket ☐ e-ticket

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- Fill in the details, by following the guidelines given below.

Plan My Travel and Book Ticket

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From *

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List of Trains

Please Select The Train From The List

S#	Select	Train No	Train Name	Departure	Arrival	Runs on
1	<input type="radio"/>	2616	G T EXPRESS	18:40	06:15	M T W T H F S S U
2	<input type="radio"/>	2622	TAMIL NADU EXP	22:30	07:10	M T W T H F S S U
3	<input type="radio"/>	2652	T N SMPRK KRNTI	07:30	18:10	- T - T H - - -

Because of technological advancement, it has become possible to book railway tickets through Internet from home, office etc..

it took months to process even their application for the purpose. As a result these companies were discouraged from investing in our country. The situation has improved over time.

- (v) **Legal Environment:** Legal environment includes various legislations passed by the Government administrative orders issued by government authorities, court judgments as well as the decisions rendered by various commissions and agencies at every level of the government—centre, state or local. It is imperative 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 land the business enterprise into legal problems. In India, a working knowledge of Companies Act

1956; Industries (Development and Regulations) Act 1951; Foreign Exchange Management Act and the Imports and Exports (Control) Act 1947; Factories Act, 1948; Trade Union Act, 1926; Workmen's Compensation Act, 1923; Industrial Disputes Act, 1947, Consumer Protection Act, 1986, Competition Act, 2002 and host of such other legal enactments as amended from time to time by the Parliament, is important for doing business. Impact of legal environment can be illustrated with the help of government regulations to protect consumer's interests. For example, the advertisement of alcoholic beverages is prohibited. Advertisements, including packets of cigarettes carry the statutory warning 'Cigarette smoking is injurious to health'. Similarly, advertisements of baby food must necessarily

Major Elements of Political Environment

- The Constitution of the country
- Prevailing political system
- The degree of politicisation of business and economic issues
- Dominant ideologies and values of major political parties
- The nature and profile of political leadership and thinking of political personalities
- The level of political morality
- Political institutions like the government and allied agencies
- Political ideology and practices of the ruling party
- The extent and nature of government intervention in business
- The nature of relationship of our country with foreign countries

inform the potential buyer that mothers milk is the best. All these regulations are required to be followed by advertisers.

ECONOMIC ENVIRONMENT IN INDIA

The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business and industry. These include:

- (a) Stage of economic development of the country.
- (b) The economic structure in the form of mixed economy which recognises the role of both public and private sectors.
- (c) Economic policies of the Government, including industrial, monetary and fiscal policies.
- (d) Economic planning, including five year plans, annual budgets, and so on.
- (e) Economic indices, like national income, distribution of income, rate and growth of GNP, per capita income, disposal personal income, rate of savings and investments, value of exports and imports, balance of payments, and so on.
- (f) Infrastructural factors, such as, financial institutions, banks, modes of transportation communication facilities, and so on.

Business enterprises in India do realise the importance and impact of the economic environment on

their working. Almost all annual company reports presented by their chairpersons devote considerable attention to the general economic environment prevailing in the country and an assessment of its impact on their companies.

The economic environment of business in India has been steadily changing mainly due to the government policies. At the time of Independence:

- (a) The Indian economy was mainly agricultural and rural in character;
- (b) About 70% of the working population was employed in agriculture;
- (c) About 85% of the population was living in the villages;
- (d) Production was carried out using irrational, low productivity technology;
- (e) Communicable diseases were widespread, mortality rates were high. There was no good public health system.

In order to solve economic problems of our country, the government took several steps including control by the State of certain industries, central planning and reduced importance of the private sector. The main objectives of India's development plans were:

- (a) Initiate rapid economic growth to raise the standard of living, reduce unemployment and poverty;
- (b) Become self-reliant and set up a strong industrial base with emphasis on heavy and basic industries;
- (c) Reduce inequalities of income and wealth;

- (d) Adopt a socialist pattern of development — based on equality and prevent exploitation of man by man.

In accordance with the economic planning, the government gave a lead role to the public sector for infrastructure industries whereas the private sector was broadly given the responsibility of developing consumer goods industry. At the same time, the government imposed several restrictions, regulations and controls on the working of private sector enterprises. India's experience with economic planning has delivered mixed results. In 1991 the economy faced a serious foreign exchange crisis, high government deficit and a rising trend of prices despite bumper crops.

As a part of economic reforms, the Government of India announced a new industrial policy in July 1991.

The broad features of this policy were as follows:

- (a) The Government reduced the number of industries under compulsory licensing to six.
- (b) Many of the industries reserved for the public sector under the earlier policy, were dereserved. The role of the public sector was limited only to four industries of strategic importance.
- (c) Disinvestment was carried out in case of many public sector industrial enterprises.
- (d) Policy towards foreign capital was liberalised. The share of foreign equity participation was increased and in many activities 100 per cent Foreign Direct Investment (FDI) was permitted.
- (e) Automatic permission was now granted for technology agreements with foreign companies.
- (f) Foreign Investment Promotion Board (FIPB) was set up to promote and channelise foreign investment in India.

Appropriate measures were taken to remove obstacles in the way of growth and expansion of industrial units of large industrial houses. Small-scale sector was assured all help and accorded due recognition.

In essence, this policy has sought to liberate industry from the shackles of the licensing system (liberalisation), drastically reduce the role of the public sector (privatisation) and encourage foreign private participation in India's industrial development (globalisation).

Liberalisation: The economic reforms that were introduced were aimed at liberalising the Indian business and industry from all unnecessary controls and restrictions. They signalled the end of the licence-permit-quota raj. Liberalisation of the Indian industry has taken place with respect to:

- (i) abolishing licensing requirement in most of the industries except a short list,
- (ii) freedom in deciding the scale of business activities i.e., no restrictions on expansion or contraction of business activities,
- (iii) removal of restrictions on the movement of goods and services,
- (iv) freedom in fixing the prices of goods services,

Crisis of June 1991

Major elements of the crisis situation which led the Government of India to announce economic reform were:

- A serious fiscal crisis in which the fiscal deficit reached the level of 6.6 per cent of GDP in 1990-91.
- Heavy internal debt which rose to about 50 per cent of GDP with interest payments draining about 39 per cent of total revenue collections of the central government.
- Low GNP growth rate which fell to 1.4 per cent from the peak level of 10.5 per cent in 1988-89 (at 1980-81 prices).
- Low overall agricultural production, foodgrain production and industrial production showed negative growth rates of -2.8 per cent, -5.3 per cent and -0.1 per cent respectively.
- Soaring inflation rate based both on wholesale price index and consumer price index (for industrial workers) at 13-14 per cent.
- Shrinkage of foreign trade, imports (in \$ terms) fell by 19.4 per cent and exports by 1.5 per cent.
- Depreciation of rupee by 26.7 per cent vis-à-vis US dollars.
- Fall of foreign exchange reserves to such a low level that they were barely adequate to meet the import requirements of a few weeks. Non-resident Indians (NRIs) were withdrawing their deposits at an alarmingly high rate.
- The confidence of the international financial institutions was badly shaken and in just over a year its creditworthiness rating fell from AAA to BB+ (put on credit watch).
- The country was on the verge of defaulting on international financial obligations and the situation warranted immediate policy action to save the situation. In May 1991, the Government had to lease 20 tones of gold out of its stock to the State Bank of India to enable it to sell the gold with repurchase option after six months. In addition, Reserve Bank of India was allowed to pledge 47 tones of gold to the Bank of England to raise a loan of \$600 million.

- (v) reduction in tax rates and lifting of unnecessary controls over the economy,
- (vi) simplifying procedures for imports and exports, and
- (vii) making it easier to attract foreign capital and technology to India.

Privatisation: The new set of economic reforms aimed at giving greater role to the private sector in the nation building process and a reduced role to the public sector. This was a reversal of the development strategy pursued so far by Indian planners. To achieve this, the government redefined the

role of the public sector in the New Industrial Policy of 1991, adopted the policy of planned disinvestments of the public sector and decided to refer the loss making and sick enterprises to the Board of Industrial and Financial Reconstruction. The term disinvestments used here means transfer in the public sector enterprises to the private sector. It results in dilution of stake of the Government in the public enterprise. If there is dilution of Government ownership beyond 51 percent, it would result in transfer of ownership and management of the enterprise to the private sector.

Globalisation: Globalisation means the integration of the various economies of the world leading towards the emergence of a cohesive global economy. 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. The new economic reforms aimed at trade liberalisation were directed towards import liberalisation, export promotion through rationalisation of the tariff structure and reforms with respect to foreign exchange so that the country does not remain isolated from the rest of the world. Globalisation involves an increased level of interaction and interdependence among the various nations of the global economy. Physical geographical gap or political boundaries no longer remain barriers for a business enterprise to serve a customer in a distant geographical market. This has been made possible by the rapid advancement in technology and liberal trade policies by Governments. Through the policy of 1991, the government of India moved the country to this globalisation pattern.

A Truly Globalised Economy

A truly global economy implies a boundaryless world where there is:

- (i) Free flow of goods and services across nations;
- (ii) Free flow of capital across nations;
- (iii) Free flow of information and technology;
- (iv) Free movement of people across borders;
- (v) A common acceptable mechanism for the settlement of disputes;
- (vi) A global governance perspective.

Activity 3

GLOBALISATION

Make a list of five Indian companies which have global operations today. Find out the major products they sell and the countries where they operate.

Early Crisis Met : Reform Measures

Some of the early major steps taken to manage the economic crisis were the following:

- Fiscal correction aimed at reducing fiscal deficit by about Rs. 7,700 crore in 1991-92 (compared to 1990-91);
- Announcement of New Industry Policy in July 1991 seeking to deregulate the industry with the objective of promoting the growth of a more competitive and efficient industrial economy;
- Abolition of industrial licensing for all industrial projects except 18 industries of high strategic and environmental importance and with high import content. About 80 per cent of the industries were delicensed;
- Amendment of the MRTP Act to eliminate the need for prior approval of the Central Government by large companies for capacity expansion, diversification and merger and amalgamation.
- Nine areas in basic and core industries earlier reserved for the public sector were opened to the private sector;
- Limit of foreign equity holding raised from 40 per cent to 51 per cent in a wide range of priority industries;
- Foreign Investment Promotion Board (FIPB) established to negotiate proposals from large international firms and expedite clearances of the investment proposals;
- Rupee devaluation by 18 per cent during July 1-3, 1991 supported by a standby credit of \$2.3 billion from the IMP over a 20 months period negotiated in October 1991;
- Negotiation of \$500 million Structural Adjustment Loan from the World Bank in April 1992 and a loan totalling SDR 1.3 billion from the International Monetary Fund (IMF) between January-September 1991;
- Introduction of India Development Bond Scheme and Immunity Scheme for repatriation of funds held abroad in October 1991, under which more than \$2 billion were mobilised during 1991-92;
- Bringing back of gold earlier pledged to the Bank of England and the Bank of Japan;
- Continuance of the measures of import control and credit squeeze;
- Administered licensing of imports replaced by freely tradeable import entitlements (called Eximscrips) linked to export earnings. The measure was expected to introduce self-balancing mechanism in India's foreign trade;
- Introduction of Liberalised Exchange Rate Management System (LERMS) under which a dual exchange rate system was established, one rate being effectively floated in the market; and
- Import licensing in most capital goods, raw materials, intermediates and components eliminated. Advance Licensing System considerably simplified.

The initial series of measures set the tone for the future economic reforms. Any of the measures taken above was continued to form a part of the ongoing reform process.

Demonetisation: The Government of India, made an announcement on November 8, 2016 with profound implications for the Indian economy. The two largest denomination notes, ₹500 and ₹1,000, were 'demonetised' with immediate effect, ceasing to be legal tender except for a few specified purposes such as paying utility bills. This led to eighty six per cent of the money in circulation invalid. The people of India had to deposit the invalid currency in the banks which came along with the restrictions placed on cash withdrawals. In other words, restrictions were placed on the convertibility of domestic money and bank deposits.

The aim of demonetisation was to curb corruption, counterfeiting the use of high denomination notes for illegal activities; and especially the accumulation of 'black money' generated by income that has not been declared to the tax authorities.

Features

1. Demonetisation is viewed as a tax administration measure. Cash holdings arising from declared income was readily deposited in banks and exchanged for new notes. But those with black money had to declare their unaccounted wealth and pay taxes at a penalty rate.
2. Demonetisation is also interpreted as a shift on the part of the government indicating that tax evasion will no longer be tolerated or accepted.
3. Demonetisation also led to tax administration channelizing savings into the formal financial system. Though, much of the cash that has been deposited in the banking system is bound to be withdrawn but some of the new deposits schemes offered by the banks will continue to provide a base loans, at lower interest rates.
4. Another feature of demonetisation is to create a *less-cash* or *cash-lite* economy, i.e., channeling more savings through the formal financial system and improving tax compliance. Though there are arguments against this as digital transactions require use of cell phones for customers and Point-of-Sale (PoS) machines for merchants, which will only work if there is internet connectivity. On the contrary, these disadvantages are counterbalanced by an understanding that it helps people into the formal economy,

Digitalisation has broadly impact three sections of society: the poor, who are largely outside the digital economy; the less largely outside the digital economy; the less affluent, who are becoming part of the digital economy who have been covered under *Jan Dhan Accounts* and *Rupay cards*; and the affluent, who are fully conversant with digital transactions.

Impact of Demonetisation

1.	Money/Interest rates	i. Decline in cash transactions ii. Bank deposits increased iii. Increase in financial savings
2.	Private wealth	Declined since some high demonetised notes were not returned and real estate prices fell
3.	Public sector wealth	No effect
4.	Digitisation	Digital transactions amongst new users (RuPay/AEPS) increased
5.	Real estate	Prices declined
6.	Tax collection	Rise in income tax collection because of increased disclosure

Adapted from Economic Survey, 2016–17

thereby increasing financial saving and reducing tax evasion.

IMPACT OF GOVERNMENT POLICY CHANGES ON BUSINESS AND INDUSTRY

The policy of liberalisation, privatisation and globalisation of the Government has made a significant impact on the working of enterprises in business and industry. The Indian corporate sector has come face-to-face with several challenges due to government policy changes. These challenges can be explained as follows:

- (i) **Increasing competition:** As a result of changes in the rules of industrial licensing and entry of foreign firms, competition for Indian firms has increased especially in service industries like telecommunications, airlines, banking, insurance, etc. which were earlier in the public sector.

(ii) **More demanding customers:**

Customers today have become more demanding because they are well-informed. Increased competition in the market gives the customers wider choice in purchasing better quality of goods and services.

(iii) **Rapidly changing technological environment:**

Increased competition forces the firms to develop new ways to survive and grow in the market. New technologies make it possible to improve machines, process, products and services. The rapidly changing technological environment creates tough 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 turbulent as a result of which the enterprises have to continuously modify their operations.

- (v) **Need for developing human resource:** Indian enterprises have suffered for long with inadequately trained personnel. The new market conditions require people with higher competence and greater commitment. Hence the need for developing human resources.
- (vi) **Market orientation:** Earlier firms used to produce first and go to the market for sale later. In other words, they had production oriented marketing operations. 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.
- (vii) **Loss of budgetary support to the public sector:** The central government's budgetary support

for financing the public sector outlays has declined over the years. The public sector undertakings have realised that, in order to survive and grow, they will have to be more efficient and generate their own resources for the purpose.

On the whole, the impact of Government policy changes particularly in respect of liberalisation, privatisation and globalisation has been positive as the Indian business and industry has shown great resilience in dealing with the new economic order. Indian enterprises have developed strategies and adopted business processes and procedures to meet the challenge of competition. They have become more customer-focused and adopted measures to improve customer relationship and satisfaction.

Key Terms

Business environment | Opportunities | Threats | Economic Environment | Political environment | Social environment | Technological environment | Legal environment | Liberalisation | Privatisation | Globalisation

Summary

Meaning of business environment: The term business environment means the totality of all individuals, institutions and other forces that are outside a business but that potentially affect its performance. Business environment can be characterised in terms of

- totality of external forces
- specific and general forces
- inter-relatedness
- dynamic nature
- uncertainty

(f) complexity

(g) relativity

Importance of business environment: Business environment and its understanding are important for (i) enabling the identification of opportunities and getting the first mover advantage, (ii) helping in the identification of threats and early warning signals, (iii) coping with the rapid changes, (v) assisting in planning and policy and (vi) improving the performance.

Elements of business environment: Business environment consists of five important dimensions including economic, social, technological, political and legal.

Economic environment includes such factors as interest rates, inflation rates, changes in disposable income of people, stock market indexes and the value of rupee.

Social environment includes social forces like traditions, values, social trends, society's expectations of business, and so on.

Technological environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business.

Political environment includes political conditions such as general stability and peace in the country and specific attitudes that elected government representatives hold toward business.

Legal environment includes various legislations passed by the government, administrative orders issued by government authorities, court judgments as well as decisions rendered by various commissions and agencies at every level of the government—center, state or local.

Economic environment in India: The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business and industry. The economic environment of business in India has been steadily changing since Independence mainly due to government policies. In order to solve economic problems of our country at the time of Independence, the government took several steps including control by the state of key industries, central planning and reduced importance of the private sector. These steps delivered mixed results until 1991 when Indian economy happened to face serious foreign exchange crisis, high government deficit and a rising trend of prices despite bumper crops.

Liberalisation, privatisation and globalisation: As a part of economic reforms, the Government of India announced a new industrial policy in July 1991 which sought to liberate the industry from the shackles of the licensing system (liberalisation), drastically reduce the role of the public sector (privatisation) and encourage foreign private participation in industrial development (globalisation).

Impact of Government policy changes on business and industry: The government policy of liberalisation, privatisation and globalisation has made a definite impact on the working of enterprises in business and industry in terms of

- (a) increasing competition
- (b) more demanding customers
- (c) rapidly changing technological environment
- (d) necessity for change
- (e) need for developing human resource
- (f) market orientation
- (g) loss of budgetary support to the public sector. In the new economic environment, the Indian enterprises have developed various strategies to meet the challenge of competition

Exercises

Multiple Choice

1. Which of the following does not characterise the business environment?
 - (a) Uncertainty
 - (b) Employees
 - (c) Relativity
 - (d) Complexity
2. Which of the following best indicates the importance of business environment?
 - (a) Identification
 - (b) Improvement in performance
 - (c) Coping with rapid changes
 - (d) All of them
3. Which of the following is an example of social environment?
 - (a) Money supply in the economy
 - (b) Consumer Protection Act
 - (c) The Constitution of the country
 - (d) Composition of family

4. Liberalisation means
 - (a) Integration among economies
 - (b) Reduced government controls and restrictions
 - (c) Policy of planned disinvestments
 - (d) none of them
5. Which of the following does not explain the impact of Government policy changes on business and industry?
 - (a) More demanding customers
 - (b) Increasing competition
 - (c) Change in agricultural prices
 - (d) Market orientation

Short Answer Type

1. What do you understand by business environment?
2. Why it is important for business enterprises to understand their environment? Explain briefly.
3. Mention the various dimensions of business environment.
4. Briefly explain the following:
 - (a) Liberalisation
 - (b) Privatisation
 - (c) Globalisation
5. Briefly discuss the impact of Government policy changes on business and industry.

Long Answer Type

1. How would you characterise business environment? Explain, with examples, the difference between general and specific environment.
2. How would you argue that the success of a business enterprise is significantly influenced by its environment?
3. Explain, with examples, the various dimensions of business environment.
4. What economic changes were initiated by the Government under the Industrial Policy, 1991? What impact have these changes made on business and industry?
5. What are the essential features of (a) Liberalisation, (b) Privatisation and (c) Globalisation?

Case Problem

Lately many companies have planned for significant investment in organised retailing in India. Several factors have prompted their decisions in this regard.

Customer income is rising. People have developed a taste for better quality products even though they may have to pay more. The aspiration levels have increased. The government has also liberalised its economic policies in this regard and permitted even cent percent foreign direct investment in some sectors of retailing.

Questions

1. Identify changes in business environment under different heads — economic, social, technological, political and legal that have facilitated the companies' decisions to plan significant investments in organised retailing.
2. What has been the impact of these changes with regard to globalisation and privatisation?

Activities

1. The Government of India announced 'demonetisation' of ₹500 and ₹1,000 currency notes with effect from the midnight of November 8, 2016. As a result, the existing ₹500 and ₹1,000 currency notes ceased to be legal tender from that date. New currency notes of the denomination of ₹500 and ₹2,000 issued by Reserve Bank of India after the announcement. Discuss 'demonetisation' in the light of the legal and economic environment of business.
2. Select a business enterprise with which you are familiar. From your recollection of current events (events you may have read about in newspapers or magazines or have heard about on television or radio) identify some of the important environmental force, which have had impact on this enterprise.
3. Select a major Indian company for which there is considerable information available in your school library. Analyse the impact of changes in the Government policies on the working of this company.