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Business Environment

Institute of Open and Distance Education

Faculty of Management

Business Environment

1BBA4

DR. C.V. RAMAN UNIVERSITY
Chhattisgarh, Bilaspur
A STATUTORY UNIVERSITY UNDER SECTION 2(F) OF THE UGC ACT

1BBA4

Business Environment

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BUSINESS ENVIROMENT

Credit- 4

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1 Introduction of Business Environment

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The Chapter Covers :

1.0 INTRODUCTION

Business may be understood as the organized efforts of enterprises to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume. Whether a business unit has one or two people working at home, 10 operating in a retail store, 1000 employed in a factory, or 100,000 operating in multiple units spread across the country, all businesses share the same purpose that is to earn profits.

The purpose of business goes beyond earning profit. It is an important institution in society. It is for the supply of goods and services; creation of job opportunities; offer of better quality of life; or contributing to the economic growth of the country and putting it on the global map; the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much.

Definition of Business

According to Lewis H. Haney, "Business may be defined as human activity directed towards producing or acquiring wealth through buying and selling goods".

According to Musselman and Hughes, "Business represents the organized efforts of enterprises to supply consumer with goods and services".

According to Arthur M. Weimer, "Business is that complex field of commerce and industry in which goods and services are created and distributed in the hope of profit within a framework of laws and regulations".

Characteristics of Business

Business possesses the following Characteristics:

1) **Dynamic:** Modern business is dynamic. New technologies indicate the arrival of new products leaving behind the old ones. The ever-changing market place has become a 'battle ground', for various companies surviving on consumers' loyalty and preferences. Ballpoint pens have acquired a potential market share compared to ink pens, TV channels have a larger viewer ship as against radio (FM radio is becoming popular among the younger generation), and the compact disc is a potential trend in the information and technology field and in the entertainment industry. This change makes the companies spend substantially on Research and Development ^.&D) to survive in the market.

2) **Vastness:** Mass production and mass marketing are the norms followed by business enterprises. Machines are gradually replacing manual labor in the manufacturing process. With operating machines, production in bulk has become possible. Marketing activities are being stepped up to match massive production. New channels of distribution, super bazaars, discount houses and trade fairs have sprung up to meet the challenges of mass production and cater to the demands of consumers.

3) **Diversification:** The three types of diversification are as follows:

   i) **Concentric Diversification:** It refers to the process of adding new, but related products or services. **For example,** Hindustan Unilever Limited (HUL) in one line has several brands as in soaps it has Liril, Pears, Rexona, Lux and Lifebuoy.

   ii) **Horizontal Diversification:** It refers to adding new, unrelated products or services for present customers. **For example,** Sony Corporation's purchase of Columbia Pictures Entertainment Company.

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iii) **Conglomerate Diversification:** It refers to adding new and unrelated products or services. **For example,** The Tata group has expended to iron and steel, fertilizers, light commercial vehicles, power, chemicals tea, textiles, shipping, hotel services, electronics, marine products, printing, oil and consultancy.

4) **Globalization:** Going international is yet another trend followed business modern business houses. Political boundaries are no barriers to business. Production facilities are being set-up in different countries and products **are** being sold through a global network. Gradually, business houses are exposed to global competition, M fact, internationalization or globalization is fast becoming imperative for modern business **due** to technological innovations; crumbling **trade** barriers; global flow of capital and technology; information explosion; intensity of market competition; changing life styles and the demand for new products. The success achieved by Japan and other Asian countries has demonstrated that imaginative and supportive economic and trade policies - domestic and external, accent on technological innovation, product design, quality, price, M arketing strategy and infrastructure back-up play a vital role in carving a niche in the international business arena. Internationalization of business is a means of sustaining a strong domestic base in terms of technology, product, market and the capital over a longer period.

5) **Science:** The development of atomic power; advances in metallurgy and allied fields; accomplishments relating to the space-age programs; application of mathematics in managerial decision-making; and progress in miniaturization are illustrations from the numerous contributions being made to business by science. Future scientific breakthroughs will offer attractive opportunities to alert businessmen.

6) **Information:** Another characteristic of contemporary business is the recognition of and the need for information. The whole area of retrieving and extending information, including data processing, information systems analysis and preparation of effective records and reports, has achieved a major status. The complexities of modern business and government requirements have spearheaded this growth. But a vital reason for progress in this area is the availability of the computer and electronic devices that have made feasible the quick and accurate gathering, processing and distributing information.

7) **Government Interference:** Interference of the government in business is common in every country, m the name of self-reliance and protecting the domestic industry, restrictions are placed on the import of foreign goods. In order to reduce inequalities of income, to prevent concentration of economic power and to realize other socioeconomic objectives, governments impose restrictions and levy taxes on domestic industries. Today, there is no government in the world, which does not interfere in business activities in some respect or other.

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8) **Competition:** Competition is another feature of modern business. Gone are the days of sheltered markets, subsidies, licenses, quotas and restrictions. Businessmen have worked out strategies to eliminate inefficiencies, cut down costs and improve productivity, hiefficient and marginal firms will either be forced to wind up or rewrite their success plan. Competition is beneficial both to the competing firms and the consumers.

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 if". Since the environment influences an organization in many ways, its understanding is or crucial importance. The concept of environment can be understood by looking at some of its characteristics.

According to Barry M. Richman and Melvyn Copen, "Environment factors or constraints are largely if not totally, external and beypnd the control of individual industrial enterprises and their managements. These are essentially the 'givers' within which firms and their managements must operate in a specific country and the> vary, often greatly, from country to country".

According to William F. Glueck and Lawrence R. Jauch, "The environment includes factors outside the firm which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of the sectors are socio economic, technological, supplier,competitors and government".

The basic characteristics of environment are given as follows:

1) **Environment is Complex:** Environment is quite complex. An environment consists of large number of factors, which are interrelated and interdependent. Any change in one factor may generate changes in other factors. However, the nature of interrelationships and interdependencies among the various factors is not fixed. Therefore, predictability of environment becomes a difficult exercise.

2) **Environment is Dynamic:** the environment is constantly changing in nature. Due to the many and varied influences operating, there is dynamism in the environment causing it to continuously change its shape and character.

3) **Environment is Multi-Faceted:** What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers. This is frequently seen when the same development is welcomed as an opportunity by one company while another company perceives it as a threat.

4) **Environment has a Far-Reaching Impact**: The environment has a far-reaching impact on organizations. The growth and profitability of an organization depends critically on the environment change has an impact on the, organization in several different ways.

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Meaning and Definition of Business Environment

Business environment refers to those aspects of the surroundings of business enterprise, which affect or influence its operations and determine its effectiveness.

According to Kieth Davis, "Business environment is the aggregate of all conditions, events and influence that surrounds and affect it".

According to Andrews, "The environment of a company as the pattern of all external influences that affect its life and development".

According to W.F.Glueck and Lawrence R. Jauch, "The environment includes factors outside the firm, which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of these factors are socio economic, technological, supplier, competitors and government".

The business environment is always changing and is uncertain. It is because of dynamism of environment (i.e., ever changing nature) said that the business environment is the sum of all the factors outside the control of management of a company, the factor, which are constantly changing, and they carry with them both opportunities and risks or uncertainties which can, make or mark the future of business.

Thus, Business Environment refers to the external environment and includes all factors outside the firm, which lead to opportunities and threats of a firm.

Nature of Business Environment

Business environment is characterized by the following features:

1) **Aggregative:** Business environment is the totality of all the external and internal forces which influence the working and decision-making of an enterprise.

2) **Inter-Related:** Different elements of business environment are closely interrelated and interdependent. A change in one element affects the other elements. Economic environment influences the non-economic environment which in turn affects the economic conditions. **For example,** economic liberalization in India since 1991 has opened up new opportunities for private sector and foreign entrepreneurs.

3) **Relative:** Business environment is a relative concept. It differs from country to country and even region to region. Capitalist economies like those of USA and UK have a different kind of environment than communist economics. The nature of economic system in a country affects the environment of business.

4) **Inter-Temporal:** Business environment is also an inter-temporal concept as it changes over time. **For example,** business environment in India today is much different from that prevailing before 1991.- In the short-run business environment may remain static. But in the long-run, it does change.

5) **Uncertain:** Business environment is largely uncertain because it is very difficult to forecast the future environment. When the environment is volatile, **i.e.,** changes very fast, uncertainty increases.

6) **Contextual:** Business environment provides the macro framework within which the business firm (a micro unit) operates. The environmental forces **are** the forces within which an individual enterprise and its management must function.

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Business environment exercises tremendous influence on the working and success of business firms. Therefore, management of a business enterprise must have a deep understanding and appreciation of the environment. The changes taking-place in environment must be continuously monitored to judge their impact on business. Appropriate and timely steps must be taken to face the environmental changes.

Scope of the Business Environment

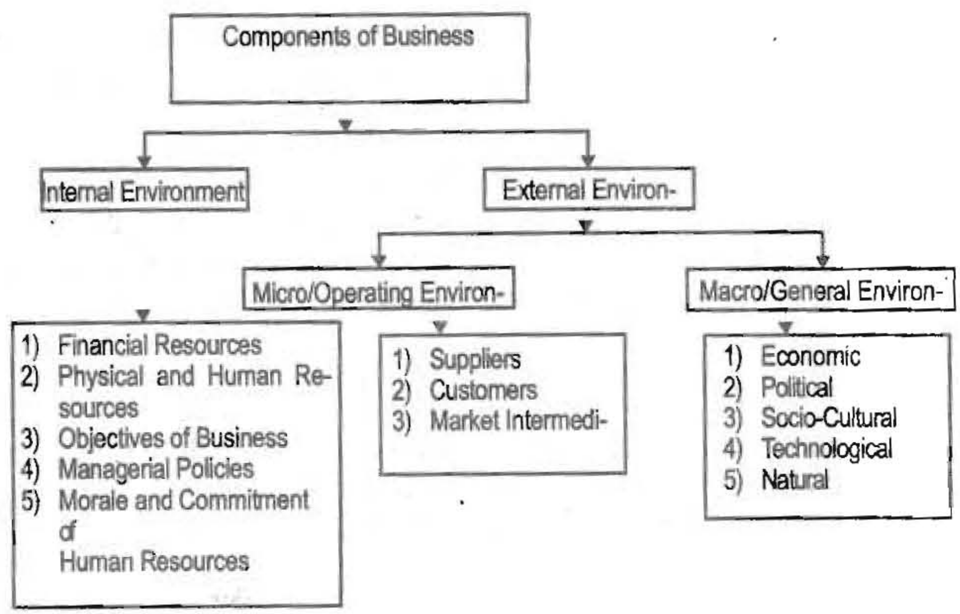
The multidimensional activities involved in bringing raw material to the factory and the end product from there to the market constitute the scope of the Business Environment. It includes activities connected with production, trade (national / international), banking, insurance, finance, and advertising. It also includes legal restrictions and government requirements, consumers, owners, employees. That is to say, people who are directly or indirectly related to business, all may form the Business Environment.

Types of Business Environment:

There are two broad types of environment:

1) Internal Environment, and

2) External Environment.



Internal Environment

Internal environment refers to factors existing within a business firm. The internal factors are generally regarded as controllable factors because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organization and functional means, such as marketing mix, to suit the environment.

Essentials of Internal Environment

There are a number of internal factors, which influence the business decisions are as follows:

1) **Value System:** The extent to which the value system is shared by all, in the organization is an important factor contributing to success. The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives the organization, business policies and practices.

2) **Mission and Objectives:** The business domains of the company, priorities, direction of development, business philosophy, business policy etc., are guided by the mission and objectives of the company. ,

3) **Management Structure and Nature:** The organizational structure, the composition of the Board of Director, extent of professionalization of management, etc., are important factors influencing business decisions.

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

5) **Human Resources: The** characteristics of the human resources like skill, quality, moral, commitment, attitude etc., could contribute to the strength and weakness of an organization. **The** involvement, initiative, etc., of people at different levels may vary from organization to organization.

6) **Company Image and Brand Equity:** The image of the company matters while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products etc. Brand equity is also relevant in several of these cases.

7) **Other Factors:** There are a number of other internal factors, which contribute to the business success/failures or influence tne decision-making. They include the following:

   i) **Physical** Assets and **Facilities** like the production capacity, technology and efficiency of the productive apparatus, distribution logistics etc., are among the factors which influence the competitiveness of a firm.

   ii) **R & D and Technological Capabilities,** determine a company's ability to innovate and compete.

   iii) **Marketing Resources** like the organization for marketing, quality of the marketing men, brand equity and distribution network have direct bearing

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on marketing efficiency. They are important also for brand extension, new product introduction etc.

iv) **Financial Factors** like financial policies, financial position and capital structure are also important internal environment affecting business performances, strategies and decisions.

External Environment

The **external environment** refers to the factors existing outside the business firm. The external factors are, by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, socio-culture factors, government and legal factors, demographic factors, geo-physical factors, etc., are therefore generally regarded as uncontrollable factors.

As the environmental factors (external) are beyond the control of a firm, its success will depend to a very large extent on its adaptability to the environment, **i.e.,** its ability to properly design and adjust the internal (the controllable) variables to take advantage of the opportunities and to combat the threats in the environment.

Although the term business environment is often used to refer to the external environment of business, the management of an enterprise confronts two kinds of environment, viz., the internal environment and external environment. A business decision, therefore, is often influenced by both the internal and external environment.

Essentials of External Environment

The external business environment consists of a micro-environment and a macro-environment. These are discussed as hereunder:

1) **Micro Environment:** The forces which are close to the company and affect its ability to work constitute micro environment. It is known as operating environment of business. It consists of company's immediate environment that affects the performance of company. It includes suppliers, customers, market intermediaries, competitors and public. These factors may affect different firms of the same industry in different **ways.** Some of the micro factors may be same for different firms in an industry, while some of the micro factors may be particular to one firm only.

   According to Philip Kotler, "The micro environment consists of factors in the company's immediate environment which affects the performance of the business unit. These include suppliers, marketing intermediaries, competitors, customers and the public".

   According to Hill and Jones, "The micro environment of a company consists of elements that directly affect the company such as competitors, customers and suppliers".

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The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. When competing firms in an industry have the same micro elements, the relative success of the firm depends on their relative effectiveness in dealing with these elements.

i) **Suppliers:** Suppliers are those who supply the inputs like raw materials and components to the company. Uncertainties regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increases. Factories in India maintain indigenous stocks of *3-4* months and imported stocks of 9 months whereas it is an average of a few hours to two weeks in Japan.

   Every business enterprise requires a number of suppliers, who supply raw materials and components to the company. The following points should be kept in mind regarding suppliers:

   a) Reliability: If our supplier is reliable, our business will run smoothly. If our supplier is not reliable, we may have to maintain high inventories which will increase our cost.

   b) Multiple Suppliers: It is very risky to depend on a single supplier because a strike, lock-out or other problem with that supplier will seriously affect the company. Multiple sources of supply will reduce such risk.

ii) **Customers:** The major task of a business is to create and sustain customers. Monitoring the customer sensitivity is a prerequisite for the business success. The choice of the customers segments should be made by considering a number of factors including the relative profitability, dependability, and stability of demand, growth prospects and the extent of competition.

   Customer is the central point of any business. Success of a business organization depends upon identifying customers, their needs, tastes, liking, etc., and enhancing the level of customer satisfaction. Because of increase in competition, attracting and satisfying the customer has become more challenging. For attracting new customers, companies conduct consumer research, design product as per needs and requirements of customers, spend heavily on advertisement, provide after-sale services, etc.

   Customers may be of different types:

   a) Wholesale customers,

   b) Retail customers,

   c) Industrial customers,

   d) Government and other institutions, and

   e) Foreign customers.

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For different types of customers, business unit will have to design different types of products, so that different classes of customers can be attracted towards company's product. Different customers have different levels of income, tastes and preferences. A person with higher level of income will buy costly product and the person with low level of income will buy cheap product. So, it is must that the business firm makes products according to the demands of customers. It should identify the differences in customer characteristics and segment the customers in different groups. Customers with same level of income, taste, preferences should be put in same segment. The business firm should make separate products for separate segments.

Following can be the basis of segmentation of customers:

a) Income level of customers,

b) Quantity to be purchased by customers,

c) Tastes and preferences of customers,

d) Age of customers,

e) Personality and lifestyle of customers,

f) Geographical area of customers, and

g) Education level of customers.

The task of customer satisfaction has become more challenging with increase in globalization. With growing globalization, various multinational corporations are entering into our markets and with the reduction in tariff duties; more imported products are available in our market. Hence, our customers are becoming more global in their shopping, because they can choose from domestic products and foreign products. Moreover, in the era of free trade, we can also attract foreign customers for our goods. So, we should make such products which can compete with foreign products.

iii) **Competitors:** A firm's competitors include not only the other firms, which market the same or similar products, but also all those who compete for the discretionary income of the consumers. **For example,** the competition for a company's televisions may come not only from other T. V. manufacturers but also from two-wheelers, refrigerators, cooking ranges, stereo sets and so on and from firms offering savings and investment schemes like banks, Unit Trust ofindia, companies accepting public deposits or issuing shares or debentures etc. This competition among these products may be described as *desire competition* as the primary task here is to influence the basic desire of the consumer. Such desire competition is generally very high in countries characterized by limited disposable incomes and many unsatisfied desires (and, of course, with many alternatives for spending/ investing the disposable income). If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still be confronted

Check Your Progress

1. What is Business?
2. Describe the term Business Environment.

with a number of alternatives to choose from like T. V., stereo, two-in-one, three-in-one etc. The competition among such alternatives, which satisfy a particular category of desire, is called *generic* competition.

If the consumer decides to go in for a T. V., the next question is which form of the T. V. black and white or color, with remote control or without it, etc. In other words, there is a *product form competition.* Finally the consumer encounters the *brand competition,* i.e., the competition between the different brands of the same product form. An implication of these different demands is that a marketer should strive to create primary and selective demand for his products.

Business has to adjust its various activities according to actions and reactions of competitors. Competitor means other business units which are marketing or producing similar products or a very close substitute of our product. **For example,** a motorcycle manufacturer faces competition not only from other brands of motorcycle but also from other types of two-wheelers, *viz.,* scooters. He may attract customers from other manufacturers of motorcycle and also from scooter manufacturing companies. Nowadays, competition has increased to a great extent. At present, no business unit enjoys monopoly in the market. Cut throat competition is often found in consumer goods like soft drinks, detergents, shampoo, toothpaste, etc. Various brands regarding these products are available in the market. For taking an edge over competitors, a business unit will have to understand the strategies framed by competitors and respond timely by making counter-strategies. Otherwise, it may lose its market share to its competitors. The business unit should also identify the weaknesses of its competitors, and use such weaknesses of competitors to strengthen its own business. Globalization is further promoting competition, and it is creating threat to the domestic industrial units.

iv) **Marketing Intermediaries:** Marketing intermediaries are the firms that aid the company in promoting, selling and distributing its goods to final buyers. Marketing intermediaries are vital links between the company and the final consumers.

The marketing intermediaries include middlemen such as agents and merchants who "help the company find customers or close sales with them", physical distribution firms which "assist the company in stocking and moving goods from their origin to their destination" such as warehouses and transportation firms; marketing service agencies which "assist the company in targeting and promoting its products to the right markets" such as advertising agencies, marketing research firms, media firms and consulting firms; and financial intermediaries which finance marketing activities and insure business risks.

Every business enterprise may be assisted by market intermediaries which include agents and brokers who help the company, to find customers. It is a link between company and final consumers. Market intermediaries help the company to promote, sell and distribute its goods to final buyers.

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Market intermediaries include the following:

a) **Middlemen:** It includes wholesalers, retailers, departmental stores, etc.

b) **Marketing Agencies:** It includes advertising agencies, consultancy firms, media firms, market research firms, etc.

c) **Financial Intermediaries:** It includes banks, insurance companies, financial institutions, money markets, capital markets, etc.

d) **Physical Intermediaries:** It includes warehouses, transport agencies, etc.

v) **Public:** "A public is any group that has an actual or potential interest in or impact on an organization's ability to achieve its interests". Media publics, citizens' action publics and local publics are some examples. Some companies are seriously affected by such publics. Growth of consumer publics is an important development affecting business.

It is wrong to think that all publics are threats to business. Some of the actions of the publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, for example, regard consumerism as an opportunity for the business.

"Public is any group that has actual or potential interest in the business. To achieve this interest, it has its impact on the business." Public includes users and non-users of the product.

Examples:

a) **Media Public:** It includes all newspapers, magazines, journals which may publish favorable or adverse remarks about company. Both types of remarks in media have effect on the reputation of company.

b) **Local Public:** It refers to people living in the area where business unit is set-up. Environment pollution is an issue that is taken by local public. Actions of local public on this issue have forced some companies to suspend operations or to install pollution control equipment. If local public goes against business unit, it may force the business unit to close its operations.

2) **Macro Environment:** Macro environment means general environment of business. Macro forces are uncontrollable in comparison to the micro forces of environment. The growth and survival of business depend upon its adaptability to macro environmental factors which include economic environment, political environment, socio-cultural environment, technological environment, natural environment, international environment, demographic environment. These factors create opportunities and pose threats to the business.

According to Philip Kotler, "Macro environment includes forces that create opportunities and pose threat to the business units. It includes economic, demographic, natural, technological, political and cultural environment".

According to Hill and Jones, "The macro environment consists of the broader economic, social, political, legal, demographic and technological setting within which the industry and the business units are placed".

The macro forces are, more uncontrollable than the micro forces. The important macro environmental forces are given below:

i) **Economic Environment:** Economic conditions, economic policies and the economic system are the important external factors that constitute the economic environment of a business. The economic conditions of a country-include the nature of the economy, the stage of development of the economy, economic resources, the level of income, the distribution of income and assets, etc.

   The economic policy of the government, needless to say, has a very great impact on business. Some types of categories of business are favorable affected by government policy, some adversely affected, while it is neutral in respect of others. **For example,** a restrictive import policy, or a policy of protecting the home industries, may greatly help the import-competing industries, while a liberalization of the import policy may create difficulties for such industries.

   The scope of private business depends, to a large extent, on the economic system. At one end, there are the free market economies or capitalist economies, and at the other end are the centrally planned economies or communist countries. In between these two are the mixed economies. Within the mixed economic system itself, there are wide variations.

ii) **Political Environment:** The political environment consists of factors related to the management of public affairs and their impact on the business of an organization. Political environment has a close relationship with the economic system and the economic policy. **For example,** communist countries have a centrally planned economic system, in most countries apart from those laws that control investment and related matters, there are a number of laws that regulate the conduct of the business. These laws cover such matters as standard of product, packaging, promotion, etc.

Some governments specify certain standards for the products including packaging. Some other governments prohibit the marketing of certain products. In most nations promotional activities are subject to various types of controls. In number of countries including India, the advertisement of alcoholic liquor is prohibited. Advertisements including packaging of cigarettes must carry the statutory warning that "Cigarette smoking is injurious to health". Similarly advertisement of baby food must necessarily inform the potential buyer that breast feeding is the best food for an infant.

Government in India has an all pervasive and predominantly restrictive influence over various aspects of business. **For example,** industrial licensing which

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decides location, capacity and process, import licensing for machinery and material, size and prize of capital issue, loan finance, pricing, expansion plans, distribution, restrictions and a host of other enactments.

India is a democratic country having a stable political system where the government plays an active role as a planner, promoter and regulator of economic activity. Businessmen therefore are conscious of the political environment that their organizations face. Most governmental decisions related to business are based on political considerations in line with the political philosophy followed by the ruling party at the centre and the state level.

Examples:

a) The Janata Government during its three year rule at the Centre after 1977 followed a strict policy with regard to multinationals. As result of the socialist approach of some of the Minister, Coca Cola and IBM were forced to move out of media causing a far reaching impact on the business environment within the country. This opened a vast market for indigenous soft drink manufacturers. The decision to allow Pepsi Cola to set up a plant in Punjab is viewed by many political commentators as a part of the government's policy to deal with the Punjab problem.

b) An example where the political environment had a direct impact on a company is of Apollo Tyres Ltd. Set up in 1972 in Kerala, the company suffered on account of hostile political environment which was taken over by the Janata Government in 1978. Legal battles ensued till 1982 when management was restored to its promoter Raunaq Singh. After that the company has turned around and is now on the path of stability and growth.

iii) **Legal Environment:** The central government, state governments and local bodies affect business operations. They pass legislation on such matters as wages and prices, employment opportunities, safety and health at work, location, what the plant can emit into the air, how much noise the product can make and other similar matters. These laws and regulations affect the day-to-day operation of business.

It is to be noted, that the actions of the government affect the strategic choices of business. They may increase or curtail business opportunities.

The following are some of the examples of opportunities that are created by the actions of governments:

a) **Governments are Large Purchasers of Goods and Services:** m some industries such as air craft and shipping, the government of India is the major purchaser. Government policy decisions will also create new industries or additional business. For example, the government of Tamil Nadu is providing a number of concessions and facilities for setting up industries in selected backward taluks.

b) **Governments Subsidize Firms and Industries and thus help them to Survive and Prosper: For example,** the central as well as state governments in our country provide subsidies and incentives to small-scale industries to help them to withstand competition from large industries.

c) **Governments Protect Home Industries against "Unfair" Foreign Competition:** The central government in our country protects home industries through import restrictions, tariffs and antidumping provisions.

Government policy changes can lead to increase in opportunities and new business for firms. If the firms analyze the environment and respond to changes, business can increase. On the other hand, the government can also retard the growth of certain industries. **For example,** the government of India has reserved as many as 836 items for the manufacture of SSI units. As a result, the large-scale industries are compelled to confine their activities to other areas of production.

Government policy changes may cause threats to some firms. A special case of threat from the government is government competition with the private sector. **For example,** in Tamil Nadu the Tamil Nadu State Road Transport Corporation is competing with the private bus operators in certain routes. However, it is to be noted that certain policy changes may lead to opportunities for some firms and threats to others.

Hence, firms should study the environment, try to seize opportunities and mitigate the threats resulting from government policy. The following are some of the important legislations passed by the government to regulate and control the working of business firms:

a) Industries Act, 1951,
b) Indian Companies Act, 1995,
c) IncomeTaxAct,1961,
d) MRTPAct,1969,
e) Foreign Exchange Regulation Act, 1973,
f) Sick Industrial Companies Act, 1985, and
g) Consumer Protection Act, 1986.

iv) **Social Environment:** The social environment factors consist of human relationships and the development, form and function of such a relationship having a bearing on the business of an organization. Some of the important factors and influences operating in the social environment are the buying and consumption habits of people, their languages, beliefs and values, customs and traditions, tastes and preferences, education and all factors that affect the business. These factors are listed below:

a) Demographic characteristics such as population, its density and distribution, etc.
b) Social concerns such as the role of business in society, etc.

c) Social attitudes and values such as the expectations of the society from business.

d) Family structures and changes in them.

e) Role of women in society.

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f) Educational levels.

g) Awareness and work ethics.

The social environment primarily affects the strategic management process within the organization in the areas of mission objectives setting and decisions related to products and markets. Strategists in the Indian context do not seem to be fully aware of the effect of social environment on business or they are so preoccupied with other environmental influences that they do not give a high priority to social factors.

For example, Vicks Vaporub which is a popular pain balm is also **used** as a mosquito repellent in some of the tropical areas. Similarly, in some languages Pepsi Cola's slogan "Come Alive" translates as "Come out of the grave".

v) **Demographic Environment:** Demographic factors like the size, growth rate, age composition, sex composition, etc. of the population, family size, economic stratification of the population, educational levels, language, caste, religion etc. are all factors which are relevant to business which affect the demand for goods and services. Markets with growing population and income are growth markets.

vi) **Natural Environment:** Geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, location aspects in the global context, port facilities, etc., are all relevant to business.

Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influence the location of certain industries. For example, industries with high material index tend to be located near the raw material sources. Climatic and weather conditions affect the location of certain industries like the cotton textile industry. Topographical factors may affect the demand pattern. For **example,** in hilly areas with a difficulty terrain, jeeps may be in greater demand than cars.

vii) **Physical and Technological Environment:** Physical factors, such as geographical factors, weather and climatic conditions may call for modifications in the product, etc., to suit the environment because these environmental factors are uncontrollable.

Technological factors sometimes pose problems. A firm, which is unable to cope with the technological changes, may not survive. Further, the differing technological environment of different markets or countries may call for product modifications.

Advances in the technologies of food processing and preservation, packaging etc. have facilitated product improvements and introduction of new products and have considerably improved the marketability of products. The television has added a new dimension to product promotion. The advent of TV and VCP/ VCR has, however, adversely affected the cinema theatres.

viii) **International Environment:** The international environment is particularly important for industries directly depending on imports or exports and import-competing industries. For example, a recession in foreign markets, or the adoption of protectionist policies by foreign nations, may create difficulties for industries depending on exports. On the other hand, a boom in the export market or a relaxation of the protectionist policies may help the export-oriented industries.

It has been observed that major international developments have spread their effects on domestic business. Oil price hikes have seriously affected a number of economies. These hikes have increased the cost of production and the prices of certain products, such as fertilizers, synthetic fibers, etc. The demand for natural fibers increased because of the oil crisis.

The oil crisis also promoted some companies to resort to demarketing. "Demarketing refers to the process of cutting consumer demand for a product back to level that can be supplied by the firm". Some oil companies -the Indian Oil Corporation, for example - have publicized tips on how to cut oil consumption. When the fertilizer price shot up following the oil crisis, some fertilizer companies appealed to the farmers to use fertilizers only for important and remunerative crops. The importance of natural manure like compost as a substitute for chemical fertilizers was also emphasized.

Relation Between Internal and External Environment

The globalization of markets and interdependence of economies had continued to increase over the years. This has resulted in increased competition, revolutionized technologies, rapid changes in organizational structure, diversity of the workforce, new demands, and changes in market and economic conditions. These developments also add to the complexity of the organizational environment. The environment of an organization, or **of** any system, includes all of the circumstances or influences that surround and/or affect it. The environment is segregated into two components, the internal and the external and refers to all variables that affect the strategy of an organization.

Environmental analysis is based on systems theory, which includes the concepts of open and closed systems. A system or organization exhibits a patterned "energic input-**output** in which the energic returns from output reactivate the systems". This **input-output**-recycle behavior is patterned and is primarily concerned with the interdependence of the organization's relationships and structures.

Closed Systems are theoretically self-contained and requiring nothing from the outside, fail to recognize the interdependency of the relationship between the internal and external environments.

Open Systems, however, not only recognize that the outside environment is essential to survival, but constantly strive for goal achievement through control **of** or adaptation to the external environment. The external environment consists of all the stakeholders concerned with the organization, i.e., customers, creditors, communities, trade associations, competitors, suppliers, and stockholders, as well as the macro-environmental factors, e.g., technology, socio-economic, political, etc.

Check Your Progress

3. Explain the scope of Business Environment?
4. What is Environmental Scanning?

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Today, managers understand that organizations are not that simple and that they face a dynamic, constantly changing environment over which management has little control. Managers realize that an organization cannot exist in isolation. Because there are external variables beyond management control, management must identify and adapt to these environmental changes and prepare for future change. This is the open-system model, which examines the relationship between the internal and external environment (See figure).

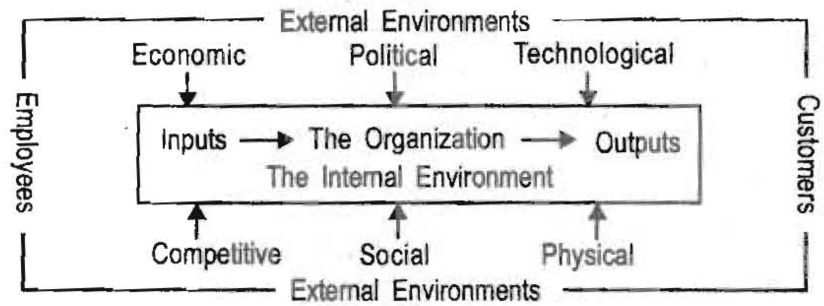

Figure : Relationship between Internal and External Ennvironment

Managers need to comprehend the various elements of the environment to understand which ones have a direct influence on operations and which ones have little or no influence. Some of these variables may have more or less influence than others depending on the type of business. Generally, the more local the business, the less influence the external environment has. For example, a cookie business in a small town is less likely to be affected by international competition. Conversely, the larger the business, the more likely it is that the external environment will have a greater influence on it. For example, aluminum companies are subject to strong competition (domestic and international) as well as government regulations in addition to their internal environments.

Strategic management includes continuous assessment of the corporation and its environment by top management. Strategic management is a process of making appropriate changes within the organization so that the organization can adapt to its environment and optimally exploit its opportunities in the market.

Strategists analyze the elements within the internal and external environments in search of relevant strategic information. The resultant findings are classified as organizational Strengths, Weaknesses, Opportunities and Threats (SWOT). The SWOT analysis becomes the premise upon which strategic objectives are determined and strategies formulated.

Information systems provide strategists with information concerning the status and the results of a company's operations in order to assist them in their decision-making. It is important for strategists to establish strategic decisions based on relevant information that will assist in the forecast of the company's future strengths, weaknesses, opportunities and threats.

Every organization's environment contains a set of influential forces that affect what it can and cannot do. Thus, the environment, as a whole, influences the organizational decision-making process, since every environmental factor or situation affects the organization and its management. Management makes decisions under dynamic conditions where variables are hard to isolate precisely and are thus frequently misunderstood. Not only do external forces affect the organization within its particular industry; these external forces may also affect the industry itself. In order to successfully manage the external forces, effective environmental scanning must be undertaken. Environmental scanning is a systematic method to monitor and forecast those forces that are external and consequently not under the direct control of the organization or its industry.

The external environment defines and organization's opportunities and threats. Generally speaking, every decision involves different sets of factors; hence every decision is made under different circumstances. Thus, management makes decisions based upon the organization's unique situation. Bridges concludes that this environmental complexity isa major factor in whether decision-making is effective. Due to this complexity, the decision-maker must undertake environmental research. Management must use informative guidelines, standards, or criteria that aid in determining the actual conditions in the environment before formulating strategies and making relevant decisions.

Interaction Matrix of Different Environmental Factors

The economic environment of business exercises a strong influence on the non-economic environment of business just as the non-economic environment can influence the economic environment. The economic environment is thus both exogenous and endogenous; it is determined as well as determining. Let us consider a few specific interactions.

The sociological environment affects and gets affected by the economic environment of business. The social attitude towards business and management influences how many people get attracted to private business as an activity or to management as a career. If business gets a social sanction as a respectable profession, the occupational structure of a country will reflect a sizeable category of professional managers. On the other hand, if more and more of active labor force join professional management service, the social attitude towards business and its management also changes. Let us take another example. Social movements largely determine the economic system. If the workers cultivate the attitude of confrontation rather than cooperation with management, a repressive economic system may be needed to cope with industrial disorder. On the other hand, if the attainment of rapid economtc growth is the aspiration, the labor productivity revolution must be brought about and for that payment may be based on productivity of labor rather than profitability of the business. To operate on the productivity based wages is to operate on the system of incentives and attitudes of labor. -The attainment of a specific economic objective is thus conditioned by a specific social attitude and discipline.

The **educational-cultural environment** and the economic environment of business are also interdependent. The stage of economic development is a decisive factor for

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the available system of education; only a relatively high-income country can afford to impart costly higher education in science and technology. The system of education, on the other hand, may be responsible for a given economic environment; the emphasis on liberal arts education and the lack of vocational training courses may be held responsible for the economic problem of unemployment in many countries. At the corporate level, the interdependence between educational and economic environmental factors may at times work out to be a vicious circle. For example, a low profit-making business concern may not find resources to finance management training or executive development program. As a result, there may be skill deformation among its staff- managerial inefficiency may cause low business efficiency as measured in terms of profitability of the business.

The **political-legal environment** and the economic environment of business are also interlocked so much so that we sometimes think of the *political economy* of business. In a situation of political stability, business enterprise happens to grow better; businessmen venture to shoulder more economic risks. But if there is political instability, business uncertainties multiply and therefore, individuals may not like to step in business ventures. In the same way, the ideology of the ruling party influences the economic system. The government which believes in socialism (Swadeshi) as a *strategy* and nationalization of enterprises (closed door to videshi /multinational) as a *tactic* may remove the private business sector and kill the business incentives to expand its scale of operations. On the other hand, sometimes a series of political legislations may be necessary to cope with the economic environment. To fight economic crisis and industrial recession, streamlining of administration and simplification of procedural matters may be evoked, m fact, different legislations of the government (like MRTP Act, Urban Land Ceiling Act) are often politico-economic in character; this is borne out be the analysis of content and intent of different legislations and political announcements. The state of economic environment decides the continuity or discontinuity of a particular political administration; the state of political environment, in its turn, decides the pattern of economic legislations.

The **historical environment** and the economic environment of business are also interdependent. The present (economic) environment of business can be treated as a legacy of its past (historical) environment. Every business has a history, every history has lesson. As such, the present is a reflection of the past, and the present can also be handled in terms of the experience of the past.

A number of examples may be quoted. The economic environment of a country today is partly constituted in terms of the available structure of industry in that country. Suppose we find there presently a number of extractive industries such as mines and plantations; these industries can be traced back to the colonial pattern of investment- in the past the empire country was interested in the colonies to get raw materials for her industries which produced finished manufactured goods which could be dumped in the colonial markets. Colonies supplied market as well as raw materials. In other words, the economic environment of business in the newly independent nation-states is the outcome of the colonial status, which those countries have enjoyed/ suffered in the past. Similarly, the past history is record of events- a storehouse oflessons, which can provide guidelines for present economic policy decisions. The achievements of the Five-Year plans or reforms program in the past may provide direction to the formulation and implementation of the present Five-Year plan and programs of an economy. And the present performance of a plan will make the course of history of planning. This suggests that the environmental factors are interrelated on the time scale.

The interaction between the **physical environment** of a **Country** and the **economic environment** of business in that country are also dependent on each other. A number of legislations have been enacted in many countries to conserve natural resources and to preserve the natural physical environment. These environmental legislations may impose a constraint for the expansion of a given business concern like a factory. Thus environment considerations limit the expansion activities of a business firm. On the other hand, the size of plant, the scale of output, the organization of firms, the structure and location **of** industries may He at the root of either environmental improvement or environmental decay. Thus, **the** social responsibility of business today is to take care of the environmental impact of its economic and technological activities. To the extent this social responsibility is not discharged, laws relating **to the** business and industry will increasingly turn out to be laws relating to the physical environment of business. From this standpoint, one may feel that in addition to the existing functional areas **of** management: production, finance, personnel and marketing, we are soon going to have a **new** area-environment. The point remains that the physical environment as a factor is assuming so much significance day by day that it may be treated as a *critical element within* the economic environment of business, rather than *outside*.

It is outlined how the economic environment *in general* interacts with the non-economic environmental factors. Each critical element of the economic environment (namely, economic system, economic structure, functioning of the economy through sectors, economic policies, programs and controls) interacts with each critical element of the non-economic environment (namely, sociological, political, historical and physical) and their respective sub-elements.

This independence or inter locking of various environmental factors may be conceptualized in terms of

Interaction Matrix.

Interaction Matrix 1: It is a **seven-by-five matrix.** When a given element of economic environment influences a given element of economic environment, we draw a short line vertically, and when an element of non-economic environment influences a given element of economic environment, we draw a short line horizontally. Thus, in case of interdependence among the environmental elements, we end up with a plus sign, which suggests a two-way interaction. The Interaction Matrix concept has no other purpose but to serve as a handy tool **in** understanding the environmental relation and reaction.

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Interaction Matrix I

Economic environment / Non-Economic Environment	Eco-nomic System	Economic Structure (Anatomy)	Functioning of the Economy (Sectors)	Economic Planning (Longterm)	Economic Programmes (Short-term)	Economic Policies – Fiscal & Monetary	Economic Control & Regulation	Economic Growth and Development
Sociological	+	+	+	+	+	+	+	+
Educational	+	+	+	+	+	+	+	+
Political-Legal	+	+	+	+	+	+	+	+
Historical	+	+	+	+	+	+	+	+
Physical—Geographical	+	+	+	+	+	+	+	+

Interaction Matrix 2: It shows the interlocking of national environment with local, regional and international environments. This is a two-by-six matrix. If we attempt to incorporate the critical elements of economic and non-economic environment separately, then this will turn out to be a twelve-by-thirty-six matrix.

Interaction Matrix II

	National Environment / Non-National Environment	National Economic Environment	National Non-Economic Environment
Local	Economic	+	+
	Non-economic	+	+
Regional	Economic	+	+
	Non-economic	+	+
International	Economic	+	+
	Non-economic	+	+

Interaction Matrix 3: It shows the interaction between present environment, past and future environments. This is a two-by-four matrix. If the critical elements of economic and non-economic environment are separately listed, then this will work out to be a twenty-by-twenty-four matrix.

Interaction Matrix III

	Present / Non-Present	Present Economic	Present Non-Eco
PAST	Economic	+	+
	Non-economic		
FUTURE	Economic	+	+
	Non-economic		

Importance of Business Environment

It is very important for business firms to understand their environment and changes occurring in it. Business enterprises which know their environment and are ready to adapt to environmental changes would be successful. Oh the other hand, firms which fail to adapt to their environment are unlikely to survive in the long run. For example, some Indian firms suffered considerably because they failed to appreciate the tightening regulations against environmental pollution. Knowledge of environmental changes is very helpful in the formulation and implementation of business plans. A business can obtain this knowledge through environmental scanning. Environmental scanning is the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business. With the help of environmental scanning, an enterprise can consider the impact of different events, trends, issues and expectations on its business operations.

Some of the direct benefits of understanding the environment are given below:

1) **First Mover Advantage**: Awareness of environment helps an enterprise to take advantage of early opportunities instead of losing them to competitors. For example, Maruti Udyog became the leader in small car market because it was the first to recognize the need for small car on account of rising petroleum prices and a large middle class.

2) **Early Warning Signal:** Environmental awareness serves as an early warning signal. It makes a firm aware of the impending threat or crisis so that the firm can take timely action to minimize the adverse effects, if any. For example, when new firms entered in the mid segment cars (threat), Maruti Udyog increased the production of its Esteem threefold. Increase in production enabled the company to make faster delivery. As a result the company captured a substantial share of the market and became a leader in this segment.

3) **Customer Focus:** Environmental understanding makes the management sensitive to the changing needs and expectations of consumers. **For example,** Hindustan Lever and several other FMCG companies launched small sachets of shampoo and other products realizing the wishes of customers. This move helped the firms to increase sales.

4) **Strategy Formulation:** Environmental monitoring provides relevant information about the business environment. Such information serves as the basis for strategy making. **For example,** ITC realized that there is a vast scope for growth in the travel and tourism industry in India and the government is keen to promote this industry because of its employment potential. With the help of this knowledge, ITC planned new hotels both in India and abroad.

5) **Change Agent:** Business leaders act as agents of change. They create a drive for change at the gross root level. In order to decide the direction and nature of change, the leaders need to understand the aspirations of people and other environmental forces through environmental scanning. **For example,** contemporary environment requires prompt decision-making and power to

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people. Therefore, business leaders are increasingly delegating authority to empower their staff and to eliminate procedural delays.

6) **Public Image:** A business firm can improve its image by showing that it is sensitive to its environment and responsive to the aspirations of public. Leading firms like Reliance Industries, ICICI Bank and others have built good image by being sensitive and responsive to environmental forces. Environmental understanding enables business to be responsive to their environment.

7) **Continuous Learning:** Environmental analysis serves as broad based and ongoing education for business executives. It keeps them in touch with the changing scenario so that they are never caught unaware. With the help of environmental learning managers can react in an appropriate manner and thereby increase the success of their organizations.

CASE STUDY:

WILLIAM HENRY GATES, III AND THE MICROSOFT MONEY MACHINE

Several years ago, when his fortune was a mere several hundred million dollars, a weekly magazine labeled Bill Gates as 'America's richest nerd.' In 1992, at age 36, he had passed Donald Trump, Ross Perot and others to be listed as America's wealthiest person by Forbes magazine; the value of his holdings had grown to an estimated $ 6.3 billion. How did the free enterprise system help him to attain such phenomenal wealth?

After graduating from high school in Seattle in 1973, Gates went to Harvard. While there, he learned that the personal computer [PC] was in the development stage. He dropped out of school and threw himself completely into designing an operating system [the program that coordinates the hardware and software of the computer] for the PC. His system, [S - DOS the Microsoft Disk Opening System] was so good that IBM agreed to use it in their line of, personal computers. With IBM setting the industry standard, other computer manufacturers quickly adopted MS DOS as well. Today it is estimated that more than 80 per cent of all personal computers in the world use this system: Gate's firm, Microsoft, Inc., makes money on every computer sold with MS-DOS as the operating system.' In the 1992, the firm recorded $2.8 billion in revenue and $ 708 million in net profit. It ranks third in size in the industry, behind IBM and Hewlett - Packard. Gate's personal holdings of some 90 million shares of common stock represent about 33 per cent ownership share of the company.

Microsoft also produces programs for word processing, spreadsheets, and a variety of other applications. One of Gate's latest ventures has been to purchase the electronic reproduction rights to thousands of art and photographic works from museums and libraries around the world. These will be used as a part of his plan for interactive home entertainment systems.

With extremely hard work, a creative mind, and a willingness to take risks, Gates has demonstrated how the market rewards the successful entrepreneur. He was able to produce what consumers wanted at a price they were willing to pay the result was that both and they are better off! This is the essence of free market economic system.

From the above case study, it would be clear how a pro-active, imaginative and innovative entrepreneur can, carry the business with him. Though a school dropout. Gates has climbed the pinnacle of business world, merely by his ability to anticipate the changes, in the personal computer industry.

Failure to read the business environment and initiate appropriate steps to protect the business, can lead to a serious threat to existence itself

QUESTIONS:

1. Discuss the above case with SWOT analysis?
2. Mention all the problems related if case and their possible solutions?

SUMMARY

- Business may be understood as the organized efforts of enterprises to supply consumers with goods and services for a profit.
- Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists.
- Business environment refers to those aspects of the surroundings of business enterprise, which affect or influence its operations and determine its effectiveness.
- Business Environment refers to the external environment and includes all factors outside the firm, which lead to opportunities and threats of a firm.
- The scope of the Business Environment includes activities connected with production, trade (national / international), banking, insurance, finance, and advertising. It also includes legal restrictions and government requirements, consumers, owners, employees.
- Internal environment refers to factors existing within a business firm. The internal factors are generally regarded as controllabie factors because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organization and functional means, such as marketing mix, to suit the environment.
- The external environment refers to the factors existing outside the business firm. The external factors are, by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors,

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socio-culture factors, demographic factors, geo-physical factors, etc., are therefore generally regarded as uncontrollable factors.

- Environmental scanning is the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. Business can be defined as the organized efforts of enterprises to supply consumers with goods and services for a profit.
2. Business Environment refers to those aspects of the surroundings of the enterprise, firm, which lead to opportunities and threats of a firm.
3. The scope of Business Environment includes activities connected with production, trade, banking, insurance, finance, and advertising. It also includes legal restrictions and government requirements, consumers, owners, employees.
4. Environmental scanning is the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business.

TEST YOURSELF

1. Define the term Business?
2. What do you mean by Business Environment? State nature and scope of Business Environment.
3. Briefly describe types of Business Environment.
4. State relation between internal and external environment.
5. Discuss interaction matrix of different environmental factors.
6. Why understanding of Business Environment is important for business firms?
7) Write short notes on:
   - Micro Environment
   - Macro Environment
   - Legal Environment
   - Social Environment

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2 Economic Development and Indian Economy

The Chapter Covers :

INTRODUCTION

An economy is a system in which productive units use scarce resources to produce a variety of marketable products (goods and services) that satisfy human needs. The term 'scarcity' means that resources are limited, have a cost and are capable of being put to alternative uses.

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Economic development is a complex process. It is influenced by natural resources and both economic and non-economic factors. Role of natural resources has always been recognized in economic development. As a matter of fact, natural resources often decide the limits of development. Among the economic factors, which determine the development process in any country, the most prominent ones are the available capital stock and the rate of its accumulation, capital-output ratio in various sectors, agricultural surplus, conditions in foreign trade and economic- system. In addition, some non-economic factors such as size and quality of human resources, political freedom, social organization, technical know-how and general education, absence of corruption and above all, will to develop on the part of the people, play an important role in determining the pace and direction of development.

Evolution of Concept of Economic Development

Till the 1960s the"term 'economic development' was often used as a synonym of 'economic growth' in economic literature. Now economic development is no longer considered identical with economic growth. It Is taken to mean growth plus progressive changes in certain crucial variables which determine the well-oeing of the people. There are qualitative dimensions in the development process which may be missing in che growth of an economy expressed in terms of an increase in the national product or the product per capita. Development economists are no longer impressed by the growth performance of a country which gets reflected in the rise in its GDP (or GNP); they now concentrate more directly on the development process.

Traditional Approach

In the present day development economics, one finds broadly two main approaches to the concept of economic development. The first one often known to be the traditional approach defines development strictly in economic terms. For the exponents of traditional approach economic development implies a sustained annual increase in GNP (or GDP) at rates varying from 5 to 7 per cent or more together with such alteration in the structure of production and employment that the share of agriculture declines in both, whereas that of the manufacturing and tertiary sectors increases. The policy measures thus suggested are the ones which induce industrialization at the expense of agricultures development.

New Economic View of Development

Having realized that about 40 per cent ofthe developing world's population had not benefited at all from economic growth during the 1950s and 1960s an increasing number of economists called for the rejection ofthe narrow definition of economic development. During the i 970s they re-defined the concept of economic deveiopment in terms of the reduction or elimination of poverty, inequality and unemployment in the context of a growing economy.

Economic development is thus a process with noble ideals and backward countries without exception are endeavoring to make it successful. This characterization of development with lofty goals is certainly very attractive; at the same time realization of these objectives has been found to be a really difficult task.

Determinants of Economic Development

There are mainly two types of determinants (factors) which influence the economic development of a country. These factors are:

1) Economic Factors

2) Non-Economic Factors

Economic Factors in Economic Development

In a country's economic development the role of economic factors is decisive. The stock of capital and the rate of capital accumulation in most cases settle the question whether at a given point of time a country will grow or not. There are a few other economic factors which also have some bearing on development but their importance is hardly comparable to that of capital formation. The surplus of foodgrains output available to support urban population, foreign trade conditions and the nature of economic system are some such factors whose role in economic development has to be analyzed:

1) **Capital Formation:** The strategic role of capital in raising the level of production has traditionally been acknowledge in economics. It is now universally admitted that a country which wants to accelerate the pace of growth, has no choice but to save a high ratio of its income, with the objective of raising the level of investment. Great reliance on foreign aid is highly risky, and thus has to be avoided. Economists rightly assert that lack of capital is the principal obstacle to growth and no developmental plan will succeed unless adequate supply of capital is forthcoming.

   Whatever be the economic system, a country cannot hope to achieve economic progress unless a cenain minimum rate of capital accumulation is realized. However, if some country wishes to make spectacular strides, it will have to raise its rate of capital formation still higher.

2) **Natural Resources:** The principal factor affecting the development of an economy is the natural resources. Among the natural resources, the land **area** and the quality of the soil, forest wealth, good river system, minerals and oil-resources, good and bracing climate, etc., are included. For economic growth, the existence of natural resources in abundance is essential. A country deficient in natural resources may not be in a position to develop rapidly. In fact, natural resources are a necessary condition for economic growth but not a sufficient one. Japan and India are the two contradictory examples.

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According **to Lewis,** "Other things being equal man can make better use of rich resources than they can of poor". In less developed countries, natural resources are unutilized, under-utilized or mis-utilized. This is one of the reasons of their backwardness. This is due to economic backwardness and lack of technological factors.

According to Professor Lewis, "A country which is considered to be poor in resources may be considered very rich in resources some later time, not merely because unknown resources are discovered, but equally because new methods are discovered for the known resources". Japan is one such country which is deficient in natural resources but it is one of the advanced countries of the world because it has been able to discover new use for limited resources.

3) **Marketable Surplus of Agriculture:** Increase in agricultural production accompanied by a rise in productivity is important from the point of view of the development of a country. But what is more important is that the marketable surplus of agriculture increases. The term 'marketable surplus' refers to the excess of output in the agricultural sector over and above what is required to allow the rural population to subsist. The importance of the marketable surplus in a developing economy emanates from the fact that the urban industrial population subsists on it. With the development of an economy, the ratio of the urban population increases and increasing demands are made on agriculture for foodgrains. These demands must be met adequately; otherwise the consequent scarcity of food in urban areas will arrest growth.

In case a country fails to produce a sufficient marketable surplus, it will be left with no choice except to import foodgrains which may cause a balance of payments problem. Until 1976-77, India was faced with this problem precisely. In most of the years during the earlier planning period, market arrivals of foodgrains were not adequate to support the urban population.

If some country wants to step-up the tempo of industrialization, it must not allow its agriculture to iag behind. The supply of the farm products particularly foodgrains, must increase, as the setting-up of industries in cities attracts a steady flow of population from the countryside.

4) **Conditions in Foreign Trade**: The classical theory of trade has been used by economists for a long time to argue that trade between nations is always beneficial to them. In the existing context, the theory suggests that the presently less developed countries should specialize in production of primary products as they have comparative cost advantage in their production. The developed countries, on the contrary, have a comparative cost advantage in manufactures including machines and equipment and should accordingly specialize in them.

In the recent years, a powerful school has emerged under the leadership of Raul Prebisch which questions the merits of unrestricted trade between developed and under-developed countries on both theoretical and empirical grounds.

Foreign trade has proved to be beneficial to countries which have been able to set-up industries in a relatively short period. These countries sooner or later captured international markets for their industrial products. Therefore, a developing country should not only try to become self-reliant in capital equipment as well as other industrial products as early as possible, but it should also attempt to push the development of its industries to such a high level that in course of time manufactured goods replace the primary products as the country's principal exports.

In countries like India the macro-economic interconnections are crucial and the solutions of the problems of these economies cannot be found merely through the foreign trade sector or simple recipes associated with it.

5) Economic System: The economic system and the historical setting of a country also decide the development prospects to a great extent. There was a time when a country could have a laissez faire economy and yet face no difficulty in making economic progress. In today's entirely different world situation, a country would find it difficult to grow along the England's path of development.

The Third World countries of the present times will have to find their own path of development. They cannot hope to make much progress by adopting a *laissez faire* economy. Further, these countries cannot raise necessary resources required for development either through colonial exploitation or by foreign trade. They now have only two choices before them:

i) They can follow a capitalist path of development which will require an efficient market system supported by a rational interventionist role of the State.

ii) The other course open to them is that of economic planning.

The latest experiments in economic planning in China have shown impressive results. Therefore, from the failure of economic planning in the former Soviet Union and the erstwhile East European socialist countries it would be wrong to conclude that a planned economy has built-in inefficiencies which are bound to arrest economic growth.

Non-Economic Factors in Economic Development

From the available historical evidence, it is now obvious that non-economic factors are as much important in development as economic factors. Here we attempt to explain how they exercise influence on the process of economic development:

1) **Human Resources:** Human resources are an important factor in economic development. Man provides labor power for production and if in a country labor is efficient and skilled, its capacity to contribute to growth will decidedly be high. The productivity of illiterate, unskilled, disease ridden and superstitious

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people is generally low and they do not provide any hope to developmental work in a country. But in **case** human resources remain either unutilized or the manpower management remains defective, the same **people** who could have made a positive contribution to growth activity prove to be a burden on the economy.

2) **Technical Know-How and General** Education: It has never been doubted that the level of technical know-how has a direct bearing on the pace of development. As the scientific and technological knowledge advances, man discovers more and more sophisticated techniques of production which steadily raise the productivity levels. **Schumpeter** was deeply impressed by the innovations done by the entrepreneurs, and the attributed much of the capitalist development to this role of the entrepreneurial class. Since technology has now become highly sophisticated, still greater attention has to be given to Research and Development for further advancement. Under assumptions of a linear homogeneous production function and a neutral technical change which does not affect the rate of substitution between capital and labor, Robert M. Solow has observed that the contribution of education to the increase in output per man hour in the United States between 1909 and 1949 was more than that of any other factor.

3) **Political Freedom**: Looking to the world history of modern times one learns that the processes of development and under-development are interlinked and it is wrong to view them in isolation. We all know

   that the under-development of India, Pakistan, Bangladesh, Sri Lanka, Malaysia, Kenya and a few other countries, which were in the past British colonies, was linked with the development of England. England recklessly exploited them and appropriated a large portion of their economic surplus.

   Dadabhai Naoroji has also candidly explained in his classic work 'Poverty and Un-British Rule in India' that the drain ofwealth from hidia under the British was the major cause of the increase in poverty in India during that period, which in turn arrested the economic development of thc country.

4) **Social Organization:** Mass participation in development programs is a precondition for accelerating the growth process. However, people show interest in the development activity only when they feel that the fruits of growth will be fairly distributed. Experiences from a number of countries suggest that whenever the defective social organization allows some elite groups to appropriate the benefits of growth, the general mass of people develop apathy towards State's development programs. Under the circumstances, it is futile to hope that masses will participate in the development projects undertaken by the State.

   India's experience during the whole period of development planning is a case in point. Growth of monopolies in industries and concentration of economic power in the modern sector is now an undisputed fact. Furthermore, the new agricultural strategy has given rise to a class of rich peasantry creating wide-spread disparities in the countryside.

5) **Corruption:** Corruption is rampant in developing countries at various levels and it operates as a negative factor in their growth process. Until and unless these countries root-out corruption in their administrative system, it is most natural that the capitalists, traders and other powerful economic classes will continue to exploit national resources in their personal interests. The regulatory system is also often misused and the licenses are not always granted on merit. The art of tax evasion has been perfected in the less developed countries by certain sections of the society and often taxes are evaded with the connivance of the government officials.

6) **Desire to Develop:** Development activity is not a mechanical process. The pace of economic growth in any country depends to a great extent onpeople's desire to develop. If in some country level of consciousness is low and the general mass of people has accepted poverty as its fate, ,then there will be little hope for development. According to Richard T. Gill, "The point is that economic development is not a mechanical process; it is not a simple adding-up of assorted factors. Ultimately, it is a human enterprise. And like all human enterprises, its outcome will depend finally on the skill, quality and attitudes of the men who undertake".

Significance of Economic Development

The various benefits which accrue to the less developed countries through economic development are:

1) **Capital Formation:** There can be no two opinions about the fact that economic development depends upon capital formation. But it is also true that economic development helps in the formation of capital. Economic development helps in raising the productivity of agriculture, industry and thereby creating economic surplus. The economic surplus can be used for productive and development activities which in turn raises income, saving and capital formation. Thus, development and capital formation are mutually reinforcing.

2) **Exploitation of Natural Resources:** Economic development promotes scientific knowledge and technology, which in turn helps in the invention of new instruments, new apparatuses and techniques for the exploitation and preservation of natural resources.

3) **Development of Agriculture:** The study of economic development throws light on the new techniques and new methods. Actually, these are the boons of economic development. In India, the green revolution has been accomplished through the instrument of economic development. It would suffice to say that economic development revolutionizes agriculture.

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4) **Development of Industries**: Development of industries is another gift of economic development. It is an admitted fact that agriculture and industry are complementary to each other. The development of these two sectors is interdependent. The developed agricultural sector helps in rapid industrialization.

5) **Increase in National Output:** Economic development helps in raising the agricultural and industrial productivity of a country. The expansion of these two sectors contributes in raising the level of national output.

   Economic development can serve as a generator of national income and harbinger of economic prosperity if price stability is ensured, otherwise, economic development will be a bitter pill for the masses of underdeveloped countries.

6) **Expansion of Social Services:** Another important gift of economic development is the expansion of social services (i.e., education, health services, roads, means of communications, electricity, etc.). As development proceeds, the demand for social services and the expansion of existing services arises. To cope with the rising demand for the expansion of social services, state governments attempt to make larger investment allocation for the purpose. This way the expansion of social services becomes a corollary of development.

7) **International Status**: As development proceeds, the public aspirations grow high. The demand for higher wages arises and that can be met by raising the levels of development tempo. This is possible through technological development. Countries grow richer with technological development and economic growth and thereby acquire esteem and recognition in the comity of nations.

8) **Take-Off:** The under-developed countries are more interested in achieving the stage of "take-off" as early as possible. This task can be accomplished through the instrument of economic development. AU the essential conditions of the "Take-off" can be met by the accelerated pace of economic development.

9) **Increase in Public Revenue:** Economic development raises the level of national output and the per capita income of the masses. Higher per capita income enhances the taxable capacity of the people. The government can collect larger revenues by exploiting higher taxable capacity of the people. This way, government can achieve the objective of fiscal reliance and can carry-on various development activities to promote national welfare. Another bright feature of fiscal self-reliance is that country will not be required to depend upon external aid or foreign assistance. Foreign capital import can be dispensed with when large development endeavor is made at home. Thus, economic development provides fiscal self-reliance to the government.

10) **Social Significance**: Economic development exerts a greater control over the environment, and thus increases the range of human choice. Though it may not necessarily result in greater human happiness, it increases freedom as the effort in relation to output is reduced. Less work would be required to satisfy human wants and greater leisure would be available for fostering higher values of life.

Obstacles to Economic Development

Broadly speaking, the features of an under-developed economy create obstacles inthe way of economic development, and hamper economic progress. These features emerge out of economic, social, political, religious and institutional factors. The factors discouraging economic development may be classified into economic and non-economic factors which are as below:

Obstacles to Economic Development

Economic Factors

1) Vicious Circle of Poverty
2) Deficiency of Capital
3) Market Imperfections
4) International Forces
5) Difficulty in Adopting Westem
6) Low Agricultural Productivity
7) Lack of Entrepreneurs

Non-Economic Factors

1) Undeveloped Human Resources
2) Political Instability
3) Socio-cultural Constraints
4) Religious Factors

Economic Factors

The important economic factors which obstacles to economic development are:

1) **Vicious Circle of Poverty:** Most important feature of under-developed countries is their dependence on vicious circle of poverty which may be considered as the highest bottleneck in the process of their economic development. Poverty is not only distressing but it is also demoralizing.

2) **Capital Deficiency:** Another basic obstacle to economic development in poor countries is the existence of capital deficiency which is reflected in two ways;

   i) The amount of capital per head available is low, and

   ii) The current rate of capital formation is aiso low.

3) **Market Imperfections:** Another important obstacle to economic development in under-developed countries is their dependence on market imperfections.

4) **International Forces:** Certain international forces have also been operating against development of under developed countries and are responsible for keeping them backward. Some of the critics maintain that international forces have operated in the past to limit the development of poor countries while the others of socialistic bent of mind have raised the issues of imperialism and colonialism.

5) **Difficulty in Adopting Western Technology:** Another serious obstacle to economic development in poor countries arises out of their difficulty in adopting

Check Your Progress

1. What is Business?
2. Describe the term Business Environment.

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modern western technology. Most hopes of progress in these countries are pinned with the adoption of modem technology developed in advanced countries.

6) **Low Agricultural Productivity**: The agriculture contributes a very large share to their exports and national income. But there is low productivity in agriculture because it is controlled and governed by^he old customs and traditions.

Non-Economic Factors

Non-economic factors imply social, cultural, **religious** and political factors that cause retardation in the process of development.

1) **Undeveloped Human Resources:**

The constraint of undeveloped human resources has also played an important role in making such economies backward or under-developed for So long a time. It is an important obstacle to economic growth in less developed countries.

2) **Socio-Cultural Obstacles:**

Socio-cultural rigidities are anotner type of obstacles to economic development of under-developed countries. Rapid economic growth requires a particular attitude of mind and highly elastic institutional pattern.

3) **Political Instability:**

Frequent changes of government and threats of external aggression or internal subversion have created a situation of political instability in several under-developed countries.

4) **Religious Factors:**

Too much of religion makes people indifferent towards economic activities. They spend most of their time in meditation and prayers and devote little time to fruitful and productive work.

INDIAN ECONOMY

Introduction to Indian Economy

India is the fifth largest economy in the world and has the second largest GDP among emerging economies, based on purchasing power parity.

In1994-95, the GDP was estimated at Rs. 8,541 billion (US$ 272 billion) at current prices. About 31% of the GDP originated in the primary sector, around 28% in the manufacturing sector and 41% in the services sector. More than two-thirds of the working population is employed in the primaiy sector (mainly agriculture),while the secondary sector (mainly manufacturing) and the tertiary sector (mainly services, trade and commerce) employ around 14.5% and 20.5%, respectively, of the workforce.

The Indian economy moved to a high growth path in the 1980s, with economic growth averaging 5.5% per annum through the decade. This was possible because of a high investment rate of over 22% of the GDP, financed mainly (over 90%) by domestic savings. Annual increase in employment was estimated at 4.3 million in the 1980s. Industrial growth averaged over 7% annually. Population growth, which is continually decelerating had come-down to 2.1% per annum.

India's major achievements are:

1) Advances in agriculture, making India one of the largest foodgrain producers in the world,
2) A broad-based and diversified industrial sector,
3) A modern financial sector spread across the country,
4) A well developed market infrastructure, and
5) An educational system that produces a large pool of high quality human resources.

While the state played an active role in guiding industrial activity, private enterprise and market mechanisms developed well in agriculture, manufacturing, trading and in the services sector. The economy was, however, largely shielded from foreign competition, both in production and trade.

India as a Developing Economy

India is a low income developing economy. There is no doubt that nearly one-fourth of its population lives in conditions of misery. Poverty is not only acute but is also a chronic malady in India. At the same time, there exist unutilized natural resources. It is, therefore, quite important to understand the basic characteristics of the Indian economy, treating it as one of the poor but developing economies of the world.

The main characteristics are as follows:

1) **Low per capita Income:** Per capita income level is much low in India as compared with other developed countries. According to World Development Report (2006) India's per capita income was $ 620 in 2004. The per capita income in India is about 1/71 ofUS level of per capita income. At present a new **modified** system of comparing and calculating per capita income has been adopted at international level in which the per capita income of a country is calculated on the basis of purchasing power of currency of that particular country; while old traditional method was based on exchange rate of currencies.

2) **Disparities in Income Distribution:** High degree of disparity in income/wealth distribution is found in India. Through the objective of establishing a socialistic society was adopted in Second Five Year Plan but truly speaking it has not yet achieved. According to the data shown by NSS, 39% of rural population possesses **only** 5% of all **the** rural **assets** while, on the other hand, 8% top

Check Your Progress

1. What is economy?
2. What are different determinants of Economic Development?

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households possess 46% of total rural **assets.** Income disparities are somewhat more intensive in urban areas as compared with those of rural areas.

3) **Dominance of Agriculture and Heavy Population Pressure on Agriculture:** Land-labor ratio **is not** favorable in **India. Per** capital and availability is very lowand, on the contrary, labor use per hectare is very high in India. Apiculture sector today provides livelihood to about 64% of the total population contributes nearly 21% of Gross Domestic Product (GDP) and accounts for about 18% share of total value of country's exports.

1) **4) Over-Population:** India is over-populated In every decade Lidian population gets increased by about 24%. During 1991-2001, population increased by 21.5%. The compound annual growth rate of population during 1991-2001 was 1.95% against the level of2.16% during the preceding decade (1981-91). With this high growth rate of population about 1.7 crore new persons are added to Indian population every year. According to 2001 census, the total Indian population stands at a high level of 102.87 crore which is16.7% of the world's total population. To maintain this 16.7% of world population India holds only 2.42% of total land area of the world.

5) **Unbalanced Economic Development:** India has not yet achieved the goal of balanced economic development. According to latest World Development Report about 64% of total labor force is dependent on agriculture. 16% on industries and the rest about 20% on trade, transport and other services.

6) **Lack of Capital:** Savings are low in India due to low national income and high consumption expenditure. Gross domestic savings which were 231% of GDP in 1990-91, increased upto a level of29.1% in 2004-05 Similarly gross domestic capital formation, which was 23.3% in 1993-94, increased upto the level of27.2% in 2003-04 and further increased to 30-1% in 2004-05.

7) **Lack of industrialization:** India lacks in large industrialization based on modern and advanced technology, which fails to accelerate the pace of development in the economy. Average annual growth rate of industrial sector (including mining, manufacturing and power generation) was 8.5% in the Seventh Plan against the target of 8.7% p.a. This rate was only 3.5% p.a. during the Sixth Plan. During 8th Plan, the annual average growth rate of industrial sector was 8.1% against the target of 7.6% p.a. During 9th plan, the annual industrial growth has been recorded tobe 4-5% which is much below the target. For 2002-03 and 2003-04, industrial growth rate was recorded at 7.0% and 7.6% respectively which improved to 8.4% in 2004-05 but slowed down to 8% during 2005-06.

8) **Operation of Economic Vicious Circles:** Economic vicious circles are still in operation in Indian economy and as a result poverty has become both cause and effect in the country. The intensity of poverty has made these vicious circles unbreakable in the country.

9) **Market Imperfections:** Indian economy faces a number of market imperfections like lack of mobility among production factors from one place to the other and lack of specializations which hinder the optimum utilization of available resources. AU these market imperfections and their results are important reasons for undeveloped state ofIndian economy.

10) **Limited Availability of Transport and Communication Facilities:** Transport and communications facilities do play a vital role in economic development of a country like India, but these facilities are not yet extended to the required level. Transport facilities are not available in remote areas of the country due tc which industrial development is not equally distributed among various parts of the economy. It also hinders the process of exploiting available resources in the country.

11) **Existence of Traditional Society:** The Indian traditional society is still facing a number of social problems like traditions and customs, malpractices, superstitious etc. Which adversely affect the process of economic development, because these social obligations do increase the unproductive expenditure of the masses and hardly spare any saving for capital formation process?

Contribution of Different Sectors to Indian Economy

National income through industrial origin refers to studying nationall income as generated in different sectors of the economy. Proportionate contribution of different sectors **tends to change** with the process of growth. In the backward countries, the bulk of income is generated in the primary sector of the economy.

Central Statistical Organization has divided the economy into three basic sectors:

1) **Primary Sector:** The primary sector of the economy extracts or harvests products from the earth. The primary sector includes the production of raw material and basic foods. Activities associated with the primary sector include agriculture (both subsistence and commercial), mining, forestry, farming, grazing, hunting and gathering, fishing, and quarrying. The packaging and processing of the raw material associated with this sector is also considered to be part of this sector.

2) **Secondary Sector**: Secondary sector comprising of manufacturing, power generation, gas and water supply. The secondary sector of the economy manufactures finished good. All of manufacturing, processing, and construction lies within the secondary sector.

3) **Tertiary Sector/Service Sector:** The tertiary sector of the economy is the service industry. This sector provides services to the general population and to businesses. Activities associated with this sector includes retail and wholesale sales, transportation and distribution, entertainment (movies, television, radio, music, theater, etc.), restaurants, clerical services media, tourism, insurance, banking, healthcare, and law.

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Composition of national income tends to change with the process of growth. This implies change in the proportionate contribution of different sectors of the economy.

As development proceeds, the proportionate contribution of primary sector tends to decrease while that of the secondary and tertiary sectors tends to increase. Thus, the level of productive activity tends to improve in the secondary and tertiary sectors of the economy in relation to the primary sector. Table below shows the relative contribution of different sectors in developed and multi-developed countries of the world:

Table : Percentage Share of Different Sectors in CDP of Different Nations in Year 2006

Country	Primary Sector (Agriculture	Secondary Sector (Industry)	Tertiary Sector
Germany	1	30	69
U.S.A	1	22	77
UK	1	26	73
Japan	2	30	68
China	12	47	41
India	18	28	55
Pakistan	20	27	53

Table above shows that the contribution of primary sector to GDP is far less in developed countries than the under-developed ones. On the other hand the contribution of secondary and tertiary sectors, ¾ much more in developed nations than in the less developed ones.

In India, the composition of national income by industrial origin has tended to change over time, as summed-up in table below:

Table : Contribution of Different Sectors in National Income

Year	Primary Sector (Percentage)	Secondary Sector (Percentage)	Tertiary Sector (Percentage)
1950-51	61	14.5	24.5
1960-61	56.6	17	26.4
1970-71	48.5	20.6	30.9
1980-81	41.8	21.6	36.6
1990-91	33	27	40
2000-01	28.1	24.8	47.1
2006-07	18.5	26.4	55.1
2007-08	17.2	26.8	56

The table above shows that the relative contribution of different sectors in the country's National Income has **tended** to change over time in conformity with the level of economic development. The contribution of primary sector is gradually reducing. The contribution of **territory sector is** increasing at the faster **rate.** This change is a favorable change in the economy.

Sectoral Growth Rates of Different Sectors in India

Sectoral growth rates, i.e., growth rates of agriculture, industry and services **are shown in table below:**

Item	Percentage Change over the Previous Year			
	2000-01	2005-06	2006-07	2007-08
1) Agriculture and allied activities	-0.2	6.0	2.7	2.6
2) Industry	6.4	9.6	10.0	9.4
i) Mining and quarrying	2.4	3.6	4.5	3.4
ii) Manufacturing	7.7	9.1	11.3	9.4
iii) Electricity, gas and water supply	2.1	5.3	7.7	7.8
iv) Construction	6.2	14.2	9.4	9.6
3) Services	5.7	9.8	11.2	10.7
i) Trade, hotels, transport and communication	7.3	10.4	13.0	12.1
ii) Financial, real estate and business services	4.1	10.9	11.1	11.7
iii) Community, social and personal services	4.8	7.7	7.8	7.0
4) Total GDP at factor cost	4.4	9.4	9.6	8.7

Table above makes it clear that agriculture sector **is** not performing **well in Indian economy. Growth rate in** industry and service sectors is higher than the overall GDP growth rate **in India. Growth rate of industry and** service sectors has entered in double digit. Low growth rate in agriculture **sector is a serious concern.**

Interdependence of Various Sectors

Different sectors of Indian economy, *viz.,* primary sector, secondary sector and tertiary sectors are interdependent. Interdependence of different sectors means that either one sector is selling its output to other sectors or it is purchasing inputs in the form of goods and services from other sectors. Output of primary sector becomes the input of secondary sector. In other words, primary sector gets market for its products by selling it to secondary sector and at the same time secondary sector gets inputs from primary sector for further processing in industries. Similarly, service sector is helpful to both primary and secondary sector as it provides services to both these sectors. In other words, primary and secondary sectors are dependent on service sector for essential services like transportation, banking, insurance, communication, storage, trade, etc. Development of primary and secondary sectors is just not possible without these services. In the same way, primary and secondary , sectors create demand for service sector, i.e., because of demand by primary and secondary sector, the service-providers (like banks and insurance companies) are able to sell their services.

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Interdependence of various sectors_ becomes clear from the following examples:

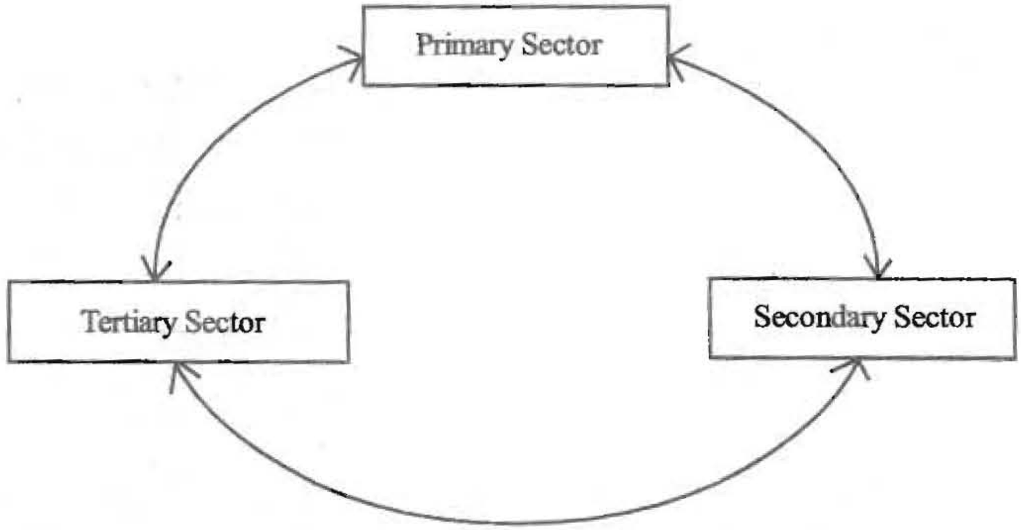

Figure : Interdependence of Various Sectors in the Economy

1) Farmers sell their produce to industries. Here, primary sector is supplying material to secondary sector. So farmers are getting market for their products while industrialists are getting essential inputs for their industry.

2) Industrialists sell agricultural equipments, fertilizers, and pesticides to farmers. Here secondary sector is supplying material to primary sector. So, industrialists are getting market for their products while farmers are getting inputs and equipments to enhance their productivity.

3) Transporters carry the products of primary and secondary sectors to the marketplace and bring the input from the market to the manufacturing place. Thus, service sector is selling its services to primary and secondary sectors while primary and secondary sectors get necessary facilities from service sector for marketing of goods and procuring inputs. For perishable products like milk, vegetables, fruits, bread, eggs, etc., the role of fast means of transportation (Service-sector) is very significant. For example, apples of Kashmir and oranges of Nagpur are sold throughout India because of good transportation facilities.

Primary Sector in India

Primary sector basically comprises of agriculture, forestry, fishing, mining and quarrying. Among all these agriculture sector is the major contributor of the primary sector.

Agricultural Sector

More than 65% of the country's population depends on the agricultural sector, which ironically produces only 23% of the GDP. In India, around 45 per cent of the total land is cultivated. Rice, wheat, pulses, and oilseeds dominate the agricultural production in India. Besides, crops like millet, corn (maize) and sorghum are also grown in large quantities. India is the largest producer of tea, jute and fibers like jute. Among livestock, cattle and buffalo are found maximum in India. Indian total milk production is the highest in the world. In terms of area, India tops the list of total irrigated land in the world. Among cereal production, India is placed third, being second largest producer of wheat and rice and the largest producer of pulses. Dairy framing, fishing and forestry are important parts of agricultural sector.

However, full potential of the Indian agriculture as a profitable activity has not been realized as yet. There are many issues plaguing the country's agricultural sector and they have been discussed subsequently.

Trends in the Agricultural Sector

1) **Food Grain Production:** According to the Economic Survey report 2004-2005, the food grain production in India was estimated at 206.4 million tonnes for the fiscal year 2004-05. Rice contributes to the largest share of food grain production at around 42 per cent with wheat at 35 per cent. Rice is grown throughout the country with highest concentration in the eastern and the southern regions, while wheat is primarily grown in the northern region. The food grain production in India depends largely on monsoons.

   India is the world's fourth largest vegetable oil producer with an annual turnover of about $15billion, but the country imports nearly 40% of its annual need of 11 million tonnes of edible oil. This is because India imports items like palm oil and exports items like coconut oil, sunflower oil and soya oil.

2) **Plantation Crops:** India is the largest producer and consumer of tea in the world and accounts for about 27 per cent of the world production and 13% of the world trade. Among other plantation crops, coffee has contributed significantly to the Indian economy since independence. Indian coffee has created a niche in the market particularly famous of its good blending quality. Rubber is primarily produced in the states of Kerala and adjoining districts of Tamil Nadu.

3) **Live Stock, Poultry and Fisheries:** Livestock sector, which contributes milk and eggs, plays a significant role in meeting the animal protein requirement of the country. This sector has contributed about 6-6.5 per cent of the country's GDP in the recent years. The livestock sector also plays an important role in the utilization of the non edible agricultural by-products, besides being an important earner of foreign exchange.

4) **Agricultural Credit:** There has been a steady rise in the flow of agricultural credit in the Indian context. The agency-wise share of the credit flow to agri-

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culture shows that commercial banks have accounted for the major share followed by regional banks and the rural banks. Realizing the need to enhance credit flow to agriculture, the government in consultation with the RBI, NABARD and other rural banks has announced a credit package for the agricultural sector, which aims at doubling the agricultural credit.

5) **Irrigation:** As efforts continue to increase the irrigation potential in the country, the last 40 years saw the gross irrigated area reach 85 million hectares. Flood forecasting has become an important activity over the years. Over 500 hydrological stations collect and transmit data through 400 wireless stations for issuing forecasts for 157 sites. About 5,000 forecasts are issued in a year with 94 per cent accuracy. India receives international support, with the World Bank as a primary source, for developing its water resources.

Main Areas of Weakness:

India's agriculture is highly sensitive to the variability in rainfall. Eighty per cent of the total rainfall over the Indian sub-continent occurs only during three moths (June-/August), as a result of the south West monsoon. While drought is a recurring problem in some areas of India, floods cause serious damages to the livelihood and agriculture in other areas. Climate variability has considerable social and economic consequences in India, where almost three quarters of the population relies directly or indirectly on agriculture for livelihood.

Irrigation is another major issue of concern for the Indian agricultural sector. More than 60 per cent of the country's agriculture is rain-fed. Apart from the states of Punjab, Haryana and Uttar Pradesh, most of the other states do not have high level of irrigation and depends more or less on the rainfall.

Apart from weak credit and insurance facilities, low land productivity and low level of mechanization are some of the weaknesses plaguing the Indian agricultural sector today.

Secondary Sector in India

Activities associated with the secondary sector include metal working and smelting, automobile production, textile production, chemical and engineering industries, aerospace manufacturing, energy utilities, engineering, breweries and bottlers, construction, and ship-building.

Industrial Sector

Industrial sector in India contributes a meager 27 per cent of the country's GDP. This is mainly because of the fact that India's competency lies in the services sector. In 2003-04 and 2004-05, the Index of Industrial Production (IIP) grew by 6.9 and 8.4 per cent respectively with the manufacturing sector being the driving force behind this growth with a contribution of almost 80 per cent. In the last 10 years, the highest growth rate of the IIP was achieved in 1995-96 with 13 per cent and

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the lowest being 2.7 per cent in 2001-02. The percentage of increase of the IIP during 1994-2005 is given below (See table below):

Table : Industrial Growth Rates

Annual Growth Rate of Industrial Production in Major Sectors of Industry
(Based on the Index of Industrial Production)
Base: 1993-1994 = 100

Period	Mining and Quarrying	Manufacturing	Electricity	Overall
Weight	10.47	179.36	10.17	100.00
1994-95	9.8	9.1	8.5	9.1
1995-96	9.7	14.1	8.1	13.0
1996-97	-1.9	7.3	4.0	6.1
1997-98	6.9	6.7	6.6	6.7
1998-99	-0.8	4.4	6.5	4.1
1999-00	1.0	7.1	7.3	6.7
2000-01	2.8	5.3	4.0	5.0
2001-02	1.2	2.9	3.1	2.7
2002-03	5.8	6.0	3.2	5.7
2003-04	5.1	7.2	5.0	6.9
2004-05	4.8	8.9	6.4	8.4

1) **Automobile Industry:** During the period 2003-06, the automobile industry witnessed a growth rate of 15 to 20per cent. The improved quality and performance of the Indian automobiles has driven the export and acceptance in the global market. The export has increased to 4.8 lac units registering a growth rate as high as 55%. Globalization, foreign collaboration and tie-ups are the main reason **for** this surge in the export of automobiles. The reduction **of** the excise duties on passenger cars from 32 to 24 **per** cent, improvements in retail credits and reduction of tariffs has greatly fueled the growth of this industry.

2) **Gems and Jewelry:** India is the largest consumer of gold in the world followed by China. Indian Jewelry industry imports the raw materials, adds value and exports them. During the last three years, the export in this industry has increased by 15 to 22 per cent. India's gems and jewelry Promotion Council (IGJPC) aims at transforming India into a global diamond trading center. Before the pie-liberalization era, gold prices were kept artificially high and there were huge restrictions on the import of gold. The result of these policies led to the smuggling of gold in bulk quantities which were to be sold at higher price in the country. But since liberalization, this smuggling as been curbed. The main export

Check Your Progress

3. What do you mean by Business cycle?
4. What are different phases of Business cycle?

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destinations of Indian Jewelry are U.K. and Switzerland.

3) **Textile Industry:** The textiles sector has been one of major sources for foreign exchange earnings for India. The textile industry registered an export value of U.S. $10.1 billion in 2003-04 as compared to U.S. $9.6 billion in the previous year. One of the key strengths of the Indian textile industry is the abundance of raw materials with India being one of the major producers of fabrics in the world. The presence of low cost skilled labor and the growing domestic market can be considered as some of the other strengths of this industry. However, drawbacks for the country can be the fragmented nature of the industry which may be detrimental in India emerging as a world-class player, historical governmental regulations like the absence of exit options, lack of adequate economies of scale, low productivity of workers when compared to countries like China, and obsolete technology. India has a huge opportunity as far as the textile industry is concerned because of the implementation of the WTO agreement. The opportunities could be through concentration in R&D, introduction of new products and so on. The government has set-up an autonomous body called Confederation of Indian Textiles Industry (CITI) in order to help the industry to achieve global competitiveness and leverage the benefits through exports.

4) **Steel Industry:** The steel industry has been strong due to the strong growth of demand for steel in both China and in the domestic market, m 2003-04, the total finished steel production was 36.19 tonnes with a record growth rate of 7.5 per cent. The export of finished steel witnessed a growth of 17.6 per cent to 5.3 million tones in 2003-04. Some of the reasons for the successful steel production include improved technology and the thrust given for exporting steel from India. Automation of the routine blue collar jobs also helped in the transition of the Indian steel industry.

Tertiary Sector in India

Services include all economic activities whose output is not a physical product. A service is generally consumed at the time it is produced, and provides value in forms such as convenience, amusement, timeliness, comfort, etc. From the above, following inferences can be drawn:

1) Service is not a physical product. It is intangible in nature.
2) In case of service, there is no time gap between its production and consumption, i.e., services cannot be stored.'
3) It provides some utility to the consumer. This utility can be in the form of comfort, convenience, entertainment, saving of time, improvement in knowledge, health, etc.

Importance of Service Sector in India

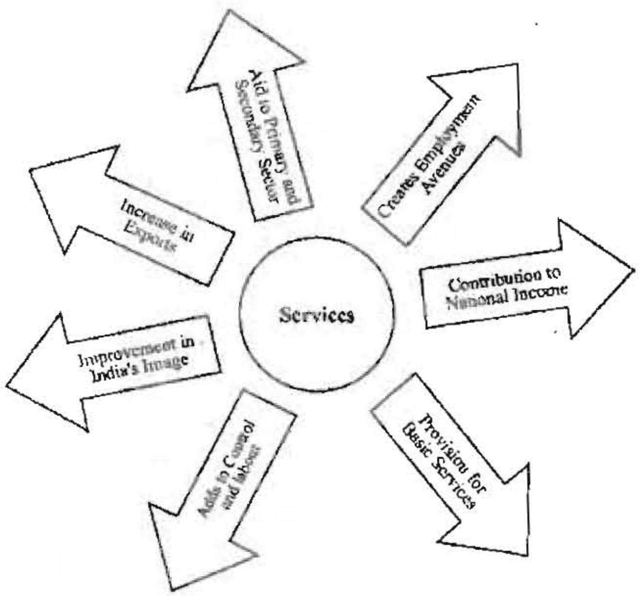
The service sector has emerged as the largest and fastest growing sector of Indian economy. Today, the service sector is the largest contributor to our Gross Domestic

Product (GDP). The share of service sector to GDP, was about55.1 per cent in year 2006-07. Highlighting the importance of service sector, Honorable Ex-President of India Dr. A.P.J. Abdul Kalam in his book, India 2020 - A Vision for the New Millennium' says that the service sector provides essential inputs to agriculture and manufacturing sector; and employment in service sector covers a large number of occupations, requiring very less initial investment.

Importance of service sector in Indian economy is discussed below:

1) Aid to primary and Secondary Sector: service sector is important for rapid development of primary and secondary sector. Primary and secondary sectors needs various kinds of services like transportation, storage, banking, insurance, trade, etc. All these services are provided by service sector.

2) Creates Employment Avenues: Many people earns livelihood in service sector. The majority of new employment in the organized sector has come in the service sector like software entertainment, brokerages, tourism, retail, hospitality, BPOs.



3) Contribution to National Income: In the recent past, one contribution of service sector to national income has increased manifold. At present, more than half i.e. more than 55.1 percent of national income is contributed by the service sector. This sector is the fastest growing sector of Indian economy and this trend is likely to continue in future.

4) Provision for Basic Services: Certain basic services are very essential for the economy. It includes hospitals, educational institutions, post offices, police stations, courts, public transport, tele communication, banks, insurance companies, etc. In India most of these services are mainly provided by the government. Now private sector has also started providing some of these services.

5) Adds to Comforts and Leisure: Many services like hotels; tourism, entertainment, travel add to comfort and leisure of people. Now many people in India

enjoy services such as eating in restaurants, going to movies, traveling to places of tourist interest, etc.

6) Improvement in India's Image: Certain services like software development, business Process Outsourcing (BPO), Information Technology enabled Services (ITES) have improved India's image in the world economy. Now India accounts for 65 per cent of global market in offshore IT service and 46 per cent of global BPO market. All this has improved the image of Indian economy.

7) Increase in Exports: Because of good performance of service sector, India's export, have increased substantially. As per World Trade Organization, India has become the tenth largest service exporting country in the year 2006.

Reasons for the Growth of Service Sector:

Following are the main reasons for the growth of service sector:

1) **Increase in Income Level:** Certain sections of people have become rich. They have started demanding services like hotels, resorts, entertainment, interior designing, personal security private hospitals, private schools, coaching centers, etc.

2) **Increase in Leisure Time:** Certain sections of people have leisure time and they demand services of travel agencies, tour operators, restaurants, resorts, etc.

3) **Increase in Number of Working Women:** Now more women are in job, running their business, profession. So, they need services of crèches, domestic servants, house maintenance services etc.

4} **Product Complexity:** Many products like water purifier, computer, microwave oven, washing machine, dish cleaner, etc., are used by households. These complex products can be serviced by specialized persons. So need of service providers has increased.

5) Growth in Information Technology: Growth in IT has led to an increase in various types *of* services like call centers, internet cafe, ATM booths, software development, etc.

6) Health Awareness: Now people have become more health conscious. It has led to increase in demand for doctors, nurses, nursing homes, private hospitals health clubs, yoga centers, gymnasiums, slimming centers, etc

7) Increase in Mobility: Increase m mobility of people has led to increase in demand tor transportation and communication

8) Increase in Complexities: Now life has become more complex. So now, people need more services of lawyers, tax-consultants, chartered accountants, architects, property advisors, etc.

India as a Major Service Provider to the World

IT-enabled services are one of the major areas witnessing tremendous growth in India. Software industry has emerged as one of the major area where India has comparative advantage over other nations because of availability of talented software engineers in India. Following facts indicate that India is a major service provider to the world:

1) India accounts for **65** per cent of global market in off-shore IT services.

2) India accounts for 1 percent of global Business Process Outsourcing (BPO)market.

3) India's consultancy professionals provide expertise in information technology, advanced financial and banking services to many countries of the world.

4) India is ranked as 10^{th} among the largest exporting countries in services.

5) In recent years, India has emerged as one of the preferred countries for outsourcing.

Growth of Service Sector in India

Service sector has emerged as the largest and the fastest growing sector of India. The growth in output of service sector has been higher than that of agriculture and industry. Growth of service sector is clear from the following points:

1) Increasing Share **in GDP:** The contribution of service sector in GDP is continuously increasing in India. In 1950-51, contribution of service sector to GDP was 29 per cent. In the year 2006-07, this contribution increased to 55.1per cent of GDP.

2) Increasing **Share in Employment:** The contribution of service sector in employment has been increasing. Ln year 1970-71,the contribution of service sector to employment was 16 per cent. In year 2004-05, it increased to 27 per cent. Although this increase is not significant, yet we find that the majority of new employment in the organized sector has come in the service sector.

3) Increasing Share **in Exports:** The contribution of service sector in exports is increasing rapidly. In year 2006, India became 10^{th} largest service exporter in the world. India is exporting Software, IT-enabled services to many countries of the world.

4) Growth of **New** Types **of** Services: Service sector has expanded in new directions also. Now many types of services have developed, like business process outsourcing, IT-enabled services,, medical tourism, consultancy, courier services, interior designing, etc.

5) Increase **in** Number of **Service** Providers: Apart from several indigenous agencies, foreign service providers have been allowed to enter in India in certain services. It has increased competition. For **example,** in case of telecommuni-

cation sector, earlier only public sector was providing telecommunication services. But now with privatization and globalization, many companies like Reliance, Tata, Airtel, Vodafone, etc., have entered in the Indian telecom market. As a result, competition in telecommunication services has increased, mereby benefiting the consumers. Similarly in case of air travel, many private airlines like Sahara Airlines, Jet Airways, Deccan Airways, Kingfisher Airlines, etc., have been permitted to provide air services. As a result, competition in airlines has increased. It has benefited the consumers as now airfares have come-down.

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Comparison of Primary, Secondary and Tertiary Sector

All the three sectors of economy are very important tor the rapid development of the nation. But it is not necessary that all these sectors will grow at the same pace. It is possible that the growth rate of these sectors is different; their contribution to national income may also be varied with the change in level of development, the share of different sectors in the national income change. Generally, with increase in level of development, the percentage contribution of secondary and tertiary sector increases.

As the nature of products of these three sectors is not the same, so for comparing production of these sectors, we have to convert their production units in monetary values. It is done by multiplying their output with the market price. For example, if a fanner has grown 100 quintals of wheat and the rate of wheat is Rs. 1,000 per quintal then the market value of his produce will be Rs. 1, 00,000. Similarly, if an industrialist has produced 20 machines and the price of one machine is Rs. 10,000 then value of his output will be Rs. 2, 00,000.

In the initial stages of development, primary sector dominates other sectors of the economy i.e., the share of primary sector in the national unemployment in primary sector.

Major Issues of Development of Indian Economy

India is an underdeveloped though a developing economy. Bulks of the population are living in conditions of misery. Poverty is not only acute but also chronic. At the same time, there exist unutilized natural resources. **The co-existence** of the vicious circle of poverty with the vicious circle of affluence perpetuates misery and foils all attempts at removal of poverty. It is in this context that an understanding of the major issues of development should be made.

The following are the major development issues in India.

1) **Low per capita Income and Low Rate of Economic Growth:** Barring a few countries in the world, the per capita income of the Indian people is the lowest in the world. In the years since 1950 the developed countries have improved their per capita income at a much faster rate but India has been limping along so badly. A major issue of development is to catch up with the developed countries - this indeed is a Herculean task.

2) **High Proportion of People below the Poverty Line:** A major development issue is the removal of mass poverty. Indian economy indicates a very high proportion of people below the poverty line. Dan-dekar and Rath showed that 40 percent of rural population and 50 percent of the urban population lived below the poverty line in 1967-68. Taken together 215 million persons constituted the poor, accounting for 41 percent ofthe total population in 1967-68. Defining poverty line on the basis of norms of nutritional requirements, i.e., 2,400 calories per person per day for the rural areas and 2,100 calories for the urban areas, the Sixth Plan (1980-85) estimated the total number of persons living below the poverty line as 317 million for 197980, that is, 48 percent of the total population. According to the Planning Commission, in 1999-2000 nearly 260 million people (26.0 percent of total population) were living below, the poverty line ^ 193 million in rural areas and 67 million in urban areas. The burden of poverty is very massive. Rapid reduction and eventually the elimination of poverty is, therefore, the most important issue of development.

3) **Low Level of Productive Efficiency due to Inadequate Nutrition and Malnutrition**: Nutrition influences economic development via raising the level of productivity, efficiency and intelligence of the community. The National Sample Survey has estimated that about 56 percent of the urban population and about 49 percent of the rural population suffer from inadequate nutrition as they do not get a calorie intake of 2,400 per day considered as a reasonable level of nutrition. The level of malnutrition in all expenditure groups was higher in the urban areas than in the rural areas. This is partly due to the relatively bwer prices offood products and their relatively easy availability in the rural areas.

   Amitabh Kundu has highlighted the deterioration in basic food availability: "It is important thatthe per capita consumption of cereals has gone down from 15.4 kgs to 14.4 kgs per month during 1970-89 in rural areas, as per the NSS data. The corresponding figures for urban areas are 11.4 and 11.0 respectively. The average calorie intake per consumer unit in rural areas has also declined from 2,858 to 2,784 during 197383. The information from the National Nutrition Monitoring Bureau QWMB) also confirms this trend."

   A relatively more detailed examination of food requirement and actual consumption reveals that (i) in India; a high proportion of calorie intake is derived from cereals which indicate a low level of living. As against the requirements of 400 calories per day per adult, actual consumption of cereals is of the order of 470 calories, (ii) As against this, actual consumption of non-cereal such as vegetables, fruits, milk and milk products, sugar, fish, meat and eggs and vegetable oils is far short of their requirements. This only underlines the unbalanced nature of the diet of an average median.

   The foregoing analysis brings out the clear need for an integrated policy with regard to prices, production and distribution of various food grains, coupled with a program for raising the output ofsuch non-cereals as milk products, poultry, fish, meat, pulses, vegetables and fruits. The highest priority has, how-

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ever, to be given to raising the output of pulses without necessarily diverting the land from cereal production.

4) **Imbalance between Population Size, Resources and Capital:** A very important problem which affects economic development is the rapid growth of population. As mentioned already the rate of growth of population L93 percent per annum by during 1991-2001 decade which is quite high. A rising population imposes greater economic burdens and, consequently, society has to make a much greater effort to initiate the process of growth. Moreover, with a rising population, per capita availability of land and such other resources fixed in supply, declines. Consequently, society has to make greater efforts to eke out more

   output per unit of land. Similarly, a significant proportion of the capital formation is utilized to provide basic facilities to the additional population at the present level of living. Obviously, checking the fast growth of population has a close relationship with economic development.

5) **Problem of Unemployment:** A major development issue in India is to eliminate unemployment and provide gainful employment to millions of people without work. In 2001-02, India had an incidence of unemployment underemployment of the order of 9.2 percent, Li other words, the development plans in India failed to absorb even the normal increase in labor force during this period, not to speak of reducing the backlog of unemployment.

6) **Inequitable Distribution of Income:** The distribution of income and wealth in India is inequitable. Income inequalities result from the concentration of wealth and capital.

7) **Predominance of Agriculture:** Occupational distribution of population in India is not at all satisfactory and clearly reflects the economic backwardness of the economy.

   A second indicator of the predominance of agriculture in the Indian economy is the proportion of national income originating in this sector.

8) **Rapid Population Growth and High Dependency Ratio:** Over the years population in India has been growing at a fast rate. The country until the last census has passed through the second stage of demographic transition which is characterized by a falling death rate without a corresponding decline in birth rate. This has resulted in population explosion partly off-setting the gains of development which this country **had** made during the planning period.

9) **Low Level of Human Development:** Human development is usually measured in terms of Human Development Index (HDI) constructed by the **United** Nations Development Program (UNDP). The HDI is **a** composite of three basic indicators of human development - longevity, knowledge and standard of living. India with a HDI value of 0.619 ranks a lowly 128 in terms of HDI.

10) **Scarcity of Capital:** Of all factors of economic development, capital is considered to be the most **important**. In tact, it is the accumulation of capital that alone can help a country in its attempt to overcome its economic backwardness.

As against India, some of the East-Asian countries have been able to maintain much higher rates of saving and investment consistently for a number of years (more than 35 per cent of GDP) and this has enabled them to achieve much higher rates of economic growth.

11) **Technological Backwardness:** While technological progress is at the heart of development process, over a wide range of productive activity, techniques of production are backward in India. Agriculture which provides subsistence to more than half of the population is even now characterized by highly backward techniques.

12) **Lack of Entrepreneurs: Joseph A. Schumpeter** has assigned a vital role to entrepreneurs in his theory of growth. Obviously, these activities require aptitudes that are present only in a small fraction of population. Therefore, if some society possesses people who are gifted with entrepreneurial skill, it is bound to grow rapidly.

BUSINESS CYCLE

Meaning and Definition of Business Cycle

The term Business Cycle (or Trade Cycle) refers to the fluctuations in economic activity that occurs in a more or less regular time sequence in all capitalist societies. The volume of economic activity in a community is shown by various indicators, *viz.*, the volume of employment, price level, output and income. When these indicators are plotted on a chart, the graph looks like a wave. This shows that economic activity rises and falls in a regular manner. Each movement, the rise and fall taken together, is called a **Trade Cycle** or a **Business Cycle.**

According to Keynes, "**A** trade cycle is composed of periods of good trade characterize by rising prices **and** low unemployment percentages altering with periods of **bad** trait characterized by falling prices and high unemployment percentages".

According to W.C. Mitchell, "Business cycles are a species of fluctuations in the economic activities of organized communities. The objective 'business' restricts the concept to fluctuations in activities which are systematically conducted on a commercial basis. The noun cycles, bars out fluctuations which do not occur with a measure of regularity".

According to Frederic Benham, "A trade cycle may be defined rather, badly as a period of prosperity followed by a period of depression. It is not surprising that economic process should be irregular, trade being good at some time and bad at others".

A business cycle can be defined as wave like fluctuations or business activity characterized by the recurring phases of expansion and contraction in periods varying from 3-4 years. .

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Features/Characteristics of Business Cycle

1) **Recurring Fluctuations:** Business cycles are characterized by fluctuations which occur periodically in a free rhythm. This implies that the recurrence of expansion and contraction has no fixed or invariable period.

2) **Period of Business Cycle is no Longer than a Year:** A typical business cycle completes itself in a period of 3 to 4 years. In some cases, duration of business cycles is shorter or longer than those of a normal business cycle. In any case the period of a business cycle is not shorter than one year. A business cycle in its character is distinctly different from seasonal fluctuations in economic activity which take place within the period of a calendar year and are due to causes connected directly or indirectly with the physical season.

3) **Presence of the Alternating Forces of Expansion and Contraction:** A business cycle is characterized by alternating an economy to prosperity and depression. These forces are in-built in the system. The force of expansion when born gathers momentum over time taking the economy to a high level of activity. This force is, however, first weakened and then completely replaced by a counter force which leads to contraction and the process ends-up with depression.

4) **Phenomenon of the Crisis:** According to Keynes, an important characteristic of the business cycle is the phenomenon of crisis. This implies that the peak and the trough are asymmetrical. Normally the prosperity phase of business cycle comes to an end abruptly, whereas recovery after the depression is gradual and slow.

5) **Synchronic:** Business cycles are Synchronic, i.e., they do not cause changes in any single industry or sector but are of all embracing character. **For example,** depression or contraction occurs simultaneously in all industries or sectors of the economy. Recession passes from one industry to another and chain reaction continues till the whole economy is in the grip of recession.

6) **Consumption of Non-Durable Goods and Services:** An important feature of business cycles is that consumption of non-durable goods and services does not vary much during different phases of business cycles. Past data ofbusiness cycles reveal that households maintain a great stability in consumption ofnon-durable goods.

7) **Inventories of Goods:** The immediate impact of depression and expansion is on the inventories of goods. When depression sets in, the inventories start accumulating beyond the desired level. This leads to cut in production of goods.

8) **Profits Fluctuate More than any other Type of Income:** An important feature of business cycles is that, profits fluctuate more than any other type of

income. The occurrence of business cycles causes a lot of uncertainty for businessmen and makes it difficult to forecast the economic conditions.

9) **International in Character:** Lastly, business cycles are international in character, i.e., once **started** in one country they spread to other countries through trade relations between them. **For example,** if there is a recession in the USA, which is a large importer of goods from other countries, will cause **a** fall in demand for imports from other countries whose exports would be adversely **affected** causing recession in them too. Depression of 1930s in USA and Great Britain engulfed the entire capital world.

5) **Classification of Business Cycles**

Professor James Arthur Estey has classified business cycles under the following heads:

1) **Major and Minor Cycles:** Major cycles may be defined as the fluctuations of business activity occurring between successive crises. The term "crisis" may be interpreted here to mean the major "breakdowns" or "downturns" that interrupt from time to time the relatively even tenor of economic activity. The major cycles are sometimes referred to as Juglar Cycles.

   It has been established from the records of business fluctuations that each major cycle is made up of two or three minor cycles. The upswing of business in the major cycle is often interrupted by minor downswings. Likewise, the downswings of business in the major cycle may be interrupted by minor upswings. These shorter cycles in major cycles are sometimes referred to as minor cycles. The duration of the minor cycles averages close to 40 months. The minor cycles are sometimes referred to as Kitchin Cycles.

2) **Building Cycles:** This refers to the cycle of building construction. The duration of the building cycles in longer than that of the business cycle.

   It has been discovered that the building industry is also subject to fluctuations of fairly regular duration. There are upswings and downswings in the building activity. The average length of the building cycles is 18 years - just twice the length of the business cycles.

3) **Kondratieff Cycles (or Long Waves):** They are sometimes referred to as "long waves" occurring in a 50 or 60-year cycle. The long waves in economic activity were discovered by the Russian economist, Kondratieff. Hence, these long waves are called Kondratieff Cycles.

Fluctuations of Business Cycle

It is obvious that business cycles are one of the many types of fluctuations/variations occurring in any economic system. All these fluctuations can be classified into four categories:

1) **Secular Trends:** Secular trends represent the overall upward, downward or horizontal trends exhibited in an economy. These may be called long run trends.

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2) **Seasonal Variations:** Those variations in economic activity, which occur within a calendar year due to change of season, can be called seasonal variations. For example, at a hill station, level of economic activity expands at the onset of summer but as soon as the season is over and at the onset of winter the economic activities are contracted to a considerable extent. Next year the same phenomenon is to be repeated.

3) **Cyclical Fluctuations:** Cyclical fluctuations are wavelike fluctuations of business activity, characterized by recurring phases of expansion and contraction in periods longer than a year. The period may differ widely. These are called business cycles.

4) **Miscellaneous Random Fluctuations**: These are irregular, uncyclical and random variations of economic activity due to exogenous factors, like wars, natural calamities, revolutions, sudden change of government, etc. These may also be called accidental fluctuations.

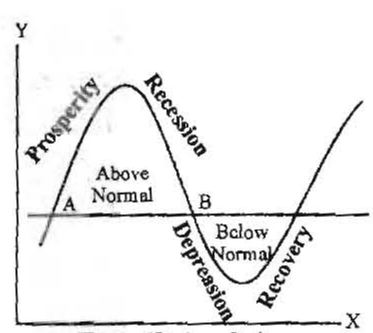
Phases of Business Cycle

The four distinct and closely related phases of business cycle are as follows:

1) Prosperity or Expansion: This stage is characterized by increase production, high capital investment in basic industries, and expansion of the bank credit, high prices, high profits, and full employment. There is the general feeling of optimism between businessman and industrialist. Boom is the above normal expansion of aggregate economic activity in an economy. The increases in the level of economic activity are not in the nature of X increasing at the cost of Y; they move the whole system upward. They move the entrepreneurs in general to expand their activities and put more resources to the productive process. The stimulants, which initiate the whole process, have been called the 'originating forces' or sometimes 'starters'.

Once, the process gets a momentum, all economic variables like output, employment, investment, consumption, profits and prices start rising collectively.

The peak or prosperity may lead the economy to over-full y employment and to inflationary rise in prices. It is a symptom of the end of the prosperity phase and the beginning of the recession. The seeds of recession are contained in the boom in the form of strains in the economic structure which act as brakes to the expansionary path. They are:



Phases of Business Cycle

i) Scarcities of labor, raw materials, etc., leading to rise in costs relative to prices,

ii) Rise in the rate of interest due to scarcity of capital, and

iii) Failure of consumption to rise due to rising prices and stable propensity to consume when incomes increase.

The first factor brings a decline in profit margins. The second makes investments costly and alongwith the first lowers business expectations. The third factor leads to the piling-up of inventories indicating that sales or consumption lags behind production. These forces become cumulative and self-reinforcing.

2) **Recession:** The recession is normally characterized by liquidation in the stock market, strains in the banking system and some liquidation of bank loans, some fall in prices, a sharp reduction in demand for capital equipment and abandoning of relatively new projects. Unemployment leads to full in income, expenditure, prices and profits. Recession has cumulative effects. Once these signals are recognized by entrepreneurs, they tend to become sceptical of the future. In this way psychological as well as real economic factor like excess investment, reduced liquidity, falling returns due to high costs, etc., indicate that the boom is over.

As soon as this realization spreads, negative sentiments become dominant, fresh investment is reduced, banks press for the recovery of their debt, the process of stock liquidation starts, and prices also start falling. In the light of these changes, consumers also postpone their purchases creating a further panic in the economy. Once a recession starts it goes on gathering momentum and finally assumes the shape of depression.

Recession may be mild or severe. The latter might lead to a sudden explosive situation emanating from the banking system or the stock exchange, and a panic or crisis occurs. "When a crisis, and more particularly a panic, does occur, it seems to be associated with a collapse of confidence and sudden demands for liquidity. This crisis of nerves may itself be occasioned by some spectacular and unexpected failure. A firm or a bank, or a corporation announces its inability to meet its debts. This announcement weakens other firms and banks at a time when ominous signs of distress are appearing in the economic structure; moreover, it sets-off a wave of fright that culminates in a general run on financial institutions.

3) **Depression:** It is a protective period in which business activities in the country is far below the normal. It is characterized by a sharp deduction of production, mass unemployment, low employment, falling prices, falling profits, low wages, contraction of credit, a high rate of business failures and **an** atmosphere of all round pessimism and despair. All construction activities come to a more or less complete standstill during a depression. The consumer goods industries and however, not much affected.

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According to Professor Estey, "This fall in active purchasing power is fundamental background of the fall in prices. That, despite the general reduction of output, characterizes the depression".

The trough or depression may be short-lived or it may continue at the bottom for considerable time. But sooner or later limiting forces are set in motion which ultimately tends to bring the contraction phase to end and pave the way for the revival. A cycle is thus completed.

4) **Recovery:** It implies increase in business activity after the lowest point of depression **has been reached.** The entrepreneur began to feel that the economic situation was after all not so bad. **This leads** to improvement in business activities. The industrial production picks up slowly and gradually. The volume of employment also stately increases. There is a slow rise in prices accompanied by a small rise in profit, wages also rise. New investment takes place in capital goods industries. The banks also expand credit. Pessimism is gradually replaced by an atmosphere of all round cautious hope.

In the early stages of the revival phase, there is considerable excess or idle capacity in the economy so that output increases without a proportionate increase in total costs. "But as time goes-on, output becomes less elastic; bottlenecks appear with rising costs, deliveries are more difficult and plants may have to be expanded.

Theories of Business Cycle

1) **Sunspot or Climatic Theory:** Sunspot theory is the oldest theory of trade cycle. It is associated with **William Herschel** and **Stanley Jevors.** They tried to link business cycles with the sunspot activity. According to this theory, the spot that appears on the sun influences the climatic conditions. When the spot appears, it will affect rainfall and hence agricultural crops. When there is crop failure that will result in depression. On the other hand, if the spot did not appear on the sun, rainfall is good leading to prosperity. Thus there is close connection between meteorological conditions depicted by cycles in sunspots and business activity through the changes in agricultural production. The variations in climate are so regular that depression is followed by prosperity. This theory treats business cycles as a natural prosperity. This theory treats business cycles as a natural phenomenon. However this theory is not accepted today. Trade cycle is a complex phenomenon and it cannot be associated with climatic conditions.

2) **Psychological Theory:** The psychological theory of business cycle was developed by **Pigou.** Even Keynes emphasized **the** role of psychological factors in the generation of trade cycle. According to Pigou, the main reason for trade cycle is over-optimism and over-pessimism among business people. During the period of good trade, entrepreneurs become optimistic which would lead to increase in production. The feeling of optimism is spread to others. Hence investments are increased beyond limits and there is over production which

results in losses. Entrepreneurs become pessimistic and reduce their investment and production. Thus fluctuations are due to optimism leading to prosperity and pessimism resulting in depression. Though there is an element of truth in this theory, this theory is unable to explain the occurrence of boom and starting of revival. Further this theory fails to explain the periodicity of trade cycle. Monetary factors reflected in the changes in interest rate are not at all taken into account,

3) **Hayek's Monetary Over-Investment Theory:** According to Hayek, so long as the natural rate of interest equals the market rate of interest, the economy remains in the state of equilibrium and full employment. Trade cycles in the economy are caused by inequality between market and natural interest rates. When the market interest rate is less than the natural rate, there is prosperity in the economy. On the contrary, when the market interest rate is more than the natural rate, the economy is in depression. The natural rate of interest is that rate at which the demand for loanable funds equals the supply of voluntary savings. On the other hand, the market rate of interest is the money rate which prevails in the market and is determined by the demand and supply of money.

According to this theory;

i) Prosperity begins when the market rate of interest is less than the natural rate of interest. In such a situation, the demand for investment funds is more than the supply ofavailable savings.

ii) **The** prices **of** factors are raising continuously, the rise in production costs bring fall in profits of producers. The producers of capital goods invest less in the expectation of loss in the future. Consequently, the natural interest rate falls.

iii) **The** fall in prices comes to an end during depression; banks begin to raise the supply ofmoney which reduces **the** market interest rate below **the** natural interest rate. This encourages investment and the process **of** revival begins in the economy.

Criticism of Hayek's Theory

i) **Restrictive Assumption of Full Employment:** The theory n based on the classical assumption of full employment in **the** economy. This is **why** it asserts that expansion of producers-goods' output can be possible only **at the expense of** consumer-goods' output. If the boom starts when there are unutilized labor **or** capital resources, **men it** can continue for quit sometime without distorting production.

ii) **Unrealistic Assumption of Equilibrium:** This theory also takes the unrealistic assumption that saving equals investment and the economy are in equilibrium initially which is disturbed by banks deciding to create extra credit. In fact, disturbances to equilibrium can come from many sources, some inside the system and others from outside.

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iii) **Undue Importance to Interest Rate Changes:** Criticism has also been directed at the prominent place given to changes in the rate of interest by Hayek. In fact, the rate of interest is not so flexible as to influence the capital intensity of production. Business firms do not bother in the short period for small changes in the rate of interest. They are more influenced by changes in the expected rate of profit occurring in the phases of the trade cycle.

iv) **Unreal Concept of Forced Saving:** In Hayek's analysis, expansion of the producers-goods sector is made possible by forced saving from the consumers when incomes get redistributed. If the group with reduced incomes is obliged to restrict consumption and the group having higher incomes voluntarily refrains from raising consumption to the same extent, there is no forced saving. Thus, the c6ncept of forced saving used by Hayek is illusory.

v) **Questionable Nature of Explanation of the Crash:** Hayek has argued that higher incomes in the hands of consumers would push up the profitability of consumer goods relatively to that of capital goods. This brings about a crash of the boom.

vi) **Explains Only the Expansion Phase:** This theory explains only the expansion phase of the business cycle. It has no convincing logic for the upturn after depression. Since the theory fails to explain both the turning points of the trade cycle, it is unable to explain the periodicity of the business cycles.

4) **Under Consumption Theory:** The chief exponent of this theory is **J.A. Hobson.** According to him, trade cycles appear due to mal-distribution of national income. This mal-distribution of national income takes place because during boom the entrepreneurs and businessmen gather income with business activities banks and become richer. Since they cannot consume the whole income they save. There is too much saving during the boom period. Reduction in the level of consumption means a fall in the demand for consumers' goods because the amount saved is not spent on consumption. The supply of consumer's goods will be far greater than the demand for them. Prices of these goods begin to fall. The general outlook becomes pessimist. If this downward movement continues depression will set in.

Criticism of Under Consumption Theory

i) The theory is an explanation of depressions only. It does not explain how booms commence.

ii) It assumes that the savings of the wealthier classes are automatically invested. If the theory was correct it would follow that during depressions prices of consumer goods would fall first; but they generally fall last.

iii) It does not offer a comprehensive explanation of the business cycle. The business cycle is indeed a very complex phenomenon. It cannot just be explained in terms of a single cause - over-saving or under- consumption,

iv) The theory does not explain why the depression occurs at fairly regular intervals.

v) The theory assumes that the savings of the rich automatically find their way into investment in industrial equipment but this may not be the case.

5) **Keynes' saving and Investment Theory:** In this 'General' Theory Keynes has given an explanation of business or trade cycle. Keynes never attempted an elaborate theory of business cycle as such. In fact business cycles show rhythmic fluctuations in the aggregate income, output, and employment, which is the main subject matter of Keynes' 'General Theory'.

According to Keynes' business cycle appear as a result of the fluctuations in the rate of investment is due to marginal efficiency of capital (MEC). Keynes' has defined marginal efficiency of capital as the relation between the prospective yield of that type of capital and the cost of producing the units. In simple words, we define marginal efficiency of capital as the expected rate of profit on new investment.

Criticism of Keynes' Saving and Investment Theory

i) Keynes bases his theory only on internal causes of a trade cycle. Moreover, he has developed his explanation with the help of multiplier principle simply.

ii) A scientific explanation of a trade cycle must consider external causes of a trade cycle and the role of the accelerator in the occurrence of a trade cycle.

iii) Keynes has not explained clearly the factors of 'marginal efficiency of capital' which guide vitally **the** investment decisions of the entrepreneurs. Keynes' concept of 'marginal efficiency of capital' **reflects** the idea of Pigou's Psychological Theory of trade cycle.

iv) Keynes does not attach due importance to the rate of interest. He considers the rate of interest only **as** an item of the cost of production of goods. On the other hand, he holds that rate of interest does not exercise any influence on investment decision.

v) The periodical aspect or the phases of the business cycle is left in darkness in Keynes' theory.

6) **Hicks' Theory of Trade Cycle:** Prof. Hicks explains the phenomenon of trade cycles by combining the principles of multiplier and acceleration.

According to Hicks, investment is of two types:

i) **Autonomous investment:** It is independent of the variations in income, output and consumption.

ii) **Induced investment:** It determined by the fluctuations in income, output and consumption. The force of autonomous investment is expressed in multiplier while the force of induced investment is expressed in acceleration.

Thus, according to Hicks, autonomous investment and induced investment **cause** cyclical fluctuations in economic activity *via* multiplier and accelerator respectively.

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Criticism of Hicks' Theory of Trade Cycle

i) **Assumption of a Constant Multiplier:** In assuming a fixed value of multiplier, Hicks assumed a **stable** consumption function. Many recent empirical studies have shown that the value of the MPC changes from one stage of the cycle to another. In Friedman's view, there is no certain or predictable relationship between the transitory income and MPC Therefore, the multiplier-accelerator interaction constituting the core of Hicks' theory is not acceptable.

ii) **Invalidity of the 'No Excess-Capacity' Assumption:** Professor Nicholas Kaldor considers the **use** of accelerator misleading in that it presupposes absence of excess capacity in capital-goods industries and permanent nature of demand for capital goods. In Kaldor's view the evidence is on the contrary. Industries subject to cyclical fluctuations maintain excess capacity as a normal routine for they face variable demand.

iii) **Mechanical Explanation:** Hicks fails to take note of the psychological factors of uncertainty **and** expectations. These play an important role in the dynamics of investment.

According to Duesenberry, "The basic concept of multiplier-accelerator interaction is an important one but we cannot really expect to obtain observed cycles by a mechanical explanation of that concept".

iv) **Resource Limitation cannot** form **a 'Ceiling':** Duesenberry has also attacked the concept of the ceiling to the expansion set by resources limitations. In his view, the experience of the 1953-54 recessions in the U.S.**A.** casts doubt on the assumption. Only resource shortages cannot cause a **very** large and sudden crash in investment.

v) **Invalid Distinction between Autonomous and Induced Investment:** Some writers have questioned the validity of the distinction on empirical level. In the short period much of investment is autonomous which induced investment from the long-period viewpoint becomes. This seriously limits the possibility of confronting the theory with facts.

vi) **Artificiality of the Separation of Exogenous and Endogenous Factor: According to Hicks,** the ceiling **is** independent of the path the output follows in the course of **a cycle.** This **is because the** ceiling **is** made to depend on such exogenous factors as population growth and technological progress. But **it** depends also on the magnitude of available resources one of which is the capital stock.

7) **Hawtrey's Monetary Theory:** According to Prof. R.G. Hawtrey, "The trade cycle is a purely monetary phenomenon". It is changes in the flow of monetary demand on the part of businessmen that lead to prosperity and depression in the economy. He opines that non-monetary factors like strikes, floods, earthquakes, droughts, wars, etc., may at best cause a partial depression, but not a general depression. In actuality, cyclical fluctuations are caused by expansion and contraction of bank credit which, in turn, lead to variations in the flow of monetary demand on the part of producers and traders. Bank credit is the principal means of payment in the present times. Credit is expanded or reduced by **the** banking system by lowering or raising the rate of interest or by purchasing or selling securities to merchants. This increases or decreased the flow of money in the economy and thus brings about prosperity of depression.

Criticism of Hawtrey's Monetary Theory

i) Contraction of credit cannot bring about a depression. At best, it can create conditions for that. Thus expansion or contraction of credit cannot originate either boom or depression in the economy.

ii) Haberler has criticized Hawtrey for his contention that the reason for the breakdown of the boom is always a monetary one and that prosperity could be prolonged and depression staved-off indefinitely if the money supply were inexhaustible. But the fact is that even if, the supply of money is inexhaustible in the country neither prosperity, can be continued indefinitely nor depression, can be delayed indefinitely.

iii) Hamberg has criticized Hawtrey for the role assigned to wholesalers in his analysis. In actuality, traders do not depend exclusively on bank credit but they finance business through their own accumulated funds and borrowings from private sources.

iv) Hamberg also does not agree with Hawtrey that traders react to changes in interest rates. According to Hamberg, traders are likely to react favorably tò a reduction in the interest rate only if they think that the reduction is permanent. But they do not react favorably during the depression phase because traders expect a further reduction every time the interest rate is reduced.

v) In Hawtrey's theory cumulative movements in economic activity are the result of changes in stocks of goods. But fluctuations in inventory investments can at best produce minor cycles which are not cycles in the true sense of the term. .

vi) The theory also fails to explain the periodicity of the cycle.

vii) Hawtrey's theory is incomplete because it emphasizes only monetary factors and totally ignores such non-monetary factors as innovations, capital stock, multiplier-accelerator interaction, etc.

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8) **Innovations Theory:** The innovations theory of business cycles was given by Joseph Schumpeter in his monumental treatise 'Business Cycles' in 1939. Schumpeter's approach is different from the other approaches in the sense that Schumpeter regards business cycles as part of the dynamic process of growth and development. In a static state, according to Schumpeter, no business cycles would take place at **all.**

Schumpeter starts his analysis by assuming an economy in a state of full employment equilibrium. Such a state of equilibrium is the point of reference or considered a normal point from which all changes **in** economic activity could be measured. The effect of innovation, according to Schumpeter is .to disturb **the** equilibrium. This causes entrepreneurs to expand their level and scale of activity. This sets up a process of cumulative demand for productive machinery because technological innovations carry with them **an** enlarged demand for capital. Gradually after some initial hesitation, majority of entrepreneurs tend **to adopt** these innovations, which tremendously increase aggregate investment in the economy.

Innovations may consist of:

i) Introduction of a new product,

ii) Introduction of a new method,

iii) Introduction or opening of a new market,

iv) A new source of raw material, and

v) A new form of business organization.

Schumpeter clarifies that innovations are not inventions. Inventions are scientific actions undertaken by **a** scientist inside a lab while the innovation is done by an entrepreneur and undertaken in **a** market. **That** is why, inventions do not cause business cycles, but innovations do.

Criticism of Innovations Theory

i) Schumpeter's analysis is based on the innovator. But now all innovations form part of the functions of a joint stock company. Innovations are regarded as the routine of industrial concerns and do not require an innovator as such.

ii) Schumpeter's contention that cyclical fluctuations are due to innovations is not correct. As a matter of fact, trade cycles may be due to psychological, natural or financial causes.

iii) Schumpeter gives too much importance bank credit in his theory. Bank credit may be important in the short-run but in the long-run when the need for capital funds is much greater, bank credit is insufficient.

iv) Is an innovation is financed through voluntary saving or internal funds; there will not be an inflationary rise in prices. Consequently, in an underemployed economy an innovation financed through voluntary savings might not generate a cycle.

v) Schumpeter's analysis is based on the unrealistic assumption of full employment of resources to begin with. But the fact is that at the time of revival the resources are unemployed. Thus, the introduction of innovation may not lead to the withdrawal of labor and other resources from old industries.

Measures to Control Business Cycles

Cyclical fluctuations in business and economic activities adversely affect the process of economic development of an economy. Therefore, the government should take preventive and corrective measures to maintain stability in economic system.

Two types of measures are adopted to control business cycles:

1) **Preventive Measures:** The preventive measures aim at avoidance of the occurrence of business cycles. These include all measures which would be adopted during the period of expansion for regulating purchases, safeguarding assets and avoiding unwise credit expansion. These measures can be adopted only if the managers of enterprises possess intimate knowledge about:

   i) The precise relation between cyclical changes in general business and cyclical changes in the business of the given enterprise.

   ii) Nature of the cyclical price movements in the purchases and sales of the particular business in relation to the general business cycle. If a business manager has secured this information, he has taken the first important step towards chalking out an intelligent program of adapting to the business cycle.

   The various preventive measures against the effects of business cycles are as follows:

   i) Conservation of assets during expansion by avoiding undue increase in plant and equipment, and in dividends,

   ii) Avoiding excessive inventories and purchase commitments beyond the available financial resources and excessive sales promotion which results in cancellation of orders,

   iii) Employing a flexible credit standard so that the terms and conditions can be tightened during expansion, and relaxed during contraction,

   iv) To reduce the dependence of agriculture on nature,

   v) Equilibrium between demand and supply,

   vi) Check on speculative activities, and

   vii) Nationalization of basic industries.

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2) **CorrectiveMeasures**

The main corrective measures are as follows:

i) **Monetary Policy:** Monetary policy refers to the control of money supply and cost of credit in the economy. In other words monetary policy means to use the various method of credit in the economy. In other words monetary policy means to use the various method of credit control by the central bank.

The central bank uses two types of credit control:

a) **Quantitative Measures:** The quantitative measures are those measures which control the total credit in the economy. The main method of quantitative are: Bank Rate, Open market operations, changes in Cash Reserve Ratio and Statutory Liquidity Ratio.

b) **Selective Measures:** The selective credit control measure aim at controlling the availability of credit for specific purposes and business activities. The main selective measures of credit rationing, direct action and moral persuasion.

ii) **Fiscal Policy:** Fiscal policy refers to the management of public revenue, expenditure and public debt to achieve certain objectives. The main sources of public revenue are taxes. The fiscal policy of the government affects the business activities and inducement to invest to a great extent. Therefore, government can control cyclical fluctuations by making appropriate changes in taxation, public expenditure and public debt policies, i.e., fiscal policy.

iii) **Direct Controls:** For the speedy and effective control of business cycles government should resort to direct physical controls. Direct controls include licensing, rationing of scare and essential goods, price and wage controls, export-import controls, exchange controls, control over hoarding and black marketing, control of monopolies and restrictive trade practices, etc.

iv) **Automatic Stabilizers**: The economists have suggested the introduction of a number of automatic stabilizers (or, built-in-stabilizers) to deal with the business cycle. An automatic stabilizer (or, built-in- stabilizer) is an economic shock-absorber that helps smooth the cyclical business fluctuations of its own accord, without requiring deliberate action on the part of the government. One such device is the federal progressive income-tax. This tax is so devised that people in higher income brackets are taxed at a progressively higher rate than those in the lower income-brackets.

For example, a rich man with a very high income may have to pay a tax of 50 per cent, whereas a person with a low income may have to pay 5 per cent of his income. Such a progressive type of income-tax tends automatically to offset cyclical fluctuations, because in an upswing, when incomes are rising, people would pay more taxes to the government and, thus, their expenditure would be checked; and a downswing when incomes are declining and tax-percentage is low, people would pay less tax to government, leaving more funds for them to spend.

v) **Fixed Investments Policy**: The fixed investments policy presents another sphere where efforts can be made to control the cyclical movements of business. In planning a building program, it has been found advisable to determine the long-term trend of the given business. Over-expansion of equipment may thus be avoided. Moreover, if future needs are thus estimated in advance, the building program may be so conducted that extensions are made and new plants are erected during those periods of the cycle when costs are the lowest. Some such policy is applicable in the conduct of practically every business enterprise, particularly in cases in which records extending over a number of years in the past are available. Such records enable the rate of normal growth to be fairly accurately determined and thus enable future extensions to be planned in advance.

vi) **Adspend Policy:** As the economy slows down, firms slowdown and cut their advertising budgets as a means of boosting their own profitability. However, some major corporates and FMCG companies believe, on the contrary, in raising their advertising budgets significantly. For example, Hindustan Lever Ltd. decided to increase its advertising and promotion expenditure in 2001 as this is the only way to counter the 2001 slowdown in consumer products sector. Other examples are Coca-Cola, Pepsi, Godrej Soaps, Dabur hidia, Pharma Major. Smithkline Beecham which all raised their adspend in 2001 compared to 2000.

Economic development in the sense of rise in real GNP and per capita real income is by itself of not much significance in India unless we remove unemployment and underemployment also.

The employment strategy of planned development will have to be directed for the following:

(a) To adopt an employment-intensive sectoral planning,

(b) To regulate technological change to protect and enhance employment, and

(c) To promote area planning for full employment. The focus should be to expand employment through labor-absorbing technologies.

The expansion of infrastructure and social services i.e., road construction, rural electrification, water supply, rural schools and community health schemes, besides, irrigation, power and housing programs will help to generate massive employment through expansion in construction activity and their secondary and tertiary effects in raising agricultural productivity and income of the poor.

13) **Instability of Output of Agriculture and Related Sectors:** One of the major problems of Indian economy is the uncertainty of agricultural production, since agriculture is still a gamble in the monsoons. Since Independence, there has been considerable increase in the production of the agricultural sector. **For**

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example, between 1950-51 and 2001-02 production of foodgrains increased from 54 million tonnes to 212 million tonnes. Between 1961 and 2001-02, production of wheat has increased spectacularly from 11 million tonnes to 72 million tonnes. In spite of this spectacular growth, foodgrains output has been fluctuating from year to year. This **is also true** of oilseeds, sugarcane, cotton and jute - the major commercial crops. **Instability** of **output** of **agriculture also** results in causing instability in the related sectors. **For example,** a fall in the production of sugarcane orjute leads to a small availability of raw material for the sugar and textile industry. Similarly a cut-back in agricultural production also results in reduction of employment in agriculture and this in turn, reduces aggregate demand in the economy as the purchasing power of the peasants' falls. Thus, a major development issue for the Indian economy is to devise a strategy of agricultural development which can promise a steady growth of agricultural output.

14) **Imbalance between Heavy Industry and Wage Goods:** During the British period, as a matter of policy, the alien government did not encourage the growth of heavy industry. But in the post-independence period, as a matter of deliberate policy, the government decided to give a boost to heavy industry so as to build the industrial base of the economy. On account of the Chinese invasion in 1962, India realized her weakness in defense preparedness and thus switched over to investment in favor of defense industries which was largely in the nature of heavy industries.

As a result of the stepping-up of investment in the heavy industry sector, as was rightly done, it was quite natural that the share of wage goods sector in **total** investment fell from 41 percent in 1950-51 to 31 percent in 1974-75. An analysis of the Indian economy during 1963-76 made by Professor P.R. Brahmananda revealed that supply of wage goods rose at smaller pace than the supply of non-wage goods, the growth rate of supply ofwage goods sector was just 2 per cent per annum as against over 4 per cent in the non-wage goods sector. This resulted in a sharp increase in the prices of wage goods at the annual rate of 8 per cent per annum. Thus, the increase in real wages of workers that had taken place during the early phase of planning was wiped out by the increase in the prices of wage goods during 1963-76.

15) **Imbalance in Distribution and Growing Inequalities:** There have been growing inequalities of income and wealth in India during the last five decades of planned economic development, redistribution of income in favor of the less privileged classes has not taken place. On the other hand, concentration of income and wealth has increased. Various studies and surveys have clearly indicated that even the small gains of development over the years have not been equitably distributed. The condition of the bottom 20 per cent of the population has definitely deteriorated and the next 20 per cent of the population has remained stagnant. A leading issue of economic development is to assure continued growth with justice through better distribution of national wealth produced in the country.

Ford Foundation - a Case Study of the Aims of Foreign Funding

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"Someday someone must give the American people a full report of the work of the Ford Foundation in India. The several million dollars in total Ford expenditures in the country do not tell one-tenth of the story." - Chester Bowles (former US ambassador to India). In the light of the steady flow of funds from Ford Foundation to the World Social Forum, it is worth exploring the background of this institution - its operations internationally, and in India. This is significant both in itself and as a case study of such agencies.

Ford Foundation (FF) was set up in 1936 with a slender tax-exempt slice of the Ford Empire's profits, but its activities remained local to the state of Michigan. In 1950, as the US government focused its attention on battling the 'communist threat', FF was converted into a national and international foundation.

Ford and the CIA

The fact is that the US Central Intelligence Agency has long operated through a number of philanthropic foundations; most prominently Ford Foundation. In James Petras' words, the Ford-CIA connection "was a deliberate, conscious joint effort to strengthen US imperial cultural hegemony and to undermine left-wing political and cultural influence." Frances Stonor Saunders, in a recent work on the period, states that "At times it seemed as if the Ford Foundation was simply an extension of government in the area of international cultural propaganda. The Foundation had a record of close involvement in covert actions in Europe, working closely with Marshall Plan and CIA officials on specific projects.

Richard Bissell, head of the Foundation during 1952-54, consulted frequently with Allen Dulles, the head of the CIA; he left the Foundation to become special assistant to Dulles at the CIA. Bissell was replaced by John McCloy as head of FF. His distinguished career before that included posts as the Assistant Secretary of War, president of the World Bank, High Commissioner of occupied Germany, chairman of Rockefeller's Chase Manhattan Bank, and Wall Street attorney for the big seven oil corporations. McCloy intensified CIA-Ford collaboration, creating an administrative unit within the Foundation specifically to liaise with the CIA, and personally heading a consultation committee with the CIA to facilitate the use of FF for a cover and conduit of funds. In 1966, McGeorge Bundy, till then special assistant to the US president in charge of national security, became head of FF.

It was a busy collaboration between the CIA and the Foundation. "Numerous CIA 'fronts' received major FF grants. Numerous supposedly 'independent' CIA sponsored cultural organizations, human rights groups, artists and intellectuals received CIA/FF grants. One of the biggest donations of the FF was to the CIA-organized Congress for Cultural Freedom which received $ seven million by the early 1960s. Numerous CIA operatives secured employment in the FF and continued close collaboration with the Agency."

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The FF objective, according to Bissell, was "not so much to defeat the leftist intellectuals in dialectical combat [sic] as to lure them away from their positions. Thus FF funneled CIA funds to the Congress for Cultural Freedom (CCF) in the 1950s; one of the CCF's most celebrated activities was the stellar intellectual journalEncounter. A large number of intellectuals were ready to be so lured. CIA-FF went so far as to encourage specific artistic trends such as Abstract Expressionism as a counter to art reflecting social concerns.

The CIA's infiltration of US foundations in general was massive. A 1976 Select Committee of the US Senate discovered that during 1963-66, of 700 grants each of over $10,000 given by 164 foundations, at least 108 were partially or wholly CIA-funded. According to Petras, "The ties between the top officials of the FF and the U.S. government are explicit and continuing. A review of recently funded projects reveals that the FF has never funded any major project that contravenes U.S. policy."

Such experiences ought to have alerted intellectuals and various political forces to the dangers of being bankrolled by such sources. FF states (on the webpage of its New Delhi office) that from its inception to the year 2000 it had provided $7.5 billion in grants, and in 1999 its total endowment was in the region of $13 billion. It also claims that it "receives no funding from governments or any other outside sources", but the reality, as we have seen, is otherwise.

Ford in India

The FF New Delhi office webpage claims that "At the invitation of Prime Minister Jawaharlal Nehru, the Foundation established an office in India in 1952." In fact Chester Bowles, US ambassador to India from 1951, initiated the process. Like the rest of the US foreign policy establishment, Bowles was profoundly shocked at the "loss" of China (ie the nationwide coming to power of the communists in 1949). Linked to this was his acute worry at the inability of the Indian army to suppress the communist-led peasant armed struggle in Telangana (1946-51) "until the communists themselves changed their programme of violence". Indian peasants expected that now, with the British Raj gone, their long-standing demand for land to the tiller would be implemented, and that pressure continued everywhere in India even after the withdrawal of the Telangana struggle.

Bowles wrote to Paul Hoffman, then president of FF: "The conditions may improve in China while the Indian situation remains stagnant.... If such a contrast developed during the next four or five years, and if the Chinese continued their moderate and plausible approach without threatening the northern Indian boundary.... the growth of communism in India might be very great. The death or retirement of Nehru might then be followed by a chaotic situation out of which another potentially strong communist nation might be born." Hoffman shared these concerns, and stressed the need for a powerful Indian State: "A strong central government must be established.... The hardcore of communists must be kept under control.... The prime minister Pandit Nehru greatly needs understanding, sympathy and help from the people and governments of other free [sic] nations.

The New Delhi office was soon set up, and, says FF, "was the Foundation's first program outside the United States, and the New Delhi office remains the largest of its field office operations". It also covers Nepal and Sri Lanka.

"The fields of activity suggested [by the US State Department] for the Ford Foundation", writes George Rosen, "were felt to be too sensitive for a foreign (American) government agency to work in.... South Asia rapidly came to the fore as an area for possible foundation activity... Both India and Pakistan were on the rim of China and seemed threatened by communism. They appeared to be important in terms of American policy....FF acquired extraordinary power over the Indian Plans. Rosen says that "From the 1950s to the early 1960s the foreign expert often had greater authority than the Indian", and FF and the (FF/CIA-funded) MIT Center for International Studies operated as "quasi-official advisers to the Planning Commission". Bowles writes that "Under the leadership of Douglas Ensminger, the Ford staff in India became closely associated with the Planning Commission which administers the Five Year Plan. Wherever there was a gap, they filled it, whether it was agricultural, health education or administration. They took over, financed and administered the crucial village-level worker training schools.

Ford Foundation intervention in Indian agriculture

Given the background of the Chinese revolution and the Telangana struggle, the US priority in India was to find ways to head off agrarian unrest. Thus the first phase of FF's work was in 'rural development'. FF was intimately involved in the Indian government's Community Development Programme (CDP), which Nehru hailed "as a model for meeting the revolutionary threats from left-wing and communist peasant movements demanding basic social reforms in agriculture." The scheme was to carry out agricultural development with some funds from the Programme and voluntary village labour, thus bringing about what Nehru described as a "peaceful revolution". At the Indian government's invitation, FF helped train 35,000 village workers for the CDP. By 1960 the Ford and Rockefeller Foundations had between them extended over $50 million on the CDP alone. And by 1971, India, with grants totaling $104 million, was by far the largest recipient of grant aid from the Ford Foundation's Overseas Development Programme. However, such cosmetic efforts neither brought about development nor solved the problem of simmering peasant discontent.

In 1959, a team led by a US department of agriculture economist produced the Ford Foundation's Report on India's Food Crisis and Steps to Meet It. In place of institutional change (ie redistribution of land and other rural assets) as the key-stone to agricultural development, this report stressed technological change (improved seeds, chemical fertilizers, and pesticides) in small, already irrigated, pockets. This was the 'Green Revolution' strategy. Ford even funded the Intensive Agricultural Development Programme (IADP) as a test case of the strategy, providing rich

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farmers in irrigated areas with subsidized inputs, generous credit, price incentives, and so on. The World Bank too put its weight behind this strategy.

Soon it was adopted by the Indian government, with far-reaching effects. Agricultural production of rice and wheat in the selected pockets grew immediately. Talk of land reform, tenancy reform, abolition of usury, and so on were more or less dropped from official agenda (never to return). But the initial spectacular growth rates eventually slowed. On the average agricultural production all-India has grown more slowly after the Green Revolution than before, and in much of the country per capita agricultural output has stagnated or fallen. Today even the Green Revolution pockets are facing stagnation in yields. However, the Green Revolution was successful in another sense: it yielded a large market for foreign firms selling either inputs or the technology to manufacture those inputs.

Shift to funding NGO 'activism'

Since 1972 there has been a shift in FF's activities in India. Earlier FF had a large staff, focusing on agriculture and rural development, providing technical assistance in these fields and directly implementing its projects. Now FF's developmental activities continue under the heading "asset-building and community development" (Ford claims that it is responsible for introducing the concept of "micro-lending" in India, now eagerly embraced by the Reserve Bank), but it has added two other heads: "peace and social justice" and "education, media, arts and culture". This is in line with changes in foundation/funding agency policy worldwide, whereby, since the late 1970s, a new breed of 'activist' NGOs, engaging in social and political activity, have been systematically promoted. Among Ford's "peace and social justice" goals are the promotion of human rights, especially those of women; ensuring open and accountable government institutions; strengthening "civil society through the broad participation of individuals and civic organizations in charting the future", and supporting regional and international cooperation.

Over the period 1952-2002, FF New Delhi office, the first and oldest of FF's 13 overseas offices, has distributed \$450 million in grants. At a press conference to mark the fiftieth anniversary of FF in India, the foundation's India representative said that it was launching a new Rs 220 crore (\$45 million) funding programme - twice the usual annual allocation - and committing substantial funds to disadvantaged groups such as adivasis, dalits and women. "Asked if the shift in focus [from FF's traditional activities in rural development] was prompted by the inequalities caused by the Indian government's economic policies of globalization and liberalization, he said there was no question of getting away from globalisation but it had brought some concern also. The projects would, therefore, act as a corrective measure to offset the adverse impact of uncontrolled market forces."

This is precisely the language of the World Bank and IMF: their answer to "uncontrolled market forces" is not to control them, but to set up tiny well-publicised safety nets to catch a handful from among the masses of people thrown out by market forces. Further, FF would specifically ensure that people's struggles against the government do not take the course of confrontation: "While admitting that several of the voluntary organisations benefitting from the funding programme could be in confrontation with the government when they were working on issues such as welfare of Adivasis, he said the Foundation did not believe in conflict with the government. The attempt was to complement and cooperate with the efforts of the government."

Ford has chosen to focus on three particularly oppressed sections of Indian society - adivasis, dalits, and women. All three are potentially important components of a movement for basic change in Indian society; indeed, some of the most militant struggles in recent years have been waged by these sections. However, FF takes care to treat the problems of each of these sections as a separate question, to be solved by special "promotion of rights and opportunities". Since FF's funds are negligible in relation to the size of the social problems themselves, the benefits of its projects flow to a small vocal layer among these sections. These are persons who might otherwise have led their fellow adivasis, dalits and women on the path of "confrontation with the government" in order to bring about basic change, change for all. Instead special chairs in dalit studies will be funded at various institutions; women will be encouraged to focus solely on issues such as domestic violence rather than ruling class/State violence; adivasis will be encouraged to explore their identity at seminars; and things will remain as they are.

QUESTIONS:

1. Discuss the above case with SWOT analysis?
2. Mention all the problems related in case and their possible solutions?

SUMMARY

- An economy is a system in which productive units use scarce resources to produce a variety of marketable products (goods and services) that satisfy human needs.
- Economic development is a complex process. It is influenced by natural resources and both economic and non-economic factors.
- Different sectors of Indian economy are primary sector, secondary sector and tertiary sectors.
- Primary sector basically comprises of agriculture, forestry, fishing, mining and quarrying. Among all these agriculture sector is the major contributor of the primary sector.
- Secondary Sector in India includes activities associated with the secondary sector include metal working and smelting, automobile production, textile production, chemical and engineering industries, aerospace manufacturing, energy utilities, engineering, breweries and bottlers, construction, and shipbuilding.
- Tertiary Sector in India includes Services include all economic activities whose output is not a physical product.

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- The term business cycle (or Trade Cycle) refers to the fluctuations in economic activity that occurs in a more or less regular time sequence in all capitalist societies.
- Phases of Business Cycle: Prosperity or Expansion, Recession, Depression and Recovery.
- Measures to Control Business Cycles: Preventive Measures, Corrective Measures

ANSWERS TO 'CHECK YOUR PROGRESS'

1. An economy is a system in which productive units use scarce resources to produce a variety of marketable products (goods and services) that satisfy human needs.
2. There are mainly two types of determinants which influence the economic development of a country. These are: Economic Factors: Capital formation, natural resources, marketable surplus of Agriculture, Conditions in Foreign trade, Economic system. Non Economic Factors: Human Resources, Technical know-how and general education, Political Freedom, Social Organization, corruption, Desire to develop.
3. The term business cycle refers to the fluctuations in economic activity that occurs in a more or less regular time sequence in all capitalist societies.
4. Phases of Business Cycle: Prosperity or expansion, Recession, Depression, Recovery.

TEST YOURSELF

1) Explain the concept of Economic Development.
2) Discuss various determinants of Economic Development.
3) Briefly describe economic and non-economic factors in Economic Development.
4) Describe the contribution of different sectors to the Indian Economy.
5) Explain different sectors of Indian economy.
6) What are the major issues of development of Indian Economy?
7) What do you mean by the term Business Cycle?
8) Discuss various theories of Business Cycle.
9) What are the measures to control Business Cycles?

1.13 References & Suggestive readings

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3 Monetary and Fiscal Policy

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The Chapter Covers :

Introduction of Monetary Policy

Monetary policy refers to the policy regarding money supply and bank credit in the country and it is formulated and announced by the central bank of the country. It is necessary to regulate money supply and bank credit in a country so as to ensure proper functioning of the economy.

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Under monetary policy the central bank of a country makes use of instruments to regulate money supply and bank credit so as to influence the level of aggregate demand for goods and services. The availability and cost of credit are regulated to influence the level and nature of economic activities in the country. In a modern economy credit serves as the basis of most economic activities. The monetary policy which affects the demand for and supply of credit is, therefore, very important for business and industry.

Maning of Monetary Policy

Monetary policy has to reconcile the objectives of economic growth and price stability. Economic growth requires expansion in the supply of money so that no legitimate productive activity suffers due to shortage of finance. Price stability requires restraint on the expansion of credit so that money supply does not become excessive to cause inflation.

According to Paul Einzig, "Monetary policy is the attitude of the political authority towards the monetary system of the community under its control".

According to Johnson, "Monetary policy is the policy employing central bank's control of the supply of money as an instrument for achieving the objectives of general economic policy".

According to G.K. Shaw, "Monetary policy Is any conscious action undertaken by the monetary authorities to change the quantity, availability or cost of money".

It is an important tool of economic policy. Its role gn the general level of economic activity has been recognized since long. It is also defined as a means to control the supply and cost of money to achieve certain objectives. Currency, deposits, credit and foreign exchanges are controlled under monetary policy. The importance of monetary policy has been realized from time to time.

In the economically advanced countries, the monetary authority concentrates on the regulatory aspect of monetary measures in order to achieve the gap of economic stabilization, while in a developing economy like India, monetary policy tends to be typical in nature aiming at *controlled expansion.*

The policy of controlled expansion contains the attempt at reconciliation of two contradictory motives:

1) To facilitate economic growth, and
2) To restrain inflationary pressures.

In fact, there are two facets of monetary policy in a developing economy:

1) Positive, and
2) Negative.

In its positive aspect, it sets out the promotional role of central banking in improving the savings ratio and expanding credit for facilitating capital formation, in its negative approach it implies a regulatory phase of restricting credit expansion, and its allocation according to the absorbing capacity of the economy.

Objectives of Monetary Policy

Broadly speaking, there can be **five major objectives** of monetary policy:

1) **Neutrality of Money:** This objective of monetary policy was first suggested by **Wicksteed.** Later on, it was supported by **Hayek** and **Robertson.** According to these economists, the monetary authority in a country should aim at complete neutrality of money vis-a-vis the economy. The exponents of neutral money hold the view that monetary changes are the root cause of all economic fluctuations. In fact, it is the monetary changes which cause the operation of the trade cycle.

   Besides these, monetary changes also cause distortions and disturbances in the operation of the economic system of the country. They cause changes in such economic entities like prices, output and employment. The changes in money supply also cause imbalances between demand and supply, production and consumption, in the economy. According to neutralists, the monetary changes are the real villains of the piece. They believe that if somehow the changes in money supply are eliminated, there will be perfect stability in the economic system. There will be no cyclical fluctuations, no trade cycle, no inflation and no deflation in the economy. These fluctuations arise, according to the neutralists, on account of the adoption of a policy of *non-neutral* money by the authorities.

   According to these economists, money is only a technical device. It plays a passive role in the functioning of the national economy. Its only purpose is to facilitate the smooth functioning of the national economy. It has no other role to play in the economy. In other words, money has only a strictly neutral role to play in the functioning of the national economy.

   Criticisms of Neutral Money Policy

   The neutral money policy has been subjected to the following criticisms at the hand of the economists:

   i) **Difficulties in Implementation:** The concept of neutral money requires that the supply of money be kept constant and adjustments be made in it on account of the fundamental changes taking place in the economy. Now it is exceedingly difficult to keep the supply of money constant in actual practice. The economists have, at present, no means whereby they can make an accurate estimate of money hoardings by the public. Nor do they have any instruments with the help of which they can measure changes in the velocity of circulation of money. Hence, it is rather impossible to maintain the supply of money at a constant level.

   ii) **Self-Contradictory:** A policy of neutral money is rather self-contradictory in character. On one side, the neutralists claim a passive role for money because this entire concept is based on the philosophy of *laissez-faire* or non-intervention by the State in economic affairs. On the other side, the monetary authority, according to them, should maintain a constant supply of money through frequent adjustments with the fundamental changes in the economy. Now this role assigned to the monetary authority conflicts with the philosophy of *laissez-faire*.

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iii) **Neutral Money Policy Impracticable:** The policy of neutral money is unrealistic on the ground that it cannot be put into actual practice. In other words, the supply of money cannot be kept constant permanently at a particular level. **For example,** the supply of money has to be increased to lift the economy out of the depths of depression. The economic development of an underdeveloped country is also not possible in the absence of monetary expansion.

iv) **Wrong Basis:** The very basis of the policy of neutral money is wrong and unrealistic. The policy has assigned a passive role to money. In actual practice, money plays a very active role in the present-day dynamic economy. As such, money cannot be neutral in its role.

2) **Price Stabilization:** Some economists have suggested price stabilization as a viable objective of monetary policy for an economy suffering from violent price fluctuations. **Prof. Gustav Cassets** and **Lord Keynes.**

Advantages of Price Stability

The following advantages accrue to the economy from a policy of price stabilization:

i) **Elimination of Cyclical Fluctuations:** A policy of price stabilization carefully implemented by the monetary authority will render the trade cycle inoperative. It will render the economy free of all cyclical fluctuations, which causes so much harm to the economy.

ii) **Promotion of Economic Stability:** A policy of price stabilization will also help to promote business activity in the economy. As is well-known, economic uncertainty is the greatest economy of sound business. With frequent price fluctuations, the progress of business activity is bound to suffer a serious setback. At least, there shall be little possibility of businessmen entering into forward contracts with each other with frequent changes in the price-structure.

iii) **Facilitates Performance of Money Functions:** As is well known, money has two very important functions to perform in an exchange economy,

a) Money as a store of value, and

b) Money as a standard of deferred payments.

Now money cannot perform these two functions smoothly at a time when the prices are fluctuating in a violent manner in the economy. In fact, money can perform these functions adequately and smoothly only during a period of price stabilization.

iv) **Prevention of Artificial Prosperity:** Lnflation is often criticized on the ground that it leads to the creation of artificial prosperity in the country. Now a policy of price stabilization will also result in prosperity but that prosperity will be *real* prosperity, not *artificial* prosperity. The economic gains of the people will be real, not illusory.

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v) **Equitable Distribution:** Still another advantage resulting from a policy of price stabilization is that it ensures an equitable distribution of national income and wealth amongst the various sections of the community. Both inflation as well as deflation results in the misdistribution of national income and wealth, and as such, they are highly inequitable in their effects.

vi) **Promotion of Economic Welfare:** A policy of price stabilization has the added advantage ofpromoting the national economic welfare of the community. Far from being discriminatory, a policy of price stabilization promotes the economic welfare of all the citizens in an equal measure.

Criticisms of Price Stabilization Policy

Price stabilization policy is criticized on the following grounds:

i) **Vagueness of the Concept:** The concept of price stabilization is rather ambiguous in as much as it does not clearly state as to which price-level is to be stabilized in the economy. There could be several price-levels which could be stabilized by the monetary authority. It is rather difficult to choose a *standard* price-level for the purpose of stabilization. The concept states no criteria for the selection of the standard price-level for stabilization. There is, therefore, considerable scope for arbitrariness on the part of the monetary authority.

ii) **Prices to be stabilized:** The concept is also silent on the question as to which prices are to be stabilized - wholesale prices or retail prices, consumer goods prices or producer goods prices. Still another difficulty here is that it shall not be possible to establish stability in the general price-level so long as there is no relative stability in the prices. Now the question arises how to establish the relative stability of prices in the economy. Keeping these difficulties in mind, the critics believe that price stabilization is no longer a practicable objective of monetary policy.

iii) **Policy Confers no Benefits:** One of the drawbacks of this policy is that it confers no solid benefits on the economy. Price changes, it should be remembered, are the result, not the cause of economic fluctuations in the economy. Price changes are the symptoms, not the disease itself. The policy of price stabilization deals only with the symptoms, not the problem. Even, if the policy of price stabilization is adopted, it is no guarantee for the stabilization of business activity in the economy. The reason being that the causes of economic instability lie not in price instability but somewhere else.

iv) **Price Stabilization impedes Economic Progress:** A policy of price stabilization will hinder the economic progress of the country. With prices already stabilized, there shall be no incentive left to the business community to increase production, because there shall be no increase in profit margins. Nor would they like to make fresh investments in the economy. This will inevitably result in impeding the economic progress of the country.

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v) **Policy of Price Stabilization is not Practicable:** Theoretically, this policy may appear to be viable but it is not easily practicable. To ensure stability in the internal price-level, it is essential that there should also be stability in the supply of money and credit on the one side, and the supply of output on the other. Now it is difficult to ensure perfect stability in these two quantities. The policy is also not practicable on the ground that during a period of deflation expansion of money supply very often fails to push up the prices back to their original level.

3) **Exchange Rate Stability:** Maintenance of stable exchange rates is an essential condition for the creation of international confidence and promotion of smooth international trade on the largest scale possible. Instability in exchange rates might lead to undesirable effects such as weakening of the value of currency in the world market, speculation and even flight of capital abroad.

The objectives of exchange stability of a monetary policy could easily achieve equilibrium in the balance of payments of a country under the gold standard. Traditionally, countries faced with balance of payments problems have used monetary policy as a means of eliminating their deficits.

A restrictive monetary policy tends to reduce a country's balance of payments deficit in the following ways:

i) It tends to reduce demand in the country, which in turn tends to reduce the demand for imports as well as for domestic goods.

ii) Reduction in domestic demands holds down the rate of inflation or reduces prices which makes imported articles less attractive and makes the deficit country's exports more attractive to foreigners. Thus, import is curtailed and export expanded.

iii) Under dear money policy, higher interest rates make it less attractive for foreign countries to borrow from the deficit country and induce them to invest there.

Criticisms of Exchange Rate Stability

Though a policy of stabilization of exchange rates was justified in the interest of maintaining stable international economic relations, the exchange stability goal of monetary policy has been strongly criticized in the following grounds:

i) Exchange stability can be achieved only at the cost of internal price stability. But fluctuations in the domestic price level or changes in the purchasing power of money cause severe disturbances in the economy of a country. This may call for internal price stability which is of prime importance for the smooth functioning and progress of the domestic economy.

ii) Since inflationary or deflationary movements in some countries are passed on to some other through fixed exchange rates, it puts the affected country at the mercy of the countries. This may seriously affect the economy of the county whose prosperity does not depend upon foreign trade.

Today, when gold standard is no longer in vogue and most of the countries of the world are members of the International Monetary Fund (IMF), the exchange stability objective of monetary policy has lost much of its force. Modern welfare states realize that their prime duty is to maintain conditions of internal stability. The MF has established a system of free multilateral trade and member countries can continue to have adverse balance of payments to be achieved through exchange stability **is** not now an **objective of the monetary** policy of modern countries.

4) **Full Employment:** Full employment is considered as the foremost and ideal objective of monetary policy. Full employment is achieved where saving is equal to the investment. There are as many jobs as there are persons seeking them. Full employment is not an end in itself. It is a pre-condition of social welfare. It relates employment of not only human resources, but full utilization of all the resources with maximum efficiency and productivity. Thus, it is an ideal objective of monetary policy for maximizing economic welfare. Employment will be provided to all the members of the society and economic resources will be utilized most, efficiently. Under the condition of full employment, under-employed and half-employed are also getting alternative employments and they are utilizing their time fully well. It does not mean that certain persons are over-employed. Similarly, it does not indicate that unemployable boys, girls, aged and incapable persons are also employed. It means that the willing members and able persons of the society are getting jobs.

   The policy of full employment is supported on the following grounds:

   i) The policy of full employment is the only suitable policy to pursue in a world which is already weary of unemployment. Millions of people the world over are jobless today, m the context of the present-day situation, full employment is the best and the ideal objective of monetary policy.

   ii) The policy of full employment is a humanitarian policy in as much as it attempts to solve a human problem, i.e., the problem of unemployment and underemployment.

   iii) By providing jobs to millions of unemployed, this policy promotes the maximum social welfare of the community.

   iv) The policy of full employment also deserves support because this policy, when implemented, eliminates all cyclical fluctuations which often disorder the economy.

5) **Economic Growth:** Economic growth relates to physical or real output. It means that growth involves quantitative and qualitative production of goods, so as to satisfy the consumers. In brief, economic growth implies substantial increase in per capita output or real national income. It does not mean more money in economic growth. It is not, but the real production that makes a nation economically advanced. Economic growth ultimately aims at total welfare of masses. It can be achieved through equitable distribution of income between different social classes and individuals.

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To achieve this objective the monetary policy should satisfy the following two criteria:

i) **Should be Flexible in Nature:** The monetary policy should be flexible in nature. This flexibility is necessary to ensure the establishment of equilibrium between aggregate money demand on the one side and the aggregate supply of goods and services on the other side. In case, the aggregate money demand exceeds the aggregate supply of goods, the monetary authority should then apply a restrictive policy to remove the disequilibrium in the economy this restrictive monetary policy necessitates the contraction of currency and credit to check any inflationary rise in the price level. If, on the contrary, the aggregate supply of goods exceeds the aggregate money demand, then the monetary authority should pursue an expansionist monetary policy with a view to remove the disequilibrium in the economy. This expansionist monetary policy necessitates the expansion of currency and credit to check the fall in the price-level. Thus, a flexible monetary policy is essential to ensure the internal equilibrium in the economy. The flexibility in the monetary policy will ensure price stabilization, and that price stabilization will, in its turn, promote the economic growth of the country.

ii) **Should also be Capable of Promoting Capital Formation:** The monetary policy should not only be flexible in nature, but it should also be capable of promoting capital formation in the economy. As is well-known, capital formation is one of the essential prerequisites of economic growth. But this capital formation is possible only under conditions of price stabilization in the economy. A fluctuating price-level always discourages capital formation in the country. Hence, the monetary policy should be such as to promote capital formation in the country by rooting out recurring price fluctuation. The monetary policy should also promote the inflow of foreign capital which is one of the essential prerequisites of the economic growth of a country.

Scope of Monetary Policy in Underdeveloped Countries

The scope of monetary policy in underdeveloped countries is extremely limited, compared to that in advance countries for the following reasons:

1) The money market is unorganized in an underdeveloped country, and, therefore, the monetary management of the Central Bank cannot be perfect.

2) In most of the underdeveloped nations, money supply primarily consists of currency in circulation while bank deposits form relatively a small proportion of it. Lack of banking habits on the part of the people in poor countries makes it difficult for the monetary authority to influence the economy by controlling the banking system.

3) Changes in bank rate or other monetary instruments are proved to be ineffective in underdeveloped countries also on account of the existence of a vast non-monetized sector in their economies.

4) Despite its various limitations, the monetary policy in an underdeveloped country can greatly assist economic growth "by influencing the supply and use of credit, combating inflation and maintaining the balance of payments equilibrium".

Role of Monetary Policy in a Developing Economy

In modern times, any newly-developing country may be concerned with the problem of how to use the monetary policy successfully to stimulate economic growth. In an under-developed country, the monetary policy has to play a vital role in developing the economy from a stage of primary backwardness to a stage of self-sustained growth. Monetary policy which is one thing in art advance economy, may be quite another in an underdeveloped economy. Thus, similar course of action cannot be appropriated to both types of countries. Advanced countries of today can afford the luxury of debating whether full employment should take precedence over price stability or whether the aim should be to achieve internal or external balance at the expenses of growth. However, poor countries cannot at any time think of anything but the policy of promoting rapid economic growth.

Under the growth-oriented monetary policy, monetary management by the central bank becomes a strategic factor of development in an underdeveloped country, on the following counts:

1) When the country aspires for rapid economic development, it adopts economic planning. In the process, financial planning needs the support of credit planning and appropriate monetary management.
2) Underdeveloped countries are most susceptible to inflation. Inflation in an underdeveloped economy generally occurs when there is an abnormal increase in the effective demand exerted mainly by huge government expenditures under the planning process. However, the maintenance of stability in the domestic price level and a fixed, realistic exchange rate are very essential preconditions for achieving a maximum rate of sustained economic growth. This needs equilibrium of savings and investment. In an underdeveloped country, however, since the rate of savings is very low, government is usually tempted to raise the level of investment by means of credit expansion and deficit financing. Development efforts of this nature are generally confronted by inflationary price increases. To some economists, this (inflation) is an inevitable price to be paid for economic growth.
3) The growth objective of monetary policy in underdeveloped countries implies the promotional role of monetary authorities. Briefly, the promotional role of the monetary authority in an underdeveloped country may be to improve the efficiency of the banking system as a whole or extend sound credit where needed and to respond promptly to changing conditions.
4) It is an important task of the monetary authority to improve the conditions of unorganized money and capital markets in poor countries in the interest of rapid economic development and the successful working of monetary management.
5) An important function of monetary policy in an underdeveloped economy is to have and also to make use of a most suitable interest rate structure.

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6) Public debt management responsibility also lies with the monetary authority of the country.In a growing economy, thus, it is very important and difficult task.

7) Underdeveloped countries are characterized with 20-30 percent of non-monetized sector. Hence, it is the prime duty of the monetary authority to extend the process of monetization in these barter sections of the economy. This will tend to improve the working and effectiveness of the monetary policy.

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Limitations of Monetary Policy in Developing Countries

Monetary policy in a developing country is an important instrument in the hands of the central bank, which may be used to ensure economic growth. However, the success of monetary policy is subject to following limiting factors:

1) **Underdeveloped Money and Capital Market:** The central bank cannot effectively implement the various credit control measures in the absence of well-organized money and capital markets. Underdeveloped countries do not have well developed and fully organized money and capital market.

2) **No Integrated Rate of Interest Structure:** The banking sector in underdeveloped countries is unorganized from where a sizeable financial resource comes. There is therefore, no integrated rate of interest and therefore the central bank fails to influence the market rate of interest by changing the bank rate. In fact, the change in bank rate must be reflected in the form of increased or decreased market rate of interest.

3) **Lack of Cooperation the Commercial Banks:** The monetary policy cannot be effectively implemented in the absence of cooperation between the commercial banks and the central bank because the central bank can implement its monetary policy through commercial banks. In developing countries there is no

> ***Check Your Progress***
>
> 1. What is Monetary Policy?

such cooperation of commercial banking institutions with the central bank and in some case the banks ignore the central bank directives. Without proper coordination and cooperation between the two institutions, monetary policy cannot succeed.

4) **Banking Habits:** In developing countries, people are not habitual to bank their savings due to low level of income and savings and lack of banking facilities. Consequently most of the transactions are entered into cash and not through credit instruments. It is for this reason that the credit control measures of the central bank do not have desired effect on the business activities.

5) **Illiteracy and Social Obstacles:** Most of the developing countries suffer from mass illiteracy, superstition, dogmatism and many other social evils. People do not understand the significance of banking institutions hence they do not deposit their money into or take loans from the banks. The success of monetary policy depends upon the vide spread banking institutions, banking habits of the people, adequate development of credit facilities, entrepreneurial ability etc.

Monetary Policy (2008-09)

The following are the highlights of Monetary Policy 2008-09:

1) Bank rate, reverse repo rate and repo rate kept unchanged.
2) Following a CRR hike by 50 bps on April 17, the ratio hiked by further 25 bps to 8.25%, with effect from the fortnight beginning May 24. This cumulative hike of75 bps is expected to suck out liquidity worth Rs 277.5 billion.
1) 3) Survey on GDP growth for 2008-09 in the range of 8.0-8.5%.
4) Inflation target rose from 5 to 5.5%, with a medium-term objective of3.0%.
5) M3 growth to be contained within the range of 16.5-17.0%.
6) Deposits projected to increase by around 17%.
7) Growth of non-food credit to be contained around 20%.
8) The limit of bank loans for housing enhanced from Rs 20 lakhs to Rs 30 lakhs for applicability of reduced risk weights at 50%.
9) Indian companies are allowed to invest overseas in energy and natural resources sectors such as oil, gas and coal in excess of the current limits.

Monetary Policy (2009-10)

In the midst of the global turmoil and huge expectation, Reserve Bank of India (RBI) announced the Monetary Policy for the year 2009-10.

1) RBI has cut Repo rate by 25bps from 5.0% to 4.75%.
2) Reverse Repo rate has been cut by 25bps from 3.5% to 3.25%.
3) The bank rate is left unchanged at 6.0%.
4) The CRR has been left untouched at 5.0%.

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5) RBI has projected the GDP growth for 2008-09 to be in the range of 6.5% to 6.7%. However, with the assumption of normal monsoon, for policy purpose, real GDP growth for 2009-10 is placed at around 6.0%.

6) Inflation is measured by year-on-year variations in the Wholesale Price Index (WPI), has fallen sharply from its intra-year peak of 12.91% on August 2, 2008 to 0.18%, recorded on April 4, 2009. However, the inflation based on various Consumer Price Indices (CPI) continues to be near double digit level, mainly because of the costly food articles.

   The WPI inflation is expected to in the negative territory for the early part of 2009-10. However, this should not be interpreted as deflation for policy purpose. RBI clearly states that this expected negative inflation has only statistical significance and is not the reflection of demand contraction as in the case in advanced economies. So keeping in view the global trends in commodity prices and domestic demand-supply balance, RBIhasprojectedWPIataround4.0%byend March2010.

7) At present, interest on savings bank accounts is calculated on the minimum balances held in the accounts during the period from the 10th day to the last day of each calendar month. The payment of interest on savings bank accounts by Scheduled Commercial Banks (SCBs) would be calculated on a daily product basis with effect from April 1, 2010.

8) As per the extant norms, Authorized Dealer Category-I and authorized banks are permitted to grant loans upto Rs.20 lacs against the security of funds. On a review, it is proposed to enhance the cap ofRs.20 lacs to Rs.I crore with immediate effect.

9) As per the interim Budget 2009-10, the revenue deficit and the fiscal deficit are projected to decline only moderately to 4.0 per cent and 5.5 per cent respectively during 2009-10.

CREDIT CONTROL TOOLS OR INSTRUMENTS OF MONETARY POLICY

The instruments of monetary policy (methods of credit control) may be broadly divided into:

1) General(Quantitative)Methods; and
2) Selective (Qualitative) Methods.

Instrument of Monetary Policy

Quantitative	**Qualitative**
1) Bank rate,	1) Rationing of credit,
2) Open market operations,	2) Margin requirement,
3) Variations in the reserve requirements.	3) Variable interest rate,
4) Repo rate	4) Regulation of consumer credit,
5) Liquidity Adjustment Facility	5) Licensing.

Check Your Progress

1. What is economy?
2. What are different determinants of Economic Development?

General (Quantitative) Methods

There are following three general quantitative instruments of credit control:

1) **Bank Rate:** The Bank Rate, also known the Discount Rate, is the oldest instrument of monetary policy. Bank rate is the rate at which the central bank discounts - or, more accurately, rediscounts - eligible bills. In a broader sense, it refers to the minimum rate at which the central bank provides financial accommodation to commercial banks in the discharge of its function as the lender of the last resort. The bank rate policy seeks to affect both the cost and availability of credit.

Benefits of Bank Rate

i) Delivers effective control over bank credit if reserve money creation is otherwise controlled.

ii) Minimizes loss of monetary control during translation to indirect instruments when transmission mechanism is uncertain.

Limitations of Bank Rate Policy

The efficacy of the bank rate policy as an instrument of controlling credit is limited by the following factors:

i) **Market Rates do not Change with Bank Rate:** The success of the bank rate policy depends upon the extent to which other market rates of interest change along with the bank rate. The theory of bank rate policy presupposes that other rates of interest prevailing in the money market change in the direction of the change in the bank rate. If this condition is not satisfied, the bank rate policy will be totally ineffective as an instrument of credit control.

ii) **Wages, Costs and Prices not Elastic:** The success of the bank rate policy requires elasticity not only in interest rates but also in wages, costs and prices. It implies that when suppose the bank rate is raised; wages, costs and prices should automatically adjust themselves to a lower level. But this was possible only under gold standard. Nowadays the emergence of strong trade unions has made wages rigid during deflationary trends. And they also lag behind when there are inflationary tendencies because it takes time for unions to get a wage rise from employers. So the bank rate policy cannot be a success in a rigid society.

iii) **Banks do not approach Central Bank:** The effectiveness of the bank rate policy as a tool of credit control is also limited by the behavior of the commercial banks. It is only if the commercial banks approach the central bank for rediscounting facilities that this policy can be a success. But the banks keep with them large amounts of liquid assets and do not find it necessary to approach the central bank for financial help.

iv) **Bill of Exchange not used:** As a corollary (outcome) to the above, the effectiveness of the bank rate policy depends on the existence of eligible

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bills of exchange. In recent years, the bill of exchange as an instrument of financing commerce and trade has fallen into disuse. Businessmen and banks prefer cash credit and overdrafts. This makes the bank rate policy less effective for controlling credit in the country.

v) **Pessimism or Optimism:** The efficacy of the bank rate policy also depends on waves of pessimism or optimism among businessmen. If the bank rate is raised, they will continue to borrow even at a higher rate of interest if there is boom condition in the economy, and prices are expected to rise further. On the other hand, a reduction in the bank rate will not induce them to borrow during periods of falling prices. Thus businessmen are not very sensitive to changes in interest rates and they are influenced more by business expectations.

vi) **Power to Control Deflation Limited:** Another limitation of the bank rate policy is that the power of a central bank to force a reduction in the market rates of interest is limited. For instance, a lowering of bank rate below 3 percent will not lead to a decline in the market rates of interest below 3 percent. So the bank rate policy is ineffective in controlling deflation. It may, however, control inflationary tendencies by forcing an increase in the market rates of interest.

vii) **Level of Bank Rate in relation to Market Rate:** The efficacy of the discount rate policy as an instrument of credit control depends upon its level in relation to the market rate. If in a boom the bank rate is not raised to such an extent as to make borrowing costly from the central bank, and it is not lowered during a recession so as to make borrowing cheaper from it, it would have a destabilizing effect on economic activity.

viii) **Non-Discriminatory:** The bank rate policy is non-discriminatory because it does not distinguish between productive and unproductive activities in the country.

ix) **Not Successful in Controlling BOP Disequilibrium:** The bank rate policy is not effective in controlling balance of payments disequilibrium in a country because it requires the removal of all restrictions on foreign exchange and movements of international capital.

2) **Open Market Operations:** Open Market Operations refers broadly to the purchase and sale by the central bank of a variety of assets, such as foreign exchange, gold", government securities and even company shares.

Under the Open Market Operations, the Central bank seeks to influence the economy either by increasing the money supply or by decreasing the money supply;

Benefits of Open Market Operation

i) **Act As Support To Bank Rate:** Open market operations can be used to support the bank rate policy to make the latter more effective. For example, during the period of depression a lower bank rate may be accompanied by purchase of securities.

ii) **Support to Government Credit:** These operations can be used to support government credit. By buying at the time when the prices of securities are low and selling when they are high, the central bank can bring about stability in the price of government securities. It can also prepare suitable conditions for the issue or conversion of government loans, for example, purchase of securities will help floating of new loans.

iii) **Influence Internal Prices and Wages:** These operations influence internal prices and wages and thus help in influencing, the balance of payments through an inflow or outflow of gold. The selling of securities, if it succeeds in bringing about a deflationary effect will create conditions for a favorable balance of trade and payments and for inflow of gold or foreign exchange.

iv) **Fulfilling Seasonal Needs:** A very important function of the operation is to offset the seasonal needs of credit expansion and contraction. During the busy season securities may be purchased and during the slack season, they may be sold out.

Limitations of Open Market Operation

The effectiveness of open market operations as a method of credit control is dependent upon the existence of a number of conditions, the absence of which limits the full working of this policy:

i) **Lack of Securities Market:** The first condition is the existence of a large and well-organized security market. This condition is very essential for open market operations because without a well developed security market the central bank will not be able to buy and sell securities on a large scale, and thereby influence the reserves of the commercial banks. Further, the central bank must have enough saleable securities with it.

ii) **Cash Reserve Ratio not Stable:** The success of open market operations also requires the maintenance of a stable cash-reserve ratio by the commercial bank. It implies that when the central bank sells or buys securities, the reserves of the commercial banks decrease or increase accordingly to maintain the fixed ratio. But usually the banks do not stick to the legal minimum reserve ratio and keep a higher ratio than this. This makes open market operations less effective in controlling the volume of credit.

iii) **Penal Bank Rate:** According to **Prof. Aschheim,** one of the necessary conditions for the success of open market operations is a penal bank rate. If there is no penal discount rate fixed by the central bank, the commercial banks can increase their borrowings from it when the demand for credit is strong on the part of the latter, hi this situation, the scale of securities by the central bank to restrict monetary expansion will be unsuccessful. But if there is a penal rate of discount, which is a rate higher than the market rates of interest, the banks will be reluctant to approach the central bank for additional financial help easily.

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iv) **Banks Act Differently:** Open market operations are successful only if the people also act the way the central bank expects them. When the central bank sells securities, it expects the business community and financial institutions to restrict the use of credit. If they simultaneously start dishoarding money, the act of selling securities by the central banks will not be a success in restricting credit. Similarly, the purchase of securities by the central bank will not be effective if people start hoarding money.

v) **Pessimistic or Optimistic Attitude:** Pessimistic or optimistic attitude of the business community also limits the operation of open market policy. When the central bank purchases securities and increases the supply of bank money, businessmen may be unwilling to take loans during a depression because of the prevailing pessimism among them. As aptly put by Crowther, banks may place plenty of water before the public horse, but the horse cannot be forced to drink, if it is afraid of loss through drinking water. On the other hand, if businessmen are optimistic during a boom, the sale of securities by the central bank to contract the supply of bank money and even the rise in market rates cannot discourage them from getting loans from the banks. On the whole, this policy is more successful in controlling booms than depressions.

vi) **Velocity of Credit Money not Constant**: The success of open market operations depends upon a constant velocity of circulation of bank money. But the velocity of credit money is not constant. It increases during periods of brisk business activity and decreases in periods of falling prices. Thus a policy of contracting credit by the sale of securities by the central bank may not be successful by increased velocity of circulation of bank credit.

Despite these limitations, open market operations are more effective than the other instruments of credit control available with the central bank. This method is being successfully used for controlling credit in developed countries where the securities market is highly developed.

3) **Variations in the Reserve Requirement**: The Reserve Bank also uses the method of variable reserve requirements to control credit in India. By changing the ratio, the Reserve Bank seeks to influence the credit creation power of the commercial banks. These requirements are of two types:

i) **Cash Reserve Ratio:** Cash Reserve Ratio refers to that portion of total deposits of a commercial bank which it has to keep with the Reserve Bank in the form of cash reserves. The Reserve Bank is empowered to vary this ratio between 3 percent and 15 percent of the total demand and time liabilities.

ii) **Statutory Liquidity Ratio:** Statutory Liquidity Ratio refers to that portion of total deposits of a commercial bank, which it has to keep with itselfin the form of liquid assets. The SLR at present is 25 percent for entire net demand and time liabilities of the scheduled commercial banks.

The ratio can be raised or lowered by Reserve Bank. Rising of the reserve ratio leads to reduction in the lending capacity of commercial banks by a multiple depending on the reserve requirement which influences the velocity of circulation of credit money.

Limitations of Variable Reserve Ratio

The variable reserve ratio as a method of credit control has a number of limitations.

i) **Excess Reserves:** The commercial banks usually possess large excessive reserves which make the policy of variable reserve ratio ineffective. When the banks keep excessive reserves, an increase in the reserve ratio will not affect their lending operations. They will stick to the legal minimum requirements of cash to deposits and at the same time continue to create credit on the strength of the excessive reserves.

ii) **Clumsy Method:** It is a clumsy method of credit control as compared with open market operations. This is because it lacks definiteness in the sense that it is inexact and uncertain as regards changes not only in the amounts of reserves but also the place where these changes can be made effective. It is not possible to tell "how much of active or potential reserve base" has been affected by changes in the reserve ratio. Moreover, the changes in reserves involve far larger sums than in the case of open market operations.

iii) **Discriminatory:** It is discriminatory that affects different banks differently. A rise in the required reserve ratio will not affect those banks which have large excess reserves. On the other hand, it will hit hard the banks with little or no excess reserves. This policy is also discriminatory in the sense that non- banking financial intermediaries like cooperative societies, insurance companies, building societies, development banks, etc. are not affected by variations in reserve requirements, though they compete with the commercial banks for lending purposes.

iv) **Inflexible:** This policy is inflexible because the minimum reserve ratio fixed by the central banks is applicable to banks located in all regions of the country. More credit may be needed in one region were there is monetary stringency, and it may be superfluous in the other region. Raising the reserve ratio for all banks is not justified in the former region though it is appropriate for the latter region.

v) **Business Climate:** The success of the method of credit control also depends on the business climate in the economy. If the businessmen are pessimistic about the future, as under a depression, even a sizable lowering of the reserve ratio will not encourage them to ask for loan. Similarly, if they are optimistic about profit expectations, a considerable rise in the variable ratio will not prevent them from asking for more loans from the banks.

vi) **Stability of Reserve Ratio:** The effectiveness of this technique depends upon the degree of stability of the reserve ratio. If the commercial banks are authorized to keep widely fluctuating ratio, say 10 percent to 17 percent,

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and change in the upper or lower limit will have no effect on the credit creation power of the banks.

vii) **Depressive Effect:** The variable reserve ratio has been criticized for exercising a depressive effect on the securities market. When the central bank suddenly directs the commercial banks to increase their reserve ratios, they may be forced to sell securities to maintain that ratio. This widespread selling of securities will bring down the prices of securities and may even lead to an utter collapse of the bond market.

viii) **Rigid:** It is rigid in its operations because it does not distinguish between desired and undesired credit flows and can affect them equally.

ix) **Not for Small Changes:** This method is more like an axe than a scalpel. It cannot be used for day-to- day and week-to-week adjustments but can be used to bring about large changes in the reserve positions of the commercial banks. Thus it cannot help in 'fine tuning' of the money and credit systems by making small changes.

x) **Other Factors:** The reserve ratio held by the commercial banks is determined not only by legal requirements but also by how much they want to hold in relation to their deposits in addition to such requirements. This, in turn, will depend upon their expectations about future developments, their competition with other banks, and so on.

4) **Repo Rate:** Repo rate are classified into inter bank repo and RBI repo rate.

i) **Inter Bank Repo:** Such repos are now permitted only under regulated conditions. Repos are misused by banks / brokers during the 1992 securities scam. They were banned subsequently, with the lifting of the ban in 1995; repos were permitted for restricted, eligible participants and instruments. Initially, repo deals were allowed in T-bills and five dated securities on the NSE. With gradual liberalization over the years, all Central Government dated securities, state government security and T-bills of all maturities have been made eligible for repo. Banks and PDs can undertake repo deals if they are routed through the SGL, accounts maintained by the RBI. Repos are allowed to develop a secondary market in PSU bonds, FIs bonds, corporate bonds and private debt securities if they are held in demat form and the deals are done throUgh recognized stock exchange(s). There are no restrictions regarding a minimum period for inter-bank repo deals. Non-bank participants (i.e., FIs and other specified participants) are allowed to participate only in the reverse repo, i.e., they can only lend money to other eligible participants. The non-bank entities holding SGL accounts with the RBI can enter into reverse repo transactions with banks / PDs, in all Government securities.

ii) **RBI Repos:** The RBI undertakes repo/reverse repo operations with banks and PDs as part of its OMOs, to absorb/inject liquidity. With the introduction of the LAF, the RBI has been injecting liquidity into the system through repo on a daily basis. The repo auctions are conducted on all working days except Saturdays and are restricted to banks and PDs. This is in addition to the liquidity support given by the RBI to the PDs through re-finance/ reverse repo facility at a fixed price. Auctions under LAF were earlier conducted on a uniform price basis, i.e., there was a single repo rate for all successful bidders. Multiple price auctions were introduced subsequently.

The RBI conducts repo auctions to provide banks with an outlet for managing short-term liquidity; even-out short-term liquidity fluctuations in the money market; and optimize returns on short-term surplus liquid funds.

The RBI participants actively in the call money market with LAF repos operations conducted through the year to modulate the surplus liquidity in the market. Both repos and reverse repo operations play an effective role in imparting stability to the market.

5) **Liquidity Adjustment Facility:** An array or instruments to transfer short-term liquidity and interest rate signals in a more flexible and bidirectional manner. A Liquidity Adjustment Facility (LAF) has been introduced since June 2000 to precisely modulate short-term liquidity and signal short-term interest rates. The LAF, in essence, operates through repo and reverse repo auctions, thereby setting a corridor for the short-term interest rate consistent with policy objectives. There is now greater reliance on indirect instruments of monetary policy. The RBI is able to modulate the large market borrowing program by combining strategic debt management with active open market operations. The Bank Rate has emerged as a reasonable signaling rate, while the LAF rate has emerged as both a tool for liquidity management and signaling of interest rates in the overnight market. The RBI has also been able to use open market operations.

Scheme of Liquidity Adjustment Facility

Pursuant to the recommendations of the Narasimham Committee Report on Financial Sector Reforms (Narasimham Committee II), it was decided in principle to introduce a Liquidity Adjustment Facility (LAF) operated through repo and reverse repo from June 5, 2000. Prior to the introduction of the LAF, banks were provided liquidity support to the extent of 125 per cent of their fortnightly average outstanding aggregate deposits of 1997-98 in two forms:

1) Export credit finance, and
2) Collateralized lending facility.

The collateralized lending facility was available to scheduled commercial banks against their collateral of excess holdings of Government of India dated securities and T-bills over SLR requirements. The apparent success of the LAF resulted in the phasing out of the Collateralized Lending Facility on October 5, 2002.

Objectives of the Liquidity Adjustment Facility (LAF)

Amongst its many functions, the RBI also acts as the banker of last resort. In this role, the Central bank has to ensure that it can inject funds into the system to help

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participants tide over temporary mismatches of funds. Refinance, as it used to happen earlier, was at a fixed rate that was largely divorced from the cost of equivalent short-term funds in the market. This gave rise to a non-egalitarian distribution of interest rates at the short end of the curve. Further, the amounts that could be borrowed were determined by a present limit. To do away with the deficiencies, the RBI moved to an auction system of repos and reverse repos to suck out and inject liquidity to the market. The three broad objectives of LAF are as follows:

1) To give the RBI greater flexibility in determining both the quantum of adjustment as also the rates by responding to the system on a daily basis.
2) To help the RBI ensure that the injected funds are being used to fund day-to-day liquidity mismatches and not to finance more permanent assets.
3) To help the RBI set a corridor for short-term rates, which should ideally be governed by the reverse repo (top band) and repo (lower band) rates. This would impart greater stability in the markets.

To sum-up, the RBI's regulation of money and credit now comprises of:

1) The reactivation of OMOs and introduction of repos,
2) The introduction of LAF and its emergence as one of the significant operating instruments,
3) The reactivation of B/R and the use of repo rate,
4) The continuation of the use of the CRR.

The B/R changes, combined with changes in the CRR and LAF repo rates have emerged as active and important tools of liquidity and monetary management. The LAF has developed as an effective tool for absorbing/injecting liquidity on a day to day basis in a flexible manner and for providing a corridor for the call money and other money markets.

Selective (Qualitative) Methods

The quantitative controls explained above affect indiscriminately all sectors of the economy, which depend upon bank credit, they control volume of credit but leave the directionary credit completely free. Selective controls are designed to regulate the direction of credit. These controls, by distinguished between essential and non-essential uses of bank credit, divert resources to essential and priority sectors. These are explained below:

1) **Rationing of Credit**: Credit rationing implies controlling and regulating the purpose for which bank credit can be used. It generally provides for three things;

   i) an overall ceiling on loans and advances for every commercial bank

   ii) fixing the ratio which the capital of a commercial bank should have and

   iii) fixing ceilings for specific categories of loans and advances.

Credit rationing is also exercised by placing restrictions on demand of accommodation and rediscounting facilities for each bank. The central may charge a penal rate of interest from banks, which cross the prescribed limits in relation to their overall liquidity position. This method curtails the freedom and initiative of the commercial bank.

Note: Unless rationing relates to various uses, places or borrowers it cannot be treated as a measure of selective credit control.

2) **Margin Requirement:** The difference between the value of security and the amount borrowed against this security is known as margin. The central bank is generally empowered to fix margin limits for various uses of credit which the commercial banks must observe. Margin requirements, while directly affecting the lender also put a restraint upon the borrower and thus keep - down the volume of credit. By prescribing different margin requirements for different uses, the central bank can divert credit to more urgent uses.

Benefits of Margin Requirements:

This method of selective credit control has certain merits which make it unique.

i) It is non-discriminatory because it applies equally to borrowers and tenders. Thus it limits both the supply and demand for credit simultaneously.

ii) It is equally applicable to commercial banks and non-banking financial intermediaries.

iii) It increases the supply of credit for more productive uses.

iv) It is a very effective anti-inflationary device because it controls the expansion of credit in those sectors of the economy which breed inflation.

v) It is simple and easy to administer since this device is meant to regulate the use of credit for specific purposes.

But the success of this technique requires that there are no leakages of bank credit for non-purpose loans to speculators.

Limitations of Margin Requirements

However, a number of leakages have appeared in this method over the years.

i) A borrower may not show any intention of purchasing stocks with his borrowed funds and pledge other assets as security for the loan. But it may purchase stocks through some other source.

ii) The borrower may purchase stocks with cash which he would normally use to purchase materials and supplies and then borrow money to finance the materials and supplies already purchased, pledging the stocks he already has as security for the loan.

iii) Lenders, other man commercial banks and brokers, who are not subject to margin requirements, may increase their security loans when commercial banks and brokers are being controlled by high margin requirements. Fur-

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ther, some of these non-regulated lenders may be getting the funds they lent to finance the purchase of securities from commercial banks themselves.

3) **Variable Interest Rates:** Variable interest rates charged selectively for different uses, places or borrowers can be considered as selective as against a general dear or cheap money policy pursued through changes in the bank rate.

   Ceilings are also provided for rates which commercial banks can charge from the borrowers for specific uses.

4) **Regulation of Consumer Credit:** This is often practiced when there is either abundance or shortage of certain consumer articles. The regulation includes permitting or banning credit for the purchase of certain consumer articles, extending or limiting the time for repayment or by lowering or raising the limit of down payment to meet the situation of depression on recession on the one hand and inflation on the other.

5) **Licensing:** The RBI ensures proper regional coverage through licensing. Through this incidentally is served the cause of selectivity in regional development.

Limitations of Selective Credit Control

Though regarded superior to quantitative credit controls, yet selective credit controls are not free from certain limitations.

1) **Limited Coverage:** Like general credit controls, selective credit controls have a limited coverage. They are only applicable to the commercial banks but not to non-banking financial institutions. But in the case of the regulation of consumer credit which is applicable both to banking and non-banking institutions, it becomes cumbersome to administer this technique.

2) **No Specificity:** Selective credit controls fail to fulfill the specificity function. There is no guarantee that the bank loans would be used for the specific purpose for which they are sanctioned.

3) **Difficult to distinguish between Essential and Nonessential Factors:** It may be difficult for the central bank to distinguish precisely between essential and nonessential sectors and between speculative and productive investment for the purpose of enforcing selective credit controls. The same reasoning applies to the commercial banks for the purpose of advancing loans unless they are specifically laid down by the central bank.

4) **Require Large Staff:** The commercial banks, for the purpose of earning large profits, may advance loans for purposes other than laid down by the central bank. This is particularly so if the central bank does not have a large staff to check minutely the accounts of the commercial banks. As a matter of fact, no central bank can afford to check their accounts. Hence selective credit controls are liable to be ineffective in the case of unscrupulous banks.

5) **Discriminatory:** Selective controls unnecessarily restrict the freedom of borrowers and lenders. They also discriminate between different types ofborrowers

and banks. Often small borrowers and small banks are hit harder by selective control than big borrowers and large banks.

6) **Mal-allocation of Resources:** Selective credit controls also lead to mal-allocation of resources when they are applied to selected sectors, areas and industries while leaving others to operate freely. They place undue restrictions on the freedom of the former and affect their production.

FISCAL POLICY

Meaning and Definition of Fiscal Policy

Fiscal policy may be defined as that part of governmental economic policy which deals with taxation, expenditure, borrowing and the management of public debt in an economy. It is an instrument of modern public finance..

According to Paul Samuelson, "Fiscal Policy means public expenditure and tax policy".

According to Arthur Smithies, "Fiscal Policy is a policy under which government uses its expenditure and revenue programs to produce desirable effects and avoid undesirable effects on the national income, production and employment".

According to Buehler, "By fiscal policy is meant the use of public finance or expenditure, taxes, borrowing and financial administration to further our national economic objective".

The term, fiscal policy, embraces the tax and expenditure policies of the government. Thus, fiscal policy operates through the control of government expenditures and tax receipts. It encompasses two separate but related decisions; public expenditures, and the level and structure of taxes. The amount of public outlay, the incidence and effects of taxation, and the relation between expenditure and revenue exert a significant impact upon the free enterprise economy.

Characteristics of Fiscal Policy of India

Main characteristics of Fiscal Policy of India are given as follows:

1) **Rationalization of Product Classification Codes:** A very welcome change brought about for administrative convenience is the adoption of a rationalized standard product code structure for indirect taxes. The change has resulted in reduced disputes and litigations about product classification.

2) **Common Accounting Year for Income Tax:** Taxation policy has adopted standard accounting year (April-March) for the purpose of income tax. The change is intended to reduce the malpractices and raise tax revenues.

3) **Long-Term Fiscal Policy:** Since 1986 budget, the Government of India has introduced long term fiscal policy to provide greater certainties in its budgetary policies and to improve the over all environment of business.

4) **Impact on Rural Employment:** Generation of employment has been an important objective of fiscal policy. The Government of India has introduced new employment schemes like Jawahar Rozgar Yojna or strengthened the existing

schemes like integrated Rural Development Program or National Rural Employment Program.

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5) **Black Money:** Unaccounted money has been a constant feature of media's economy. Fiscal measures have generally failed to reduce the creation of black money. Schemes like Voluntary Disclosure, Bearer Bonds or Indira Vikas Patra have had marginal impact on the incidence and growth of black money.

6) **Reliance on Indirect Taxes:** The tax policy is increasingly becoming regressive in nature by large dependence on indirect taxes like excise duty or custom duty as compared to that on direct taxes like income taxes, corporation tax, capital gains tax, etc.

7) **Inadequate Public Sector Contribution:** Contrary to repeated assertion by the Government of India, public sector continues to be a drain on the meager resources of the Government. Plan schemes of finance have expected sizable contribution from public sector, which has not materialized in most cases.

8) **Introduction of MODVAT:** In 1986 the introduction of MODVAT has helped to reduce the cumulative impact of indirect taxes on manufactured products. Under MODVAT the manufacturer while charging full rate of excise duty on his output, gets credit for tax paid on inputs. This reduces the cascading effect of excise duty.

9) **Inflationary Potential:** With large budget deficits, indirect taxes, shortages, black money and rising money incomes, inflationary trend in economy has been remarkable. The fiscal policy instead of being a cure of inflation has become the cause of inflation.

Objectives of Fiscal Policy

Fiscal policy, in modern era, subscribes to the following major macro-economic goals:

1) **Fiscal Policy for Full Employment:** Fiscal policy is considered as an effective instrument for reducing unemployment and securing full employment. Full employment occurs where there is job available for everyone who is fit to work and wants a job at the prevailing wage rates.

   To pursue this goal, Keynes suggested that:

   i) Taxation should be devised to promote and sustain consumption and investment.

   ii) To raise the level of effective demand and to overcome depressionary forces, budget should be in deficit and it should have deficit financing.

   iii) Public expenditure has to be compensatory one. It has to be in a planned way to finance public works programs and provide social security measures.

   iv) Direct taxes should be lowered to encourage savings and investments directed towards creation of more employment opportunities.

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v) Public expenditure should be meant for uplifting the level of aggregate demand, investment and employment.

vi) Public borrowings should be on a large scale to finance productive public expenditure.

Once full employment level is reached, it has to be constantly maintained by adopting appropriate fiscal measures from time to time.

2) **Fiscal Policy and Economic Stabilization:** Economic stability is another prime aim of a sound fiscal policy. This goal implies maintenance of full employment with relative price stabilization. Price stability here means relative price stability, inflation should be curbed and deflation should be avoided. In short, economic growth and stability are the twin objectives jointly pursued by a developing country's fiscal policy. Therefore, stimulating growth process should be given a boost at a time while inflationary pressures are to be curbed.

In a growing economy, when huge investment is undertaken to construct social overhead capital, infrastructures of the economy and development of heavy industries, on account of long gestation period, returns are not immediate, as scarcity of consumption goods is felt. This leads to a rising price spiral. A demand-pull inflation thereby causes wages, etc., to go up and cost-push inflation is provoked. This vicious circle of inflation has to be checked through appropriate fiscal measures.

3) **Fiscal Policy and Economic Growth:** Poor countries are entangled in the vicious circle of poverty. It should be broken. Thus, rapid economic growth is the fundamental objective of fiscal policy in a developing economy.

Fiscal policy as a means of encouraging growth process has the following objectives:

i) To realize and mobilize potential resources into the productive channels. For this fiscal policy should aim at improving marginal propensity to save and the consequent incremental saving ratio.

The following methods have been suggested by **Prof. Tripathy** for raising the incremental saving ratio:

a) Imposition of additional taxes,

b) Direct physical control,

c) Revenue of public enterprises,

d) Increase in the rates of taxation,

e) Public debt, and

f) Deficit financing.

ii) To accelerate the rate of economic growth, m this regard, fiscal measure must be conducive to growth process. In no way should fiscal means adversely affect the ability and willingness to work hard, save more and invest.

Check Your Progress

3. What is Statutory Liquidity Ratio?
4. Define Fiscal Policy.
5. What are different elements of Fiscal Policy?

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iii) To induce and stimulate private sector investment.

iv) To promote investment into socially desirable channels.

v) To alter the pattern of investment and production in such a way as to improve the general economic welfare and sustain egalitarian goals like equity in distribution and eradication ofpoverty.

4) **Fiscal Policy and Social Justice:** A welfare state should provide social justice by giving equitable distribution of income and wealth. Fiscal policy can serve as an effective means of achieving this much desired goal of socialism in developed as well as developing countries. Progressive tax system can be of much use in realizing this objective. Moreover, public expenditure helps in redistributing income from the rich to the poor section of the society.

   Thus, fiscal policy insists that in a budget, growing allocation should be made for programs like free medical care, free education, subsidized housing, subsidized essential commodities like milk, etc.

From the above discussion, it follows that the objectives of fiscal policy are not conflicting but complementary to each other.

Elements of Fiscal Policy

The main components of fiscal policy are as follows:

1) **Budgetary Policy:** The old classical economists advocated a policy of balanced and small budgets. However, this policy will not help to tide over depression and unemployment according to **Prof. J. M. Keynes.** The need at such a time is to increase the flow of income-stream into the economy and could be made possible, according to Prof. J. M. Keynes, only through deficit budgeting. Hence, it is essential that the government should incur large deficits in the budget and then meet these deficits either by borrowing from the banks, etc., or through printing fresh currency notes. It will inject fresh purchasing power in the economy, helping it to fight depression and employment effectively.

2) **Taxation Policy:** hi order to fight depression and unemployment, taxation policy of the government, according to Keynesians, should be so designed as to stimulate both consumption and investment simultaneously. The only way to do it successfully is to reduce the general burden of taxation on the community. The commodity taxes should be cut down to the minimum so as to stimulate consumption on the part of the public. Further, to promote increased investments, it may also be essential to cut down business and corporate taxes.

   Taxation measures in particular may be used to accomplish the following objectives:

   i) Curtailing consumption and thus garnering resources for public sector investment.

   ii) Inducing the people to work bard, save and invest in production.

   iii) Curbing the use of scarce resources in unproductive private investment and then diverting them to the productive public sector.

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iv) Reshaping the pattern of investment in a socially desirable manner.

v) Reducing inequalities in income and wealth through progressive taxation.

3) **Public Debt:** Public debt can also be employed by the government as an instrument to fight depression and unemployment. The deficits in government's budgets shall have to be met partly if not wholly through public borrowings. But while adopting the fiscal policy of public borrowing (public debt), the government shall have to keep the following two considerations in mind.

   Firstly, in order to keep the burden of public debt low, the government should aim at a policy of low interest rates during depression.

   Secondly, the government should try as far as possible to borrow from those sections of the community with whom the funds are lying idle. The idea is to utilize those idle funds through borrowing for productive purposes.

4) **Public Expenditure:** An increase in public expenditure can also be employed by the government as an instrument to fight against depression and unemployment. Increase in public expenditure at such a time may take the following two forms:

   i) **Pump Priming:** Pump Priming refers to that public expenditure which helps initiate and revive economic activity in an economy where stagnation reins supreme consequent upon depression. The object is to increase private investment through an injection of purchasing power in the form of an increase in public expenditure.

   ii) **Compensatory Spending:** On the other hand, compensatory spending refers to the government expenditure which is undertaken with a view to compensating the decline in private investment. Usually private investment suddenly declines at the time of depression. Under these circumstances, there is no alternative before the government except to resort to public investment. However, public investment should be undertaken on a large scale so asto have an effective impact on the employment situation.

Evaluation of the Fiscal Policy

The seriousness of the fiscal problem facing the country is now so widely recognized that it is useful to put in some perspective.

In 1991, when the economic reforms began, we faced an exceptionally severe crisis and the Central Government's fiscal deficit which had reached 8.3% of GDP in the preceding year was seen as the root cause of the crisis. This gave a sense of urgency to the need for fiscal correction and we were able to reduce the deficit to around 6 per cent of GDP in the very first year. It was recognized at that time that even this was too high and further reduction was needed to release resources into the economy and reduce interest rates both very necessary to stimulate private investment. The medium term objective was to reduce fiscal deficit to around 3 per cent by 1996-97. Unfortunately this target was never achieved. The result has been that interest rate remained very high.

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Meanwhile the fiscal position of states including the so called better administered states has deteriorated significantly. Unlike the centre, the states are not allowed to borrow freely and this puts automatic limit on their fiscal deficit. This only means uncontrolled non-plan expenditure and mounting losses on the supply of various economic services. Losses in State Road Transport Corporation are about 1000% and of State Electricity Boards are 11,000 crore.

In effect, therefore a large portion of plan expenditure is not financing new development projects but only covering salaries and rising costs of old projects. The situation in some states is such that they find it difficult to meet salary payments.

The consequences of not correcting this situation are self-evident. The high deficit will perpetuate the present high interest rates which hurt investments in the economy and indeed hurt the small producers the most.

Much larger investments are also needed in health and education especially in rural areas to bring social development indicators upto respectable levels comparable with other developed countries.

The fiscal objective for the next decade must therefore have two dimensions. We must reduce fiscal deficit to release resources for private investment out and simultaneously increase public investment in critical areas. This suggests that the scale of fiscal effort needed is very large.

The total fiscal improvement required to achieve these twin objectives is around 5.5 per cent of GDP over a three year period, i.e., around 1.8 percentage points per year.

Advantages of Fiscal Policy

Following are some important merits or contributions of fiscal policy of Government of India:

1) **Capital Formation:** Fiscal Policy has played a very important role in raising the rate of capital formation in country - in private as well as public sector. A major part of budgetary resources has been invested in Public Sector enterprises which have resulted in increase in gross domestic capital formation as per cent of GDP from 10.2 per cent in 1950-51 to 22.9 in 1997-98 and to 23.7 per cent in 2001-02.

2) **Resource Mobilization:** Fiscal policy has helped to mobilize resources through taxes, savings, public debt, etc., for economic development of the country. Resource Mobilization which was 70 per cent in 1965-66 has increased to 90 per cent in 2001-2002.

3) **Incentives to Private Sector:** Private Sector has been encouraged under fiscal policy for investment and production. Tax concessions, cash subsidies exemptions in taxes have been given as incentives to private sector units set up in backward areas and export oriented units. Similarly subsidies and tax concessions have also been given to encourage imports and as a result it has greatly affected exports and imports of the country.

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4) **Encourages Savings:** Various incentives have been given to raise the rate of savings in household and corporate sector. To encourage savings in household sector various concessions and tax benefits have been given on fixed deposits, life insurance schemes, Kisan Vikas Patras CKVPs), National Saving Certificates Q4SCs), provident funds, etc., savings have also been encouraged in corporate sector by offering them tax concessions and tax exemptions. Results of such incentives can be seen from the figure of increase in saving rate from 10.4 per cent in 1950-51 to 24 per cent in 2001-200.2.

5) **Poverty alleviation and Employment Generation:** To fulfill one of its major objectives of providing full employment, allocation of huge amount has been made in fiscal policy to eradicate poverty and generate employment. For this a huge amount has been spent on different schemes like twenty point program, Integrated Rural Development Program (LRDP), Jawahar Rozgar Yojana (JRY), Prime Minister Rozgar Yojana (PMRY), Employment Assurance Scheme (EAS), encouraging small scale and cottage industries, etc.

6) **Reduction in Inequality of Income and Wealth:** Fiscal Policy of the country has been making constant endeavor to reduce inequality of income and wealth. Resources have been mobilized from rich class to poor by way of progressive taxes, wealth tax, corporation tax and capital gains tax, etc., and this money has been utilized for the welfare of poor people.

7) **Export Promotion:** Exports have been encouraged by way of providing subsidies, concessions, tax exemptions, cash subsidies, etc. Exports have shown a rise from 4.5 per cent in 1960-61 to 23.4 per cent in 2001-2002. Import duty on raw material and capital goods used for production of goods meant for export has also been reduced with a view to encourage exports.

) **Development of Public Enterprises:** Fiscal policy has been providing finance for development of public enterprise. These public enterprises have been set up in the area ofbasic and heavy industries. Establishment of basic and heavy industries involves great deal ofrisk and huge capital investment. So private sector hesitates in setting up these industries. These industries have played significant role in the industrial development of our nation. Public enterprises have promoted infrastructure like railways, power, ports, roads, dams, etc.

) **Social Welfare:** Through fiscal policy government spends huge amount on public health, education, and safe drinking water, welfare of weaker sections of society, child welfare, woman welfare, and welfare of aged persons.

imitations of Fiscal Policy

he limitations of Fiscal Policy are given as follows:

Inflation: Deficit financing has proved inflationary. Deficit financing results in increase in money supply, which results into fall in the value of money and in turn leads to rise in prices.

Dependence on the Size of Measures and their Timing: The effectiveness of fiscal policy depends on the size of measures adopted and their timing. The

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exact change effected in the national income will depend on the change in the revenue expenditure made by authorities. Moreover, the current timing of the change is an essential factor in their success. Oneof the limitations of fiscal policy is the practical difficulty of observing these conditions. The correct timing of the measures is also a very difficult job. It is very difficult for the authorities to realize when a boom or slump is coming.

3) **Dependence on the Redistribution of Income:** The exact effects of fiscal measures adopted also depend on the redistribution of income that results from them. When a large part of any addition to income goes to the classes which are in the habit of saving, the effect on total demand is likely to be smaller than expected. On the contrary, if the large part of any addition to income goes to the classes which are in the habit of excessive expenditure, the multiplier effects are likely to be larger than expected.

4) **Flexibility of the Government Revenue:** The flexibility of government revenue itself may work as a restrictive influence on any fiscal policy adopted by the government. When increased income is made for the purpose of expanding total spending in the community, a part of the same might come back to the government as more revenue and thus reduce the extent of higher public expenditure. On the contrary, a decrease in government expenditure might reduce revenue also.

5) **Effects on Private Investment:** Government spending does not have full effect on national income if its effect on private investment is contradictory.

6) **Changes in the Balance of Payment:** Another limiting influence is exerted by changes in the balance of payment. The effects of an increase in government expenditure are counteracted to some extent by an expansion in the value of imports and a decline in the value of exports.

7) **Dependence on the Supply of Human Efforts:** The effects of fiscal policy depend on the supply of human effort. The national income will rise when people desire to work. On the contrary, rising income might make people less inclined to work hard, m the same way, an anti-inflationary policy is partly nullified by people trying to work harder & making up for the discouragement provided by the government.

8) **Lack of Coordination and Integration:** There is lack of coordination and integration in different fields of economy and thus the fiscal policy fails in creating the requisite effect.

9) **Limitations of Budgetary Policy:** Budget is a small part of national income of a country and it is not in a position to have effective effect in the economy of a country.

Suggestions for Reforms in Fiscal Policy

The important point to be noted is that a fiscal correction or 5.5 per cent points of GDP over the next three years is an extremely difficult task in any situation. Action will be needed on several fronts:

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1) **Improving Tax Administration to Raise Larger Revenue:** Anyone who has studied the Indian tax system, both at the central and the state level is struck by the fact that it is very complex - a multiplicity of rates all of which lends itself to evasion by tax payers and harassment by tax authorities. This also lends itself to corruption at alllevels. Half the fiscal adjustment needed could therefore come from effective implementation of tax reforms.

   This can be done if we can translate general statements about "improving tax administration" and "widening the tax" into specific proposals for removal of exemptions simplifying the system by reducing the number of rates and also modernizing procedures.

   Hopefully, the new Tax Reforms Committee referred to in the President Address, can quickly come up with specific recommendations in this regard.

2) **Reducing Subsidies:** What is needed is not complete elimination of all these subsidies but only a substantial reduction combined with better targeting. This will release resources which will enable us to finance some of the critical expenditures which need to be increased to meet our development objectives.

3) **Privatization:** Many developing countries have been able to bring about a substantial improvement in their fiscal position by undertaking major privatization of public sector enterprises.

4) **Reprioritize Plan Schemes:** Finally, it is necessary to re-prioritize plan expenditure to eliminate schemes which are of doubtful value. Detailed post evaluation studies show that many of our plan schemes, though well intentioned, simply do not achieve their stated objectives, or do so only to a limited degree making the schemes cost-ineffective. This is due to a combination of poor design of the schemes and inadequate administrative capability.

   Whatever we do, we can be sure of one thing. If we do not make a move on most, if not all of the issues we will not see significant progress on the fiscal front. This in turn will mean a continuous erosion of public investment in critical areas, continuation of high interest rates limiting the flow of funds for private investment and an international rating which means below investment grade. It is unlikely that we can achieve 7 to 8 per cent growth in such circumstances.

   According to a study made in April, 2000 it is been argued that fiscal deficit will be controlled by next 2 or 3 years completely if these reforms are taken properly.

5) **Agricultural Taxation:** Agricultural income is fully tax free. But rich agriculturists can be brought under tax net to increase revenue in the hands of government. With the increase in revenue of government there will be no need to resort to deficit financing or depend on public debt for generation of revenue.

6) **Reduction of Non-Development Expenditure:** Fiscal policy should aim at bringing down non-development expenditure. Once the unproductive expenditure is reduced the rate of growth of economy will increase and inflationary impact of such expenditure will also reduce.

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7) **Progressive Tax Structure:** Taxes should be progressive so that the rich have to pay more taxes. High rate of tax should be charged on luxury goods so that the rich will have to pay more tax.

8) **Public Sector Performance to be Improved:** To increase the return on huge investments made in public sector enterprise, the efficiency of public sector should be properly supervised and improved. Public Sector undertakings should be managed on commercial lines with least interference of government.

9) **Check on Black Money:** Problem of black money is a major problem being faced by India. Different Schemes like VDS or Voluntary Disclosure Scheme should be relaunched. Rates of income tax and corporate taxes should be reduced. System of quota, permit and licenses should also be abolished. Practices of Corruption and political interference should be totally stopped.

Macro-Economic Policy

A macro-economic policy is, in fact, an instrument of policing the economy to achieve certain economic goals. The macro-economic goals include a sustainable growth rate, full or near full employment, equitable distribution of national income, a stable price level, and equilibrium in the balance of payments.

As regards to scope of macro-economic policy, it encompasses all major macro-economic variables. Macro-economic variables include both real and monetary variables. Real variables including GNP, total employment, aggregate expenditure, saving and investment, government expenditure and tax, and non-tax revenue, exports and imports, and the balance of payments. Monetary variables include supply of money, demand for money, supply of credit, bank deposits, and interest rate. Accordingly, there are two kinds of tools or measures to control and regulate the macro-variables, *viz.*, monetary measures and fiscal measures.

According to Brooks and Evans, "Macro-economic policy can be thought of as an attempt by the authorities to achieve particular target levels of certain major economic aggregate".

Macro-economic policy can be defined as a program of action undertaken to control, regulate and manipulate macro-economic variables to achieve the macro-economic goals of the society.

Need of Macro-Economic Policies

Macro-economic problems have always been there ever since countries began the endeavor to improve their living conditions. But the role of government in managing the economy and use of macro-economic policies to solve the macro-economic problems are of recent origin. Until the Great Depression of 1930s, there was nothing like macro-economic policy. The reason was that the classical economic thoughts that prevailed until the Great Depression did not favor government intervention with the economic system beyond its promotional and supportive roles. They held the view that the economy should be allowed to work on the principles of free market mechanism and the government intervention with the economic system must be minimum. However, the Great Depression (1929-1933) shattered the classical doctrine as it could offer neither an explanation nor a solution to the devastating and unprecedented economic problems caused by the Great Depression.

Keynes showed the need for the government role in economic management to achieve growth and stability. Keynes' view gained prominence in the post-Second World War period, especially in the reconstruction of the war-ravaged economies. A reasonably successful role of the government in the re-construction of the war-ravaged economies established the view that the government can play a significant role of the prime-mover and can accelerate the pace of economic growth, reduce unemployment and stabilize the economy through its fiscal measures. "Many early enthusiasts of the Keynesian approach believed that fiscal policy was like a knob they could turn to control the pace of the economy".

Some economists believe that "The need for macro-economic policy arises because the economic system does not adjust appropriately to the shocks to which it is constantly subjected". However, the role of macro-economic policy did not remain confined to controlling business cycles: it was extended far beyond. In fact, the early success of Keynesian prescription to cure economic problems of those days created a strong belief that macro-economic policies could be used to solve the problems of under-development in the under-developed countries, *viz.:*

1) Breaking the 'vicious circle of poverty' of the backward economies and pushing them out of their 'low equilibrium trap',
2) Creating conditions for capital formation and economic growth,
3) Solving their problem of chronic mass open and disguised unemployment, and
4) Reducing the inexplicable wide gap between the rich and the poor.

In backward economies, therefore, the need for macroeconomic policy was felt for creating conditions for economic growth.

Objectives of Macro-Economic Policies

The four major objectives are

1) Full employment,
2) Price stability,
3) A high, but sustainable, rate of economic growth, and
4) Keeping the Balance of Payments in equilibrium.

The objectives of macro-economic policies are determined by the policy-makers in view of the social and economic aspirations of the people, which, of course, vary from country to country and from time to time depending on the changing economic conditions. Therefore, the policy objectives are bound to vary from country to country and from time to time.

Check Your Progress

6. What is Macro-Economic Policy?
7. Describe Industrial Policy.
8. What do you mean by Industrial Licensing?

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For example, the foremost need of most industrial countries in the post-depression period was to provide jobs to the unemployed people, to stabilize the economy, and to prevent the violent economic ups and downs. Therefore, employment and economic stabilization were the two primary objectives of macro-economic policies of most countries ih the post-depression period. During the post-War II period, however, many other objectives were added later to the list of macro-economic policy objectives.

The major and common objectives of macro-economic policies i.e. economic growth:

Economic Growth

Achieving and maintaining a high growth rate has been accorded a top priority in the economic agenda of most nations - rich and poor. Also, the emphasis on a reasonably high growth rate in accordance with growth potentials of the nation has increased tremendously over the past half a century.

It may be mentioned here that none of the objectives of India's macn>economic policies have been achieved satisfactorily. Achievements have been far below the target rates:

1) Long-term growth rate has been about 3-4%,
2) Employment rate has been much lower (1-1.5% p.a.),
3) Economic disparity is claimed to have widened instead of decreasing as claimed by many researchers, and
4) The price level has almost continuously increased - the annual average rate of inflation has been about 8% per annum since 1960-61. Not only in India, it has been a common experience of many developed and developing countries that policy targets have not been satisfactorily achieved.

INDUSTRIAL POLICY

Introduction to Industrial Policy

Industrial policy is an important document, which lays a wide canvas and sets the tone for implementing promotional and regulatory roles of the government.

The term 'industrial policy' refers to the government's policy towards industries - their establishment, functioning, growth and management. The policy will indicate the respective areas of the large, medium and small-scale sectors. It will also spell out government's policy towards foreign capital, labor, tariff, and other related aspects. Naturally, the industrial development of a country will be shaped, guided, fostered, regulated and controlled by its industrial policy.

Industrial policy is probably the most important document, which indicates the relationship between government and business. The document is helpful to planners and administrators in the government, in as much as it give clear guidelines for promoting and regulating industries. It is equally helpful to industrialists and others for deciding areas and priorities of their investments.

Objectives or Rationale of Industrial Policy

Objectives of the Industrial Policy of the Government are as follows:

1) To clearly demarcate areas of production under public sector, private sector, joint sector, cooperative sector and small scale sector as well as large scale, medium scale and small scale units.

2) To establish clear monetary and fiscal policies that could augment industrial developments.

3) To provide guidelines for importing foreign capital in cash and kind, and their role.

4) To optimize production through a process of capacity utilization of scarce resources.

5) To correct imbalance in the growth and development of industries.

6) To prevent formation of combinations, monopolies and concentration of wealth in the hands of a few entrepreneurs as that would widen the gap between the rich and poor.

7) To take all necessary measures to solve the problem of unemployment that was threatening the country.

8) To bring about diversification of industries to avoid economic and regional imbalances.

9) To define clearly the role of private sector and its active participation.

Measures of Industrial Policy

Some of the important policy measures announced and procedural simplifications undertaken to pursue the above objectives are as under:

1) **Liberalization of Industrial Licensing Policy:** The list of items requiring compulsory licensing is reviewed on an ongoing basis. At present, only six industries are under compulsory licensing mainly on account of environmental, safety and strategic considerations. Similarly, there are only three industries reserved for the public sector. The lists of industries reserved for the public sector and of items under compulsory licensing are at Appendix III and rV respectively.

2) **Introduction of Industrial Entrepreneurs' Memorandum (IEM):** Industries not requiring compulsory licensing are to file an Industrial Entrepreneurs' Memorandum (IEM) to the Secretariat for Industrial Assistance (SLA). No industrial approval is required for such exempted industries. Amendments are also allowed to IEM proposals filed after*July 1998.

3) **Liberalization of the Locational Policy:** A significantly amended locational policy in tune with the liberalized licensing policy is in place. No industrial approval is required from the Government for locations not falling within 25kms of the periphery of cities having a population of more than one million except

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for those industries where industrial licensing is compulsory. Non-polluting industries such as electronics, computer software and printing can be located within 25kms of the periphery of cities with more than one million populations. Permission to other industries is granted in such locations only if they are located in an industrial area so designated prior to 25th July 1991. Zoning and land use regulations as well as environmental legislations have to be followed.

4) **Policy for Small Scale Industries:** Reservation of items of manufacture exclusively for the small scale sector forms an important focus of the industrial policy as a measure of protecting this sector. Since 24th December, 1999, industrial undertakings with an investment upto rupees one crore are within the small scale and ancillary sector. A differential investment limit has been adopted since 9th October, 2001 for 41 reserved items where the investment limit upto rupees five crore is prescribed for qualifying as a small scale unit. The investment limit for tiny units is Rs. 25 lakhs.

   749 items are reserved for manufacture in the small scale sector. All undertakings other than the small scale industrial undertakings engaged in the manufacture of items reserved for manufacture in the small scale sector are required to obtain an industrial license and undertake an export obligation of 50% of the annual production. This condition of licensing is, however, not applicable to those undertakings operating under 100% Export Oriented Undertakings Scheme, the Export Processing Zone (EPZ) or the Special Economic Zone schemes (SEZs).

5) **Non-Resident Indians' Scheme:** The **general** policy **and** facilities for Foreign Direct Investment as available to foreign investors/company **are** fully applicable to NRIs as well. In addition, Government has extended some concessions especially for **NRIs and overseas** corporate bodies having more than 60% stake by the NRIs.

   These inter-alia includes:

   i) NRI/OCB investment in the real estate and housing sectors upto 100%, and

   ii) NRI/OCB investment in domestic airlines sector upto 100%.

   NRI / OCBs are also allowed to invest upto 100% equity on non-repatriation basis in all activities except for a small negative list. Apart from this, NRMOCBs are also allowed to invest on repatriation / non-repatriation under the portfolio investment scheme.

6) **Electronic Hardware Technology Park (EHTP)/Software Technology Park (STP) Scheme:** For building-up strong electronics industry and with a view to enhancing export, two schemes, *viz.,* Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) are in operation. Under EHTP/STP scheme, the inputs are allowed to be procured free of duties.

   The Directors of STPs have powers to approved fresh STP^HTP proposals and also grand post-approval amendment in respect of EHTP/STP projects as

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have been given to the Development Commissioners of Export Processing Zones in the case of Export Oriented Units. All other application for setting up projects under these schemes, are considered by the Inter-Ministerial Standing Committee (IMSC) Chaired by Secretary (Information Technology). The IMSC is serviced by the SIA.

7) **Policy for Foreign Direct Investment (FDI):** Promotion of foreign direct investment forms an integral part of India's economic policies. The role of foreign direct investment in accelerating economic growth is by way of infusion of capital, technology and modern management practices. The Department has put in place a liberal and transparent foreign investment regime where most activities are opened to foreign investment on automatic route without any limit on the extent of foreign ownership. Some of the recent initiatives taken to further liberalize the FDI regime, *inter alia,* include opening up of sectors such as Insurance (upto 26%); development of integrated townships (upto 100%); defense industry (upto 26%); tea plantation (upto 100% subject to divestment of 26% within five years to FDI); enhancement of FDI limits in private sector banking, allowing FDI upto 100% under the automatic route for most manufacturing activities in SEZs; opening up B2B e-commerce; Internet Service Providers (ISPs) without Gateways; electronic mail and voice mail to 100% foreign investment subject to 26% divestmentcondition, etc.

The Department has also strengthened investment facilitation measures through Foreign Investment Implementation Authority (FILA).

Need and Importance of Industrial Policy

Need and importance of industrial policy can be understood by the following points:

1) Helpful in establishing coordination between industrial development and agricultural development.
2) Helpful in establishing coordination between public sector and private sector.
3) Helpful in directing national resources in desired direction.
4) Helpful in formulating a plan of industrial development.
5) Helpful in formulating rules, principles and policies for the management regulation and control of industrial undertakings.
6) Helpful in preventing the concentration of economic power.
7) Helpful in establishing effective coordination between capital and physical resources on one hand and natural and social resources on other hand.
8) Helpful in promoting exports and reducing the dependence on imports.
9) Helpful in maintaining regional balances.
10) Helpful in formulating the target and program of industrial development.

Industrial Policy of the Post 1991

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On 24th July 1991, the government headed by Mr. P.V. Narasihma Rao, announced a new industrial policy. The most important initiatives are with respect to the virtual scrapping of industrial licensing and registration policies, an end to the monopoly law and a more welcoming approach to foreign investments, apart from redefining the role of the public sector.

Objectives of 1991 Policy

The objectives of Industrial Policy, 1991 are enlisted below:

1) Self-reliance to build on the many sided gains already made.
2) Encouragement to Indian entrepreneurship, promotion of productivity and employment generation.
3) Development of indigenous technology through greater investment in R&D and bringing in new technology to help Indian manufacturing units attain world standards.
4) Removing the regulatory system and other weaknesses.
5) Increasing the competitiveness of industries for the benefit of the common man.
6) Incentives for the industrialization of the backward area.
7) Enhanced support to the small-scale sector.
8) Ensure running of public sector undertakings (PSUs) on business lines and cut their losses.
9) Protect the interest of workers.
10) Abolish the monopoly of any sector in any field of manufacture except on strategic or security grounds.
11) To link Indian economy to the global market so that we acquire the ability to pay for imports,and to make us less dependent on aid.

Industrial Policy of 1991 and Recent Developments

In pursuit of the above objectives, the Government has decided to take a series of initiatives in respect of the policies relating to the following areas:

1) **Industrial Licensing:** Industrial licensing in India is a unique instrument of direct control designed to implement a major part of the industrial policy. Though many developing countries have resorted to similar direct controls, these does not seem to be any parallel in the developed countries for exercising so much direct control over industrial investment. The Industries (Development and Regulation) Act, 1951, through which the licensing system is operated, in effect empowers the Government of license (or permit) new investment, expansion of licensed units, production of new articles, change of location by the licensed units and

also to investigate the affairs of licensed units in certain cases and to take over the management thereof, if conditions so warrant. The objectives behind these powers are, of course, development and regulation of industries. It is in the actual implementation of these objectives while exercising the powers of the Government under the Industries Act, that the relevant aspects of the industrial policy are expected to be fulfilled.

Objectives of Industrial Licensing

The basic objectives of industrial licensing are as follows:

i) Planned industrial development through appropriate regulations and controls.

ii) Balanced industrial growth and development through regulation of proper location of industrial units and to check regional disparities.

iii) Directing industrial investment in accordance with plan priorities.

iv) Ensuring government control ovet industrial activities in India.

v) Regulating the industrial capacity as per targets set for planned economy.

vi) Preventing concentration of industrial and economic power and monopoly.

vii) Checking unbalanced growth of industrial establishments and ensuring economic size of industrial units..

viii) Encouraging healthy entrepreneurship, while discouraging unhealthy competition, monopoly, and restrictive industrial practices.

ix) Broadening the industrial base in media through new entrepreneurship development and ensuring industrial dispersion.

x) Protecting of small-scale industries against undue competition of large-scale industries.

xi) Utilizing full capacity oflarge-scale industries.

xii) Utilizing appropriate technology.

xiii) License was necessary to carry on an industrial activity. Licensing is mandatory in respect of starting **a** new unit, change in product, manufacturing a new product, affecting a substantial expansion by an established unit.

2) **Foreign Investment:** While welcoming foreign investment with its attendant advantage of technology transfer, marketing expertise, introduction of modern managerial techniques and export promotion, the Industrial Policy Resolution provides for automatic appraisal of foreign equity participation upto 51% in high priority industries which include 34 broad areas like metallurgy, electrical equipment, transformer, food processing, hotel and tourism industry.

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it was decided to provide approval for direct foreign investment upto 51 per cent foreign equity in such industries.

For the promotion of exports of Indian products in world markets, the government would encourage foreign trading companies to assist Indian exporters in export activities.

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i) Approval would be given for direct foreign investment upto 51 per cent foreign equity in high priority industries. There shall be no bottlenecks of any kind in this process. Such clearance will be available if foreign equity covers the foreign exchange requirement for imported capital goods.

ii) While the import of components, raw materials and intermediate goods, and payment ofknow-how fees and royalties would be governed by the general policy applicable to other domestic units, the payment of dividends would be monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.

iii) To provide access to international markets, majority foreign equity holding upto 51% equity would be allowed for trading companies primarily engaged in export activities.

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

Automatic Approval

The Reserve Bank of India, through its regional offices, accords automatic approval to all industries for foreign technology collaboration agreements subject to:

i) Lump-sum payments not exceeding US $2 Million,

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

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

Payment of royalty upto 2% for exports and 1% for domesticsales is allowed under the automatic route on use of trademarks and brand names of the foreign collaborators without technology transfer. In case of technology transfer, payment of royalty sub-sumes the payment of royalty for use of trademark and brand name of the foreign collaborator. Royalty on brand name/trade mark shall be paid as a percentage of net sales, *viz.,* gross sales less agents'/dealers' commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts, and components imported from the foreign licensor or its subsidiary/affiliated company.

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

Government Approval

For the following categories, government approval would be necessary:

i) Proposals attracting compulsory licensing.

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

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

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

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

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

The performance of public sector was far from satisfactory. Most of the PSUs posted losses. Even companies like SAIL, which enjoyed high demand posted losses year after year. Lack of accountability, political interference, excessive labor, poor project management, and inadequate attention to R&D, socialist objectives, etc., lead to even the erosion of paid up capital of some PSUs.

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

Memorandum of Understanding

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

BIFR

Sick unviable units were referred to the Board of Industrial and Financial Reconstruction (BIFR) to advice the government on whether to invest further in PSUs to close them down or to divest government stake in them. The National Renewal Fund fl^RW) provided assistance to cover the cost of retraining and redeployment of labor and also provide compensation to labor affected by the closure of unviable public sector units.

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Disinvestments and Privatization

The government decided to reduce its stake in PSUs and also decided to privatize a few PSUs. In the coming years, many PSUs were in fact were privatized and disinvested.

5) **Monopolies and Restrictive Trade Practices Act (MRTP ACT):** The pre-entry scrutiny of investment decisions by the so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopoly houses to obtain prior approval of the Central government for expansion, establishment of new undertakings, mergers, amalgamation and take over and the appointment of certain directors. The thrust of policy will be more on controlling unfair or restrictive business practices.

   The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and the establishment of new undertakings. The provisions relating to merger, amalgamation, and take-over will also be repealed. Similarly, the provisions regarding restrictions on the acquisition of and the transfer of shares will be appropriately incorporated in the Companies Act.

   Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation *suo moto* or complaints received from individual consumers or classes of consumers.

Merits of the 1991 Policy Statement

Certain merits of the 1991 Policy Statement are given as hereunder:

1) The 1991 **Policy Statement is** truly historic, whether it is the result of ^F pressure or our own realization that the time has come **to** open up the economy.

2) The changes, long overdue, need to be welcomed as a bold initiative aimed at making **Indian** industry **more** competitive internally as well **as** internationally, and at freeing the industry **from needless** and irksome controls, most of which have outlived their utility.

3) The delicensing of a host of industries and the abolition of all registration schemes will free Indian entrepreneurs from the need to make endless trips to New Delhi. They can now concentrate on their business and move quickly to seize business opportunities.

4) The scrapping of any asset threshold or market share prescription for the definition of an MRTP company and a dominant undertaking allows companies to go ahead with investment programs without delay.

5) The liberalization of the rules relating to direct foreign investment, permitting 51 per cent equity in a wide range of industries, the easier facilitation of

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foreign technology agreements and other related measures go a long way in attracting foreign investment and technology.

6) Reforms relating to the public sector like privatization and transferring sick units to BIFR will help improve the performance of the government undertakings.

7) Finally, the new Policy Statement is a most welcome package. There is a greater reliance on the market, a bold attempt at deregulation, a desire to integrate with the world economy, and to modernize.

Limitations of 1991 Policy

There are also certain limitations of the industrial policy of 1991. These are given as follows:

1) Virtual scrapping of licensing means absence of a mechanism to determine priorities and to develop backward areas.

2) The policy is silent about tackling the growing industrial sickness. The government has not announced a clear exit policy for sick units. Clearly government seems to have yielded to the pressure of trade union lobby.

3) Off-loading of 20 per cent equity in profit making public sector units to mutual funds is a revenue raising exercise than genuine attempt at privatization.

4) Even with the scrapping of all regulations, the expected foreign investment may not come through. Infrastructural deficiencies will deter foreign investment.

5) The policy is drafted at the behest of IMF which means virtual surrender of economic sovereignty of the county to a foreign agency.

CASE STUDY:

DOORDARHSAN: BROADCASTING BLUES

[DD India's national television network is one of the world's largest broadcasting organizations with respect to the infrastructure it possesses. It present telecasts programs on 19 channels. Over the years, DD has been losing its advertising revenues to its competitors [private channels]. The continuously falling Television Viewers Rating added to the problem. DD has also been facing many problems regarding its managements, right from the time when Prasar Bharati was created. In mid-90's, cable television reached many Indian homes and several private channels, were launched. All of a sudden DD had to content with a host of channels whose programs were better produced. Poor quality of transmission and program content prompted viewers, to switch to private channels. The case provides an overview of the problems faced by DD due to mismanagement and competition from private channels.] "DD needs an owner" - CEO, Carat Media Services India.

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IS DD DEAD?

After years of falling revenues, in 1999-2000 DD had a revenue growth of 50%. In 1999-2000, DD earned revenues of Rs, 6.1 bn compared to Rs. 3.99 bn in 1998-99. DD showed signs of revival with the launch of DD Worlds [a channel for NRIs] and had a certain measure of success with some of its regional channels [Table-1 DD Channels: A snapshot]. However, by the end of 2000-01, DD's revenues were projected to grow at 6 - 15 % while private channels such as Zee T V, Star and Sony had a projected 40 -50 % revenue growth.

According to some analysts, DD's sagging revenues were only the tip of the iceberg. DD was plagued by several problems. By the late 1990's, most private producers and advertisers and a good part of the audience had deserted DD. Not even one car company advertised on DD and even two wheeler manufacturers kept away. Advertisements of Pepsi and Coca - Cola were found only during sports telecasts. Only FMCG companies stuck to DD, because its terrestrial network would help them to reach the rural and semi urban audience. Despite having over 21000 employees, DD outsourced 50 % of its programs from private producers.

In the late I990's, DD faced allegations of large scale scams and irregularities. Under-utilized infrastructure, improper investments and poor financial management adversely affected DD's performance. In 1992, when the Government opened the airwaves to private players, HD had to face competition from private satellite channels. In Cable and Satellite [C & S] homes it was found that DD programs had hardly any viewers. The depleting Television Viewer Ratings [TVRs] of the DD programs was also a cause of concern as advertisers deserted due to its low viewer ratings.

According to analysts, DD would need a budgetary support of Rs. 5 bn during fiscal 2000-01 to sustain itself, as its revenues would not cover its expenditure. Many analysts felt that privatization would be the only solution.

DD : THE INSIDE STORY

DD was launched in 1959 as the National Television Network with a modest 21 community sets in Delhi. In the year 1982, with the introduction of regular satellite link between Delhi and different transmitters, DD began the transmission of national programs. In the same year, DD switched to colour transmission. Soon it had penetrated every nook and corner of the country, cutting across demographic and geographic barriers.DD had a three-tier program service - national, regional and local. The national programs focused on the national culture and included news, programs on current affairs, and science, cultural magazines, serials, music and dance recitals, plays and feature films. At the regional level the programs were similar to the ones broadcast at the national level, the only difference being that they were broadcast in the regional language.

In 1984, DD introduced a second channel [DD2] in cities like Delhi, Mumbai, Kolkata and Chennai. DD2 was targeted at urban viewers, particularly the young viewers.

In 1995, DD launched DD - India, its international channel to cater to the NRI population. This service covered SAARC countries.. Gulf countries, West Asia, Central Asia, North Africa and Europe. In the same year, DD entered into an agreement with the Cable News Network [CNN] and launched a 24 - hours news and current affairs channel : DD News. In 1999, DD launched a separate channel for sports.

In the early 1990s, about 479 mn people in Indian homes viewed DD and an additional 1.5 mn watched DD on community sets. DD was ahead of the private channels in terms of viewership with a 90% reach. However, in the late 1990s, it could not maintain the lead and phase channels were catching up in terms of revenue even though they lagged behind in viewership and reach.

Cable onslaught

In 19S4, cable television entered India. For local entrepreneurs, cable television provided a good business opportunity, as investments required to install a cable network were low. In the early 1990s, many-private television channels were launched. Zee TV launched in 1992 led the pack. During 1992-94, there was rapid increase in the number of cable connection in Western and Northern India. In Tamil Nadu and Andhra Pradesh, a number of Tamil and Telugu channels came up in the mid-1990's.

Though by 2000, DD had an incredible reach of 70 mn homes, in comparison to C & S's reach of only 30 mn homes. It could not turn this network into an advantage [Table II for growth of cable and satellite penetration in India]. In urban households, DD programs had hardly any viewers. DD was also behind the private channels in terms of ad revenues, as its TVRs were very low compared to the TVRs of programs on private channels.

Falling Revenues

During 1996-99, the TV advertisement market grew by 76%, but DD's revenue from advertisement registered a negative growth [Table III for fall in revenues of DD]. Though DD continued to be number one in overall audience share, it lost out on viewership segments that had the highest purchasing power.

In 1998-99, DD's revenue from advertisements was Rs. 4 bn [25.8% of the market], Zee TV was close with Rs. 3.85 bn, Sony had Rs. 2.53 bn and Star channels grossed Rs. 2 bn. But the ad revenues of private channels have grown significantly, when compared to those of DD. During the period 1996-99, Zee registered a growth of 122% in ad revenues, Sony 299% and Star channels 206%. During the same period, DD's ad revenues went down by 70.17 %. DD's falling TVRs were a matter of concern for clients like Hindustan Lever - DD's largest advertiser. Said Ashutosh Srivastava, VP, HTA-Fulcrum, the media-buying arm of HLL, "Our only source of reaching 40% of this country is going down." Till 1998-99, 70% of HLL's ad spend went to DD but by 2000-01, due to tailing TVRs HLL's ad spend to DD had gone down to 50%.

During 1999-2000, producers and distributors stopped giving films to DD when it began to demand a minimum guarantee of Rs. 10 mn to broadcast a film. This

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forced DD to repeat the same old films that it had aired several times, and the RVRs went down further. According to some analysts, DD's revenues were going down because advertisers considered it a down market channel, which catered only to the lowest socio-economic groups, whose purchasing power was limited. The revenues earned by DD showed a negative growth during 1997-99. In 1999-2000, DD saw its revenue grow by 52.8%, but in 2000-01, it was projected to grow only at 6% [Table III]

Identity Crisis

DD's problems were largely attributed to what Kiran Karnik, former CEO, Discovery Communications; India called 'its loss of identity. Said Karnik, The channel has lost its identity, What is Doordharshan : Is it a public broadcaster or a commercial entity? Initially, DD officials had envisaged that the national channel would play the role of public broadcaster, while DD Metro would be the commercial Channel. Private Producers and advertisers pointed out that this attitude increased the confusion. They argued that no other network had two channels competing against each other.

With the launch of the Star News Channel, [the first independent news channel] in 1998, DD News lost its viewers to Star news. The in-depth analysis of news items"by Star News caught the imagination of the viewers [Table IV Comparative study of different news channel]. DD's image of being the propaganda machinery of the Government also went against it.

Some analysts said Political interference and corruption were another reason for DD's poor performance. In 1997, The Indian Broadcasting Bill was introduced in Parliament. The Bill was not passed, but it was enforced through an ordinance nearly a decade after it was enacted. DD was brought under a holding company called the Prasar Bharati. In 1998, the Government sacked Prasar Bharali CEO SS Gill and the Government made DD answerable to a parliamentary committee. Political interference at the top level made matters worse for DD.

There were allegations that members of the Central Commissioning Unit of DD look bribes from producers to air their programs. In 1998, the CBI arrested two DD officials for taking bribes from a serial producer. This, incident focused attention on the rampant corruption in the organization and forced management to issue guidelines regarding acceptance of gifts by employees.

DD had a poor track record in both payments to and collections-from private players. Over 50 companies owed Rs. 18.2 mn to DD, 45 on July 2001, Amitabh Bachchan Corporation Limited was DD's highest debtor with outstanding dues of Rs. 330 mn. Another allegation that DD faced was that it had allowed International Cricket Council's [ICC] ex-chief Jagmohan Dalmiya and World Tel's Mark Mascarenhas to defraud it of Rs. 160 mn over the telecast of 1998 tournament in Dhaka. The exorbitant prices that DD charged for advertisements slots also contributed to its poor performance. DD charged the producers around Rs. 1 lakh for 10 seconds, while some of the highest rated soaps on private channels charged half that price.

DD did not have a marketing team, which could market the advertisements slots as a package. Private channels like ZEE and Star had their own marketing teams/ which provided the advertisers with a package of advertisement slots on their programs. But DD had 5o different producers with 56 different half-hour programs slots for four hours of prime time each week. Each producer sold commercial time separately, to the advertisers. But advertisers preferred package deals, which, would give them airtime across the programs for a whole week.

Breathing fresh life into DD

After SS Gill was sacked in 1998, Rajeeva Ratna Shah was appointed as new CEO of Prasar Bharti. Shah began overhauling the programs of the two DD channels and weeding out corruption in the network. He stopped commissioning programs on DD1 and DD2. He decided to auction programming hours to the private players who produced the programs for DD and market them. Shah also announced the setting up of a board comprising eminent film-makers, actors, poets, writers and people from different walk of life. This board was to be entrusted the task of revamping DD.

In 2000, the government appointed a committed headed by Shunu Sen [CEO, Quadra Advisory, a strategic marketing Consultancy], NR Narayana Murthy [CEO, Infosys] and Kiran Karnik to work out a program for reviving DD. The committee considered three options. : Privatizing of DD, continuing to run it as a Public Service .Broadcaster [PSB], and running DD on both PSB and commercially viable lines. Of the three options, the committee recommended the third option. The committee felt that there was no need to privatize DD, but recommended drastic steps for reviving it.

Some of the important steps suggested by the committee were :

- Downsizing 25 % of DD's 21000 strong staff
- Getting into new media
- Setting up its own marketing department
- Developing a sharper programming focus.

One of the recommendations was to improve the quality of broadcast. DD sought the help of BBC to digitize its channels. Modi Entertainment Network began distributing the five DD channels via satellite. DD went in for a revenue sharing deal with B4U for showing movies, arid auctioned the 7:10 pm slot on DD Metro to the HFCL - Nine networks. In addition to Rs. 1.21 bn that DD got from this deal, the move helped DD to penetrate urban homes as well as C & S homes to some extent. DD also entered into an agreement with Direct to Home platforms like Echostar and Astra to distribute DD - World in 79 countries. DD employed Accenture to advise it on how to go about revamping its financial, management and administrative systems. The National Institute of Design was employed to redesign the logo.

In 2000, DD announced that it would start its own people meter project through a separate corporate entity in partnership with a few private channels and some

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advertisers. DD felt that its programs were not getting enough viewership ratings because the viewer samples used by the two firms doing the ratings -IMRB - AC Nielsen and ORG MARG were largely from C & S homes. Their ratings did not accurately reflect the viewing habits of the Indian populace.

According to most, these steps were bound to have a positive effect on revenue. However, for real growth DD had to be freed from political interference.

TABLE I :DD CHANNELS : A SNAPSHOT

DD 1	Primary channel with national, regional, local and educational programs on a time sharing basis
DD2	Metro entertainment channel targeted at urban viewers, particularly the young viewers. Programs relayed by the terrestrial transmitters in 47 cities
DD4 to DD 13	Ten separate regional language channels : Malayalam, Tamil, Oriya, Bengali, Telugu, Kannada, Marathi, Gujarati, Kashmiri and Assamese
DD 14 to DD 17	Networking of the regional services of the four Hindi speaking states : UP, Bihar, MP and Himachal Pradesh
DD18	Punjabi Regional Service
DD India [DD World]	International channels
DD Sports	Sports channel
DD News	24 hours news channel

TABLE : II ; CABLE TV GROWTH IN URBAN INDIA

YEAR	NUMBER OF HOUSEHOLDS WITH CABLE TV [IN MILLION]
1992	1.20
1993	3.30
1994	11.80
1995	15.00
1996	18.00
2000	22.00
2001	30.00

TABLE III: FALL IN REVENUES OF DD

YEAR	REVENUE [RS. BN.]	GROWTH OVER PREVIOUS UYEAR [%]
1995-96	4.30	8.10
1&96-97	5.72	33.20
1997-98	4.90	- 14.30
1998-99	3.99	- 18.50
1999-00	6.10	52.80
2000-01 [Estimate]	6.50	6.00

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TABLE: IV COMPARISON OF THE NEWS CHANNELS

STAR NEWS	ZEE NEWS	DD NEWS
Channel encrypted	Channel not encrypted	Channel not encrypted
Decoders are required	Can be freely aired	Can be freely aired
Content caters to the premium segment	Content caters to the mass market	Content caters to the mass market
English predominant language	Hindi predominant language	Hindi predominant language
Only premium brand's ad taken. Very selective regarding ads	All brands accepted. Not selective regarding ads.	No ads. Only social messages were broadcast

Economic Reforms

Indian economy had experienced major policy changes in early 1990s. The new economic reform, popularly known as, Liberalization, Privatization and Globalization (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector aimed at making the economy more efficient.

With the onset of reforms to liberalize the Indian economy in July of 1991, a new chapter has dawned for India and her billion plus population. This period of economic transition has had a tremendous impact on the overall economic development of almost all major sectors of the economy, and its effects over the last decade can hardly be overlooked. Besides, it also marks the advent of the real integration of the Indian economy into the global economy.

This era of reforms has also ushered in a remarkable change in the Indian mindset, as it deviates from the traditional values held since Independence in 1947, such as self reliance and socialistic policies of economic development, which mainly due to the inward looking restrictive form of governance, resulted in the isolation, overall backwardness and inefficiency of the economy, amongst a host of other problems. This, despite the fact that India has always had the potential to be on the fast track to prosperity.

Now that India is in the process of restructuring her economy, with aspirations of elevating herself from her present desolate position in the world, the need to speed up her economic development is even more imperative. And having witnessed the positive role that Foreign Direct Investment (FDI) has played in the rapid economic growth of most of the Southeast Asian countries and most notably China, India has embarked on an ambitious plan to emulate the successes of her neighbors to the east and is trying to sell herself as a safe and profitable destination for FDI.

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Globalization has many meanings depending on the context. In context to India, this implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalization programs by switching over from quantitative restrictions to tariffs and import duties, therefore globalization has been identified with the policy reforms of 1991 in India.

The Important Reform Measures (Step Towards liberalization privatization and Globalization)

Indian economy was in deep crisis in July 1991, when foreign currency reserves had plummeted to almost $1 billion; Inflation had roared to an annual rate of 17 percent; fiscal deficit was very high and had become unsustainable; foreign investors and NRIs had lost confidence in Indian Economy. Capital was flying out of the country and we were close to defaulting on loans. Along with these bottlenecks at home, many unforeseeable changes swept the economies of nations in Western and Eastern Europe, South East Asia, Latin America and elsewhere, around the same time. These were the economic compulsions at home and abroad that called for a complete overhauling of our economic policies and programs. Major measures initiated as a part of the liberalization and globalization strategy in the early nineties included the following:

Devaluation: The first step towards globalization was taken with the announcement of the devaluation of Indian currency by 18-19 percent against major currencies in the international foreign exchange market. In fact, this measure was taken in order to resolve the BOP crisis

Disinvestment-In order to make the process of globalization smooth, privatization and liberalization policies are moving along as well. ***Under the privatization scheme, most of the public sector undertakings have been/ are being sold to private sector***

RECENT DEVELOPMENTS IN INDIAN ECONOMY

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted in a mixed response. There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced a radical change in economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries; disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channelise foreign capital investment in India. Let us discuss the developments under three heads, viz., (a) Liberalization, (b) Privatization, and (c) Globalization.

(A) LIBERALIZATION

Liberalization refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

(i) abolishing industrial licensing requirement in most of the industries;

(ii) freedom in deciding the scale of business activities;.

(iii) freedom in fixing prices of goods and services;

(iv) simplifying the procedure for imports and exports;

(v) reduction in tax rates; and

(vi) simplified policies to attract foreign capital and technology to India.

Through this liberalization process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organizations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalization has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

(B) PRIVATISATION

Privatization refers to reducing the role of public sector by involving the private sectors in most activities. Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post liberalise period. The issues of privatization include:

(i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced further to 3 later on) and the introduction of selective competition in the reserved area;

(ii) disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership in business;

(iii) improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results. In India, as a result of these steps, the post liberalization phase has witnessed a massive expansion of the private sector business in India. You can have an idea of their expansion from the fact that the total capital employed in top 500 private sector companies rose from Rs. 1,39,806 crores in 1992-93 to Rs. 2, 34, 751 crores in 1994-95 (an expansion of 68% in just two years).

(C) GLOBALISATION

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Globalization means 'integrating' the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labor across national boundaries. To achieve these objectives of globalization, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment and encouragement of foreign technology. These measures are expected to achieve a higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

Impact of Globalization of Indian Economy *(At the present, we can say about the tale of two Indias):* We have the best of times; we have the worst of times. There is sparkling prosperity, there is stinking poverty. We have dazzling five star hotels side by side with darkened ill-starred hovels. We have everything by globalization, we have nothing by globalization. Though some economic reforms were introduced by the Rajiv Gandhi government (1985-89), it was the Narasimha Rao Government that gave a definite shape and start to the new economic reforms of globalization in India. Presenting the 1991-92 Budget, Finance Minister Manmohan Singh said: After four decades of planning for industrialization, we have now reached a stage where we should welcome, rather fear, foreign investment. Direct foreign investment would provide access to capital, technology and market.

In the Memorandum of Economic Policies dated August 27, 1991 to the IMF, the Finance Minister submitted in the concluding paragraph: The Government of India believes that the policies set forth in the Memorandum are adequate to achieve the objectives of the program, but will take any additional measures appropriate for this purpose. In addition, the Government will consult with the Fund on the adoption of any measures that may be appropriate in accordance with the policies of the Fund on such consultations.

The Government of India affirmed to implement the economic reforms in consultation with the international bank and in accordance of its policies. Successive coalition governments from 1996 to 2004, led by the Janata Dal and BJP, adopted faithfully the economic policy of liberalization. With Manmohan Singh returned to power as the Prime Minister in 2004, the economic policy initiated by him has become the lodestar of the fiscal outlook of the government.

The Bright Side of Globalization:

The rate of growth of the Gross Domestic Product of India has been on the increase from 5.6 per cent during 1980-90 to seven per cent in the 1993-2001 period. In the last four years, the annual growth rate of the GDP was impressive at 7.5% (2003-04), 8.5% (2004-05), 9% (2005-06) and 9.2%(2006-07). Prime Minister Manmohan Singh is confident of having a 10% growth in the GDP in the Eleventh Five Year Plan period.

The foreign exchange reserves (as at the end of the financial year) were $ 39 bn (2000-01), $ 107 bn (2003-04), $ 145 bn (2005-06) and $ 180 bn (in February 2007). It is expected that India will cross the $ 200 bn mark soon.

The cumulative FDI inflows from 1991 to September 2006 were Rs.1, 81,566 crores (US $ 43.29 bn). The sectors attracting highest FDI inflows are electrical equipments including computer software and electronics (18 per cent), service sector (13 per cent), telecommunications (10 per cent), transportation industry (nine per cent), etc. In the inflow of FDI, India has surpassed South Korea to become the fourth largest recipient.

India controls at the present 45% of the global outsourcing market with an estimated income of $ 50 bn.

In respect of market capitalization (which takes into account the market value of a quoted company by multiplying its current share price by the number of shares in issue), India is in the fourth position with $ 894 bn after the US ($ 17,000 bn), Japan ($ 4800 bn) and China ($ 1000bn). India is expected to soon cross the trillion dollar mark.

As per the Forbes list for 2007, the number of billionaires of India has risen to 40 (from 36 last year) more than those of Japan (24), China (17), France (14) and Italy (14) this year. A press report was jubilant: This is the richest year for India. The combined wealth of the Indian billionaires marked an increase of 60 per cent from $ 106 bn in 2006 to $ 170 bn in 2007. The 40 Indian billionaires have assets worth about Rs. 7.50lakh crores whereas the cumulative investment in the 91 Public Sector Undertakings by the Central Government of India is Rs. 3.93 lakh crores only.

The Dark Side of Globalization:

On the other side of the medal, there is a long list of the worst of the times, the foremost casualty being the agriculture sector. Agriculture has been and still remains the backbone of the Indian economy. It plays a vital role not only in providing food and nutrition to the people, but also in the supply of raw material to industries and to export trade. In 1951, agriculture provided employment to 72% of the population and contributed 59% of the gross domestic product. However, by 2001 the population depending upon agriculture came to 58% whereas the share of agriculture in the GDP went down drastically to 24 per cent and further to 22% in 2006-07. This has resulted in a lowering the per capita income of the farmers and increasing the rural indebtedness.

The agricultural growth of 3.2% observed from 1980 to 1997 decelerated to two per cent subsequently. The Approach to the Eleventh Five Year Plan released in December 2006 stated that the growth rate of agricultural GDP including forestry and fishing is likely to be below two per cent in the Tenth Plan period. The reasons for the deceleration of the growth of agriculture are given in the Economic Survey 2006-07: Low investment, imbalance in fertilizer use, low seeds replacement rate, a distorted incentive system and lo post-harvest value addition continued to be a drag on the sectors performance. With more than half the population directly depending on this sector, low agricultural growth has serious implications for the inclusiveness of growth.

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The number of rural landless families increased from 35 %in 1987 to 45 % in 1999, further to 55% in 2005. The farmers are destined to die of starvation or suicide. Replying to the Short Duration Discussion on Import of Wheat and Agrarian Distress on May 18, 2006, Agriculture Minister Sharad Pawar informed the Rajya Sabha that roughly 1, 00,000 farmers committed suicide during the period 1993-2003 mainly due to indebtedness.

In his interview to The Indian Express on November 15, 2005, Sharad Pawar said: The farming community has been ignored in this country and especially so over the last eight to ten years. The total investment in the agriculture sector is going down. In the last few years, the average budgetary provision from the Indian Government for irrigation is less than 0.35%.

During the post-reform period, India has been shining brilliantly with a growing number of billionaires. Nobody has taken note of the sufferings of the family members of those unfortunate hundred thousand farmers.

Further, the proportion of people depending in India on agriculture is about 60 % whereas the same for the UK is 2 %, USA 2 %and Japan 3 %. The developed countries, having a low proportion of population in agriculture, have readily adopted globalization which favors more the growth of the manufacturing and service sectors.

About the impact of globalization, in particular on the development of India, the ILO Report (2004) stated: In India, there had been winners and losers. The lives of the educated and the rich had been enriched by globalization. The information technology (IT) sector was a particular beneficiary. But the benefits had not yet reached the majority, and new risks had cropped up for the losers the socially deprived and the rural poor. Significant numbers of non-perennial poor, who had worked hard to escape poverty, were finding their gains reversed. Power was shifting from elected local institutions to unaccountable trans-national bodies. Western perceptions, which dominated the globe media, were not aligned with local perspectives; they encouraged consumerism in the midst of extreme poverty and posed a threat to cultural and linguistic diversity.

Social Services: About the quality of education given to children, the Approach to the Eleventh Five Year Plan stated: A recent study has found that 38 per cent of the children who have completed four years of schooling cannot read a small paragraph with short sentences meant to be read by a student of Class II. About 55 per cent of such children cannot divide a three digit number by a one digit number. These are indicators of serious learning problems which must be addressed. The less said about the achievements in health the better. The Approach to the Eleventh Plan concedes that progress implementing the objectives of health have been slow. The Report gave the particulars of the rates of infant mortality (per 1000 live births) for India as 60 against Sri Lanka (13), China (30) and Vietnam (19). The rate of maternal mortality (per 1, 00,000 deliveries) of India is 407 against Sri Lanka (92), China (56) and Vietnam (130).

Growth of Slum Capitals: In his 2007-08 Budget Speech, Finance Minister Chidambaram put forth a proposal to promote Mumbai as a world class financial centre and to make financial services the next growth engine of India. Of its 13 million population, Mumbai city has 54 per cent in slums. It is estimated that 100 to 300 new families come to Mumbai every day and most land up in a slum colony.

The cumulative FDI inflows (until September 2006) to the New Delhi region were of Rs. 27,369 crores and to Mumbai Rs. 24,545 crores. The two spots of New Delhi and Mumbai received 46 per cent of the total FDI inflows into India. The FDI inflows have in no way assisted in improving the health and environment conditions of the people. On the other hand, the financial capital of India and the political capital of India are set to become the topmost slum cities of the world.

To make Globalization Work:

Under the phenomenal growth of information technology which has shrunk space and time and reduced the cost of moving information, goods and capital across the globe, the globalization has brought unprecedented opportunities for human development for all, in developing as well as developed countries. Under the commercial marketing forces, globalization has been used more to promote economic growth to yield profits to some countries and to some groups within a country. India should pay immediate attention to ensure rapid development in education, health, water and sanitation, labor and employment so that under time-bound programmes the targets are completed without delay. A strong foundation of human development of all people is essential for the social, political and economic development of the country.

Though at present India appears to be dominant in some fields of development as in IT-ITES, this prosperity may be challenged by other competing countries which are equipping themselves with better standards of higher education. As detailed earlier, our progress in education has been slow and superficial, without depth and quality, to compete the international standards.

The government should take immediate steps to increase agricultural production and create additional employment opportunities in the rural parts, to reduce the growing inequality between urban and rural areas and to decentralize powers and resources to the panchayati raj institutions for implementing all works of rural development. Steps should be taken for early linking of the rivers, especially in the south-bound ones, for supply of the much-needed water for irrigation.

It should be remembered that without a sustainable and productive growth of the agricultural sector, the other types of development in any sphere will be unstable and illusory. Despite the concerted development in manufacturing and service sectors, despite the remarkable inflow and overflow of foreign reserves, agriculture is still the largest industry providing employment to about 60 per cent of the workforce in the country.

Mere growth of the GDP and others at the macro level in billions does not solve the chronic poverty and backward level of living norms of the people at the micro level. The growth should be sustainable with human development and decent em-

Check Your Progress

9. What is Liberalization?
10. Describe Privatization.

ployment potential. The welfare of a country does not percolate from the top, but should be built upon development from the bottom.

COMPETITION LAW IN INDIA – AN OVERVIEW

The competition regime in India has undergone a complete change in the recent years resulting in the introduction of the new legislation, viz.: The Competition Act, 2002.

The Competition Act replaces the Monopolies & the Restrictive Trade Practices Act, 1969 (MRTP). MRTP was the first piece of legislation aimed at regulating free and unfettered trade in India. The MRTP focused on curbing monopolies, and regulating restrictive trade practices and unfair trade practices which hampered competition or were prejudicial to public interest.

The liberalization policy of 1991 brought about an overall change in the Indian economic scene with changes in the trade policy, de-licensing of industries, privatization, opening up of the market to foreign investors, etc. It was felt that the MRTP had become obsolete and the need of the hour was to shift focus from curbing monopolies to preventing misuse of dominance and power. Though the MRTP underwent some significant changes at the time, it still was an inadequate law for fostering competition in the market and eliminating anti-competitive practices in national and international trade. Also absent from the MRTP were important trade practices such as cartels, collusion and price fixing, bid rigging, refusal to deal, and predatory pricing.

Competition Act

The Competition Act was enacted in 2003 in line with the international competition regime. It aims at promoting and sustaining competition and ensuring freedom of trade rather than curbing monopolies. The Competition Act has specific provisions dealing with abuse of dominance, cartels, and predatory pricing.

Competition Commission

The objectives of the Competition Act are sought to be achieved through the Competition Commission of India (CCI). CCI is an independent body established under the Act to investigate into alleged anti-competitive practices and eliminate practices having adverse effect on competition. The Act also empowers CCI to take cognisance of anti-competitive behaviour, which originates outside of India but has an appreciable adverse effect on competition in the relevant market in India. CCI is empowered to investigate into any alleged contravention either on its own, on receipt of information from any person or consumer, or on a reference made by the Government. CCI has the power to levy penalties for contravention of its orders, making of false statements or refusal to furnish material information.

Though the CCI was set up in 2003, the substantive provisions of the said Act relating to anti-competitive agreements and abuse of dominance were made effective only in May 2009.

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The Competition Act renders void any agreement with respect to production, supply, distribution, storage, and acquisition or control of goods or services, which causes or is likely to cause an appreciable adverse effect on competition within India.

The Act specifies a number of factors which must be taken into account while determining whether an agreement has an appreciable adverse effect on competition, including whether the agreement creates barriers or forecloses competition by creating impediments to entry, or drives existing competitors out of the market.

At the same time, CCI is also required to examine the possible pro-competitive effects of an agreement i.e., benefits to consumers, improvements in the production or distribution of goods or in provision of services, and the promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services. Thus, a balanced assessment of the beneficial as well as harmful effects on competition is required.

The Act does not use the words horizontal or vertical agreements. However, horizontal agreements that directly or indirectly determine purchase or sales prices; limit or control production, supply, markets, technical development, investment, or the provision of services; share the market or source of production or provision of services by way of allocation of the geographical area of the market, type of goods or services, or number of customers in the market, etc.; and directly or indirectly result in bid rigging or collusive bidding, are presumed to have an appreciable adverse effect on competition. The same strict treatment is also given to cartels.

The Competition Act gives due recognition to intellectual property rights by providing that the prohibition against anti-competitive agreements shall not restrict the right of any person to restrain any infringement of, or to impose reasonable conditions as may be necessary, for protecting any intellectual property rights.

Abuse of Dominant Position

The Competition Act does not condemn or contain a blanket ban on achieving a dominant position as was the case under the MRTP but only prohibits abuse of dominant position which has an appreciable adverse affect on competition.

Under the MRTP, dominant position was defined in terms of market share only, while under the Competition Act, dominant position also implies the ability of an enterprise to (i) operate independently of competitive forces in the relevant market, or (ii) sway consumers, competitors or the relevant market in its favor. The relevant market may be determined with reference to the relevant geographic or the product market or both.

After the relevant market has been determined, the Competition Act identifies a variety of factors that should be considered in determining dominance. While market share remains an important factor under the new law, other factors such as size and resources of the enterprise and the competitors, economic power of the enterprise

Check Your Progress

11. What do you mean by Globalization?
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including commercial advantages over competitors, dependence of consumers, entry barriers, market structure, etc. are also to be considered. In fact, under the Competition Act social commitments and any relative advantage by way of contribution to the economic development are some novel factors that may be considered by CCI in its assessment of dominant position.

The Act enumerates practices which are to be treated as instances of abuse such as, unfair or discriminatory conditions or price, predatory pricing, imposing limits or restrictions on production of goods or provision of services or on the relevant market or denial of market access in any manner. The provisions for abuse of dominance are also applicable to holders of intellectual property rights, provided such rights are considered by CCI to render the holder a dominant player in the relevant market.

If the CCI is satisfied that there has been an abuse of dominance, it can direct the enterprise to desist from practices which constitute such abuse. CCI is empowered to impose a penalty of up to 10 percent of the average turnover of last three preceding financial years. CCI can also direct the division of the enterprise to ensure that the enterprise does not abuse its dominant position.

Merger Control Regulations

The Competition Act also seeks to regulate combinations which may have an adverse effect on competition in India. Combinations include mergers, amalgamations and acquisition of control, shares, voting rights, or assets.

The said provisions are yet to be brought into force but are expected to be notified shortly. Once these provisions are brought into force, it would be mandatory to notify the CCI, when parties of a combination meet certain combined assets or turnover threshold in India or worldwide. The notification requirement will be applicable to any overseas combination if the threshold set out in terms of assets or turnover in India is met, irrespective of the size of the transaction or its impact in India.

The notice is required to be given within 30 days of execution of any agreement or other document for acquisition. The Act provides a long gestation period as a combination cannot take effect until 210 days have passed from the date of notice to the CCI or the date of the order, whichever is earlier. The Government is in the process of framing regulations for the combination provisions and is expected to address the concerns of the industry that the long gestation period under the Act would make M&As in India an extremely long and drawn out process, even killing a deal.

Conclusion

With the enactment of the new law, the competition regime in India has undergone a complete overhaul. Though it is difficult at this early stage to tell how effective or efficient the new legislation would be, it is certainly a sincere attempt to meet the needs of the global business community. CCI has been proactively carrying out the work of competition advocacy since its establishment but now faces a huge chal-

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lenge and task ahead. It is hoped that the CCI shall be able to overcome any shortcomings in the Act and iron out any difficulties in enforcement. Thus, many developments in this field are expected.

CASE STUDY:

Kinetic Honda - The Break-Up: Break-Up Blues

It was in August 1998 that the first chinks in the Kinetic Honda Motors Ltd. (Kinetic Honda) armor were reported by Business India. Both Honda and the Firodias of Kinetic were quick to deny rumors of a split, though reports of the Firodias quietly raising resources to buy out Honda's stake kept surfacing. The Firodias were even reported to have securitized the assets of their two-wheeler finance company - 20th Century Kinetic Finance (TCKF) - to raise this money.

Trouble had been brewing since the company recorded a loss of Rs. 6 crore in the first quarter of 1998. Eventually Honda decided to put the matter to rest and called Arun Firodia (Firodia) to Japan in December 1998.

Honda made Firodia an offer - either he buys their 51% stake or Honda would buy out his 19% stake. Analysts remarked that it was difficult for Firodia to let go of the company that he had nurtured for the best part of his life. Eventually, Firodia negotiated a deal with Honda, to acquire its stake at Rs 45 per share, (when the market price was almost double), at a total cost of Rs 35 crore. He also signed an agreement with them for continuing to manufacture and sell the existing Kinetic Honda models. Honda also agreed to continue providing technical know-how support in return for royalty and technical fees from Kinetic.

Considering the fact that Honda was the world's biggest and most successful scooter manufacturer, the pullout came as a surprise to industry observers, as it was quite uncharacteristic of Honda Motor to give up a segment. More so, as just a couple of months earlier, Honda had been reported to be planning to make further investments in Kinetic Honda*. This was seen as a major setback for the company. It was also perhaps the only instance of a Honda failure anywhere in the world.

*In June 1998, Honda was reported to be contemplating further investments in KHML, despite the Japanese sanctions imposed on India during that period. Honda was also expected to launch a new range of four-stroke scooters. This was however not confirmed by either party.

CASE STUDY:

DOORDARHSAN: BROADCASTING BLUES

[DD India's national television network is one of the world's largest broadcasting organizations with respect to the infrastructure it possesses. It present telecasts programs on 19 channels. Over the years, DD has been losing its advertising revenues to its competitors [private channels]. The continuously falling Television Viewers Rating added to the problem. DD has also been facing many problems regarding its managements, right from the time when Prasar Bharati was created. In

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mid-90's, cable television reached many Indian homes and several private channels, were launched. All of a sudden DD had to content with a host of channels whose programs were better produced. Poor quality of transmission and program content prompted viewers, to switch to private channels. The case provides an overview of the problems faced by DD due to mismanagement and competition from private channels.] "DD needs an owner" - CEO, Carat Media Services India.

IS DD DEAD?

After years of falling revenues, in 1999-2000 DD had a revenue growth of 50%. In 1999-2000, DD earned revenues of Rs, 6.1 bn compared to Rs. 3.99 bn in 1998-99. DD showed signs of revival with the launch of DD Worlds [a channel for NRIs] and had a certain measure of success with some of its regional channels [Table-1 DD Channels: A snapshot]. However, by the end of 2000-01, DD's revenues were projected to grow at 6 - 15 % while private channels such as Zee T V, Star and Sony had a projected 40 -50 % revenue growth.

According to some analysts, DD's sagging revenues were only the tip of the iceberg. DD was plagued by several problems. By the late 1990's, most private producers and advertisers and a good part of the audience had deserted DD. Not even one car company advertised on DD and even two wheeler manufacturers kept away. Advertisements of Pepsi and Coca - Cola were found only during sports telecasts. Only FMCG companies stuck to DD, because its terrestrial network would help them to reach the rural and semi urban audience. Despite having over 21000 employees, DD outsourced 50 % of its programs from private producers.

In the late I990's, DD faced allegations of large scale scams and irregularities. Under-utilized infrastructure, improper investments and poor financial management adversely affected DD's performance. In 1992, when the Government opened the airwaves to private players, HD had to face competition from private satellite channels. In Cable and Satellite [C & S] homes it was found that DD programs had hardly any viewers. The depleting Television Viewer Ratings [TVRs] of the DD programs was also a cause of concern as advertisers deserted due to its low viewer ratings.

According to analysts, DD would need a budgetary support of Rs. 5 bn during fiscal 2000-01 to sustain itself, as its revenues would not cover its expenditure. Many analysts felt that privatization would be the only solution.

DD : THE INSIDE STORY

DD was launched in 1959 as the National Television Network with a modest 21 community sets in Delhi. In the year 1982, with the introduction of regular satellite link between Delhi and different transmitters, DD began the transmission of national programs. In the same year, DD switched to colour transmission. Soon it had penetrated every nook and corner of the country, cutting across demographic and geographic barriers.DD had a three-tier program service - national, regional and local. The national programs focused on the national culture and included news, programs on current affairs, and science, cultural magazines, serials, music and

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dance recitals, plays and feature films. At the regional level the programs were similar to the ones broadcast at the national level, the only difference being that they were broadcast in the regional language.

In 1984, DD introduced a second channel [DD2] in cities like Delhi, Mumbai, Kolkata and Chennai. DD2 was targeted at urban viewers, particularly the young viewers.

In 1995, DD launched DD - India, its international channel to cater to the NRI population. This service covered SAARC countries.. Gulf countries, West Asia, Central Asia, North Africa and Europe. In the same year, DD entered into an agreement with the Cable News Network [CNN] and launched a 24 - hours news and current affairs channel : DD News. In 1999, DD launched a separate channel for sports.

In the early 1990s, about 479 mn people in Indian homes viewed DD and an additional 1.5 mn watched DD on community sets. DD was ahead of the private channels in terms of viewership with a 90% reach. However, in the late 1990s, it could not maintain the lead and phase channels were catching up in terms of revenue even though they lagged behind in viewership and reach.

Cable onslaught

In 19S4, cable television entered India. For local entrepreneurs, cable television provided a good business opportunity, as investments required to install a cable network were low. In the early 1990s, many-private television channels were launched. Zee TV launched in 1992 led the pack. During 1992-94, there was rapid increase in the number of cable connection in Western and Northern India. In Tamil Nadu and Andhra Pradesh, a number of Tamil and Telugu channels came up in the mid-1990's.

Though by 2000, DD had an incredible reach of 70 mn homes, in comparison to C & S's reach of only 30 mn homes. It could not turn this network into an advantage [Table II for growth of cable and satellite penetration in India]. In urban households, DD programs had hardly any viewers. DD was also behind the private channels in terms of ad revenues, as its TVRs were very low compared to the TVRs of programs on private channels.

Falling Revenues

During 1996-99, the TV advertisement market grew by 76%, but DD's revenue from advertisement registered a negative growth [Table III for fall in revenues of DD]. Though DD continued to be number one in overall audience share, it lost out on viewership segments that had the highest purchasing power.

In 1998-99, DD's revenue from advertisements was Rs. 4 bn [25.8% of the market], Zee TV was close with Rs. 3.85 bn, Sony had Rs. 2.53 bn and Star channels grossed Rs. 2 bn. But the ad revenues of private channels have grown significantly, when compared to those of DD. During the period 1996-99, Zee registered a growth of 122% in ad revenues, Sony 299% and Star channels 206%. During the same period, DD's ad revenues went down by 70.17 %. DD's falling TVRs were a matter of concern for clients like Hindustan Lever - DD's largest advertiser. Said Ashutosh Srivastava, VP, HTA-Fulcrum, the media-buying arm of HLL, "Our only source of reaching 40% of this country is going down." Till 1998-99, 70% of HLL's ad spend went to DD but by 2000-01, due to tailing TVRs HLL's ad spend to DD had gone down to 50%.

During 1999-2000, producers and distributors stopped giving films to DD when it began to demand a minimum guarantee of Rs. 10 mn to broadcast a film. This forced DD to repeat the same old films that it had aired several times, and the RVRs went down further. According to some analysts, DD's revenues were going down because advertisers considered it a down market channel, which catered only to the lowest socio-economic groups, whose purchasing power was limited. The revenues earned by DD showed a negative growth during 1997-99. In 1999-2000, DD saw its revenue grow by 52.8%, but in 2000-01, it was projected to grow only at 6% [Table III]

Identity Crisis

DD's problems were largely attributed to what Kiran Karnik, former CEO, Discovery Communications; India called 'its loss of identity. Said Karnik, The channel has lost its identity, What is Doordharshan : Is it a public broadcaster or a commercial entity? Initially, DD officials had envisaged that the national channel would play the role of public broadcaster, while DD Metro would be the commercial channel. Private producers and advertisers pointed out that this attitude increased the confusion. They argued that no other network had two channels competing against each other.

With the launch of the Star News Channel, [the first independent news channel] in 1998, DD News lost its viewers to Star news. The in-depth analysis of news items"by Star News caught the imagination of the viewers [Table IV Comparative study of different news channel]. DD's image of being the propaganda machinery of the Government also went against it.

Some analysts said political interference and corruption were another reason for DD's poor performance. In 1997, The Indian Broadcasting Bill was introduced in Parliament. The Bill was not passed, but it was enforced through an ordinance nearly a decade after it was enacted. DD was brought under a holding company called the Prasar Bharati. In 1998, the Government sacked Prasar Bharali CEO SS Gill and the Government made DD answerable to a parliamentary committee. Political interference at the top level made matters worse for DD.

There were allegations that members of the Central Commissioning Unit of DD look bribes from producers to air their programs. In 1998, the CBI arrested two DD officials for taking bribes from a serial producer. This, incident focused attention on the rampant corruption in the organization and forced management to issue guidelines regarding acceptance of gifts by employees.

DD had a poor track record in both payments to and collections-from private players. Over 50 companies owed Rs. 18.2 mn to DD, 45 on July 2001, Amitabh

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Bachchan Corporation Limited was DD's highest debtor with outstanding dues of Rs. 330 mn. Another allegation that DD faced was that it had allowed International Cricket Council's [ICC] ex-chief Jagmohan Dalmiya and World Tel's Mark Mascarenhas to defraud it of Rs. 160 mn over the telecast of 1998 tournament in Dhaka. The exorbitant prices that DD charged for advertisements slots also contributed to its poor performance. DD charged the producers around Rs. 1 lakh for 10 seconds, while some of the highest rated soaps on private channels charged half that price.

DD did not have a marketing team, which could market the advertisements slots as a package. Private channels like ZEE and Star had their own marketing teams/ which provided the advertisers with a package of advertisement slots on their programs. But DD had 5o different producers with 56 different half-hour programs slots for four hours of prime time each week. Each producer sold commercial time separately, to the advertisers. But advertisers preferred package deals, which, would give them airtime across the programs for a whole week.

Breathing fresh life into DD

After SS Gill was sacked in 1998, Rajeeva Ratna Shah was appointed as new CEO of Prasar Bharti. Shah began overhauling the programs of the two DD channels and weeding out corruption in the network. He stopped commissioning programs on DD1 and DD2. He decided to auction programming hours to the private players who produced the programs for DD and market them. Shah also announced the setting up of a board comprising eminent film-makers, actors, poets, writers and people from different walk of life. This board was to be entrusted the task of revamping DD.

In 2000, the government appointed a committed headed by Shunu Sen [CEO, Quadra Advisory, a strategic marketing Consultancy], NR Narayana Murthy [CEO, Infosys] and Kiran Karnik to work out a program for reviving DD. The committee considered three options. : Privatizing of DD, continuing to run it as a Public Service .Broadcaster [PSB], and running DD on both PSB and commercially viable lines. Of the three options, the committee recommended the third option. The committee felt that there was no need to privatize DD, but recommended drastic steps for reviving it.

Some of the important steps suggested by the committee were :

- Downsizing 25 % of DD's 21000 strong staff
- Getting into new media
- Setting up its own marketing department
- Developing a sharper programming focus.

One of the recommendations was to improve the quality of broadcast. DD sought the help of BBC to digitize its channels. Modi Entertainment Network began distributing the five DD channels via satellite. DD went in for a revenue sharing deal

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with B4U for showing movies, arid auctioned the 7:10 pm slot on DD Metro to the HFCL - Nine networks. In addition to Rs. 1.21 bn that DD got from this deal, the move helped DD to penetrate urban homes as well as C & S homes to some extent. DD also entered into an agreement with Direct to Home platforms like Echostar and Astra to distribute DD - World in 79 countries. DD employed Accenture to advise it on how to go about revamping its financial, management and administrative systems. The National Institute of Design was employed to redesign the logo.

In 2000, DD announced that it would start its own people meter project through a separate corporate entity in partnership with a few private channels and some advertisers. DD felt that its programs were not getting enough viewership ratings because the viewer samples used by the two firms doing the ratings -IMRB - AC Nielsen and ORG MARG were largely from C & S homes. Their ratings did not accurately reflect the viewing habits of the Indian populace.

According to most, these steps were bound to have a positive effect on revenue. However, for real growth DD had to be freed from political interference.

TABLE I :DD CHANNELS : A SNAPSHOT

DD 1	Primary channel with national, regional, local and educational programs on a time sharing basis
DD2	Metro entertainment channel targeted at urban viewers, particularly the young viewers. Programs relayed by the terrestrial transmitters in 47 cities
DD4 to DD 13	Ten separate regional language channels : Malayalam, Tamil, Oriya, Bengali, Telugu, Kannada, Marathi, Gujarati, Kashmiri and Assamese
DD 14 to DD 17	Networking of the regional services of the four Hindi speaking states : UP, Bihar, MP and Himachal Pradesh
DD18	Punjabi Regional Service
DD India [DD World]	International channels
DD Sports	Sports channel
DD News	24 hours news channel

TABLE : II ; CABLE TV GROWTH IN URBAN INDIA

YEAR	NUMBER OF HOUSEHOLDS WITH CABLE TV [IN MILLION]
1992	1.20
1993	3.30
1994	11.80
1995	15.00
1996	18.00
2000	22.00
2001	30.00

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TABLE III: FALL IN REVENUES OF DD

YEAR	REVENUE [RS. BN.]	GROWTH OVER PREVIOUS UYEAR [%]
1995-96	4.30	8.10
1&96-97	5.72	33.20
1997-98	4.90	- 14.30
1998-99	3.99	- 18.50
1999-00	6.10	52.80
2000-01 [Estimate]	6.50	6.00

TABLE: IV COMPARISON OF THE NEWS CHANNELS

STAR NEWS	ZEE NEWS	DD NEWS
Channel encrypted	Channel not encrypted	Channel not encrypted
Decoders are required	Can be freely aired	Can be freely aired
Content caters to the premium segment	Content caters to the mass market	Content caters to the mass market
English predominant language	Hindi predominant language	Hindi predominant language
Only premium brand's ad taken. Very selective regarding ads	All brands accepted. Not selective regarding ads.	No ads. Only social messages were broadcast

CASE STUDY :

Impact of Economical Reforms and Imperialist Globalization on Handloom Weavers - A Case Study

A pathetic story of a Handloom weaver who migrated to Chirala, under starving conditions caused due to be Economic Reforms and influence of Globalization.

Munagala Venkata Subbaiah by occupation is a Handloom weaver. His wife is Adilakshmi. They are blessed with two boys and on girl child. There are 5 members in the family. The family was residing at Eethamukkala village, Kothapatnam Revenue Mandal, Prakasam Dist of A. P. before migration. This village is known for Handloom Industry close to Bay of Bengal and the shore is situated just 400 mts away.

Munagala Venkata Subbaiah inherited the caste occupation from his father Venkata Subbaiah as it is being handed over from one generation to another. Economic Reforms introduced by the central Government in 1991 posed unexpected serious threats to the profession to the just married Venakata Subbaiah who got married in the year 1989. Venkata Subbaiah who is innocent of worldly affairs, more particularly the Economic Reforms, could not understand the changes of Globalization. He was under strong opinion that the changes that are rapidly taking place

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are ones due to the competition from power loom and failure to supply required yarn. The drought and starving conditions are due to nature's curse against weaving industry. He was working 10 hours per day on the loom to feed his family but the income thus received was not sufficient for the entire family. To feed his child aged 3 years he was working 12 hours on the loom. Even then he was unable to meet the family demands. For 12 hours of work in a day on the loom, he was getting only Rs. 34/- per day.

The Master weavers or the cooperative societies were paying only Rs.280/- if the plain cloth of 25 yards is completed on the loom which takes about five days and pre loom processing consumes another couple of days. Therefore the total income per week is just Rs.280 only. This 25 yards is calculated as one warp and if a weaver completes 4 warps in a month, he would probably earn Rs.1020/ -. Thus the average income per day is Rs.34/- only. The income thus earned is only sufficient for sustenance of family and to meet medical expenses of the family members till the implementation of the new Economic Reforms were introduced under structural Adjustment policy & GATT. The Bretton Wood Brothers (WTO and WB) are indirectly responsible for untold disturbance and irreparable loss to the Handloom sector. Due to such effect, Venkata Subbaiah was unable to get the required raw material as well as regular income. He was compelled to understand and realize the irreparable effects of Globalization and Economic Reforms that affected him and also his family. He tried to understand the relation between Handloom Industry and the New Economic Reforms. The amount he was receiving for single warp is reduced from Rs.280/- to 240/-. On the other hand, the prices of essential commodities were steeply hiked. He was not getting the equal wage to equal work, which provoked him to think about the developments that created unrest in his mind and family affairs.

He began to search for the root causes for all the sufferings and pains. He realized that due to reform started from 1991 allowed import of Auto loom which threatened the power loom as well as Handloom Industry. The powerlooms started manufacturing 22 varieties of reserved Handloom items which were providing him work and also for other weavers. In fact these reserved items (22) today are largely produced by power looms. He realized that master weavers are also forced to reduce the mazdur (wages) of the Handloom weavers,while he was encountering the hike of essential commodities and reduction of wages, the number of family members has slowly increased. He felt further depression, as the second child was a girl because of the status given to a girl by the male dominated society. He began to share the pains and changes are taking place in the Industry with the family members. Wife of Venkata Subbaiah, despite bad health and unable to give breast-feeding to her second child decided to go for agricultural labour to help her husband. Venkata Subbaiah who was seriously influenced and dominated by false prestige and pseudo mentality felt it would be a shame on his part to allow his wife to work as agricultural labour. However, the financial condition of the family compelled V.Subbaiah to allow his wife to do agricultural labor work. He was able to come out of the traditional

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practice. He realized that he himself alone himself to break the chains of traditions, customs and old practices. He realized the dignity allowed can't maintain the family. Having understood the realities in right perspective, he to break the chains of traditions, customs and old practices. He realized the dignity of labor for the first time. Against the tradition and customs of the community, he sent his wife to earn Rs.25/- from agriculture work. Even though both of them were earning, it was not sufficient to feed the entire family. They could not give sufficient food to the children. Adilakshmi, wife of Subbaiah, used to forgo dinner to feed her children and hid the same from the knowledge of her husband, which eventually led to serious illness.

Only then Subbaiah came to know the cause for her illness and felt very sad about it. Their eldest son Srirama Murthy though younger in age, could notice that his mother is not joining them for dinner. Later on he decided not to attend the school (Elementary) due to economic conditions of the family. Children used to force their mother to eat with them during lunch and dinner times. As mother she thought her portion of food might satisfy her children hunger and they can eat well. Thus she used to control her hunger, behaving as if she does not have any sorrows and pains. While the family was undergoing severe poverty and struggle for survival, another child was born. The new born child, Srinivasulu, fell sick soon, add more pain and burden. With the passage of agricultural season, there was no work for the wife, depleting their earnings further. Serious illness of the third child left the couple with untold pains. Meanwhile, there is increasing conversion of fertile paddy lands to fish and prawn ponds in the village, probably as a response to changes brought in by globalization and economical reforms. All these developments made them to realize that two important rural sectors, handloom Industry and agriculture, are badly affected by Globalization.

Venkata Subbaiah finally decided to change the style of work according to times, having understood all the changes in the Handloom Industry. He shared everything with his wife before a final decision was taken. They decided to migrate to Chirala, a place made even on a power loom. He knew that traditional varieties bring in less wages and loss of employment. The competition between powerlooms and Handlooms also allowed him to produce a variety of cloth by adding extra weft to weave better designs. He thought that he alone in the world had that knowledge, technology and expertise. But by then upgradation of technology was introduced by the power loom service center and as a result 22 items reserved for handlooms are also being produced on power looms.

This change in the government policy, he understood, was solely due to the strict conditions imposed on Indian Government by World Trade Organization and World Bank. In pursuance of the changes catering to the imperialist Globalization, Government of India appointed Satyam Committee. He also knew the reasons why the committee was opposed by the Rastra Chenetha Karmika Samakya (RCKS). Not only he believed that the Economic Reforms and Globalization is responsible for loss of occupation and employment in his beloved profession, but was also convinced that the government is making rules in order to the close Handlooms industry so that it would double the profits of the power loom owners

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and the investors. He realized that the rules and amendments brought about by the Government is only to help the powerloom owners. Thus the powerloom owners and government colluded with each other to serve their selfish interests. In a way he thought that the Government is pro-capitalist and anti-poor. Though 22 Handloom reserved items are manufactured by powerlooms violating the Act of Parliament, government did not take any action against the power loom owners and save the Handloom Industry. He further learnt that the negligence and failure of the government in controlling the powerlooms is the sole reason for his poverty, hunger, illness among the family members and sufferings in the community of Handloom Weavers.

The deteriorating family situation, economic conditions and poverty forced him to employ his eldest son in a hardware shop as a daily labour - whose age is not more than 12 years by then. He used to go to the shop at 9 a.m. and return by 9.30 p.m. to earn just Rs.400/- p.m. The income of the child was. invested in small chits with a view to clear amounts borrowed earlier. On the other hand, debts of the family increased along with hardships. This family paid Rs.200/- for house rent, electricity Rs.150/-, Rs. 50/- to clear master weavers advances - all together Rs.400/- is paid out of a total income of Rs.1,500/-. Remaining balance of Rs.1,100/- is not sufficient for five members of the family to maintain themselves. His family has been facing poverty, hunger and prolonged illness due to lack of protein food experiencing serious health problems.

SUMMARY

- Monetary policy refers to the policy regarding money supply and bank credit in the country and it is formulated and announced by the central bank of the country.
- In the economically advanced countries, the monetary authority concentrates on the regulatory aspect of monetary measures in order to achieve the goal of economic stabilization, while in a developing economy like India, monetary policy tends to be typical in nature aiming at controlled expansion.
- The concept of neutral money requires that the supply of money be kept constant and adjustments be made in it on account of the fundamental changes taking place in the economy.
- In an under-developed country, the monetary policy has to play a vital role in developing the economy from a stage of primary backwardness to a stage of self-sustained growth.
- Inflation in an underdeveloped economy generally occurs when there is an abnormal increase in the effective demand exerted mainly by huge government expenditures under the planning process.
- Monetary policy in a developing country is an important instrument in the hands of the central bank, which may be used to ensure economic growth.

- The Bank Rate, also known the Discount Rate, is the oldest instrument of monetary policy. Bank rate is the rate at which the central bank discounts - or, more accurately, rediscounts - eligible bills. In a broader sense, it refers to the minimum rate at which the central bank provides financial accommodation to commercial banks in the discharge of its function as the lender of the last resort.
- Open Market Operations refers broadly to the purchase and sale by the central bank of a variety of assets, such as foreign exchange, gold", government securities and even company shares.
- Cash Reserve Ratio refers to that portion of total deposits of a commercial bank which it has to keep with the Reserve Bank in the form of cash reserves.
- Statutory Liquidity Ratio refers to that portion of total deposits of a commercial bank, which it has to keep with itself in the form of liquid assets.
- The RBI undertakes repo/reverse repo operations with banks and PDs as part of its OMOs, to absorb/inject liquidity.
- The Liquidity Assessment Facility, in essence, operates through repo and reverse repo auctions, thereby setting a corridor for the short-term interest rate consistent with policy objectives. There is now greater reliance on indirect instruments of monetary policy.
- Selective controls are designed to regulate the direction of credit.
- Fiscal policy may be defined as that part of governmental economic policy which deals with taxation, expenditure, borrowing and the management of public debt in an economy.
- Macro-economic policy can be defined as a program of action undertaken to control, regulate and manipulate macro-economic variables to achieve the macro-economic goals of the society.
- Keynes showed the need for the government role in economic management to achieve growth and stability.
- The need for macro-economic policy arises because the economic system does not adjust appropriately to the shocks to which it is constantly subjected.
- There are four major objectives of macroeconomic policies are as follows:

  i. Full employment,

  ii. Price stability,

  iii. A high, but sustainable, rate of economic growth, and

  iv. Keeping the Balance of Payments in equilibrium.
- The objectives of macro-economic policies are determined by the policymakers in view of the social and economic aspirations of the people, which, of course, vary from country to country and from time to time depending on the changing economic conditions.

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- Industrial policy is an important document, which lays a wide canvas and sets the tone for implementing promotional and regulatory roles of the government.
- Industrial policy is probably the most important document, which indicates the relationship between government and business.
- Industrial licensing in India is a unique instrument of direct control designed to implement a major part of the industrial policy.
- The provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices.
- The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and the establishment of new undertakings.
- The new economic reform, popularly known as, Liberalization, Privatization and Globalization (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive.
- Globalization has many meanings depending on the context. In context to India, this implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalization programs by switching over from quantitative restrictions to tariffs and import duties, therefore globalization has been identified with the policy reforms of 1991 in India.
- Under the privatization scheme, most of the public sector undertakings have been/ are being sold to private sector.
- The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government.
- Liberalization refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises.
- Privatization refers to reducing the role of public sector by involving the private sectors in most activities.
- Globalization means 'integrating' the economy of a country with the world economy.
- The competition regime in India has undergone a complete change in the recent years resulting in the introduction of the new legislation, viz.: The Competition Act, 2002.
- The objectives of the Competition Act are sought to be achieved through the Competition Commission of India (CCI).

- The Competition Act renders void any agreement with respect to production, supply, distribution, storage, and acquisition or control of goods or services, which causes or is likely to cause an appreciable adverse effect on competition within India.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. Monetary Policy refers to the policy regarding money supply and bank credit in the country and it is formulated and announced by the central bank of the country.
2. Bank rate is the rate at which the central bank discounts or more accurately rediscounts eligible bills.
3. Statutory liquidity ratio refers to that portion of total deposits of a commercial bank which it has to keep with the Reserve Bank in the form of cash reserves.
4. Fiscal Policy can be defined as that part of governmental economic policy which deals with taxation, expenditure, borrowing and the management of public debt in an economy.
5. Elements of Fiscal Policy: Budgetary policy, Taxation Policy, Public Debt, Public Expenditure.
6. Macro-economic policy can be defined as a program of action undertaken to control, regulate and manipulate macro-economic variables to achieve the macroeconomic goals of the society.
7. Industrial policy is an important document, which lays a wide canvas and sets the tone for implementing promotional and regulatory roles of the government.
8. Industrial licensing in India is a unique instrument of direct control designed to implement a major part of the industrial policy.
9. Liberalization refers to the process of eliminating unnecessary controls and restrictions from the smooth functioning of business enterprises.
10. Privatization refers to reducing the role of public sector by involving the private sectors in most of the countries.
11. Globalization means 'integrating' the economy of a country with the world economy.
12. The Competition Act renders void any agreement with respect to production, supply, distribution, storage and acquisition or control of goods or services, which causes and is likely to cause an appreciable adverse effect on competition within India.

TEST YOURSELF

1. What do you mean by Monetary Policy?
2. Discuss objectives and scope of Monetary Policy.
3. Explain role of Monetary Policy in a Developing Economy.
4. Discuss various Credit Control Tools/Instruments of Monetary Policy.
5. Define Fiscal Policy.

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6. Explain features and objectives of Fiscal Policy of India.
7. Discuss various elements of Fiscal Policy.
8. Give necessary suggestions for Reforms in Fiscal Policy.
9. What do you mean by Macro Economic Policy?
10. Explain need and objectives of Macro-Economic Policies.
11. Write a short note on Industrial Policy.
12. Discuss various measures of Industrial Policy.
13. Discuss recent developments of Industrial Policy.
14. Explain merits and demerits of the 1991 Policy.
15. What are the recent developments in Indian Economy?
16. Discuss the impact of Globalization of India Economy.
17. Briefly describe the Competition Law in India.

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4 Trade Policy and Disinvestment

The Chapter Covers :

Introduction of Trade Policy

The economic policy which regulates the **export-import activities of any economy is known as the trade policy.** It is also called Foreign Trade Policy or the EXIM Policy. This policy needs regular modifications depending upon the economic policies of the economies of the world or the trading partners.

The Export-Import Policy (EXIM Policy), announced under the Foreign Trade (Development and Regulation) Act, 1992, would reflect the extent of regulations or liberalization of foreign trade and indicate the measures for export promotion. Although the EXIM Policy is announced for a five-year period, announcing a Policy on March 31st of every year, within the broad frame of the Five Year Policy, for the ensuring year.

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A very important feature of the EXIM policy since 1992 is freedom. Licensing, quantitative restrictions and other regulatory and discretionary controls have been substantially eliminated.

Objectives of EXIM Policy

The objectives of EXIM Policy are given as hereunder:

1) To establish the framework for globalization.
2) To promote the productivity competitiveness of Indian Industry.
3) To encourage the attainment of high and internationally accepted standards of quality.
4) To augment export by facilitating access to raw material, intermediate components, capital goods from the international market.
5) To promote internationally competitive import substitution and self-reliance.

Recent Foreign Trade / Exim Policies

Foreign Trade Policy 2004-09 (EXIM Policy 2004-09)

The new foreign trade policy of the union government was announced by the Commerce Minister Mr. Kamal Nath on 31'August 2004. The new policy reflected no major departure from the five year EXIM Policy of 10th plan (i.e., for the period 2002-07), even as it carried a definite mark of the common minimum program of the ruling alliance. With foreign trade largely freed and import duties falling progressively, the policy have necessarily restricted itself to a facilitating role. Now the sphere of trade has been extended and the new foreign trade policy goes beyond the traditional focus on pure exports.

The new trade policy highlights the view, "Trade is not an end in itself, but a means to economic growth. Exports are not just for foreign exchange generation but are an engine of growth that can create incremental economic activity in the country". Government announced Foreign Trade Policy @TP), 2004-09 with a vision to double India's share in world trade within five years. The basic objective of this policy is to stimulate greater economic activity through exports and to make exports an effective instrument of economic growth by giving thrust to employment generation during the next five years. A number of key strategies have been adopted in the Foreign Trade Policy @TP) and in its annual supplement; released on 8th April 2005 which endeavors to achieve these objectives. These include simplification of procedures, reduction in transaction cost, neutralization of incidence of levies and duties used for production for exports and development of global hubs for manufacturing, trading and services.

Features of New Trade Policy:

The salient **features** of the new trade policy are:

1) An express thrust of the policy is on the exports of farm produce.
2) While exporters of specified farm goods would benefit from a new duty free credit entitlement upto 5% of the FOB value of exports, for all other agriculture products exporters would be allowed to import capital goods free of duty under EPCG 0&port Promotion Capital Goods) Scheme.
3) Policy comprises 'Special focus initiatives' for employment intensive sectors like gems and jewelry, handlooms, handicrafts, leather and footwear.
4) The threshold for becoming a status holding exporter has been brought down from Rs. 45 crore to Rs. 15 crore and export clusters of Rs. 250 crore (as against Rs. 1000 crore at present) have been qualified as 'Town of Export Excellence'.
5) Small and medium exporters would be benefited from the liberalization of import of capital goods and the additional flexibilities for the fulfilment of export obligation under EPCG scheme.
6) Three new export promotion schemes - 'Target Plus', 'Vishesh Krishi Upaj Yojana' and 'Served from India'- have been introduced. These schemes would benefit exporters who excel others, exporters of farm products and exporters of services respectively.

The target plus scheme gives incentives based on incremental export growth. The duty **free** entitlement for exporters of fruits, vegetables, flowers and minor forest produce would be freely transferable and can be used for import of variety of inputs and goods.

Under the 'served from India' scheme, the policy tries to create a powerful brand for Indian Services exports in the global market.

1) New policy focuses a lot on procedural simplification and rationalization of measures for the exporters. This in the long run would reduce transaction cost for the exporters.
2) The new policy aims to create warehousing infrastructure for both exports and imports in mdia and wants to increase competition for the Free Trade Zones (FTZs) set up by UAE.
3) For giving a boost to foreign trade, policy proposes to set up FTWZs (Free Trade and Warehousing Zones) on the lines of SEZs (Special Economic Zones). These zones would be established in the areas proximate to sea-ports, airports or dry ports so as to offer easy access by rail and road.
4) Policy makes room for setting up of bio-technology parks across the country.
5) The policy announcement on service tax exemption for all goods and services exported - including those from the Domestic Tariff Area (DTA) - will be available on 161 tradable services.

6) Policy offers duty free import of labor intensive services. Such services are to be associated with labor intensive industries like gems and jewelry, handloom and handicraft leather and footwear.

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Implications of the Foreign Trade Policy (2004-09)

The Implications of the Foreign Trade Policy (2004-09) are given as follows:

1) **Implications on Indian Economy:** This policy proposes to simplify procedures and develop technology and infrastructure.
2) **Implications on Agriculture:** Special Agricultural Produce Scheme has been introduced for promoting the export of fruits, vegetables, flowers, and their value added products.
3) **Implications on Handlooms and Handicraft**: Establishment of Handicraft SEZ and Handicraft Export Promotion Council would promote development of Handloom and Handicraft Industry.
4) **Implications on Gem and Jewelry Sector:** This is special thrust area in this policy. Duty free imports of other inputs would give a further boost to this sector.
5) **Implications on Leather and Footwear Industry:** Duty free import as a specified percentage of exports. Exemption on customs duty on equipment for effluent treatment plants would help promoting export from this sector.
6) **Implications on Service Industry:** An exclusive service promotion council has been set up in order to map the opportunities for key services in key market.

Foreign Trade Policy (Exim-Policy) 2009-2014

Foreign trade has gained immense importance in India in the recent years. The Exim Policy of India has laid guidelines for India to become a major player in world trade, an all encompassing; comprehensive view needs to be taken for the overall development of the country's foreign trade. The new Exim policy states that reasonableness and consistency among trade and other economic policies is important for maximizing the contribution of such policies to development. The foreign trade policy implies in its preamble that while incorporating the existing practice of enunciating an annual Exim policy, it is necessary to go much beyond and take an integrated approach to the developmental requirements of India's foreign trade.

The Exim policy of India can be viewed at our website which is updated on a regular basis. The import laws of India are governed by the foreign trade policy. AH exporters/importers trading from India have to adhere to the Foreign Exim policies in order to gain benefits on the trade front.

FEATURES OF FOREIGN TRADE POLICY 2009-14

The features of the Foreign Trade Policy for 2009-14 which was announced by Commerce Minister, Anand Sharma are as follows;

1) Duty entitlement passbook scheme extended till December 2010.

2) Extension of sops for export-oriented units till March 2011.
3) Export target of $200 billion set for 2010-11.
4) Growth target of 15 per cent for next two years, 25 per cent thereafter.
5) Inter-ministerial group to address issues raised by exporters.
6) Obligation under export promotion capital goods scheme relaxed.
7) Permission for tax refund scheme for jewelry sector.
8) No fee on grant of incentives to cut transaction costs.
9) Steps to help exporters in reducing transaction costs.
10) Plan for diamond bourses in the country.
11) Single-window scheme for farm exports.
12) Re-export of unused leather allowed subject to 50 per cent duty.
13) Minimum value addition for tea reduced to 50 per cent from 100 per cent.
14) Export units allowed to sell 90 per cent of goods in domestic market.
15) Provision for state-run banks to provide dollar credits.
16) Twenty-six new markets added to focus market scheme.
17) SOPs under focus market scheme hiked from 2.5 per cent to 3 per cent.
18) Number of duty-free samples for exporters raised to 50 pieces from 15.
19) New directorate of trade remedy measures to be set-up.
20) Zero duty under technology upgrade scheme.

DISINVESTMENT

Meaning of Disinvestment

The term disinvestment is defined as the shrinkage of capital investment which is caused by the failure of a firm to maintain or replace its capital assets which are being used-up or by the sale of the capital goods by the firm, such as the equipment owned by it. Disinvestment also means the withdrawal of capital from a country or a corporation.

Disinvestment is the sale of a part of equity holdings held by the government in any PSUs to private investor. Disinvestment has been a major strategy by which the government has financed fiscal deficit. Besides financing fiscal deficit, the economic motivation behind it is to improve efficiency of PSUs.

The government expects that even small per cent of private ownership will discipline inefficient managers and motivate them. This can be substantiated by the fact that during 1982-93, the net profit to the capital employed in the PSUs was one-third (2.0%) as that of the private sector.

Disinvestment has a much wider connotation as it could either involve dilution of government stake to a level that results in a transfer of management or could also be limited to such a level as would permit government to retain control over the organization. Disinvestment beyond 50 per cent involves transfer of management, whereas disinvestment below 50 per cent would result in the government continuing to have a major share in the undertaking.

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Disinvestment, sometimes referred to as divestment, refers to the use of a concerted economic boycott, with specific emphasis on liquidating stock, to pressure a government, industry, or company towards a change in policy, or in the case of governments, even regime change. The term was first used in the 1980s, most commonly in the United States, to refer to the use of a concerted economic boycott designed to pressure the Government of South Africa into abolishing its policy of apartheid. The term has also been applied to actions targeting Iran, Sudan, Northern Ireland, Myanmar, and Israel.

Background of Disinvestment

The Indian economy had virtually embraced bankruptcy during the period 1981-91. The public sector which was to achieve commanding heights and was taught to be the correct path for India's economic growth, right from independence was characterized by poor performance. In 1991 there were 236 operating public sector undertakings, of which only 123 were profit making. The top 20 profit making PSUs counted for 80 per cent of the profits, implying that less than 10 per cent of the PSUs were responsible for 80 per cent of profits. The return on public sector investment for the year 1990-91 was just over 2 per cent.

The basic charges against the public sector for its poor performance are as follows:

1) Low rate of return on investment,
2) Declining contribution to national savings,
3) Poor capacity utilization, and
4) Overstaffing, bureaucratization leading to excessive delays and wastage of scare resources on account of this phenomenon many public sector enterprises have become more a burden than an asset to the Government.

Objectives of Disinvestment

Disinvestment has the following objectives:

1) The main objectives of disinvestment are:
2) To put national resources and assets to optimal use.
3) To raise resources from within the public sector for meeting loss relating to restructuring of those units which are sick but can be revived by re-training the displaced workers.
4) To improve performance of the Public Sector Units in order to make them globally competitive.
5) To modernize public sector units through strengthening R&D.
6) To retire public debt.
7) To fund the genuine need of expansion.
8) To widen the capital market base.
9) To mitigate fiscal deficits.

Check Your Progress

1. What is Foreign Trade Policy?
2. What do you mean by Disinvestment?
3. What are the basic problems in Disinvestment?

Privatization / Disinvestment in India

Before Independence, private sector dominated in India. During the period of planning, importance of public sector increased and that of private sector relatively declined. In 1991, New Economic Policy was declared. Under this policy, private sector has been accorded great importance and the process of privatization has been initiated.

Main features of the process of privatization in India are as follows:

1) **Contraction of Public Sector:** Number of industries reserved for the public sector has been reduced from 17 to 3 only. These three industries are - atomic energy, atomic minerals and railways, and the remaining industries have been opened for private sector. This measure will increase the flow of investments to priority sectors. It is hoped that competition and efficiency will increase in the areas which have been opened for private sector. **For example,** in the area of telecommunication, after privatization huge funds are invested by private sector; and it has promoted competition.

2) **Sale of Shares of Public Sector to the Private Sector:** Upto 74 per cent of shares of public sector have been sold to foreign investors, institutional investors, mutual funds, public and workers. Till the end of March 2008, shares of public sector worth Rs. 53,423 crore were sold. In some PSUs even 100 per cent shares are disinvested. Now shares of PSUs are sold through bidding process.

3) **Sick Public Sector Industries:** Public sector industries will be treated in the same way as sick industries of private sector. In order to reorganize the sick enterprises of public sector, the same will be entrusted to Board of Industrial and Financial Reconstruction (BIFR). Various cases of sick industrial companies of public sector have been forwarded to BIFR. Sick PSUs which cannot be revived are sold to private sector.

4) **Memorandum of Understanding (MOU):** With a view to improve the working of public sector enterprises, a system of MOU has been introduced. Under it, management of public sector enterprises is given more freedom and they are accountable for the results. In MOU, more autonomy is given to directors and they need not take permission for routine decisions from ministers.

Table: Amount of Disinvestment of Public Sector Units in Recent Years

Year	Target Amount to be Realized by Disinvestment (Rs. in Crore)	Actual Amount Realized (Rs. in Crore)
2000-01	10,000	1,871
2001-02	12,000	5,632
2002-03	12,000	3,348
2002-04	14,500	15,547
2002-05	4,000	4,091
2002-06	....	1,568
2002-07	....	2,368
2002-08	....	1,814

Amount of disinvestment proceeds was highest in the year 2003-04. In this year, Rs. 15,547 crore disinvestment proceeds were realized. From 1991 to 2008 government has realized Rs. 53,423 crore from disinvestment. In the years 2005-06, 2006-07 and in 2007-08 disinvestment process has slowed down.

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1) Shipping Credit and Investment Corporation of India
2) Container Coporation of India Ltd.
3) Videsh Sanchar Nigam Ltd. (VSNL)
4) Oil and Natural Gas Corporation Ltd. (ONGC)
5) Gas Authority of India Ltd. (GAIL)
6) Steel Authority of India Ltd. (SAIL)
7) Mahanagar Telephone Nigam Ltd. (MTNL)
8) Indian Petrochemicals Corporation Ltd. (IPCL)
9) Power Grid Corporation
10) Shipping Corporation of India
11) National Aluminum Company (NALCO)
12) National Fertilizers Ltd. (NFL)
13) Indian Airlines
14) Dredging Corporation
15) LNG Petro Net
16) Madras Refineries Ltd.
17) Hindustan Zinc Ltd.
18) Maruti Udyog Ltd.
19) Modem Food Industries (India) Ltd.
20) Indian Tourism Development Corporation (10 hotels)
21) Bharat Aluminum Company Ltd. Q3ALCO)
22) CMC Ltd.
23) IBP Company Ltd.
24) Paradeep Phosphates Ltd.

Process of Disinvestment

The Government in July 1991 initiated the disinvestment process in India, while launching the New Economic Policy ^IEP). The Government had appointed the Krishnamurthy Committee in 1991 and Rangarajan Committee in 1992.

These committees distinguished between the short-term and long-term goals of disinvestment and advised the government not to sacrifice the long-term goals for the sake of fulfilling the short-term objectives. The Government has announced in its NEP that mitigating the fiscal deficits is the only objective of disinvestment.

The crucial shift in the Government policy for disinvestment of PSU's was mainly attributable to poor performance of these enterprises and burden of financing their requirements through budget allocations. Further, the Government constituted a five member public sector Disinvestment Commission under the chairmanship of G.K. Ramakrishna in 1996 for drawing a long-term disinvestment program for the PSUs.

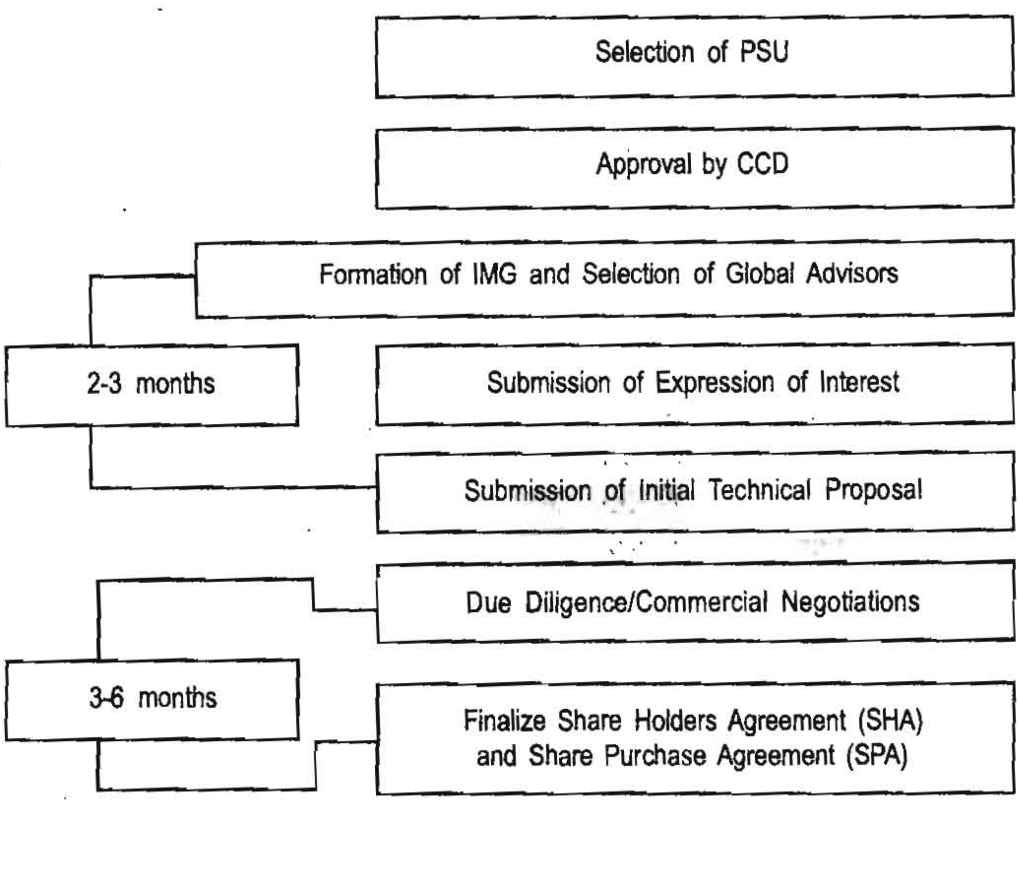
The Disinvestment Commission submitted its report covering 58 enterprises, out of 70 enterprises referred to it by the Government Recommendations ranged from strategic sales in various proportions to disinvestments at varying levels. The Commission's recommendations are in various stages of implementation. The Disinvestment Commission was ultimately abolished in November 1999.

m 2001, the Government re-constituted the Disinvestment Commission with R.H. Patil as its chairman. The government has decided to refer all 'non-strategic' PSUs and their subsidiaries, excluding IOC, **ONGC** and GAH^ to the Commission for its independent advice. The government set-up a new department of disinvestment in 1999 to establish a systematic policy approach to disinvestment and to give a fresh impetus to the program of disinvestment, which will increasingly emphasize strategic sales of identified PSUs.

The procedure for carrying-out the disinvestment, according to the rules laid down by the Government of India, is as follows:

Proposals for disinvestment in any PSU are placed for consideration of the Cabinet Committee on Disinvestment (CCD). An Advisor is appointed to invite Expressions of biterest **@lOr)** from parties. The prospective bidders undertake due diligence ofthe PSU. Concurrently, the task of valuation of the PSU is undertaken.

The share purchase agreement and shareholders' agreement are sent to the prospective bidders for inviting the final binding bids (technical and financial). The bids received are placed before the CCD for the final approval. The CCD then approves the final buyer. After the transaction is completed, all papers and documents relating to it are turned-over to the Controller and Auditor General of India (CAG), to enable the CAG to undertake an evaluation of the disinvestment, for placing it in Parliament and releasing it to the public.



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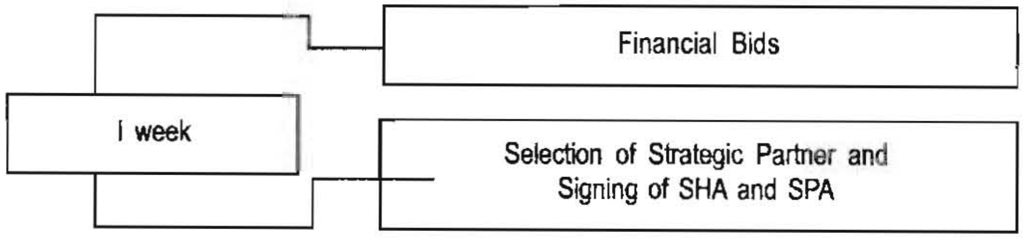

Figure: Disinvestment Process

Methods of Disinvestment

There are three methods adopted by the government for the valuation of shares for disinvestment. They are:

1) **Net Asset Method:** This will indicate the net asset of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It does not reflect position of profitability.

2) **Profit Earning Capacity Value Method:** The profit earning capacity is generally based on the profits actually earned or anticipated.

3) **Discounted Cash flow Method:** In this method the future incremental cashflows are forecasted and discounted into present value by applying cost of capital rate. The method indicates the intrinsic value of the firm.

Disinvestment in Indian Public Sector Units Since 1991

Disinvestment of a percentage of shares owned by the Government in public undertakings emerged as a policy option in the wake of economic liberalization and structural reforms launched in 19-91. mitially, it was not conceived as.privatization of existing undertakings but as limited sales of equity with the objective of raising some resources to reduce budgetary gaps and providing market discipline to the performance of public enterprises in general.

A comprehensive policy on public sector was set-out in the Industrial Policy Statement of July 24, 1991 - the year when the country had to tide-over an unprecedented economic crisis reflected in its internal and external finances. The steps adumbrated included a review of public sector investments to focus on strategic and essential infrastructure enterprises and new procedures to tackle chronically sick and loss-making units.

The ambit of disinvestment was gradually widened in the latter half of 1990s by the subsequent coalition governments to make a clear distinction between strategic and non-strategic enterprises so as to bring-down Government share holding to 26 per cent in non-core undertakings through gradual disinvestment or strategic sale while retaining majority holding (51 per cent) in strategic undertakings.

A Disinvestment Commission was set-up in 1996 to carefully examine withdrawal of public sector from non-core, non-strategic areas with assurance to workers of job security or of opportunities for re-training and reemployment. The Commission, in its three-year term, gave its recommendations on 58 enterprises referred to it and proposed, instead of public offerings as in the past, strategic trade sales involving change in ownership/management for 29 and 8 undertakings respectively. Ln other cases, there was to be offer of shares or closure and deferment of disinvestment.

By strategic sale, privatization was envisaged though confined to non-strategic areas. The classification was redefined by Government in 1999 to include only defense-related, atomic energy undertakings and railway transport among strategic enterprises and treat all other undertakings as non-strategic. This major decision of the Government also stipulated that reduction of its stake going-down to less than 51 per cent or to 26 per cent would not be automatic but would be governed by consideration as to whether continued presence of the public sector in an enterprise was required to prevent concentration of power in private hands. A Department of Disinvestment was established early in 2000 to give an impetus to the program of disinvestment and privatization.

In a policy statement while presenting the Union Budget for 2000-01 last year, the Finance Minister, Shri Yashwant Sinha, said the main elements were re-structuring and reviving potentially viable PSUs; closing down PSUs which cannot be revived; bringing down Government equity in all non-strategic PSUs to 26 per cent or lower, if necessary; and fully protecting the interests of workers. Over the last three years, the Finance Minister had listed in his budget speeches some major public undertakings for sizeable disinvestment or re-structuring in the oil, telecom and aviation .sectors. These are yet to take-off. The utilization of receipts from disinvestment/ privatization was to be for meeting expenditure in social sectors, re-structuring of PSUs or retiring public debt.

Progress of Disinvestment

The disinvestment program started in 1991-92 but the disinvestment carried-out so far has been half-hearted. Disinvestment has also been undertaken in states. Out for the 222 state level public enterprises identified for disinvestment, the process has been initiated in 124 enterprises. 30 enterprises have been privatized and 68 have been closed-down.

The reasons for such low proportion of disinvestment proceeds as against the target set were identified and have been presented below:

1) The unfavorable market conditions are the main reason responsible for this downward trend of disinvestment.
2) The proceeds realized through disinvestment were not paid to the enterprise concerned for its expansion and improving efficiency but the government has been using such disinvestment proceeds to bridge the budget deficit.
3) The offers made by the Government for disinvestment ofPSUs are not attractive and stringent bureaucratic procedures causing discouragement to the private sector investors.
4) Undervaluation of assets leading to 'under-pricing' of public sector enterprises shares resulting in considerable loss to the Government.

5) The Government does not have a comprehensive policy on disinvestment of its PSUs. The procedures adopted for disinvestment suffered from adhocism. It narrowly focused only on disinvestment of shareholdings.

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6) The Government is not transparent about its approach towards sequencing the re-structuring and the methods of privatization of PSEs.

Thus, the disinvestment process of the Government has not really been successful both in terms of realization of proceeds from disinvestments and achieving the targets for that purpose. As disinvestment and privatization process gains momentum, there is need for a comprehensive strategy for disinvestment.

Present Disinvestment Policy

The first disinvestment policy was framed in the year 2000-2001. On June 4, 2009, the UPA government announced its disinvestment policy. The main points of this policy are as follows:

1) Disinvestment will be encouraged in non-strategic public enterprises, m these enterprises, after disinvestment, government share can go even below 26 per cent.
2) In profit-making public enterprises, government plans to retain 51 per cent holding and disinvesting the rest to the public.
3) To sell loss-making public enterprises to private sector which cannot be revived.
4) To protect the interest of workers of PSEs which are to be disinvested.
5) To use entire receipts from disinvestment for meeting expenditure on social sectors and further strengthening of strategic and profit-making PSEs.

The present trend of disinvestment in India is disinvesting public sector enterprises. The present UPA government will promote disinvestment. The disinvestment proceeds are utilized in repaying public debt of Government, to develop education and health in mdia and to reform and revive the strategic and important PSEs. The disinvestment policy of the government also gives lesson and creates fear to the employees of PSEs to work hard for earning more profits so as to avoid disinvestment of that public enterprise. Now disinvestment policy is implemented in a more transparent manner. To avoid the ill affects of disinvestment (by privatizing a unit) on consumers, government is strengthening Consumer Protection Act for the benefit of consumers.

Basic Problems in Disinvestment

Some of the basic problems in the process of disinvestment have been discussed here in brief:

1) **Increase in Managerial Efficiency:** Normally, this has been the presumption that the privatization of equity in public sector undertakings would enable them to enhance managerial efficiency but due to very slow process of disinvestment

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the dominance of government official's representatives is still there in the management of these undertakings.

2) **Political Instability and Security Scam:** The political instability in any country invariably adversely affects the foreign investment. Due to political change also; the possibility of change in investment policy persists. The scams occurred in security and money markets in the past, have also created a strong resistance in participation of foreign investors in disinvestment of public enterprises. They treat it as the risky area for investment in mdia.

3) **Rate of Return:** The rate of returns on capital employed in public enterprises is normally less than the existing rate of return in the private sector. As a result of this; there is under pricing of government securities on one hand and the government's revenue is also less on the other hand.

Foreign Direct in India

The international business environment includes political, legal. socio-cultural and ethical environments. The political and legal environments play an important role in international business.A firm cannot ignore the political situations and legal formalities existing either at the home or host country if it has to operate successfully in the international business environment. The socio-cultural and ethical environments vary in different countries. In order to operate successfully in international business, managers have to be fainiliar with the socio-cultural and ethical environments of the home country as well as that of the host country.

'Multinational financial environment' is a very broad concept in the field of international business environment. It is a structure of various a mponents without which it cannot fiuictiott .---global financial markets, the international monetary system and multinational corporations (ivINCs). These components are interrelated and interdependent and the entire multinational financial environment will be defunct if one of the components aces not function properly.

The foreign exchange market is a global market in which traders buy and sell currencies using different communication media, including telephone, Internet, telex and computers. The purpose of the foreign exchange market is to facilitate the transfer of a specific amount of money denominated in the currency of one country to another country. The foreign market acts as a mediator between the

- Market-based economy: In a market-based economy, it is market forces that allow businesses and firms to decide how to invest and produce. This system allows freedom and choice to both producers and consumers, who then decide on the basis of how far they can maximize their wealth.

Primary Economic Indicaters

When a firm contemplates operating in another country, it has to take note of a set of primary economic indicators. The host country's primary economic indicators will enable the firm to determine the following:

- How much demand there is for the proposed product
- How much it will cost to prod ice the product
- How much can be earned from it
- How efficiently the earnings can be sent back to the home country

Demand, cost, earnings and ease of transfer of profit depend on a number of variables, such as income and distribution of wealth in a population, rate of price rise, availability ofresources and a skilled workforce, the industrial and fiscal policies the government implements and the country's overall strength in terms of foreign exchange, trade and balance of payments.

Income and wealth

A country's income level is best determined by its per capita income. The World Bank has classified all countries into three groups-low-income, middle-income and high-income. Table 2.1 shows the per capita income for the three groups.

Table 2.1 Per Capital Income Classification for Different Countries

Country Classification	Per Capita Income
Low-income	Up to US $755
Middle-income	US $756- 9,265
High-income	US $9,265 or above

A country's income level has significant implications for firrr s plaruung to do business there as it determines consumer behaviour. Low-income countries will not be a good market for high-pi iced goods, and similarly, consumers in high- or middle-income countries will be choosier about the quality of a product rather than its price. Multinationals also favour manufacturing products in low-income countries, due to the easy_availability of cheap labour, and then selling them in high- or middle-income countries. Distribution of wealth can also determine if there is a market for a particular product. Even in a low-income country, if the distribution of wealth is so uneven that only ten per cent of the population holds sixty per cent of the wealth, there could be a market for high-priced products.

buyers and sellers of the currencies and is involved in all financial activities related to the various deals of traders and brokers. You will learn more about the economic, cultural and economic environments in relation to international business.

THE ECONOMIC AND POLITICAL ENVIRONMENT

The political environment of a country has a great impact on the operations of international business units. It is determined by the extent to which various sections of society, such as individuals, media, businesses and industry have a say in the affairs of governance. Democracy is a political system in which either the citizens themselves, or their elected representatives, as in a parliamentary democracy. take part in policy-making. The type of democracy a country follows plays an important role in the establishment of a company in a foreign country. On the other hand, in a tc talitarian system, political power is in the hands of only one individual or party, who implement policies.

An economic system can be defined as the set of principles and techniques by which a society decides and organizes the ownership and allocation of different types of ect nomic resources. Economic system is basically a mechanism which deals with the production, distribution and consumption of goods and services in a particular society. Economic system can be classified into following categories:

- Centrally planned economy (CH). In a C PE, it is a central authority, in most cases the government, which decides how to produce and distribute goods and services, usually following a certain economic or political agenda.

Price rise

The demand for a product and its cost of production also depends on the rate of inflation in the country. If the rate of inflation in a country is high, the real income of its citizens will be low, leading to lower purchasing power. In other words, you can say that the rate of inflation in a country is inversely proportional to the purchasing power of the consumers. The rate of inflation in a country also influences the cost of production. Ifthe rate of inflation is high in a country, then the cost ofproduction will also he higher.

Workforce and material resources

Cost and convenience of production depends on easy availability of a trained workforce and material resources. A country with a high level of education and abundance of raw materials will provide greater human and material resources than a country that has neither.

Economic and industrial policies

Multinationals prefer countries that have beneficial economic and industrial policies. such as low taxes and duties. and favourable rates of interest or credit.

Foreign exchange

As multinationals want to transfer their profits to their home countries, it makes sense for them to operate in countries that have liberal fiscal policies and a favourable ratio of export-import. current account balance and GDP, and current receipt and GDP.

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THE HUMAN CULTURAL ENVIRONMENT

The social environment is concerned with the social attitudes and cultural values or different societies. As attitudes and values formthe essence of a society's essence, they often drive not only demographic and economic changes but also politicali legal and technological changes. It is a challenge for firms to understand the meaning. of attitudinal and cultural changes in societies across the globe.

A significant workforce trend in many countries concerns diversity. In End 16, a large number of the young population of men and women are expected to participate in the workforce in 2010. In the US, for example, 76.3 million women are expected to be in the labour force by 2011. In addition, a large percentage of new entrants into the work-force will be ethnic minorities. As a result, the workforce will become increasingly diverse.

In the US, approximately 46 percent of the workforce is composed of women. In Sweden. it is 50 percent; Japan. 41 percent; and Mexico, 37 percent. In the US, women hold 17 percent of the managerial jobs. In Sweden, n 7 percent are held by women and in Japan, it is only 9.4 percent. But in India, this percentage is even lower.

In Japan, many women head businesses, but they are self-employed. 1 he wle is true in the US. but women, excluding those who are self-employed; head approximately 17 per cent of all US businesses.

In the US, women arc paid approximately 76 per cent of the compensation paid to men. In Sweden, it is 77 per cent; in Japan it is 61.0 per cent; and in Mexico it is 68.2 per cent. Thus, while women have experienced employment problems in the US, the barriers to their participation in the workplace in many other countries seem to be greater.

Many women now choose to start their own businesses, as implied earlier, often because of the frustration in dealing with the glass ceiling (a subtle barrier to the advancement of women and ethnic minorities in corporations). In 1982, there were 2.4 million female entrepreneurs in the US; in 1991, that number exceeded 3

In 1994, women owned 7.7 million businesses, more than one-third of all US firms. The number of businesses owned by minority women continues to glow. increasing 153 per cent between 1937 and 1996. The same trend has been observed in other countries such as Japan.

The number of women in the corporate world who are relocating was up to 26 per cent in 1996 from 16 per cent in 1993. Many of these women relocate without their familie.> and thereby lead complex lifestyles while trying to maintain their family life.

Dorrit J.Bem, for example, ' as had a significant influence on the corporation she leads. She is CEO of Charming Shoppes, Inc., which is headquartered in Philadelphia, but her family lives in Chicago.

She maintains an apartment in Philadelphia from Monday to Friday and a family life in Chicago on weekends. Her husband is a consultant and has more flexibility to manage the home and dr2 lives of their three children.

Moreover, the number of sir gle fathers with custody of their children has increased dramatically to 1.86 mil ion in 1996 from 393,000 in 1970. There are still more single mothers at 9.86 million, but single-father families have been growing by 10 per cent annually. Demographers and marketers are noting this change.

The influx of women and the increasing ethnic and cultural diversity in the workforce yield exciting challenges and significant opportunities. Included among these is the need to combine the best of the leadership styles of both men and women for a firm's benefit and to identify ways to facilitate contributions from all the employees of the firm

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An example of a firm attempting to do this is Avon. Four out of the eleven members of the board are women, and over 40 per cent of its global managers are women. Some companies now train women to bring of their leadership potential. Changes in the structure of the organization and in management practices are needed to get rid of existing barriers.

Learning to manage diversity in the domestic workforce can increase a firm's effectiveness in managing a globally diverse workforce, as it acquires more international operations. This kind of commitments to promote and manage diversity enhances a company's performance.

Organization should have a good understanding of the different cultural and institutional attributes of global markets in which they operate or hope to operate. For example, a firm operating in South Korea must understand the value placed on hierarchical order, formality, self control, and on duty rather than rights.

Furthermore, Korean ideology places emphasis on communitarianism, an Asian characteristic. The Korean approach differs from that of Japan and China with its focus on Inhwa or harmony.

Inhw a is based on respect for hierarchical relationships and obedience to authority. Alternatively, the approach in China is focused on Guanxi or personal relationships and in Japan on Wa or group harmony and social cohesion. The institutional context of Korea suggests primary focus on centralized planning by the government. The focus on growth by many South Korean companies is the result of a government policy to promote economic growth in the country.

The cultural and institutional contexts in which firms must operate in global markets can be critical. For example, in India, there was a nationalist campaign which led to the closure of a KFC outlet on grounds of health after inspection. However, executives of several US food companies blamed political posturing related to an upcoming election as the reason for the closure.

Also, those who opposed the opening of KIT were mostly those who were also lobbying against meat eating. KFC was one of the first major fast food giants to open a facility in India. Furthermo-e, it has 'ocen quite successful in Asia with more than 2,200 restaurants operating in that region. Still, even a firm that has been as successful as KFC must carefully and thoroughly analyse the institutional and cultural environment of its global markets:

With the takeover of Hong Kong, China offers potential opportunities but also threats to a number of firms with domestic headquarters outside its borders. Moreover, with Hong Kong a part of China, the latter 's growing economic prowess transforms its firms into potentially significant conipetitors, particularly in labourintensive industries. As a result, firms operating in such industries worldwide must view the development of Chinese entrepreneurial operations as an environmental threat.

Alternatively, firms that can invest in China may be able to take advantage of the low-cost labour; and China also offers a huge and growing market for products, as

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evidenced by the success of Procter and Gamble's (P & G) produci:s there. P&G sells approximately 50 per cent of the shampoo used in China, and its nationwide distribution system maybe best in that country.

P&G owes its success to being an early mover in China, and its aggressiveness has paid dividends. It has been successful even though its prices are sometimes 300 per cent higher thanihose of the iccai brands. The development of the Chinese economy is one that must be analysed carefully by firms operating in many industries regardless of their home country.

INFLUENCE ON TRADE AND INVESTMENT PATTERNS

`Culture' refers to the distinctive way of life of a group of people—their complete 'design for living'. alture seems to be the master concept of American anthropologists. For ethnologists, folklorists, anthropological linguists, archaeologists and social anthropologists, culture is always a point of departure or a point of reference if not invariably the point of emphasis.'

Culture consists of patterns. explicit and implicit, of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artifacts; the essential core of culture consists of traditional (i.e., historically derived and selected) ideas and especially their attached values; culture systems may, on one hand, be considered as products of action, on the other, as conditioning elements in a future action.' Culture has many complex dimensions to define in simple terms. It seems that each anthropologist has defined culture from riis own perspective. However, certain anthropological thinkers had agreed on fundamentals, as may be seen from the description provided by Hoeber – 'Culture is the integrated sum total of learned behavioural traits that are shared by members of a society.' Culture may be described in reference to three basic concepts. Ficst, culture is a total pattern of behaviour that is consistent and compatible in its-components. It is not a collection of random behaviours, but behaviours that are related and integrated. Second, it is a learned behaviour and not biologically transmitted. It depends on environment, not hei edity. It can be called the man-made part of our err ironment. Third, culture may be manifested in the behaviour that is shared by a group of people or a society. It can be considered as the distinctive way of life c fa people. Accordingly, a marketing manager of an international firm is supposed to be familiar with the reference groups, social class, consumption systems, family structure and decision-making, adoption and diffusion, market segmentation, and consumer behaviour in order to understand the cultural environment in the host country.

Cultural Factors Affecting International Business

Some of the factors ti tat affect international business, culturally, are:

- Technology and material culture
- Language
- Aesthetics
- Education

- Religion
- Perceptions and Attitudes
- Social Values and Life Style (VALS)
- Social organization
- Political life

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Market integration lets consumers purchase goods from all over the world in their local shops and supermarkets. Not only do local businesses have to compute with these foreign goods on home ground, they also have new opportunities to develop their export markets by selling in a multitude of other countries. Cultural goods and services are also affected by these new patterns of production, consumption and trade. Cultural markets are increasingly going global as may be observed by the trends in cultural goods trade in the post-1980 period across countries in different regions. With widespread consumption of cultural products and services across the world, production itself tends to concentrate. This gives rise to an oligopolistic market possessin g an asymmetric structure. The impact of this market profile is unknown. However, we are aware that a large share of the cultural products circulating in most countries are produced elsewhere. We however. know little about the effect of this global cultural market on governments citizens, businesses and audiences. In the past few years, interest in culture has grown due to globalization, regional integration processes and cultures claiming their right to express themselves — all this in a context where cultural industries are progressively taking over traditional forms of creation and dissemination and bringing about changes in cultural practices. The issue of 'culture and trade' has now acqui red strategic significance. Cultural goods and services convey and construct cultural values, produce and reproduce cultural identity and contribute to social cohesion; at the same time, they constitute a key free factor of production in the new knowledge economy. Culture is an essential dimension of business development. Business solutions should be designed for local traditions and institutions and should employ local expertise and knowled ge. The international company entering the host country should ensure that people, their cultures and society, and their organizations and institutions are taken into account in formulating business goals and operational strategies. Such develo p ment coordination with local culture improves the lives of people, espec Tally the poor, and builds the social capital fel a company to sustain long in the host country.

Culture contributes to core business development objectives by:

- Providing new opportunities for local communities to share skills and generate incomes from their own cultural knowledge;
- Catalysing local-level development through communities using their diverse social, cultural and economic resources;
- Conserving and generating revenues from existing assets, that is, reviving city centres, conserving natural resources and generating sustainable tourism revenues;
- Strengthening social capital by providing marginalized groups a basis to pursue activities that enhance their self respect and efficacy, and to strengthen respect for diversity and social inclusion; and

- Diversifing strategies of !luman development and capacity buildin g for knowledge-based dynamic societies e.g.. through support to local publishing, library and museum services.

Depending on the context, cultural industries' may also be referred to as `creative industries', 'sunrise' or 'future-oriented industries' in the jargon of economics, or content industries in technological jargon. The notion of cultural industries generally includes printing, publishing and multimedia, audio-visual. phonographic and cinematographic productions, as well as crafts and design. For some countries, this concept also includes architecture, visual and perform irm arts. sports; manufacturing of in usical instruments, advertising and cultural tourism. Cultural industries add value to content and generate values for individuals and societies. They are knowledge and labour-intensive, create employramt and wealth. nurture creativity—the 'raw material' they are made from — and fot ter innovation in production and commercialization processes. At the same time, cultural industries are central in promoting and maintaining cultural diversity and in ensurin g democratic access to culture. This two-fold nature — both cultural and economic — builds up a distinctive profile for cultural. industries.

Cultural Variables and International Business Environment

Culture may be understood as the underlying value framework that governs individi ial and group behaviour. It is seen in the perceptions of individuals in events, personal exchanges, and in the selection of appropriate responses in social situations. Culture often manifests itself in learned behaviour, as individuals age and begin to understand what their culture required them to do.

Material culture

Material culture such as tools and artifacts — the material or physical objects — in a society, excluding the physical objects found in nature unless they undergo some technological procedure is seen all around us. A tree, for instance is not part of a culture, but the Christmas tree is, and so is an orchid. Technology refers to the techniques or methods of making arid using those things. Technology and material culture are related to the wa-y a society organizes its economic activities. The term `technology gap' refers to differences in two socie-ties' ability to create, design, and use things. The level of technology in a cultural environment manifests in many ways including the societal response to technology diffusion, perceived use value of the technological appliances and rate of adaptation.' This may be explained in terms of sophisticated electric kitchen appliances, cutters, can openers and fry pans are acceptable largely in the developed countries unlike India where they are less attainable and probably unwanted as disposable income is spent more meaningfully on better houses, clothi ig, or food. Such concepts as preventive maintenance are foreign in many low-technology cultures. In the United States, Japan, Germany and other developed countries with high levels of technology, tho general population has a broad level of technical understanding that allows them to adapt and learn new technology more easily that populations with lower levels of technology. Simple

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repairs, preventive maintenance, and a general understanding of technological processes constitute a higii 1,Nel of technology. Material cul ure impacts the level of demand, the quality of goods and types of products demanded, their functional features, their means ofproduction and distribution. Culture directly influences consumers with reference to what they understand, analyze and adapt. This interpretation of culture is useful for global marketing managers. It suggests that culture is si gnificant in how managers make decision, and less to do with witai their decisions should be. Culture influences the way strategies are in formulation. Countries with large populations such as India, China, Russia, and the United States are really multicultural, meaning that thev contain a wide variety of cultures within their borders. The same goes for some smaller nations, such as Belgium, Canada, South Africa, and forme Yugoslavia. In other cases, several countries can be seen as one cultural grouping such as the Scandinavian countries (Denmark, Norway, Finland and Sweden) and LatinAmcrican countries (Mexico,Venezue l a. Colombia. Ecuador, but not necessarily Brazil).

Language

Language is an important cultural tool for effectively conducting international business in the host countries. Language has z deep-rooted sentiment in people. It is just not a spoken word, but also symbolic communication of time, space, things, friendship, and agreements. The language people speak is part of the culture in which they are raised. Therefore, the language used in all marketing communications, including advertising, public relations, and general communications, should reflect the unique cultural expressions and values of the target locale. Non-verbal communication occurs through gestures, expressions, and other body movements. The language in business should be regarded to offer the most appropriate sense of communication and should not be literally translated into the other language. Some examples may be illustrated such as the phrase, body by Fisher. If translated literally into Flemish language spoken widely in Belgium, the Netherlands and Luxemburg (Benelux) countries, it conveys the meaning corpse by Fisher. Similarly, the Nova model of the car of General Motors means it does not go in Spanish and it has been difficult for the company to position this brand in the Latin American market. Another relevant example in this context is of Olympia's Roto photocopier machines, which did nol sell well in Latin America because ro'o refers to the lowest class in Chile and the avoid roto stands for broken in Spanish. The English language differs so much from one English-speaking country to another that sometimes the same word means something entirely opposite in a different culture. Table the report in the US means postponement; in England and India it means bring the matter for discucsion. Gerber, the name of Cie famous baby food maker, means to throw up, spew or vomit in French. It becomes a problem when the firm goes global and gets trapped in the language conflict that hinders the brand positioning in the host country. Therefore, Gerber is not in France, and although Gerber has a French-Canadian web page, that delinea:es Les aliments pour bebes Gerber ne sent disponibles pour l'instant qu 'aux Etats-Unis6 which means the food for Gerber babies is available for the moment only to the United States. The literal translations of some of the sports analogies that are frequently used in American and European cultures and terms like 'a ball park figure' or 'give it your best shot' may cause confusion and even problems in other language.

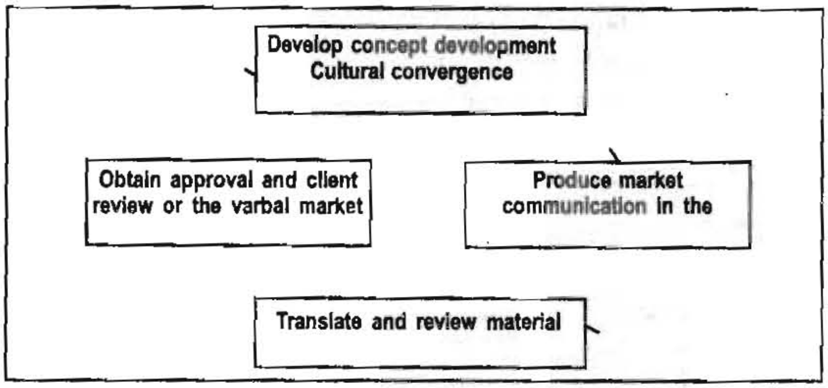

Figure : Model of Market Voice Conversion

Marketing activities are highly dependent on communication particularly in developing localized advertising, branding, packaging, personal selling, and conducting marketing research. The management of the company should speak the same language as its various consumers if they are to reach the market extensively and penetrate the segments intensively. In each of its foreign markets, the company must communicate with several audiences including its workers, managers, customers, suppliers, and the government. Each cf these audiences may have a distinctive communication style within the language common to all. The number of language areas the firm operates is approximates the number o countries it is selling in. Any advantage gained by the fact that one language may be used in more than one country is partly offset by the fact that in many countries, more than one language is mcessary. Language differences can affect all sorts of business dealings, contracts, negotiations, advertising, and labelling. International marketing communication managers must keep facing difficulties of localizing their messages for multiple audiences speaking and understanding different lan guages and possessing diverse cultures. In an age of growing globalization, international companies cannot ignore the localizing of their messages to ensure consistency. Companies are not solely dependent on the traditional word-for-word approaches to translation. Multinational companies should operate through the various links available in the markets as cultural bridges in many countries. For example, in countries where the firm is operating through a distributor, the distributor may act as the bridge between the firm and its local market. In advertising, the firm can rely on a local advertising agency. Agency personnel, like the distributor, probably speak the advenisiig manager's lan guage--especially if he firm communicates principally in English. The Netherlands firm Philips uses English as the official company language; even though its native language is Dutch in view of its global operations. Figure 2.1 exhibits the model of market voice co aversion that may be practised by multinational firms to develop customized marketing communication fit to the cultural environment of the host country. However, language is one of the most difficult cultural elements to master unless a strong social and cultural empathy is developed towards the activities of the company, and towards business and corporate social responsibility.

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Understanding the elements of culture as well as the cultural differences or similarities, of target audiences empoN ers marketin g professionals to realize that one universal message whether verbal or visual, can never reach a global audience. A single global culture consistin g of people with identical values does not exist. even within a country. Differences in learning and thought processes affect the manner in which people process information, as demonstrated in their innate responses to marketing communications. Audiences differ in the way they perceive and value concepts of time, space, mor ey, relationships, power, risk, and even the protocols of gender roles. While attempting to customize communications with cultural differences in mind, it is essential to recognize the cultural similarities. As much as localization vendors like to overemphasize 'extreme customization', cultural similarities are found to be well embedded in the core values of product and service offerings. Culture is an omnipresent evolution of social behaviours that continually transforms over not merely spatial and temporal subgroups but also demographic subgroups. This is a different concept than tradition, which does not change but may have an influence on societal behaviours. False assumptions are often created owing to emphasis on tradition instead of culture. This results in a negative connotation for the marketing attempt.

Social Institutions

Social institutions play a significant role in nurturing the cultural heritage, which is reflected in individual behaviour. Institutions such as family, the media' education. and political structures affect the manner in which people relate to one another, arrange/structure their activities to live in harmony with one another, teach acceptable behaviour to succeeding generations, and govern themselves. The status of gender in society, the family, social classes, group behaviour, age groups, and how societies define decency and civility are understood or interpreted different ways within every culture. Social institutions imply a system of regulatory rules or norms of governing actions in pursuit of immediate ends in terms of whether they conform to the ultimate common value system of a community. They comprise the underlying norms and values makelip the common value system of a society. Institutions are intimately related to ar d derived from the value attitudes common to members of a community. This establishes institutions as primarily moral phenomena, which leads to enforce individual decisions on all human needs including economic and business-related issues. The main means for enforcing norms is moral authority. An individual obeys the norm because he believes that it is good for its own sake.

Social interactions establish the roles that people play in a society and their authority/responsibility patterns. These roles and patterns are supported by society's institutional framework, which includes, for example, education and marriage. Consider the traditional marriage of an Indian woman which is typically arranged by the parents. The social role assigned to women is to abide by the norms of the society and culture thereiii and yield to social pressures. Social roles are extensively established by culture. Fcr example, a woman can be a wife, a mother, a community leader, and/or an employee. However, what role is prefen-ed in different situations is culture-bound. Most Swiss women consider household work as their primary role, and that makes them procure modem gadgets and machines. The recent concern of society on organic products has prompted a new thought process on green consumerism. The research on recent buyers of green products and empirical evidence leads to the belief that educated women consumers are most receptive — to environmentally oriented marketing appeals. These women are aged between 30-44, with $30,000-plus household incomes in the US. It has been observed that women consumers are at the forefront of green purchasing and contribute considerable share in consumption of green products. It might sound sexist but they take care of most of the shopping they may yet exhibit a natural maternal consideration for the health and welfare of the next generation. In conventional marketing, demographics are often a key determinant of intent to buy specific products. But in green marketing. what seem to determine willingness to purchase environmentally conscious products—more than demographics or even levels of concern for a specific environmental issue—are consumers' feelings of being able to act on these issues, or erripowernient.7

Aesthetics

Aesthetics may be described as a set of creative ideas embedded in culture concerning the sensory appeals of the people towards beauty, arts and taste. Since actions or behaviour can be said to have beauty beyond sensory appeal, aesthetics and ethics often overlap to the degree that this impression is embodied. in a moral or ethical code. A value system, which is the prioritization of the values held by an individual or group in a society, forms the basis of moral code. Such dimensions are reflected in consumer behaviour. In conservative societies in Asia, such as Japan and India, any communication or art that express women is not

Seeally aespite the aesthetic standpoint of the critics. In some cultures. e relationship between moral and legal codes is often one and the same. Mcrai codes drive personal conduct. Aei• thetics include the arts, drama, music, folk culture, and architecture prevalent in a society ana these convey its concept of beauty and modes of expression. In different societies colours have different meanings across countries. In western societies, wedding gowns are usually white, but in Asia, white symbolizes peace or sorrow. The aesthetic values of a society show in the design, styles, colours, expressions, symbols, movements, emotions, and postures valued and preferred in a particular culture. These attributes have an impact on the design and promotion of differei t products. In many situations the symbolic expressions of communication have greater appeal than the actual words, and people respond accordingly. Therefore, an international businessperson must understand nonverbal cultural di fkerences to avoid communicating the wrong message.

Respecting employees' religious beliefs

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Any human activity, and that includes business, conducted under the guidelines of one of the major religions will work better because the essence of business is tnist and religion teaches trust. Trust means an honest day's work for an honest day's pay, a tough but fair dealing, and transparancy without hidden agendas. Above all, trust means truth that is an outgrowth of religious sentiments in a society or an individual. The relationship between business and reli gion truly poses a selfchallenge. There is a sense that we must improve the fundamental actions of business in a global setting at the moment. Capitalism looks like it has won the day, but if it suffers from some kind of moral bankruptcy, it is not going to last.' Although religion is an eternal driving force for various segments of society, there also exist ideological conflicts in the streams of religion. Corrigan' found that for the Protestants, the expression of emotion was a matter of transactions. They saw emotion as a commodity, and conceptualized relations between people, and between individuals and God, as transactions of emotion governed by contract. Religion became a business relationship with God, with prayer as its legal tender. By entering this relationship, they were conducting the 'business of the heart.' This innovative study shows that the revival — with its commodificotton of emotional experience became an occasion for 'white Protestants to underscore differences between themselves and others. The display of emotion was a primary indicator of membership in the Protestant majority, as much as language, skin colour, or dress style.

Mary Kay Inc. operates on the Go-Give philosophy. 1 ° All you send into the lives of others does come back into your own. All consultants and sales directors share thei experiences with and guide new team members until each reaches her potential. When illness or emergency keeps someone from a scheduled skincare class, it is not unusual to have some help from others. 'In business for yourself but not alone,' is a Mary Kay Ash philosophy that guides the independent sales force. Mary Kay skincare is taught, not sold. Rather than approach customers with `dollar signs in their eyes,' consultants operate with the goal of helping women achieve positive self-image and of leaving the customer feeling better about herself Mary Kay Ash says, 'Ours is a business where selling results from a truly one-onone personal relationship.' Accord' n g to her, a career is not considered an end i n itself, but a means to an end; to personal fulfillment, family comfort and harmony; to a balanced life; to self-expression. Hence, the business philosophy of Mary Kay Inc. has been centred on the re, igion that reveals 'God is first, family second and third is the career.'

> ***Check Your Progress***
> 4. What is Economic System?
> 5. Describe Culture.
> 6. What is Counter Trade?

As workplace diversity has gained attention inside companies, it has taken on ever-growing dimensions. Amon g those dimensions is a relatively recent focus on religion—specifically, on how companies and employees are developing policies and practices that respect and accommodate employees' beliefs and practices in a way that does not undermine a corn Jany's ability to conduct business. The need for companies to address this issue I as never been greater. The globalization of companies. shiftin g immigration patterns, the need to hire workers from more diverse backgrounds, and a renewed spiritual awakening among some segments of the population have combined to put religion on the front burner of many businesses. Some companies have reco gnized that there are benefits to policies and practices that support and encourage employees to participate in and express their religious convictions. The global manufacturing principles of Mattel Inc..' the largest toy manufacturing company of United States of America. enforce nondiscrimination practices and promote understanding of reli gious freedoms. The company respects not only the cultural, ethical, and philosophical differences of the various countries in which it operates, but also the needs of distinct employee groups within its manufacturing facilities. For example, at its die-cast plant in Penang. Malaysia, a country recognized as one of the most ethnically diverse in the world. Mattel has provided a Hindu shrine, a Buddhist shrine, and a mosque to address varying prayer needs of its employees. Mattel also operates two plants in Indonesia. employs approximately 10,000 people, of whom Muslims constitute about 90 per cent of the total strength. When developing a collective labour agreement on behalf of the employees in 1996, an employee-elected committee was established to determine policies that would best accommodate religious practices. These included two prayer rooms. one each for men and women, flexible schedules to accommodate Friday prayers, and Muslim-sensitive menus in company cafeterias. During the fasting month, employees who fast during their shift are entitled to make other arrangements fur their meals. In addition to recognizing all state holidays, workers are given paid leave for religious activities and state obligations, with written proof from appropriate institutions. In addition, Muslim employees with three years of service at Mattel are permitted to make a pilg rimage to Mecca, entitling them to 45 days leave of absence with full pay.'2

Religion affects patterns of living in various other ways. It establishes authority relationships, an individual's duties and responsibilities in all stages of life and the sanctity of different acts such as honesty, truthful communic ation and the like.

Religious feelings also guide consumer behaviour in many countries like Hinduism prohibits the consumption of beef and reveres tile cow as a sacred animal, and the Catholic Church officially continues to prohibit the use of birth control devices. In general, religion and faith inevitable motivate people and their customs in numerous ways. The impact of religion is continuous and profound in societal and individual behaviour. Consequently, interna ional firms must he sensitive to the religious principles of each host country.

Cultural influence on marketing mix

Culture influences many aspects of the marketing-mix in the host country. An international firm makes its market-oriented decisions in reference to the various customer perspectives that are determined by customer lifestyles and behaviour patterns. Cultural aspects largely affect the prod; lets that people buy, the attributes they value, and the referrals that govern their buying decisions. It is observed that a person's perSpectives or resources, problems, and opportunities are generated and conditioned by cultural values to a considerable extent. Culture creates the

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system of communication among consumers about acceptance and rejection of the products and services, say in regard to food. Italian cultural influence in global markets plays an important role for the creation or expansion of markets for Italian products. One example is a collaboration project between the Italian government and the Japanese government called the 'Italian Year in Japan, 2001'.Utilizing this event, Italy succeeded in generating a sophisticated brand image in the Japanese market. An important part of this event was the generation of a network system through the interne. Information about Italian technological products like automobiles and cultural products like paintings were distributed to members of the network.

Cultural pressures easily overrule physiological necessities, making it impossible for an individual from one culture to predict the preferences of another culture. he American fast-food is not easily accepted in all the countries as the taste, food habits and preferences vary widely. McDonald's considered the following cultural issues during its entry into the Indian fast-food market:

- Indian market has 70 per cent vegetarian food preferences
- A repugnance to either beef or pork among the minority meat eaters
- A hostility to frozen meat and fish
- The general Indian taste towards spicy food

In order to provide maximum satisfaction to the Indian consumer towards tastes and choice of food, McDonald's had to develop innovative marketing strategies rather than just provide burgers with American standards. Accordingly, the company serves vege-tarian burgers as well as chicken and fish burgers, and makes sure that vegetarian burgers are cooked in a separate area in the kitchen using separate utensils that can be inspected by the consumer on demand. Cultural diversity is a major issue inArnericar eating. To fully understand the impact cultures play in American nutrition, one must study both food and culture. However, given the nature of the variations that exist in each cultural group in reference to socioeconomic status, religion, age, education, social class, location, duration of stay in the United States, and location of origin, one cannot generalize or imply that these characteristics apply to all individuals of a cultural group.

Over and above the French fries beef controversy of the past, Big Mac's Indian plans seem to be proceeding as scheduled. The quick service chain was to achieve its target of breaking even on operations by December 2003, and expand to 80 outlets the same year. Inves,ments in McDonald's India Pvt. Ltd. (MIPL), the wholly-owned subsidiary of US-based fast-food giant McDonald's Corporation, are expected to be doubled, from the US $90 million already pumped in, toUS $180 million by 2005. Fresh investments would take care of expansion- - of McDonald's India's supply chain, refurbishing its cold chain, and setting up more outlets in the country. Investments per outlet average US $550 thousand. which include cost of leasehold equi7ment, signage, seating arrangement and decor, While in North India. McDonald's restaurants are owned and managed by Connaught Plaza Restaurants, in tl ie Western region its operations are managed by Hardcastle

Restaurants Pvt. Ltd.. While the average seating space per Mac outlet is designed to accommodate about 150 people, the chain has had to increase seating in at least four owlets in New Delhi alone. Walk-ins at the 38 McDonald's restaurants now average more than 4,000 people per outlet per day. Growth intermsof outlet transactions has been on a consecutive upswing, growing 15 per cent year-on-year over the last four years. The new outlets will be a combination of highway restaurants. outlets at n ilway stations, at shopping malls and tine complexes, besides at residential area; with significant footfalls. McDonald's India has also wo a the tender for setting up an outiet each at railway stations in Mumbal and Jaipur. Meanwhile. McDonald's has begun testing a range of Nestle products. including Nestle iced tea and coffee, sauces and food toppings at select outlets. A tie-up with Nestle India could happen later this year. The tie-ups between McDonald's Corporation and Nestle SAalready exist in some international markets. McDonald's India has a tie-up with Coca-Cola for cold beverages. While the soft drink major's carbonated beverages are served at McDonald's, Coca-Cola's Georgia tea is also being tested at a few outlets.14

The art of giving

Giving gifts is an essential part of the business culture in Japan that symbolizes the strength of relationship to the Japanese. Giving and receiving gifts are part of everyday life and can range from.the small and insignificant to the truly impressive and it should not be mistaken as an unethical practice or as a bribe. The businesspersons may like to take lots of gifts — crystal, special whisky, interesting desk accessories, water colours 07 handcrafted items for display. However. the quality and the presentation of the gift to Japanese executive matters to realize the strength of the relationship. On the contrary; it is not usually part of business culture in Belgium to either give or receive gifts during the negotiation process. If any executive wishes to give a present to a particularly close business associate, for example on closure of a deal, he may do it without including a business card with it, the gift may be a flower basket or anything featuring the company logo. International executives need to be cautious while choosing appropriate flowers. For example, sending chrysanthemums (especially white ones) in Belgium and elsewhere in Europe should be avoided since they are mainly used for funerals. In Europe, it is also considered bad luck to present an even number of flowers. Beware of white flowers in Japan, where they are associated with death.15

Attributes of a product

During the last two decades of the twentieth century, numerous barriers to international trade were brought down and many firms began pursuing global strategies to gain cultural advanta ge. However. benefits to some industries from globalization is more than others. Some nations have a comparati%e advantag: over other nations in certain industries. To create a successful global strategy, managers must first understand the nature of socio-cultural dynamics in the host country. A product that has been hi ghly profitable in a country may not achieve the same success elsewhere, because the product attributes desired in one couillrn may not be lesired by consumers of another courtry. The Campbell Soup Company found out the hard

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way that the condensed soups so popular and acceptable in the US were not liked in England. Another good example is the Barbie doll of Mattel Inc. with reference to cultural adaptation. in India, Barbie doll ran into a slightly diflerent problem. In a conservative country like India,, the concept of a boyfriend was unacceptable, so Ken did not accompany her, However, since brothers and sisters in India are much closer than they are in Western societies, the Mattel Inc. company has created Mark as Barbie's brother for the Indian market.

Consumers' experience of brands is an emotional experience and, not through individual communications, i.e., advertising, packaging, online presence or promotions, but in their totality. In every country there is a 'culture screen,' which gives shape to the determinants of the consumer behaviour of its members. International marketing must be more multi-local tiun global and the differences in international markets are more critical than the similarities. In other words, one size fits all will not work in most cases. Hence, marketing strategies must be tailored according to the targeted culture.

The determinants of price

The price that a customer is willing to pay for a product may depend largely on its perceived use value than its actual value. Since in developing countries the value of any imported good from a western country is perceived as much higher than that of domestic products, the price of such products is often inflated in the developing countries. It may happen sometimes that an Indian tourist may buy a ca sual 1,N. ear from Marks and Spencer's during his trip to England and later upon close examination may find the label 'Made in India' on it. What had seemed a reasonable price for a British product was too high for a domestic one. In such circtunstances,. the perceived value associated with the product as guided by the cultural issues determines the acceptable price and not an actual value of the product. On the contrary, the label 'Made in England' may be regarded by French consumers as promising more luxurious and more inventive products than 'Made in the USA' On the other hand, 'Made in Germany' products have greater perceived value for Americans than for French consumers.

Place

In Mexico, Sears Reobuck SA has done two things differently in order to respond to pride aspects in the local culture. The Company buys over 90 per cent of its items from national manufacturers and also carries the national brands of USA made in Mexico to cater to the premium consumer segment who like to use the US brands to distinguish their status from the locals. In some countries, like India. where women enjoy buying household appliances, they prefer to attend to the direct sales which vary from high technology products like electric water filters to small kitchen appliances. To purchase or from the comfort of one's home is the root culture of the direct-selling industry. The sellers visit people's homes by appointment to display products and demonstrate their working. Customers invite family and friends to witness the demonstration. Eureka Forbes, the Rs 390-crore direct-selling company, is enhancing its range of vacuum cleaners with the introduction of new sub-brands and models under its Euroclean brand in the Indian market. I he company has a potential of reaching out to 20 million families compared to the 200 thousand households at present. Hoping for a growth of 20 ----- per cent, Eureka Forbes plans to post a turnover of US $100 million during 2003. , Eureka Forbes is a 40:60 partnership joint venture between Electrolux of Sweden and the Forbes Group. The con ipany also makes electronic security systems and air purifiers, for which it has brands in both the direct selling and dealer segments. Channels of distribution largel'i function under the influence of local culture and may need to be adjusted to the k cal sociocultural conditions. Mary Kay Cosmetics uses door-to-door and other direct-selling methods in the US with great success. Americans appreciate the opportunity to make buying decisions in the privacy of their homes or workplaces. Such arrangements, however, did not work abroad. For instance, Mexican women considered calls by beauty consultants of Mary Kay Cosmetics as an intrusion on their privacy and safety, and the representatives felt uncomfortable: as well. Thy? Body Shop, Canada has developed fair trade relationships with local commun ities since the late 1980s. The company identitic: this as a community trade. These small communities, often in remote areas, do not usually have the chance to sell 'their products to global companies such as Du Body Shop. The company buys accessories and natural ingredients such as cocor beans, sesame oil and rhea butter from them at a fair price. As a resu lt, the community trade suppliers work together to meet their communities' goals and have more control over their futures.

Promotion of products

Promotion practices, particularly advertising, are perhaps most susceptible to cultural errors. Examples abound where adl, ertisin p. copy and design were culturally repugnant and therefore totally ineffective. In Thailand, the Warner-Lambert Company used its US ad for Listerine showing a 'coy and a girl being affectionate with each other. Since the boy-girl relationship shovai was ultra-modern and hence against the cultural norms of Thailand's conservative society it did not go down well. A slight modification—two girls talking about Listerine—had a positive effect on sales. Loc al ization of international advertising campaigns is done by adapting the company's communication to the local environment ofthe host nations targeted by the campaign. The localization of communication should adhere to the see iocultural norms of the host country including the local religious seculiarities, customs. social and cc mmercial habits, rules of conduct and ethical norms. Over the past twenty years. along with women's salaries and purchasing power the percentage of advertisements objectifying men have also increased. A global brand may possess a stronghold in its home market, strength across other geographies, address si rn; needs. worldwide and show consistent positioning where the consumers value the cultural issues and identify the corporate brand within its purview. This statement can be discussed further, linking the product with universal human emotions and needs, being consistent over time and refresh its appeal through cultural events like sports and using powerful symbols or i:ons. Marlboro has shifted from the cowboy campaign for marketing

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their cigarettes in many nations and switced to the Formula-1 driver as it was felt that it embodies the same theme ofthe independent hero as the cowboy. It was also found to be more suitable to certain parts of the globe for a variety of cultural reasons.

It has been observed that the lar gest share of commercials tend to be of Spanish language advertising programmes among the Hispanic population in the United States ofAmt.rica. Since consumers in spain are relatively recent immigrants, the Hispanic consumers rely on advertising to assist their buying decisions. These consumers perceive Spanish language advertising as information that can be used to make sense of the wide array of goods they are faced with. Since not many brands have decided to concentrate en the Spanish language market, those who show some interest stand to gain. In addition to advertising, tradition from Latin American countries also affects brand preferences. Even after immigrating to the US, many Hispanic consumers continue to be loyal to the brands they were used to in their countries of origin. Colgate is one ofthe best examples. It is the traditional toothpaste par excellence in many LatinA merican countries. Colgate red or Colgate rojo, gets a boost from Spanish language advertising in the US, and is therefore able to maintain and reinforce the traditi it established in the past.

Business Operations within Cultural Limits

It is necessary for a marketer to remember that self-referencing can be misleading while interpreting various cultural manifestations in different countries. Self referencing Criterion (SRC) may be described as a process by which judgements on others are formed. It involves] udging others' behaviour against antecedents and experiences that are weighed on a preconceived platform of thinking. Before framing perceptions and conclusions, it is advisable to check with people who are familiar with the culture of the host country. However, the bottom line is that an international marketer should learn about the culture—ignoring the first impressions o: preconceptions—and playing down self-referencing in favour of more objective intbrmation. Cultural adaptation refers to the making of business decisions appropriate to the cultural traits of the society. In other words, d c ision makers must ensure that native customs and conditions, and taboos do not constrain the implementation of the marketing plan.

The high versus IOW context distinction and silent languages describing the non-verbal communication elements, provide useful clues by which to think about various cultures. The study of IBM employees around the globe conducted by Hofstede in 1980 is a much more systematic assessment of cultures across counties.' Although there have been significant cultural shifts since the study was done, cultures have changed less —and judging from recent events in Eastern Europe and Russia, ethnicity and cultural toots are stronger than ever. According to Hofstede's paradigm of cultural influences, countries can be classified along four basic cultural dimensions. The first cultural dimension is individualism versus collectivism as revealed by Hofstede's study. In a collective society, the identity and worth of the individual is rooted in the social system, less on individual achievement. A second dimension is high versus low power distance, which exhibits that high power distance societies tend to be less egalitarian, while democratic countries exhibit low power distance. The third dimension is the masculine versus feminine equation that captures the degree to which a culture is dominated by assertive males rather than nurturing females and their corresponding values. The final dimension describes weak versus strong risk avoidance rates in various countries, leading to different: levels of risk tolerance or risk aversion criteria.

In general, culture defines a set of acceptable and unacceptable behaviours within the social norms. Individuals act according to these behavioural norms while managers learn how to do business. These are the processes of enculturation and socialization. They determine how individuals behave as consumers in the marketplace, how demanding they are, how they voice complaints, how managers approach subordinates and peers, and so forth. In course of time. individuals become skilled in exhibiting acceptable behaviours and identifying the unacceptable behaviours to be less risk averse. An American marketer will be able to briefly present his or her point of view, wr i le the Japanese counterpart will be a good listener. But going beyond one's accustomed norms is hard to do. Acceptable behaviour in the business firm is usually a reflection of acceptable behaviour in society, especially if the company is large. In multinational companies, employees cannot know each other personally and thus have to rely on more arm's-length relationships based on the general culture of the company that may be stated as corporate culture. Regional business houses which are relatively smaller in size than multinational companies may be less orthodox. with an organizational culture that is cultivated, unique and different to those of the larger societies. Relationship• building is a prerequisite for an international firm to achieve success in business The manaaer of an international firm should a3k the sales representative of his company as to how many new relationships were built and if the employee had participated in the local culture, before evaluating his performance at the end of the day of business. The manager may then seek the impressions of his local colleagues to determine how well the expatriate was working out in their country.

The urban and ethnic marketing strategy requires an understanding of in.. culture nuances and lifestyles of the. marketing segment that a business is trying to reach. While urban marketing is employed to reach Hispanic, Latino, Asian American. and African American rilarkets because oldemouraphic clustering of these subcultures in metropolitan areas, it is also used to reach certain niche markets best found in urban environments. 'Urban and ethnic marketing strategies integrate consumer marketing solutions including Internet and technology aspects within the cultural environment ofthe host country. An international marketer should evaluate the psychographic and demographic profiles that indicate the target market of urban and ethnic groups. The firm may choose to provide the marketing communication to the target segments close to th it lifestyle. The General Motors (GM) Company has made significant contributians to the cultural event titled `America on the Move' exhibited at

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Smithsonian's National Museum of American History. GM is probably the largest single donor to have contributed to a cultural group. This promotional strategy won the car company naming rights and a prominent place in all promotions." However, museum curators insist that the car company had no influence on content; there had been accusations that the exhibit was a commercial for GM.

FOCUS ON INTERNATIONAL INVESTMENTS

Multinational enterprises form a significant part of the international economy. They bring advantages to the home and host nations through international direct investment, in the form of productive capital. managerial and technological knowledge, job creat on and tax revenues. The investment objectives of a multinational company should:

- Ensure that the operations of e aterprises are in harmony with government policies;
- Strengthen the basis of mutual confidence between enterprises and the societies in which they operate;
- Improve the foreign investment climate; and
- Enhance contribution of the en erprise to sustainable development.

An investment proposal is a type of business plan. but is designed specifically to meet the informaboil needs of potential investors. It is abridged and focuses on those managemen'. marketing and financial aspects of the company that would make it an attractive in' estment. 'Mere are tv o stages of an investment proposal that include the sel l lna of the proposal and its review. The process of selling and reviewing should eo through a variety of formal and informal procedural followups and negotiations. Successful international companies continue to be interested in growth prospects, evaluating a variety of proposals from different sources that potentially could lead to investments abroad. These sources include company employees, unknown host country firms, licensees, distributors, and joint venture partners. The following precautions need to be taken by the multinational company while drafting and pursuing the investment proposals with the governments or organizations of tl host countries:

- Focus the investment proposal specific to the requirements ofthe country or region
- Develop necessary convergence with the macro policies of the country
- Delineate the approval points and schedules
- Check with all the people whose approval is needed
- Define alternative goals and approaches and keel advised accordingly
- Determine the key contacts for all the aspects of the proposal
- Prospect for selling the proposal at a reasonable bid, to optimize longterm gains

- Establish priori ties and develop activity schedule accordingly
- It is necessary to be on the competitive edge along with participating bidders and draw defense for the project in terms of project execution and achievements
- Identify potential competitors of the project and points of potential resistance, and then establish strategies, or at least mental contingency plans, for dealing with them
- Measure the proposal against all stated corporate policy objectives Write the proposal on the prescribed format with the required information only
- Prepare strong defense for all possible objections on the investment project
- Try to keep the project moving at a deliberate speed. Don't let it get stalled due to excessive reviewing.

MANAGEMENT OF FINANCE BY MNCs

The financial objectives of the multinational companies are aimed at measuring the performance on the capital employed. Capital employed is the sum of all assets along with the accumulated reserves, including provision for depreciation. The multinational companies, in their financial goals, may recognize that not all operation are directly comparable and state that targets for area profit centres and operations will tare into account the nature of the operations and performance plans thereof: Emphasis on asset management by the multinational company at all levels is laid in reference to annual targets for cash generation, capital expenditures, and balance sheet items, including inventory and receivables management. The finance ma-lagers of the company thaw special attention to the differences between actual cash generating capacity and book results. Each production group and profit centre both of product categories and territorial regions, develops net cash-generating capacity for its own requirements and also pools sufficient funds for the company to meet its high-priority investment commitments and opportunities. Financial objectives constitute the foundation for making financial decisions for a company. The companies should be able to integrate the financial objectives for both don iestic and international business. Financial objectives also constitute the foundation for making financial decisions for a company. For example, in order to protect iself against exchange rate fluctuations, it might require managers in overseas subsidiaries to forecast regularly the exchange rates i-nonth-by-month for the upcoming six months. On the basis of those fore easts, corporate funds in a currency likely to he substantially depreciated would be utilized before funds in stronger currencies.

In most of the multinational companies, cash management is a centrally organized process. The major goal in this process is to concentrate on overall group liquidity as much as possible and to a reasonable extent. Ideally, this pooling is done across banks and borders. In a broader sense, cash management involves the organization of all incoming and outgoing payments in the most efficient way. To achieve this, multinational comp, inies depend on instruments like bank policy and cash pooling

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software intelligence. In reality, the right mix of organizational and software intelligence probably l eads to the best results. The quality of cash pooling can be measured by the gap between the forecasted and the realized cash position of a company. The smaller the difference between expectations and reality, the higher the efficiency of cash management. Cash poolin g is the standard tool used for efficient cash managemen'. The two basic concepts involved are: the national pooling organized to another alternate, compens across the participating bank accounts; the zero balancing approach interest requires physical concentration of cash flows on one concentration account. The latter approach is the most frequently used one today. A step that follows logically in cash management is the centralized organization of payments. Such concepts are expressed as payment factory whereby all payments for connected subsidiaries of an MNC multinational corporate can be managed at a centralized location or branch. This includes single as well as mass payments.

The goal of an international money manager may be to obtain finances for foreign projects towards expansion, subsidiaries or strategic alliances with the companies of the host country in such a way as to maximize the resources availability and lower the after-tax interest costs and foreign exchange losses. The exchange rate parity theory suggests that internal ional differentials in interest costs are offset by changes in forei gn exchange rates; that is, the expected value for net financing costs will be equal for all currencies over any given time period, provided foreign exchange markets arc efficient. However, the multinational companies are susceptible to the following risks related to money management.

- The political risk of assets being taken over by the host country;
- The exchange risk, whereby the value of the US dollar changes with reference to the host country currency; and
- The translation risk, whereby the corporate financial statements are required by the country-specific regulations to be based on historical costs rather than current value.

In some countries, gains and losses from long-term exchange transactions are subject to preferential capital gains tax rates or reserves treatment. Conversely, many countries —Australia, Indonesia, South Africa, and Germany — have no taxes on gains or losses arising from most long-term exchange transactions. Traditionally, foreign investors foresee low opportunity for raising capital locally in the developing counties. HoWever, there may be an inadequacy of the local capital in these countries. It has been experienced in India that often the initial public offers (IPOs) of multinational companies fetched an encouraging response. The Honda Motor Company's issue was oversubscribed 165 times within a span of 72 hours! Similarly, Burroughs Corporation's stock and debenture issue was oversubscribed 30 times.

Financial management also involves significantly the matters of repatriation of funds and profits ofa multinational organization. Repatriation may be explained as the

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return from abroad of the financial assets of an organizat on or individual. A multinational firm needs to formulate a strategy on remission of dividends from overseas affiliates to headquarters. The international dividend policy is determined by the following factors19:

- Tax implications
- Political risk
- Foreign exchange risk
- Age and size of affiliate
- Availability offiuids
- Presence of ioint venture partners

The policy of the Government of India is liberal with regard to the remittance of profits, dividends, royalties, etc., but the Government is cautious of excessive remittance while approving foreign investment proposals and collaboration agreements. Thus, foreign enterprises have complete freecic,m for the remittance of profit and repatriation of capital subject to exchange considerations. Remittance falling due under the collaboration agreements will however be subject to the approval of the Reserve Bank of India (RBI).2° On the contrary, many multinationals operating in China have started to turn in profits, and, as they become more profitable, they are being frustrated by complex arrangements currently in place to deter repatriation. The strict regulations discourage transfer of funds out of China. Multinational companies op rating in China are also restricted from lendinti intra-company."

The United States—Argentina Bilateral Investment Treaty (BIT) came into force in 1994. Under the treaty, US investors enjoy national treatment in all sectors except shipbuilding, fishing, and nuclear power generation. An amendment to the treaty removed mining, except uranium production, from the list of exceptions. The treaty allows arbitration of disputes by the International Centre for the Settlement of Investment Disputes (ICS ID) or any other arbitration ins ti tut i k-)ri mutually aureed by the parties. Several US firms have invoked the provisions of the treaty in ongoing disputes with Ar gentine national or provincial authorities. Under the Convertibility Law of 1991, the exchange rate of the.Argentir re peso is fixed to the dollar at the rate of c re to one, under a currency board type of arrangement called 'convertibility.' fhis rate is expected to remain unchanged in the medium term. Argentina has no exchan ge controls. Foreign investment receives national treatment underArgentine law. Finns need not obtain permission to invest in Argentina. Foreign investors may wholly own a local compan y. and investment - - in firms whose shares trade on the local stock exchange requires no government approval. There are no restrictions on repatriation of funds.22

In the countries where political risk may not be an important factor, the repatriation policy will be based on availability and use of funds. For example, if funds are needed in the United Kingdom, headquarters might decide to transfer- its retained

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earnings from a German subsidiary to the United Kingdom rather than transferring funds from the United States. An alternative to this action would be the investment of funds in euro. In reference to the risk factors discussed above, on the basis of the six factors just liste.i and discussed, a multinational firm may follow either a pooled strategy or a flexible strategy for distribution of earnircas generated by foreign affiliates. The pooled strategy refers to a stated policy of remittance of profits to the parent on a regular basis. The flexible strategy leaves the decision on dividends to factors operating at the time. The flexible strategy permits the parent to make the most viable use of funds vis-a-vis its long-term global corporate objectives.

Country Risk

After World War II, country risk became an issue of prime concern for the international financial community. Various methods have been used by the risk rating agencies to determine the extent of country risk, integrating a range of qualitative and cluanti ve inixanatioa on alternative inea•mrt-s ofpolitical, etviveaa: and financial risk to evoive composite risk indices. Cotmtry risk anal ysis is a eompl ex task and demands a holiAic vision. expert skills and consistency in measurements. The analyst must follow standard procedures to assure coherency in its studies, using reliable and useful sources ofdata, including rating agencies, official institutions and other several sources. The country-risk analysis reports show the strengths and weaknesses of a country, after dealing with the macroeconomic, socio-political and financial aspects in order to define a risk level and, consequently-, a related price for the asset in risk. Managing the risks of a portfolio demands a systematic follow up concerning the external arh internal environment, governmental policies' outlook provided by rating agencies, and so on.

During the 1 970s, the sharp increase in oil prices, followed by worldwide inflation, a collapse in commodity prices, global recession and high interest rates walloped the economies of the developing countries the world over. When oil prices shot up, these countries borrowed heavily at high interest rates to prevent the economic downfall. The international financial institutions lent money to developing countries alongwith official subsidies and such aid grew very rapidly during this period. As a result of the irresponsibility of both creditor and debtor governments (e.g., cot rupt ion, private projects benefitting only the rich, etc.), the countries did not use the money for productive investment; rather, they spent these new dollars on immeiliate consumption and the countries were unable to repay such amassed debt. Consequently, the total medium and long-term debt of developing countries quadrupled in nominal terms, from about $ 140 billion at the end of 1974 to about S .560 billion in 1982. The debt trap got stiffer for these countries and the borrowings had reached $ 2.4 trillion by the end of 1998.

The debt crisis has had a deep impact on the economic growth of the developing countries. The situation became alarming and of major concern to the international community. International institutions includin g IMF, and the World Bank sought to find ways ofreducing the impact of continuin g debt of the developing countries. A framework to reduce the burden of debt was evolved at two levels wherein the debtors tieeded to grow faster and export more and to pull down the cost of debt service. During the process of overcoming the debt crisis, most countries sought IMF assistance for debt relief. As a crisis managing institute, the Fund assumed anew role as financial organizer for the troubled debtor nations. According to the IMF 'structural adjustment programmes' were required in these nations. Debtor governments had to allow the imposition strict economic programmes on their countries to borrow more money or reshedule their loans. Simply put, countries had to reduce, spending to decrease their debt and stabilize their currency. The governments cost limitations by reducing social spending (e.; education, health. social services, etc.) by devaluation of the national currency (via lowering export earnings and increasing import costs), creation of rigid limits on food subsidies, cutting workers' jobs and salaries taking over small subsistence farms for large scale export crop tanning and encouraging the pi i 3atization 01 public industries. Most nations went through a recession and often a depression; and the poorest were the most affected care of most of the shopping they may yet exhibit a natural maternal consideration for the health and welfare of the next generation. In conventional marketing, demographics are often a key determinant of intent to buy specific products. But in green marketing. what seem to determine willingness to purchase environmentally conscious products—more than demographics or even levels of concern for a specific environmental issue—are consumers' feelings of being able to act on these issues, or erripowernient.7

Aesthetics

Aesthetics may be described as a set of creative ideas embedded in culture concerning the sensory appeals of the people towards beauty, arts and taste. Since actions or behaviour can be said to have beauty beyond sensory appeal, aesthetics and ethics often overlap to the degree that this impression is embodied. in a moral or ethical code. A value system, which is the prioritization of the values held by an individual or group in a society, forms the basis of moral code. Such dimensions are reflected in consumer behaviour. In conservative societies in Asia, such as Japan and India, any communication or art that express women is not

Seeally aespite the aesthetic standpoint of the critics. In some cultures. e relationship between moral and legal codes is often one and the same. Mcrai codes drive personal conduct. Aei• thetics include the arts, drama, music, folk culture, and architecture prevalent in a society ana these convey its concept of beauty and modes of expression. In different societies colours have different meanings across countries. In western societies, wedding gowns are usually white, but in Asia, white symbolizes peace or sorrow. The aesthetic values of a society show in the design, styles, colours, expressions, symbols, movements, emotions, and postures valued and preferred in a particular culture. These attributes have an impact on the design and promotion of differei t products. In many situations the symbolic expressions of communication have greater appeal than the actual words, and people respond accordingly. There-

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fore, an international businessperson must understand nonverbal cultural di fkerences to avoid communicating the wrong message.

Respecting employees' religious beliefs

Any human activity, and that includes business, conducted under the guidelines of one of the major religions will work better because the essence of business is tnist and religion teaches trust. Trust means an honest day's work for an honest day's pay, a tough but fair dealing, and transparancy without hidden agendas. Above all, trust means truth that is an outgrowth of religious sentiments in a society or an individual. The relationship between business and reli gion truly poses a selfchallenge. There is a sense that we must improve the fundamental actions of business in a global setting at the moment. Capitalism looks like it has won the day, but if it suffers from some kind of moral bankruptcy, it is not going to last.' Although religion is an eternal driving force for various segments of society, there also exist ideological conflicts in the streams of religion. Corrigan' found that for the Protestants, the expression of emotion was a matter of transactions. They saw emotion as a commodity, and conceptualized relations between people, and between individuals and God, as transactions of emotion governed by contract. Religion became a business relationship with God, with prayer as its legal tender. By entering this relationship, they were conducting the 'business of the heart.' This innovative study shows that the revival — with its commodificotton of emotional experience became an occasion for 'white Protestants to underscore differences between themselves and others. The display of emotion was a primary indicator of membership in the Protestant majority, as much as language, skin colour, or dress style.

Mary Kay Inc. operates on the Go-Give philosophy. 1 ° All you send into the lives of others does come back into your own. All consultants and sales directors share thei experiences with and guide new team members until each reaches her potential. When illness or emergency keeps someone from a scheduled skincare class, it is not unusual to have some help from others. 'In business for yourself but not alone,' is a Mary Kay Ash philosophy that guides the independent sales force. Mary Kay skincare is taught, not sold. Rather than approach customers with `dollar signs in their eyes,' consultants operate with the goal of helping women achieve positive self-image and of leaving the customer feeling better about herself Mary Kay Ash says, 'Ours is a business where selling results from a truly one-onone personal relationship.' Accord' n g to her, a career is not considered an end i n itself, but a means to an end; to personal fulfillment, family comfort and harmony; to a balanced life; to self-expression. Hence, the business philosophy of Mary Kay Inc. has been centred on the re, igion that reveals 'God is first, family second and third is the career.'

As workplace diversity has gained attention inside companies, it has taken on ever-growing dimensions. Amon g those dimensions is a relatively recent focus on religion—specifically, on how companies and employees are developing policies and practices that respect and accommodate employees' beliefs and practices in a way that does not undermine a com Jany's ability to conduct business. The need for companies to address this issue I as never been greater. The globalization of companies. shiftin g immigration patterns, the need to hire workers from more diverse backgrounds, and a renewed spiritual awakening among some segments of the population have combined to put religion on the front burner of many businesses. Some companies have reco gnized that there are benefits to policies and practices that support and encourage employees to participate in and express their religious convictions. The global manufacturing principles of Mattel Inc..' the largest toy manufacturing company of United States of America. enforce nondiscrimination practices and promote understanding of reli gious freedoms. The company respects not only the cultural, ethical, and philosophical differences of the various countries in which it operates, but also the needs of distinct employee groups within its manufacturing facilities. For example, at its die-cast plant in Penang. Malaysia, a country recognized as one of the most ethnically diverse in the world. Mattel has provided a Hindu shrine, a Buddhist shrine, and a mosque to address varying prayer needs of its employees. Mattel also operates two plants in Indonesia. employs approximately 10,000 people, of whom Muslims constitute about 90 per cent of the total strength. When developing a collective labour agreement on behalf of the employees in 1996, an employee-elected committee was established to determine policies that would best accommodate religious practices. These included two prayer rooms. one each for men and women, flexible schedules to accommodate Friday prayers, and Muslim-sensitive menus in company cafeterias. During the fasting month, employees who fast during their shift are entitled to make other arrangements fur their meals. In addition to recognizing all state holidays, workers are given paid leave for religious activities and state obligations, with written proof from appropriate institutions. In addition, Muslim employees with three years of service at Mattel are permitted to make a pilg rimage to Mecca, entitling them to 45 days leave of absence with full pay.'2

Religion affects patterns of living in various other ways. It establishes authority relationships, an individual's duties and responsibilities in all stages of life and the sanctity of different acts such as honesty, truthful communic ation and the like.

Religious feelings also guide consumer behaviour in many countries like Hinduism prohibits the consumption of beef and reveres tile cow as a sacred animal, and the Catholic Church officially continues to prohibit the use of birth control devices. In general, religion and faith inevitable motivate people and their customs in numerous ways. The impact of religion is continuous and profound in societal and individual behaviour. Consequently, interna ional firms must he sensitive to the religious principles of each host country.

Cultural influence on marketing mix

Culture influences many aspects of the marketing-mix in the host country. An international firm makes its market-oriented decisions in reference to the various customer perspectives that are determined by customer lifestyles and behaviour pat-

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terns. Cultural aspects largely affect the prod; lets that people buy, the attributes they value, and the referrals that govern their buying decisions. It is observed that a person's perSpectives or resources, problems, and opportunities are generated and conditioned by cultural values to a considerable extent. Culture creates the system of communication among consumers about acceptance and rejection of the products and services, say in regard to food. Italian cultural influence in global markets plays an important role for the creation or expansion of markets for Italian products. One example is a collaboration project between the Italian government and the Japanese government called the 'Italian Year in Japan, 2001'.Utilizing this event, Italy succeeded in generating a sophisticated brand image in the Japanese market. An important part of this event was the generation of a network system through the interne. Information about Italian technological products like automobiles and cultural products like paintings were distributed to members of the network.

Cultural pressures easily overrule physiological necessities, making it impossible for an individual from one culture to predict the preferences of another culture. he American fast-food is not easily accepted in all the countries as the taste, food habits and preferences vary widely. McDonald's considered the following cultural issues during its entry into the Indian fast-food market:

- Indian market has 70 per cent vegetarian food preferences
- A repugnance to either beef or pork among the minority meat eaters
- A hostility to frozen meat and fish
- The general Indian taste towards spicy food

In order to provide maximum satisfaction to the Indian consumer towards tastes and choice of food, McDonald's had to develop innovative marketing strategies rather than just provide burgers with American standards. Accordingly, the company serves vege-tarian burgers as well as chicken and fish burgers, and makes sure that vegetarian burgers are cooked in a separate area in the kitchen using separate utensils that can be inspected by the consumer on demand. Cultural diversity is a major issue inAmericar eating. To fully understand the impact cultures play in American nutrition, one must study both food and culture. However, given the nature of the variations that exist in each cultural group in reference to socioeconomic status, religion, age, education, social class, location, duration of stay in the United States, and location of origin, one cannot generalize or imply that these characteristics apply to all individuals of a cultural group.

Over and above the French fries beef controversy of the past, Big Mac's Indian plans seem to be proceeding as scheduled. The quick service chain was to achieve its target of breaking even on operations by December 2003, and expand to 80 outlets the same year. Inves,ments in McDonald's India Pvt. Ltd. (MIPL), the wholly-owned subsidiary of US-based fast-food giant McDonald's Corporation, are expected to be doubled, from the US $90 million already pumped in, toUS

$180 million by 2005. Fresh investments would take care of expansion- - of McDonald's India's supply chain, refurbishing its cold chain, and setting up more outlets in the country. Investments per outlet average US $550 thousand. which include cost of leasehold equi7ment, signage, seating arrangement and decor, While in North India. McDonald's restaurants are owned and managed by Connaught Plaza Restaurants, in tl ie Western region its operations are managed by Hardcastle Restaurants Pvt. Ltd.. While the average seating space per Mac outlet is designed to accommodate about 150 people, the chain has had to increase seating in at least four owlets in New Delhi alone. Walk-ins at the 38 McDonald's restaurants now average more than 4,000 people per outlet per day. Growth intermsof outlet transactions has been on a consecutive upswing, growing 15 per cent year-on-year over the last four years. The new outlets will be a combination of highway restaurants. outlets at n ilway stations, at shopping malls and tine complexes, besides at residential area; with significant footfalls. McDonald's India has also wo a the tender for setting up an outiet each at railway stations in Mumbal and Jaipur. Meanwhile. McDonald's has begun testing a range of Nestle products. including Nestle iced tea and coffee, sauces and food toppings at select outlets. A tie-up with Nestle India could happen later this year. The tie-ups between McDonald's Corporation and Nestle SAalready exist in some international markets. McDonald's India has a tie-up with Coca-Cola for cold beverages. While the soft drink major's carbonated beverages are served at McDonald's, Coca-Cola's Georgia tea is also being tested at a few outlets.14

The art of giving

Giving gifts is an essential part of the business culture in Japan that symbolizes the strength of relationship to the Japanese. Giving and receiving gifts are part of everyday life and can range from the small and insignificant to the truly impressive and it should not be mistaken as an unethical practice or as a bribe. The businesspersons may like to take lots of gifts — crystal, special whisky, interesting desk accessories, water colours 07 handcrafted items for display. However. the quality and the presentation of the gift to Japanese executive matters to realize the strength of the relationship. On the contrary; it is not usually part of business culture in Belgium to either give or receive gifts during the negotiation process. If any executive wishes to give a present to a particularly close business associate, for example on closure of a deal, he may do it without including a business card with it, the gift may be a flower basket or anything featuring the company logo. International executives need to be cautious while choosing appropriate flowers. For example, sending chrysanthemums (especially white ones) in Belgium and elsewhere in Europe should be avoided since they are mainly used for funerals. In Europe, it is also considered bad luck to present an even number of flowers. Beware of white flowers in Japan, where they are associated with death.15

Attributes of a product

During the last two decades of the twentieth century, numerous barriers to interna-

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tional trade were brought down and many firms began pursuing global strategies to gain cultural advanta ge. However. benefits to some industries from globalization is more than others. Some nations have a comparati%e advantag: over other nations in certain industries. To create a successful global strategy, managers must first understand the nature of socio-cultural dynamics in the host country. A product that has been hi ghly profitable in a country may not achieve the same success elsewhere, because the product attributes desired in one couillrn may not be lesired by consumers of another courtry. The Campbell Soup Company found out the hard way that the condensed soups so popular and acceptable in the US were not liked in England. Another good example is the Barbie doll of Mattel Inc. with reference to cultural adaptation. in India, Barbie doll ran into a slightly dillerent problem. In a conservative country like India,, the concept of a boyfriend was unacceptable, so Ken did not accompany her, However, since brothers and sisters in India are much closer than they are in Western societies, the Mattel Inc. company has created Mark as Barbie's brother for the Indian market.

Consumers' experience of brands is an emotional experience and, not through individual communications, i.e., advertising, packaging, online presence or promotions, but in their totality. In every country there is a 'culture screen,' which gives shape to the determinants of the consumer behaviour of its members. International marketing must be more multi-local tiun global and the differences in international markets are more critical than the similarities. In other words, one size fits all will not work in most cases. Hence, marketing strategies must be tailored according to the targeted culture.

The determinants of price

The price that a customer is willing to pay for a product may depend largely on its perceived use value than its actual value. Since in developing countries the value of any imported good from a western country is perceived as much higher than that of domestic products, the price of such products is often inflated in the developing countries. It may happen sometimes that an Indian tourist may buy a ca sual 1,N. ear from Marks and Spencer's during his trip to England and later upon close examination may find the label 'Made in India' on it. What had seemed a reasonable price for a British product was too high for a domestic one. In such circtunstances,. the perceived value associated with the product as guided by the cultural issues determines the acceptable price and not an actual value of the product. On the contrary, the label 'Made in England' may be regarded by French consumers as promising more luxurious and more inventive products than 'Made in the USA' On the other hand, 'Made in Germany' products have greater perceived value for Americans than for French consumers.

Place

In Mexico, Sears Reobuck SA has done two things differently in order to respond to pride aspects in the local culture. The Company buys over 90 per cent of its items from national manufacturers and also carries the national brands of USA made in

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Mexico to cater to the premium consumer segment who like to use the US brands to distinguish their status from the locals. In some countries, like India. where women enjoy buying household appliances, they prefer to attend to the direct sales which vary from high technology products like electric water filters to small kitchen appliances. To purchase or from the comfort of one's home is the root culture of the direct-selling industry. The sellers visit people's homes by appointment to display products and demonstrate their working. Customers invite family and friends to witness the demonstration. Eureka Forbes, the Rs 390-crore direct-selling company, is enhancing its range of vacuum cleaners with the introduction of new sub-brands and models under its Euroclean brand in the Indian market. I he company has a potential of reaching out to 20 million families compared to the 200 thousand households at present. Hoping for a growth of 20 ----- per cent, Eureka Forbes plans to post a turnover of US $100 million during 2003. , Eureka Forbes is a 40:60 partnership joint venture between Electrolux of Sweden and the Forbes Group. The con ipany also makes electronic security systems and air purifiers, for which it has brands in both the direct selling and dealer segments. Channels of distribution largel'i function under the influence of local culture and may need to be adjusted to the k cal socio-cultural conditions. Mary Kay Cosmetics uses door-to-door and other direct-selling methods in the US with great success. Americans appreciate the opportunity to make buying decisions in the privacy of their homes or workplaces. Such arrangements, however, did not work abroad. For instance, Mexican women considered calls by beauty consultants of Mary Kay Cosmetics as an intrusion on their privacy and safety, and the representatives felt uncomfortable: as well. Thy? Body Shop, Canada has developed fair trade relationships with local commun ities since the late 1980s. The company identitic: this as a community trade. These small communities, often in remote areas, do not usually have the chance to sell 'their products to global companies such as Du Body Shop. The company buys accessories and natural ingredients such as cocor beans, sesame oil and rhea butter from them at a fair price. As a resu lt, the community trade suppliers work together to meet their communities' goals and have more control over their futures.

Check Your Progress

7. What is licensing?
8. What is Turnkey Projects?

Promotion of products

Promotion practices, particularly advertising, are perhaps most susceptible to cultural errors. Examples abound where adl, ertisin p. copy and design were culturally repugnant and therefore totally ineffective. In Thailand, the Warner-Lambert Company used its US ad for Listerine showing a 'coy and a girl being affectionate with each other. Since the boy-girl relationship shovai was ultra-modern and hence against the cultural norms of Thailand's conservative society it did not go down well. A slight modification—two girls talking about Listerine—had a positive effect on sales. Loc al ization of international advertising campaigns is done by adapting the company's communication to the local environment ofthe host nations targeted by the campaign. The localization of communication should adhere to the see iocultural norms of the host country including the local religious seculiarities, customs. social and cc mmercial habits, rules of conduct and ethical norms. Over the past twenty years. along with

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women's salaries and purchasing power the percentage of advertisements objectifying men have also increased. A global brand may possess a stronghold in its home market, strength across other geographies, address si m; needs worldwide and show consistent positioning where the consumers value the cultural issues and identify the corporate brand within its purview. This statement can be discussed further, linking the product with universal human emotions and needs, being consistent over time and refresh its appeal through cultural events like sports and using powerful symbols or i:ons. Marlboro has shifted from the cowboy campaign for marketing their cigarettes in many nations and switced to the Formula-1 driver as it was felt that it embodies the same theme ofthe independent hero as the cowboy. It was also found :o be more suitable to certain parts of the globė for a variety of cultural reasons.

It has been observed that the lar gest share of commercials tend to be of Spanish language advertising programmes among the Hispanic population in the United States ofAmt.rica. Since consumers in spain are relatively recent immigrants, the Hispanic consumers rely on advertising to assist their buying decisions. These consumers perceive Spanish language advertising as information that can be used to make sense of the wide array of goods they are faced with. Since not many brands have decided to concentrate en the Spanish language market, those who show some interest stand to gain. In addition to advertising, tradition from Latin American countries also affects brand preferences. Even after immigrating to the US, many Hispanic consumers continue to be loyal to the brands they were used to in their countries of origin. Colgate is one ofthe best examples. It is the traditional toothpaste par excellence in many LatinA merican countries. Colgate red or Colgate rojo, gets a boost from Spanish language advertising in the US, and is therefore able to maintain and reinforce the traditi it established in the past.

Business Operations within Cultural Limits

It is necessary for a marketer to remember that self-referencing can be misleading while interpreting various cultural manifestations in different countries. Self referencing Criterion (SRC) may be described as a process by which judgements on others are formed. It involves] udging others' behaviour against antecedents and experiences that are weighed on a preconceived platform of thinking. Before framing perceptions and conclusions, it is advisable to check with people who are familiar with the culture of the host country. However, the bottom line is that an international marketer should learn about the culture—ignoring the first impressions o: preconceptions—and playing down self-referencing in favour of more objective intbrmation. Cultural adaptation refers to the making of business decisions appropriate to the cultural traits of the society. In other words, d c ision makers must ensure that native customs and conditions, and taboos do not constrain the implementation of the marketing plan.

The high versus IOW context distinction and silent languages describing the nonverbal communication elements, provide useful clues by which to think about various cultures. The study of IBM employees around the globe conducted by Hofstede in 1980 is a much more systematic assessment of cultures across counties.' Although there have been significant cultural shifts since the study was done, cultures have changed less —and judging from recent events in Eastern Europe and Russia, ethnicity and cultural toots are stronger than ever. According to Hofstede's paradigm of cultural influences, countries can be classified along four basic cultural dimensions. The first cultural dimension is individualism versus collectivism as revealed by Hofstede's study. In a collective society, the identity and worth of the individual is rooted in the social system, less on individual achievement. A second dimension is high versus low power distance, which exhibits that high power distance societies tend to be less egalitarian, while democratic countries exhibit low power distance. The third dimension is the masculine versus feminine equation that captures the degree to which a culture is dominated by assertive males rather than nurturing females and their corresponding values. The final dimension describes weak versus strong risk avoidance rates in various countries, leading to different: levels of risk tolerance or risk aversion criteria.

In general, culture defines a set of acceptable and unacceptable behaviours within the social norms. Individuals act according to these behavioural norms while managers learn how to do business. These are the processes of enculturation and socialization. They determine how individuals behave as consumers in the marketplace, how demanding they are, how they voice complaints, how managers approach subordinates and peers, and so forth. In course of time. individuals become skilled in exhibiting acceptable behaviours and identifying the unacceptable behaviours to be less risk averse. An American marketer will be able to briefly present his or her point of view, wr i le the Japanese counterpart will be a good listener. But going beyond one's accustomed norms is hard to do. Acceptable behaviour in the business firm is usually a reflection of acceptable behaviour in society, especially if the company is large. In multinational companies, employees cannot know each other personally and thus have to rely on more arm's-length relationships based on the general culture of the company that may be stated as corporate culture. Regional business houses which are relatively smaller in size than multinational companies may be less orthodox. with an organizational culture that is cultivated, unique and different to those of the larger societies. Relationship• building is a prerequisite for an international firm to achieve success in business The manaaer of an international firm should a3k the sales representative of his company as to how many new relationships were built and if the employee had participated in the local culture, before evaluating his performance at the end of the day of business. The manager may then seek the impressions of his local colleagues to determine how well the expatriate was working out in their country.

The urban and ethnic marketing strategy requires an understanding of in.. culture nuances and lifestyles of the. marketing segment that a business is trying to reach. While urban marketing is employed to reach Hispanic, Latino, Asian American. and African American rilarkets because oldemouraphic clustering of these subcultures in

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metropolitan areas, it is also used to reach certain niche markets best found in urban environments. 'Urban and ethnic marketing strategies integrate consumer marketing solutions including Internet and technology aspects within the cultural environment ofthe host country. An international marketer should evaluate the psychographic and demographic profiles that indicate the target market of urban and ethnic groups. The firm may choose to provide the marketing communication to the target segments close to th it lifestyle. The General Motors (GM) Company has made significant contributians to the cultural event titled `America on the Move' exhibited at Smithsonian's National Museum of American History. GM is probably the largest single donor to have contributed to a cultural group. This promotional strategy won the car company naming rights and a prominent place in all promotions." However, museum curators insist that the car company had no influence on content; there had been accusations that the exhibit was a commercial for GM.

FOCUS ON INTERNATIONAL INVESTMENTS

Multinational enterprises form a significant part of the international economy. They bring advantages to the home and host nations through international direct investment, in the form of productive capital. managerial and technological knowledge, job creation and tax revenues. The investment objectives of a multinational company should:

- Ensure that the operations of e aterprises are in harmony with government policies;
- Strengthen the basis of mutual confidence between enterprises and the societies in which they operate;
- Improve the foreign investment climate; and
- Enhance contribution of the en erprise to sustainable development.

An investment proposal is a type of business plan. but is designed specifically to meet the informaboil needs of potential investors. It is abridged and focuses on those managemen'. marketing and financial aspects of the company that would make it an attractive in' estment. 'Mere are tv o stages of an investment proposal that include the sel l lna of the proposal and its review. The process of selling and reviewing should eo through a variety of formal and informal procedural followups and negotiations. Successful international companies continue to be interested in growth prospects, evaluating a variety of proposals from different sources that potentially could lead to investments abroad. These sources include company employees, unknown host country firms, licensees, distributors, and joint venture partners. The following precautions need to be taken by the multinational company while drafting and pursuing the investment proposals with the governments or organizations of tl host countries:

- Focus the investment proposal specific to the requirements ofthe country or region

- Develop necessary convergence with the macro policies of the country
- Delineate the approval points and schedules
- Check·with all the people whose approval is needed
- Define alternative goals and approaches and keel advised accordingly
- Determine the key contacts for all the aspects of the proposal
- Prospect for selling the proposal at a reasonable bid, to optimize longterm gains
- Establish priori ties and develop activity schedule accordingly
- It is necessary to be on the competitive edge along with participating bidders and draw defense for the project in terms of project execution and achievements
- Identify potential competitors of the project and points of potential resistance, and then establish strategies, or at least mental contingency plans, for dealing with them
- Measure the proposal against all stated corporate policy objectives Write the proposal on the prescribed format with the required information only
- Prepare strong defense for all possible objections on the investment project
- Try to keep the project moving at a deliberate speed. Don't let it get stalled due to excessive reviewing.

MANAGEMENT OF FINANCE BY MNCs

The financial objectives of the multinational companies are aimed at measuring the performance on the capital employed. Capital employed is the sum of all assets along with the accumulated reserves, including provision for depreciation. The multinational companies, in their financial goals, may recognize that not all operation are directly comparable and state that targets for area profit centres and operations will tare into account the nature of the operations and performance plans thereof: Emphasis on asset management by the multinational company at all levels is laid in reference to annual targets for cash generation, capital expenditures, and balance sheet items, including inventory and receivables management. The finance ma-lagers of the company thaw special attention to the differences between actual cash generating capacity and book results. Each production group and profit centre both of product categories and territorial regions, develops net cash-generating capacity for its own requirements and also pools sufficient funds for the company to meet its high-priority investment commitments and opportunities. Financial objectives constitute the foundation for making financial decisions for a company. The companies should be able to integrate the financial objectives for both don iestic and international business. Financial objectives also constitute the foundation for making financial decisions for a company. For example, in order to protect iself against exchange rate fluctuations, it might require managers in overseas subsidiaries to forecast regularly the exchange rates i-nonth-by-month for the upcoming six months. On the basis of those fore easts, corporate funds in a currency likely to he substantially depreciated would be utilized before funds in stronger currencies.

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In most of the multinational companies, cash management is a centrally organized process. The major goal in this process is to concentrate on overall group liquidity as much as possible and to a reasonable extent. Ideally, this pooling is done across banks and borders. In a broader sense, cash management involves the organization of all incoming and outgoing payments in the most efficient way. To achieve this, multinational comp, inies depend on instruments like bank policy and cash pooling software intelligence. In reality, the right mix of organizational and software intelligence probably l eads to the best results. The quality of cash pooling can be measured by the gap between the forecasted and the realized cash position of a company. The smaller the difference between expectations and reality, the higher the efficiency of cash management. Cash poolin g is the standard tool used for efficient cash managemen' . The two basic concepts involved are: the national pooling organized to another alternate, compens across the participating bank accounts; the zero balancing approach interest requires physical concentration of cash flows on one concentration account. The latter approach is the most frequently used one today. A step that follows logically in cash management is the centralized organization of payments. Such concepts are .expressed as payment factory whereby all payments for connected subsidiaries of an MNC multinational corporate can be managed at a centralized location or branch. This includes single as well as mass payments.

The goal of an international money manager may be to obtain finances for foreign projects towards expansion, subsidiaries or strategic alliances with the companies of the host country in such a way as to maximize the resources availability and lower the after-tax interest costs and foreign exchange losses. The exchange rate parity theory suggests that internal ional differentials in interest costs are offset by changes in forei gn exchange rates; that is, the expected value for net financing costs will be equal for all currencies over any given time period, provided foreign exchange markets arc efficient. However, the multinational companies are susceptible to the following risks related to money management.

- The political risk of assets being taken over by the host country;
- The exchange risk, whereby the value of the US dollar changes with reference to the host country currency; and
- The translation risk, whereby the corporate financial statements are required by the country-specific regulations to be based on historical costs rather than current value.

In some countries, gains and losses from long-term exchange transactions are subject to preferential capital gains tax rates or reserves treatment. Conversely, many countries —Australia, Indonesia, South Africa, and Germany — have no taxes on gains or losses arising from most long-term exchange transactions. Traditionally, foreign investors foresee low opportunity for raising capital locally in the developing counties. HoWever, there may be an inadequacy of the local capital in these countries. It has been experienced in India that often the initial public offers (IPOs) of multinational companies fetched an encouraging response. The Honda Motor Company's issue was oversubscribed 165 times within a span of 72 hours! Similarly, Burroughs Corporation's stock and debenture issue was oversubscribed 30 times.

Financial management also involves significantly the matters of repatriation of funds and profits ofa multinational organization. Repatriation may be explained as the return from abroad of the financial assets of an organizat on or individual. A multinational firm needs to formulate a strategy on remission of dividends from overseas affiliates to headquarters. The international dividend policy is determined by the following factors19:

- Tax implications
- Political risk
- Foreign exchange risk
- Age and size of affiliate
- Availability offluids
- Presence of ioint venture partners

The policy of the Government of India is liberal with regard to the remittance of profits, dividends, royalties, etc., but the Government is cautious of excessive remittance while approving foreign investment proposals and collaboration agreements. Thus, foreign enterprises have complete freecic,m for the remittance of profit and repatriation of capital subject to exchange considerations. Remittance falling due under the collaboration agreements will however be subject to the approval of the Reserve Bank of India (RBI).2° On the contrary, many multinationals operating in China have started to turn in profits, and, as they become more profitable, they are being frustrated by complex arrangements currently in place to deter repatriation. The strict regulations discourage transfer of funds out of China. Multinational companies op rating in China are also restricted from lendinti intra-company."

The United States—Argentina Bilateral Investment Treaty (BIT) came into force in 1994. Under the treaty, US investors enjoy national treatment in all sectors except shipbuilding, fishing, and nuclear power generation. An amendment to the treaty removed mining, except uranium production, from the list of exceptions. The treaty allows arbitration of disputes by the International Centre for the Settlement of Investment Disputes (ICS ID) or any other arbitration ins ti tut i k-)ri mutually aureed by the parties. Several US firms have invoked the provisions of the treaty in ongoing disputes with Ar gentine national or provincial authorities. Under the

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Convertibility Law of 1991, the exchange rate of the.Argentir re peso is fixed to the dollar at the rate of c re to one, under a currency board type of arrangement called 'convertibility.' fhis rate is expected to remain unchanged in the medium term. Argentina has no exchan ge controls. Foreign investment receives national treatment underArgentine law. Finns need not obtain permission to invest in Argentina. Foreign investors may wholly own a local compan y. and investment - - in firms whose shares trade on the local stock exchange requires no government approval. There are no restrictions on repatriation of funds.22

In the countries where political risk may not be an important factor, the repatriation policy will be based on availability and use of funds. For example, if funds are needed in the United Kingdom, headquarters might decide to transfer- its retained earnings from a German subsidiary to the United Kingdom rather than transferring funds from the United States. An alternative to this action would be the investment of funds in euro. In reference to the risk factors discussed above, on the basis of the six factors just liste.i and discussed, a multinational firm may follow either a pooled strategy or a flexible strategy for distribution of earnircas generated by foreign affiliates. The pooled strategy refers to a stated policy of remittance of profits to the parent on a regular basis. The flexible strategy leaves the decision on dividends to factors operating at the time. The flexible strategy permits the parent to make the most viable use of funds vis-a-vis its long-term global corporate objectives.

Country Risk

After World War II, country risk became an issue of prime concern for the international financial community. Various methods have been used by the risk rating agencies to determine the extent of country risk, integrating a range of qualitative and cluanti ve inixanatioa on alternative inea•mrt-s ofpolitical, etviveaa: and financial risk to evoive composite risk indices. Cotmtry risk anal ysis is a eompl ex task and demands a holiAic vision. expert skills and consistency in measurements. The analyst must follow standard procedures to assure coherency in its studies, using reliable and useful sources ofdata, including rating agencies, official institutions and other several sources. The country-risk analysis reports show the strengths and weaknesses of a country, after dealing with the macroeconomic, socio-political and financial aspects in order to define a risk level and, consequently-, a related price for the asset in risk. Managing the risks of a portfolio demands a systematic follow up concerning the external arh internal environment, governmental policies' outlook provided by rating agencies, and so on.

During the 1970s, the sharp increase in oil prices, followed by worldwide inflation, a collapse in commodity prices, global recession and high interest rates walloped the economies of the developing countries the world over. When oil prices shot up, these countries borrowed heavily at high interest rates to prevent the economic downfall. The international financial institutions lent money to developing countries alongwith official subsidies and such aid grew very rapidly during this period. As a result of the irresponsibility of both creditor and debtor governments (e.g., cot rupt ion, private projects benefitting only the rich, etc.), the countries did not use the money for productive investment; rather, they spent these new dollars on immeiliate consumption and the countries were unable to repay such amassed debt. Consequently, the total medium and long-term debt of developing countries quadrupled in nominal terms, from about $ 140 billion at the end of 1974 to about S .560 billion in 1982. The debt trap got stiffer for these countries and the borrowings had reached $ 2.4 trillion by the end of 1998.

The debt crisis has had a deep impact on the economic growth of the developing countries. The situation became alarming and of major concern to the international community. International institutions includin g IMF, and the World Bank sought to find ways ofreducing the impact of continuin g debt of the developing countries. A framework to reduce the burden of debt was evolved at two levels wherein the debtors tieeded to grow faster and export more and to pull down the cost of debt service. During the process of overcoming the debt crisis, most countries sought IMF assistance for debt relief. As a crisis managing institute, the Fund assumed anew role as financial organizer for the troubled debtor nations. According to the IMF 'structural adjustment programmes' were required in these nations. Debtor governments had to allow the imposition strict economic programmes on their countries to borrow more money or reshedule their loans. Simply put, countries had to reduce, spending to decrease their debt and stabilize their currency. The governments cost limitations by reducing social spending (e.; education, health. social services, etc.) by devaluation of the national currency (via lowering export earnings and increasing import costs), creation of rigid limits on food subsidies, cutting workers' jobs and salaries taking over small subsistence farms for large scale export crop tanning and encouraging the pi i 3atization 01 public industries. Most nations went through a recession and often a depression; and the poorest were the most affected. In 1982, Mexico expressed to inability to repay its debts. Mexico owed huge sums of money to commercial banks in the West. This was a serious threat to the stability of the global a financial system. The commercial banks designed a system in consul tation with IMF whereby countries in debt could spread out or reschedule their debts instead of defaulting. It was during this time that IMF and World Bank began taking over much the debt owed to commercial hanks. These institutions offered new loans developing countries to with certain rigid conditions attached. Since the 1980s, the IMF and the World Bank have been controlling the debt crisis. Countries in debt were required to follow policies favoured by IMF and World Bank to procure new loans or aid. These policies had a direct impact on the lives and livelihoods of the citizens of the indebted nations.

In this unit, you have learned that:

- The political environment of a country has a great impact on the operations of international business units.
- In a totalitarian system, political power is in the hands of only one individual or party who implements policies.

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- The social environment is concerned with the social attitudes and cultural values of different societies.
- Technology and material culture, language, aesthetics, education, religion, perceptions and attitudes, social values and life style, social organization and political life are the cultural factors that affect international business. In most multinational companies, cash monagement is a centrally organized process.
- Cash pooling is the standard instrument for efficient cash management. Th international dividend policy is determined by tax implications, political risl,, foreign exchange risk, age and size of affiliate, availability of funds and presence of joint venture partners.
- Country risk analysis is a complicated task and demands a holistic vision, expert skills and consistency in measurements.
- Country risk analysis reports show the strengths and weaknesses of a country after dealing with the macroeconomic, socio-political and financial aspects in order to define a risk level.

INTERNATIONAL BUSINESS MODES

DETERMINANTS OF ENTRY MODE

A firm adopts various modes for its entry into business transaction acre. borders. Which particular mode a firm should adopt depends, at least, um four factors. They are:

1. Subservience of the corporate objective
2. Corporate capability
3. Host country environment
4. Perceived risk

When the objective of a firm spreading internationally is simpl y to e: profits and not necessarily to maintain control over the entire operation, or trading activities will serve its purpose. But if control is the primar y objecta the investment mode, and especially investment in a whoil y owned fore* subsidiary, will be the best course of action. Thus, a particular mode is selecti.. in tune with the very objective of the firm behind international business

The corporate objective shaping the entry mode must be supported by company's capability to select the particular entry mode. For example. if company' financial position is not strong enough to make large investrtte abroad, it will be difficult for the company to make such investment even if it desirable on the grounds of ful filling corporate objectives. Thus, the the entry mode depends, to a coi tsiderable extent, on the capability of the car pany going international.

The host country environment too influences the entry mode. it many aspects, such as the regulatory environment; cultural environment, pollitical and legal environment;

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economic environment, especially the size oi!i market and the production; the shipping cost, and so on (Root, 19F7). When

all not well acquainted with the values, beliefs, customs, • lNeige, religion, and other aspects of the target market, the firm does not to invest there. Rather, it limits its business only to trading activities in The company starts operation ir the host country only when the e-3r3;:er., are acottainted with the cuitural environment in the host countries. if the political conditions are not congenial in the target market or if the inr.nalities are lengthy, large investment is often avoided. Sometimes, t- 114,y the host government bans certc in t ypes of investment, foreign investors iriake such investments even if they wish to make them. In India, in 1973. ',IA: government fixed a ceiling on foreign equit y participation. Foreign ziempanies that did not favour the ceiiiim dismantled their operations in India C.F,hari,n, 1992). Yet again, it is the size of the market in the host country that soiuences the entry mode of foreign firms. When the market is large and ever riding, foreign firms prefer to enlarge their involvement through investwent. But if the size of the market remains small, trade is the only suitable -aption. 1.2st but not least, if the cost of production in the host economy is le wer than Li the home co , entry, the host country attracts foreign investment. In act, i5 one of the important reasons that companies from the developed world moved to developing countries. If the shipping cost is also low, it is pos-Oble that the firm may shift the entire prod action process to the low cost host tountry and may ship the output baci: to the home country for meeting the dimestic demand. If, on the other hand, the host country does not represent oust eitEctiveness, trading remains the only way out.

Besides these factors, it is risk involved in the different modes of entry that influences the decision of a firm in this respect. Different modes involve varying degrees of risk. The lesser the amount of control in a particular mode, the lower the risk. If trading activities are ranked on the lowest rung of the 11tider from the viewpoint of control, it carries the least risk. On the contrary, if investment in a wholly owned subsidiary possesses the largest element of control, it is supposed to be highly risky. Thus, the choice of the entry mode .lepends, among other things, upon the control-risk consideration of the firm.

TRADE MODE

Direct and Indirect Export

ihe trade mode presents the first step in international business. It includes export and import. Export may be either direct or indirect. In case of direct export, a company takes full responsibilit y for making its goods available in the target ma rket by selling directly to the end use rs, normally through its own agents. Direct export is feasible when the exp. rter desires to involve itself greatly in international business; and at the same time possesses the capacity to do so. There are also some commod i ties where direct export is more cot we- 6ent. They are, for example, air crafts and similar industrial products.

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When the exporting company does not posse&, the necessary infrastructure to involve itself in direct exporting, indirect export takes place. It takes place when the exporting company sells its products to intermediaries, who in turn sell the same products to the end-users in the target market.

It is a fact that the nature of intermediary differs in direct expert or ii-nport-„1, from that in an indirect export and import. However, when one talks about intermediaries, export management ...sorapanies (EMCs) and trading compai: nies cannot be ignored. When an EMC functions as a distributor, it takes title tv, goods, sells them on its own account, and assumes the trading risk. A iterna caltively, when it acts as an agent, it charges a commission. Sometimes it acts as aryl„; agent for one client and as a dirt; ibutor for the other. Trading companies, orgthe other hand, provide services to exporters, in addition to exporting activir,.0 ties, such as storage facilities, financing services, and so on. These companies are originated in Europe but are now common in Japan and South Korea.

Counter-trade

Counter-trade is a sort of bilateral trade where one set of goods is exchanged trade another set of goods. In this type of external trade, a seller provide:; buyer welt deliveries and contractually agrees to purchase goods from the buyer equal the agreed percentage of the original sale contract value (US Ov rtrrien t Commerce, 1978). Counter- trade is classified broadly as:

1. Commercial counter -trade such as classical barter, counter-1)urchasiit' and pre-compensati
2. Industrial counter-trade such as hay-back agreements, develop On" import arrangements, and framework agreements.

Commercial Counter-trade: Classical barter is one of the oldest modes of commercial counter-trade. It involves a once only exchange of goods on the term agreed upon between the buyer and the seller: The quantum, quality, and value of goods to be exchanged are well defined. Naturally, the trade flows in one direction are fully compensated by those in the reverse direction. There is no need for bridging finance. Negòtiating parties are often governments. The exchange of Iranian oil for New Zealand's Iamb or the exchange of Argentir wheat for Peruvian iron pillets are exzahples of classical barter (Banks,1983) 1" Li case of counter-purchase, which is also known as parallel barter, the contracts are often separate for import and export. The type and price of good ttraded are generally not specified at the time of signing of the contract. The exporter of goods agrees to accept, in return, a wide range of goods from thP importer. Balancing of the value of export and import is done every three to five years. If the two sides are not equal, the balance is paid in cash.

In case of pre-compensation, the value of exports is entered into an eviden account and imports are made on that basis. This means that payment. imports are not made immediately. fey;

Industrial Counter-trade: Being a form of industrial counter-trade, buy-back agreements normally involve a larger amount corresponding to the sale industrial equipment or turnkey plaiits in exchange for the products manufactured by these industrial plants. Naturally, the contract period is longer, varaing from 10 to 20 years. The United Nations Economic Commission for Europe te (979) mentions the case of Austria selling pipeline equipment and related material to the then Soviet Union su that the latter could develop certain gas fields and could pipe a part of the output back to Austria. In case of developing countries, such agreements are conunon as they suffer from the technology gap on a large scale.

Develop-for-import arrangements are also a variant of the buy-lack agreement whore the exporter of the plant and machinery participates in the capital of the importing firm and, thereby; takes a share in the profits thereof. This means the inv clvement of the exporting firm is deeper than in a general buy-back arrangement. Japanese investment in an Australian firm developing gun-power copper mine is an apposite example (Narneth, 1984).

Framework agreements are the long term protocol or bilateral clearing agreement normally concluded between governments. Trade is balanced after a long twit d rs mentioned in the agreement. If the trade is not equal in value, the debtor sells the agreed upon commodity in the international market and the creditor is paid off. For example, Mexico sold cocoa to the United States of America 'co pay for its excess import from Malaysia (Far Eastern Economic Feview, 1933).

Growth of Counter-trade: Barter trade was the mode of international trade in the eighteenth century when there was no sufficient monetisation. During the twei theft' century, especially during the inter-War years, the West german lovcal tent had resorted to bartering for strategic raw material (Banks, 1983). In the post-War period, counter-trade was initiated on a large scale by East Eurowan countries while trading with western countries and developing countries .because they did not relish multilateral trade. In the wake of the oil cris s of 1970s, oil was exchanged for Soviet arms. The share of counter-trade in the world trade rose from around two per cent in 1964 to 20-30 per cent by the late I960s (Debroy, 1987), although accurate estimates cannot be made on account of unavailability of figures. There is also region -wise difference as far as the volume of counter-trade is concerned.

Merits of Counter-trade: It is true that the multilateral trading system is beneficial, tut the gains from it are limited in view of imposition of trade barriers. In such cases bilateral trade plays a vital role. First of all, it is a good option for ateAing import requirements, especially in case of developing countries whose export faces high barriers.

Secondly, counter-trade helps stabilise export earnings because it pre-determines the size of export and import. it also helps stabilise the terms of trade as the raiio between export and import prices is predetermined. Through stabilising export earnings and terms of trade, it transfuses stability- in the development process.

Thirdly, it helps in trade diversification and, thereby, reduces the risk of geooolitical chaos. Diversification of exports allows greater outlets for exportable goods, which in turn creates a more competitive market, increases export earnings, and reduces import costs.

Distortions can take place in many ways. The price of the import may be very low and hence may harm domestic industries. If it is abnormally high, terms of trade will deteriorate. Once caught in counter-trade, the weak trading partner is covered by the strong counterpart.

Again, difficult to sell products are sometimes traded. This means the country exporting such goods never tries to improve its efficiency. This negatively influences the export performance in the long un. let again, there is always a difficulty of double coincidence of traded goods with the result that the i:rade earnings become unstable.

Last out not least, the balancing of trade poses a serious problem both at the micro level and at the macro level. Experience shows that micro level balancing is often more cumbersome. The problem also occurs at the macro level when eworts face supply constraints. This happened in Indonesia during 1982 and 1983, when the country faced serious problems in balancing trade (Miramon, 1985).

CONTRACTUAL ENTRY MODES

Contractual entry modes are found in case of intangible products such as technology, patents, and so on. When a company develops a particular technology through its own research and development programme, it likes to recover the cost of research and development. To this end, it sells the technology either to a domestic firm or to a foreign firm. But in this case, the secrecy of technology is p gut maintained and the firm's ownership advantage is always at stake. Thus, in order to maintain the ownership advantage, a firm passes on the technology only to its own subsidiary located abroad. But if the host government does not ermit any foreign investment, the subsidiar y of the firm in that host country cannot exist. Transfer of technology through contractual deals is the only way out. The contractual entry mode, often known as technical collaboration or ,cchnical joint-venture, is very common. It is preferred in many cases where:

1. The licensor does not possess enough capital for investmen.'sr does it possess the requisite knowledge of the foreign market for the purpose of export.
2. The licensor wishes to exploit its technology in the foreign market.
3. The licensor finds the host country market too small to make any investment for reaping economies of scale.
4. Nationalisation is feared in the host country.
5. Foreign investment in the host country is restricted.

Technical collaboration normally takes four forms. They are:

1. Licensing
2. Franchising

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3. Management Cc
4. Turnkey Projects

These different forms of the contractual mode are explained here.

Fourthly, counter-trade augment, the flow of technology to developin countries, especially when they suffer from a serious technology gap. Buy-bacl agreements are particularly helpful in such cases.

Fifthly, when the counter-trade agreem:.>n t is long term, the importing court try gets the same advantage a it get, troll: loans. This means that counter-had serves the purpose of loans and at the same time does not impose the bu rden interest payment.

Sixthly, despite the fact th, t balancing of trade sometimes poses a problem, reduces the net currency out low and, thus, helps avoid foreign exchancw problems.

Seventhly, developing countries of ten face distortions caused by unsuitable exchange rate policies. For example, over evaluation of currency tends to mak export uncompetitive despite its impact in form of reduced import cost Counter-trade helps correct such distort ons. Goods can be exported at than the quoted price and this can act a!.. an export subsidy.

All this shows that counter-trade helps avert the problem of foreign example change, which is endemic tot. eveloping countries. In fact, this has been a ma;, factor for resorting to counter-trade. To quote a few examples, Brazil are Mexico opted for counter-t-c. de in 1979 when their external balance was disturbed. So was the case with Indonesia in 1981. India was ready to exchair various raw materials for wheat and other agricultural commodities from th USA only after its foreign exchange crisis in the late 1950s.

Counter-trade

Merits

- Absence of tariff barriers.
- Stabilisation of export earnings.
- Scope for benefits from trade diversification.
- Possibility for flow of technology, expecially in buy-back agreements.
- Some advantages similar to those of loans.
- No need for foreign exchange for making imports.
- Avoiding distortions caused by unsuitable exchange rate policy.

Demerits

- Non-conforming with the norms of the multilateral trading system.
- Absence of multilateral surveillance leading to distortions in markets and price.
- Lack of encouragement for quality improvement.
- Lack of double coincidence of goods to be traded.

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- Balancing of trade sometimes turns difficult.

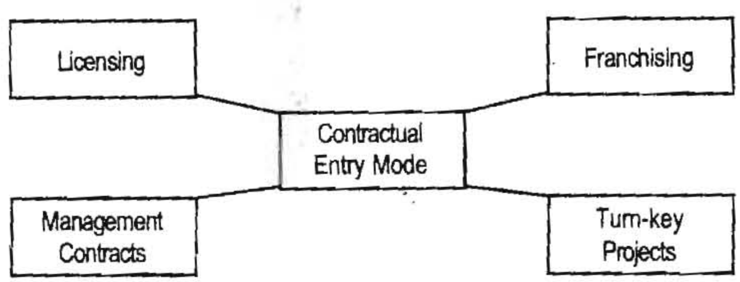
Demerits of Counter-trade : It is maintained that counter-trade goes again the norms of multilateral trade and so countries opting for it, abstain from reaping gains, from the multilateral trading system. There is always the posibility of markety distortions because of the lack of multilateral surveillance.

Licensing

Nature and Forms: Licensing is an arrangement by which a firm transfers it intangible property such as expertise, know-how, blueprints, technology. and manufacturing design to its own unit, or to a firm, located abroad. It is also known as technical collaboration. The firm transferring technology, and so on is known as the licensor. The firm receiving technology, at the other end, and on is known as the licensee. The arrangement is meant for a specific period. The licensor gets technical service fee from the licensee. The licensee, on the other t end, does not have to make a huge investment on research and development. Thus both the parties reap the benefits of licensing.

A licence can be exclusive, non-exclusive, or cross. In an exclusive licence, the arrangement provides exclusive rights to produce and market an intangible property in a specific geographic region On the contrary, a non-exclusive licence does not grant a firm sole access to the market. The licensor can grant even more companies the right to use the property in the same region. Cross licensing is reciprocal where intangible property is transferred between two firms, both of them being the licensor and the licensee at the same time. In the early 1990s there was cross licensing between Fujitsu of Japan and Texas Instruments of the USA. Both the companies used each other's technology for a given period.

Advantages and Disadvantages: There are many advantages in a licensing arrangen tent. A licensor can expand its operation in different countries by exploiting its innovative technology, without making any investment. In oft words, it can reap benefits from its technology without making any investment abroad. Secondly, it is less risky than the investment mode because it does not commit any investment. Even if there is an unfavourable political climate in the most country, the licensor is not going to lose anything except for some amount of technical fees. But in case of investment, the loss may be huge. Thirdly, licensing can be advantageous to the licensee too as it is able to upgrade its production technology and can develop its competitiveness in the international market.



However, there is the fear that licensing can reduce the global consistency of the quality and marketing of a licensor's product in different national markets especially if different licensees operate in their own way. Again, the secrecy of technology is known to the licensee the moment the licensing agreement it made. In this way, a licensing arrangement hampers the very competitive advantage possessed by the licensor. During 1960s, RCA transferred .cechnical 11 know-how for the production of colour televisions to Sony and Matsushita for a handsome price. The licensee3 assimilated the technology and left RCA fan behind in the competition in the world market.

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Franchising

Meaning and Forms: In this form of technical collaboration, the franchiser is the entrant and the franchisee is the host country entity. The franchisee makes use of intellectual property rights, like trademarks, copyrights, business know– how, managerial assistance, geographic e) clusivity, or of specific set of procedures of the franchiser for creating tie product in question. In the lieriture available on this subject, a few expt its have established similarities between licensing and franchising. Omen (1984) suggests that "franchising may 'b regarded as a particular type of licensing". Root (1 q87) too feels that frechising is a form of licensing in which the franchiser licenses a business system and other property rights to a franchisee. On the contrary, there are views to suggest that these two are dilferent. Perkins (1987) is of the view that while franchising encompasses transfer of she total business function, licensing concerns just one part of business, including transfer of right to manufacture or distribute a single product or process. Again, franchising differs from licensing in that the termer gives a company greater control over the sale of the product in the targei: market. When the franchisee fails to abide by the set of procedures, the fra ochi5ler takes back the franchise. Yet again, licensing is common in manufacturing industries, whereas franchising is more common in service industries where the brand name is more important. Franchising may take different forms. In direct franchising, the franchiser frames policy and monitors and directs the activities in each host country from it home-country base. But incase of indirect franchising, there are subfrenchisers between the original 'franchiser and the host country units. The sub-franchiser possesses the exclusive right to exploit the original franchiser's business package within a defined geographic area..

Advantages and Disadvantages: The merit of franchising is that it allows the fraw:hiser to maintain consistency of its standard products in different target markets. Moreover, it is a very low-risk mode of entry in different markets. however, there is often the problem of controlling a large number of franchisees in different markets. To avoid tiiis problem, a master franchisee is establshed ina particular market to monitor tire operation of individual franchisees in that market. -

On the other hand, franchising i s not cost-free. There are different types of cults n olved in it. The costs are search costs, servicing costs, property right .... costs, and monitoring costs. The search cost is involved in evaiu,eing, selecting and

Check Your Progress

11. What do you mean by Globalization?
12. What is Competition Act?

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contacting a foreign party. The servicing cost includes th, cc. ac codifying the franchise format appropriately, the cost of prcvidire managerial and technical assistance, support, and ongoing tralhing. The property right protection cost occurs in the process when the franchiser taketi,,- steps to safeguard its ownership advantage embodied in the franchise format trea Last but not least, the franchiser needs to police and supervise the activities ea=, the franchisee in order to maintain its brand image. The cost of policing supervision is known as monitoring cost.

Management Contracts

Nature of Management Contracts: In a management contract, one comma, supplies the other with managerial expertise. Such agreements are narma ilj signed in case of turnkey projects where the host country firm is not able manage day to day affairs of the project, or in other cases where the desired managerial capabilities are not available in the host country. The transfer in. eludes both technical expertise and managerial expertise. Merits and Demerits: It is through management contracts that many develoia ing countries are able to utilise specialised expertise in different areas of the economy. But the moment local talent is developed, management contracts lot;, their significance.

Management contracts often supplement the licensing agreement insofar they help the firm reap the advantages of licensing. Suppose a firm gets in proved technology but lacks managerial inputs for better marketing, its prot ucts gill remain unsold and the ultimate impact of the licensing agreemen will be zero.

The transfer of managerial know-how is very easy as the licensor has simply overstretch its management resources and make them available to the licensee. But the problem is that there is often misunderstanding between ta foreign managers and the local managers, ultimately effecting productivih Again, if foreign managers work only for a short period and do not train the local personnel, managerial efficiency will not be up to the mark. This will leave to problems when they go back to their home country.

Turnkey Projects

Meaning: In a turnkey project agreement, a firm agrees to construct an entire plant in a foreign country and make it fully operational. It is known as turnke aecau se the licensor starts the operation. a:id hands over the key of the operating plant to the licensee. Agreements for turnkey projects normally take place where the initial construction part of the plant is more complex than the opera ional part. Such projects are either self-engineered or made to specifications. h ease of the former, it is the licensor who decides the design of the project. 1,1 the atter, it is the licensee who takes such decision. In both cases, the contract involves either a fixed price or a cost-plus price. In a fixed-price contract, the risk of cost over-runs lies with the licensor.

Advantages and Disadvantages: Turnkey projects allow firms to specialise in their core competencies, which they could not have done in the absence of such or

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contracts. Moreover, such contracts allow the host government to obtain world tit ciass designs for its infrastructure projects.

Turnkey projects are also advantageous in cases where the host government restrict the inflow of capital. For example, many oil exporting countries did not pet in t foreign direct investment in the oil sector. Foreign firms entered these rad.rkets through turnkey projects. But the suppliers of turnkey projects often fall back on their own monopoly position in the international market.

FOREIGN INVESTMENT

Foreign Portfolio Investment and Foreign Direct Investment

Foreign investment takes two forms. One is foreign portfolio investment, which does not involve the production and distribution of goods and services. It is not concerned with the control of the host countr y enterprise. It simply gives the xinvestor, a non-controlling interest in the company. Investment in securities on T.V. Stock exchanges of a foreign country or ,rider the global depository receipt trechanism is an example of foreign portfolio investment. On the other hand, Foreign direct investment (FIN is very much concerned with the operation and Governorship of the host country firm. It is often said that even in case of FIJI, if a :ompany acquires around 10 percent of the equity in a foreign firm, it should be treated as foreign portfolio investment as the investing or the acquiring firm docs not have a sa y in the affairs of the target company (United Nations, 2000). FDI is found in form of either green-field investment (GI) or mergers and ict]uisitions (M&As) or brown - field investment. Green-field investment takes either through opening of or inches in a foreign country or through foreign financial collaborations—meaning investment in the equity capital of a to7eign company, in the majority of cases a newly established one. If the firm buys the entire equity shares in r foreign company, the latter is known as the Ictolly-owned subsidiary of the buying firm. In case of purchase of more than 10 percent shares, the latter is known as a subsidiary of the buying firm. In case et' less than 5) per cent purchase, it is known simply as an equity alliance. t-c)nietimes an equity alliance is reciprocal, meaning that both companies inrest in the equity capital of each other. To cite an example, General Motors of he L5A has 20 per cent share n the equity of the Italian firm Fiat and Fiat maintains 5 per cent share in the equity of General Motors.

M&As are either outright pu:chase of a running company abroad or an .qualgamation with a running foreign company. The term "brown-field" in Vu;traent is used to denote a combination of green-field investment and M&As. found in cases when a firm acquires another firm; and after the acquisition it completely replaces the plant and equipment, labour, and product line (Meyer and Estrin, 1998).

Again, FDI is either horizontal or vertical. Horizontal FDI is said to ex, when a tirm invests abroad in the same operation/industry. Suzuki's illy ment in India to manufacture cars is an example of horizontal FDI. On tt. contrary, vertical FDI is found when a firm invests abroad in other operation either with a view to have control over

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the supply of inputs or to have contn over marketing of its product. British Petroleum and Royal Dutch Shell hat invested abroad in the production of oi l. Volkswagen has acquired a imber r US dealers in order to sell its cars to consumers in the USA. These two examples of vertical FDI. However, the first example is an example of a back ward vertical FDI, where FDI assures the supply of inputs for its production home. The second one is an example of forward vertical FDI in which it helps: the sale of domestically produced goods in the host country. It may be notedt; that the forward vertical FDI is not as common as the backward vertica! FIR Last but not least, based on the motives of the MNCs, FDI may be classifier; as: (1) market-seeking, (2) resource-seeking, and (3) efficiency-seeking. Market.: seeking FDI moves to a country where per capita income and the size of th4 market 3re large. The resource-seeking MI flows to a host country where material and manpower are available in abundance. Again, the efficiency seeking FDI moves to a country where . hc abundance of resources and presence of large market help MNCs improve their efficiency.

Mergers and Acquisitions (M&As)

Forms of M&As: As mentioned above, FD1 takes place also through merge: and acquisitions (M&As) that are not a start-from-scratch mode or a greenfie - investment. Broadly speaking, M&As take two forms. One is the acquisitior where one firm acquires or purchases another firm. The former is know n acquiring company and the later is known as target company. No new fire' comes into existence after the merger. The other form manifests in consolichtion or amalgamation where two merging firms lose their identity into a iiew firm that comes to exist representing the interest of the two.

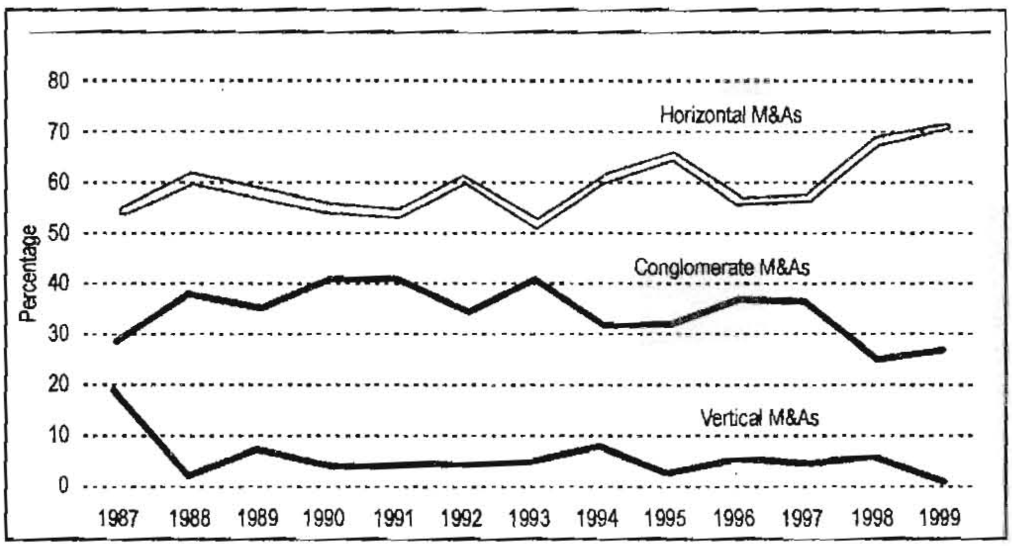
The M&As are either horizontal, or vertical, or conglomerate. Horizontal M&As are found where two or more firms engaged in similar lines of activities join hands. For example, if two firms manufacturing automobiles merge, it will be called a horizontal merger. Horizontal M& As help create economies cif scale because the size of the firm becomes larger to reap such gains. On the other hand, vertical M&As occur among firms involved in different stages of the production of a single final product. if an oil exploration firm and a refinery unit merge, it will be called a vertical integration. It reduces cost of transportation, and of communicating and coordinating of production. Uncertainty over input supply is overcome a also the marketing of goods of a particular unit is assured throu ;h backward and forward linkages. Aga i n, a conglomerate merger or consoli(ation involves two or more firms in unrelated activities. Three types of conglomerate M&A s are often found. Productextension combination broadens the product lines of the firm. Similarly, a

Forms of M&As

- Based on corporate structure:
  1. Acquistion
  2. Amalgamation/consolidation

- Based on financial relationship:
  1. Horizontal
  2. Vertical
  3. Conglomerate
- Based on technique
  1. Hostile
  2. Friendly

geographic market extension merger involves two firms operating in different and non-overlapping geographic areas. The size of the market expands after the merger. Lastly, conglomerates representing neither of the two are known as pure conglomerate mergers. There are financial conglomerates where a financial company manages the financial functions of other companies in the group. Similarly, there are managerial conglomerates combining the management of several companies under one roof.



Source: UNCTED Crossborder M&A Database

Figure : World Cross-border M&As by Type (Horozontal, Vertical, Conglomerate), 1987-1999

Again, from the viewpoint of techn ; que, M&As are either hostile or friendly. In the hostile takeovers, the time devoted to negotiations is minimised as much as possible because it is just the discreet purchase of the shares of the target company. There are two waN:s to acquire shares. One is known as dawn raid, where the acquiring company makes a sudden purchase of shares of the target company. The other is by securing an i rrevocable call option over someone else's shat .?s. After the initial stake is finalised, the acquiring company makes a bid. In order to grab the shares it quotes a much higher price, which deters other parties from making bid. Such a bid is cane(' as pre -emptive strike. On the other hand, if the company does not see a formidable competitor, it quotes very low bid, often lower than the worth.

This i s done in order to gain more and this is called low-ball offer.

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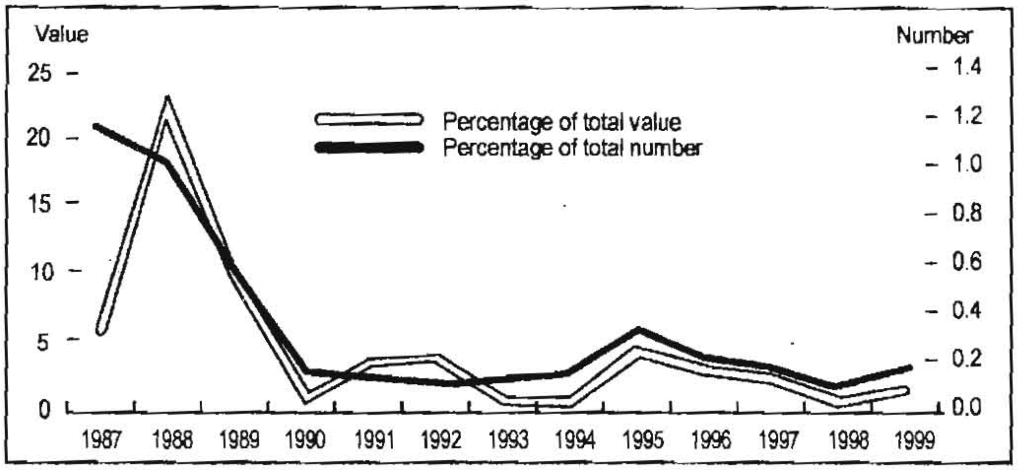
As far as friendl y takeovers are concerned, there are a lot of negotiations The take-over deal is not disclosed until it :s finalised. To this end, the acquiring company signs confidentiality letter whereby it promises not to disclose the fact to any third party. When the negotiation is on and all the relevant issues are sorted out, a letter of intent is signed. Finally, after the formal announcement is made to the press, a contract is signed.



Source: UNCTED, Crossborder M&A Database

Share of Hostile Takeovers in Cross-border M&As, 1987-1999 (Percentage of total)

Motivations behind M&A: M&A s preterable to other modes of investment or t he start-from-scratch mode of m y stnient. Firstly, the M&A provides a synergistic advantage. This means that the firms opei.ating individually do not reap the benefits that they are able to reap when ihey are combined. This occurs because the combination allows firms to derive the economies of scale on different counts, especially on the count of production, technological research, management, finance, and marketing. For example, when the fixed cost in Firm A does not cross the relevant range even after it acquires Firm B, the combination will lead to saving of the fixed cost t 'Iat Firm B was previously incurring. This would result in lower cost of produc ti on. Similar savings would occur in other relevant areas. These economies are most likely to occur in case of horizont a combinations where opportunities exist for avoiding duplicate facilities. Secondly, M&A enables overnight growth of the firm. At the same time, the very risk of competition reduces after merger. However, emergence of monopo used character has some amount of disadvantage for consumers when the price is imwarrantedly raised.

Thirdly, M&A reduces financial r i sk through greater amount of diversificatrm. More particularly in case of conglomerates, assets of completely different itsk classes are acquired and consequently there is the possibility of negative currelation between the rates of return from these different classes of assets. If the return from total portfolio of assets would be comparatively stable.

Fourthly, M&A leads to diversification, which raises the debt capacity of the firm. Because of greater stability in the rates of return or in the cash flow after merger, the firm goes ahead to em ploy leverage in the capital structure. This llcips the cost of capital move downward and raises the value of corporate wealth.

Fifthly, tax savings sometimes leads firms to combine. Suppose Firm A is caning high profits. It combines with Firm B which is incurring loss. After combination, the total profit will be lower than Firm A's profit alone with the re !It that the amount of tax would be lower.

In international business, M&As are very common now a days because Of the above mentioned reasons. However, international M&As sometimes be come an essential step when the domestic market is saturated and the firm is desirous of further expansion for reaping gains from external economies. Again, international marketing often faces high tariffs, in which case M&A with the host country firms becomes a necessary step. It is found also when the rinn having superior technology or managerial efficiency likes to reap advantages in the international market or when the firm likes to acquire improved foreign technology in order to make a lead in the domestic market. Besides all this, international M&A is also resorted to assure a regular source of raw matedal that is not available domestically.

FDI COMPARED WITH TRADE

In the very beginning of the discussion on FDI, it is worth examining whether it is better than trade especially when the fulfilment of major international business objectives is concerned. Let us assume the objectives to be:

1. Expansion in sales and, thereby, in revenue
2. Acquisition of resources
3. Minimisation of risk through diversification
4. Political motive

Sales can be expanded also through greater magnitude of exports. But there are cases when export has only a limited scope. In such cases, FDI is made to generate sales. FDI overcomes the transportation cost involved in export. It is true that if the same product is exported to different markets, the firm produces more, exports more, and achieves economies of scale that largely compensates the transport cost. But when the product is differentiated, depending upon varying consumption pattern in different markets, economies of scale cannot be achie ved. FDI is a better alternative in the sense that products with dissimilar features are produced in different countries in order to meet the specific demands of consumers there. It is the only way to generate sales.

Again, it is not only transport cost but also tariff and non-tariff barriers tint are overcome by FDI. The generation of export is often handicapped by, high tariff or non-tariff barriers imposed by importing countries. But if the exporting firm begins production in the importing country, trade barriers do nut come in the way. The product becomes cheaper in the hands of the host country consumers. The firm finds itself in a competitive position and is able to raise its sales.

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Apart from the generation of sales and revenue, the issue of the acquisition of resources is also important. Resources can be imported, but the import is possible only when the exporter agrees to export. On the other hand, FDI is a more reliable means to acquire resources. In the last quarter of the 19th century and the early decades of the 20th century, a goad number of the British firms were engaged in mining activities. Even today, we find that Digital Equipment has made investments in India in order to access Indian software talent. Again, a large number of firms from industrialised countries have moved to developing countries to reap the benefit of cheap labour in the host countries. Suzuki produces cars with cheap Indian labour and exports them to the international market at competitive rates. Sot netirnes it is the cheap raw material that attracts FDI. Indian firms have moved Sri Lanka for the manufacture of rubber products and to Nepal for the manufacture of herbal products. Thus FDI is more effective than other modes for the purpose of acquisition of resources. The resource acquisition process becomes easier, especially in a cross-border vertical set-up where the firm of an industrialised country uses cheap labour of a labour abundant economy through an off shore assembly operation. Maximisation of return cannot be thought of in isolation of risk. With a given level of return, the risk has to I T minimised. It can no doubt be inn iiinised through the diversification of tr y de among larger number of countries. But the diversification process is easier in case of FDT. A firm can make in,iestment in different countries; can source puts from different countries, and can ma rket its products in different countries. It is possible that the currency of a country from v. here the inputs are imported appreciates or it may be that the polltical relations with that country deteriorates. In such cases, risk can be reduced through diversifying the sources of inputs. Again, it is possible that the sales performance in a particular market is not good in a particular year; it may be diversified. Similarly, if returns from different ventures are negatively correlated, there will be stability in earnings and financial risk would be low. But all this is possible through diversification of the firm's operation. FDI is a better instrument to develop harmonious political relationship with other countries. It is a fact that political moti ve is not the primary motive behind FDI, but it is definitely complementary to more important economic motives. The USA has made huge investments in some of Caribbean countries. One of the reasons is that these countries were opposed to the Cuban communist regime.

FDI COMPARED WITH CONTRACTUAL ENTRY MODE

It is true that, in almost all the cases, FDI also involves the transfer of technology with the result that the contractual entr y mode can go side by side with FDI. But the two ate different in nature. While FDI involves flow of funds investment in the equity capital of a foreign company, contractual entry mode does not involve such investment. As a result, the co. itractual mode does not confer controlling power to the management of the company to which licenses/management know-how/trade mark, and so on are provided. Thus, from the viewpoint of control, FDI is superior to contractual entry mode.

Again, FDI is a broader form of joint venture compared to the contractual entry mode. It is because it ins olves capital investment and also, when required, the transfer of technical and managerial know-how. The investor can am dividend and also charge ro valtv and technical service fees. Dividend is rot payable to a licensor or a franchiser. This is why investors prefer FDI to the Contractual entry mode.

It is true that FDI has an edge over the contractual entry mode, but even then there are cases when the contractual entry mode is preferred. It is preferred when the host government imposes restrictions on the inflow of FDI. Contractual mode is the only way out, apart from trade, to enter a foreign market. Again, it carries lesser risk of operating in a foreign land compared to FDI, especially when the investor is unaware of the political, legal, economic and socio-cultural environment prevailing in the host country. In such cases, firms enter a foreign market only gradually—first through trade, then through the contractual entry mode and filially through making investment in the equity. In short, the two modes are to a large extent complementary rather than being competitive.

GREENFIELD INVESTMENT (GI) VERSUS M&As

Substitutability between GI and M&As

The trends of international investment show that the share of M&As in total FDI outflow registered an increase from 60 per cent tc 95 per cent and more during 1990-2000 (United Nations, 2001). This raises a very pertinent question whether M&As are an alternative to the greenfield investment (GI). It is often said that-GI and M&As are the substitutes of each rather. It may be correct if the level of economic development, institutional framework, and the FDI policy in the two countries—home country and the host country—are similar. Moreover, in the developed world, where financial markets are quite developed, M&As may serve as an alternative to CI. Again, as far as the impact of these two modes on the development in the host country is concerned, trey are more or less the same and so they may be treated as an alternative to each other. But in a developing country, M&As should not be treated so. The reason is that:

1. The level of technology and management expertise is different from that in a developed country.
2. There are still governmental restrictions on the M&As, despite the liberalisation of economic policies.
3. Asset market is underdeveloped and. accounting standard is poor, with the result that :he assets of target companies are often undervalued, causing them to incur 106S.

In short, the GI and the M&As are not the alternatives in the true sense of the term. Moreover, there are reasons to believe that the two differ in detaile. The difference is manifest in many ways.

Differing Impact of GI and M&As

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The preceding section makes it clear that greenfield investment and M&As are not the substitutes of each other if the host country is a developing onc. There are many viewpoints from which the two are found different from each other. Some of the more important vievi. points are discussed here.

Availability of Financial Resources:

First of all, from the viewpoint of the inflow of the financial resources into the host economy it can be said that the financial resources provided under M&As do not necessarily add to fie capital stock required for production. It i because they involve transfer of the ownership of the local assets to foreign hands normally in return for some amount of disposable shares. However, in case of distress sale when the target company is on the verge of bankruptcy and is not able to get financial resources from any of the sources, M&A adds to the foreign exchange resources of the host country. There are cases to show that during the Asian crisis, many firms could be saved in crisis-hit countries through cross-border M&As. Moreover, M&As oftén lead to currency appreciation of the host country insofar as the investment inflow is often lumpsum and immediate. GI does not lead to such effects because the investment inflow spreads over time and in most cases it is in kind. Similarly, outflow of resources in the form of dividend repatriation in case of I'vt, grAs is sooner than in case of GI. Again, the G f essentially represents an investment in the plant; on the contrary, the M&As consideration value is fungible and can be used also for non-productive purposes.

The Technology Considerations:

From the viewpoint of the transfer. upgrading, and diffusion and generation of technology, the two modes differ to some extent. Since M&As involve working with an existing facility and the GI is concerned with setting up a new one, the Litter is more likely to involve newer equipment from the very beginning. However, this is not always the case. Caves (1998) finds that since the technology gap between a developed and a developing country is large, M&As too are found injecting new technology in the target firm and additionally, they help preserve the technology developed by the acquired firm.

As far as technological upgrading is concerned, it depends more upon the market orientation of the investment, local skills and capabilities in the host country, and the corporate strategy, and not much on the entry mode. However, empirical studies have shown that FDI through M&As has led to considerable technological upgrading (United Nations, 2000).

Apart from transfer and upgrading of technology, diffusion of technology is greater in case of M&As in so far as the acquired firms enjoy greater linkages with the local economy, whereas it takes time to develop such linkages in the case of GI. However, in the context of it novati on or generation of technology, the views are different. It is true that if the R&D in the acquired firm is uneconomic, the acquiring firm's sword falls on it. But there is nothing wrong if uneconomic R&D is substituted by an economic one. If the existing R&D in the acquired firm is economic, there is no reason for its substitution. Rather, in case ef efficiency seeking or created asset seeking foreign direct investment, the acquired company avails of the R&D capabilities within no time. In case of CI, it takes a long time to develop R&D activities.

Employment Considerations:

From the viewpoint of quantity and quality of employment, the two modes—M&As and GI—differ substantially. GI generates new employment, while MS:As transfers responsibility for existing employees who may be laid off by the new owner on the grounds of efficiency or over-staffing. In fact, the pact of M&A on employment generation depends an the motivation behind it as also on the characteristics of the acquired firm. First, if the M&A is a market seeking move, the impact on the employment generation is expected to be neutral or, to some extent, positive in the short run and medium term, as the existing employees are retained to work for the new market. Second, if the M& A is strategic asset seeking, employment in the acquired firm is expected to expand as the employees possess valuable skills and capabilities. Third, if the M&A is efficiency seeking, employment in the acquired firm may decrease it it has substantial excess capacity or has a duplication of functions. Cross-bolder M&As in automotive, financial, and service industries during the 19Ws and 1990s led to cut in employment despite increase in output (United Nations, 2000). Fourth, if the motive is financial, employment may decrease owing to restructuring or asset-stripping. Fifth, if the motive is to privatise a pubic-sector unit, employment may decrease as a result of restructuring. Evidences from cross-border M&As in seven countries of Central and Eastern Europe sup port this phenomenon (United Nations, 1999). But if the acquired firm had been liquidated in the absence of an M&A, the M&A would have been employment conserving, even if there was a partial lay-off to some extent.

This is all about the impeet of M&As on direct employment of generation. There may be positive impact on indirect employment generation following forward and backward linkages of the acquired firm with other enterprises in the economy.

Turning to the qualitative aspects of employment, it is often found that both Greenfield investment and M&As provide better-quality employment. But in specific circumstances, wages may be lowered and facilities may be cut on the grounds of cost reduction.

Building of Export Competitiveness:

Greenfield investment is more useful for building export competitiveness when the host country firm does not possess large export potential. However, the experience varies from case to case. in Hungary, M&As were less expert oriented than greenfield investment. In the Czech Republic, the export potential of M&As was the same ,as that of Greenfield investment (United Nations, 2004 Again, when Greenfield irojects have weak linkages with local firms and depend more on imported inputs, imports tend to rise.

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Impact on Market Structure and Competition:

It is normally believed that greenfield Investment adds to the number of enterprises and ;educes market concentration. But this is not always true. If the investing firms were present earlier in the market through ofline r modes, new firms will not be cr eated. Again, if the new foreign affiliate offsets the domin, ant market positions of incumbent firms or takes a dominant market position itself, the market will be more concentrated.

On the contrary, cross-border M&As y have a positive impact on the market structure if an ailing firm is acquired, which would have otherwise been forced out of the market. But if it is a monopolising or quasi-monopolising M&A, the market structure will turn more concentrated. In India, when Hindustan Lever Limited, the Indian subsidiary of Unilever, acquired its main rival, Tata Oil Mills Company, the market for toilet soaps and detergents became concentrated (Mehta, 1999). However, when market is open to imports and to foreign investment, the domestic concentration level may not necessarily make a difference to effective competition.

- The choice of entry model depends on the objective, extent and capability of a firm's involvement in international business on the one hand, and the host country environment and the magnitude of risk involved on the other.
- The broad modes of international business are :
    1. Trade, including direct and indirect trade, and counter-trade;
    2. Contractual mode, including licensing, franchising, management contracts, and turnkey jobs; and
    3. Foreign direct investment, including Greenfield investment and mergers and acqisitions.
- Direct trade means direct involvement of the firm in trade, while indirect trade is conducted through any other agency. In countertrade, one set of goods in exchanged for the other set of goods.
- Contractual modes are found in case of intangible products such as technology, patenis and so on.

CASE STUDY:

IPCL Disinvestment

The current disinvestment proposal of the Union Government is a change from the earlier Nehruvian vision of self-reliance to the more limited one of Reliance. Only this explains the Government's decision to sell off 25% of the equity of IPCL -- declared as a navaratna in 1997 -- to a "strategic" partner. In the last round of bidding, it was clear that Reliance was the most likely candidate as the strategic partner, a scenario unlikely to change by hiking off the Baroda plant of IPCL and selling it to Indian Oil.

IPCL was set up in 1969 to provide vital raw materials for the Indian industry. Till Reliance entered this area, it was virtually the sole supplier. If Reliance takes over the unit, a recent internal study of the Government indicates that Reliance will have a total monopoly in a number of basic materials required by the industry. It was for this reason that the Disinvestment Commission had suggested a basic safeguard (Report VII, pp 204): " ... care should be taken, while pre-qualifying bidders, to ensure that strategic sales do not lead to market dominance by a single player". Yet, from the statements issued by the Shri Dhindsa, the Chemicals and Fertiliser Minister clearly Reliance is very much a player in this game.

The government is fostering a number of myths to justify its disinvestment programme. One is that even in the current period, it has invested more than it has gained as dividend: the Plan outlay on PSUs has been Rs. 222,671.76 crore from 1992-93 to 1998-99. The Working Group on Disinvestments, an independent expert body, (Issues in Public Sector Disinvestment, 2000) has shown that the budgetary support for this outlay was a mere Rs. 27,545.61 crore. The remaining Rs. 1,95,126.15 crore has been raised by the PSUs through a combination of their own internal resources and their borrowings in roughly equal proportions. What is more, even the budgetary support of a little over Rs. 27,500 crore is helped in no small measure by the dividend payments of Rs. 16,838 crore made by the PSUs over the same period.

Even the figure that the government regularly trots out of Rs.200,000 crore invested in PSUs over the years is fudged as it lumps equity with loans. The total equity put in (till 1997-98) was Rs. 64,668 crore; the rest are loans that have been largely paid back. As against this, even by the most conservative estimates, the asset value of just the top 10 PSUs is more than Rs.500,000 crore. Obviously, the capital ploughed back into the PSUs enhance their asset value and have to be taken into account while talking about the poor returns from the public sector.

The IPCL case makes the above even clearer. IPCL has a total equity of Rs. 249 crore. As against this investment, its assets at market value is 40 times: a whopping Rs. 10,000 crore; even its free reserves are of the order of Rs.3,000 crore. The case of the IPCL disinvestment brings out the other fallacies in the scheme of disinvestment. One is regarding the valuation of these assets. The other is the decision to hand over these companies to a "strategic partner", who will buy only 25% of the shares.

The earlier valuation of IPCL shares suggested that 25% stakes in IPCL can be sold at a share value of Rs.160. The valuation done by the Working Group on Disinvestments -- A Case Study of IPCL -- based on replacement costs showed then that it should be at least Rs.265. If we take into account that with 25% share the "partner" was to be handed over control, the share value, purely by normal commercial practice, should not have been less than Rs.500 per share. If we see the actual figures, the magnitude of what was happening will become clear. The "strategic partner" was to pay about Rs.1,100 crores to acquire 25% share and get

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control over assets worth Rs.10,000 crores and cash reserves of Rs.2,780 crores! Some of the above figures may change with the decision to spin off the Baroda plant and merge it with IOC; however, the essential process - handing over IPCL at a fraction of its value as proposed earlier -still remains same.

While the declared decision of the Government in 1997 was that companies such as IPCL should be given autonomy and helped to become global players, it went about it in a strange way indeed. IPCL was left headless for long periods, with a Joint Secretary from the parent ministry officiating as CMD. No attempts were made to either understand the new competitive scenario or chalk out a new strategy. Instead, its profits were allowed to plummet: IPCL's profits fell from a consistent high level of level of more than Rs.500 crore in 1994-95, 1995-96, 1996-97 to Rs.29 crore in 1998-99. While a part of this could be attributed to low international prices of petro-chemical products, it is difficult to escape the suspicion that IPCL was being deliberately run down to lower its market value.

Apart from the financial aspects of the deal, the other problem with this kind of disinvestment springs from the understanding of "strategic" and "non-core" industries. The Disinvestment Commission had suggested that in any industry, where there is competition, the PSUs can be put up for disinvestment. In IPCL's case, it was felt that as Reliance is another major player, therefore there was competition and the government could disinvest in IPCL. If Reliance becomes the "strategic partner", then effectively there will be no competition; in such a scenario, does the sector become "strategic"?

In the current proposal, IPCL will hike off its Baroda plant and sell it to Indian Oil Corporation (IOC). It will help in bringing down the amount that Reliance - if it becomes successful -- will have to shell out for the rest of IPCL. It will also help the Government mop up IOC's current surplus for meeting its burgeoning budget deficit while shorn of its surplus, IOC will be prevented from bidding for IPCL's Nagarthone and Gandhar plants.

It of interest to know the source of funds that Reliance will use for an IPCL buy out. Reliance currently owes more than Rs.2,000 crore to the public sector banks and its overall borrowings, largely to the public sector financial institutions, is to the tune of Rs. 10,000 crore. It is good public money then that will be used by Reliance to "buy" IPCL. To help this process, the Government is willing to give up control to the strategic partner even if it buys only 25% of the shares. As the Maruti case has shown, once a partner secures control, the Government's share has little value: it can only be sold to the "strategic" partner who then dictates its terms.

The other disinvestments proposed are not significantly different. All of them have near same modalities: handing over profitable PSUs to private partners at throw away prices and creation of private monopolies. The Government is liquidating the country's prime assets built up over the last 50 years with peoples' money.

The original vision of allowing the navaratnas to become autonomous and global players is being given an official burial. Instead of building on the high technological skills that exist in the public sector, the real agenda is dismantling and handing it over at throwaway prices to global and domestic capital.

Economic trade between Australia and India: A case study of foreign direct investment

Australia and India have had few reasons in the past to develop systematic and significant levels of economic engagement. This was due to very different positions they have held in the world-system since the Second World War. De-colonization, the fall of the British Empire, the weak status of the British Commonwealth, and the realpolitik of the Cold War saw India and Australia located on different parts of the geo-political and economic world map with small demographic and cultural flows, and insignificant economic trade. Both countries developed similar economic policy regimes that were essentially state-led nationalist projects of economic development with concomitant policies of import-substitution, local industry-subsidization, highly-regulated financial systems, and high tariffs. The last quarter of the 20th century saw a radical revision of both nations' economic strategies, with Australia moving first to drop many of its trade barriers in the 1970s and '80s. It is now one of the most open economies in the world. India's liberalization programme commenced much later in 1991 but nonetheless has had a dramatic impact on its economic fortunes and growing status in the world economy. With these changes there are increasing opportunities for bilateral trade and a greater economic enmeshment in regional engagements and alignments in the Indian Ocean and in wider Asian forum. One significant indicator of change in growing Australia-India economic engagement is to look at Foreign Direct Investment (hereafter FDI). Currently, the movement of FDI between these two countries is still not very large but has a strong potential to grow over the short to medium term. This paper looks at the future prospect of this growth and asserts that, by engaging in areas of comparative advantage, it will benefit both national economies. Moreover, economic flows are also indicators of great social and cultural traffic. The movement of FDI between the two countries will not only encourage greater flow of people, especially outward migration from India to Australia, but also trigger more Australian expatriates living in India (from a very low base). Greater economic trade promises more cultural exchange.

SUMMARY

- The economic policy which regulates the export-import activities of any economy is known as the trade policy.
- Trade Policy is also called Foreign Trade Policy or the EXIM Policy.
- The Export-Import Policy (EXIM Policy), announced under the Foreign Trade (Development and Regulation) Act, 1992, would reflect the extent of regulations or liberalization of foreign trade and indicate the measures for export promotion.
- The new trade policy highlights the view, "Trade is not an end in itself, but a means to economic growth. Exports are not just for foreign exchange

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generation but are an engine of growth that can create incremental economic activity in the country".

- The term disinvestment is defined as the shrinkage of capital investment which is caused by the failure of a firm to maintain or replace its capital assets which are being used-up or by the sale of the capital goods by the firm, such as the equipment owned by it.
- The foreign exchange market is a global market in which traders buy and sell currencies using different communication media, including telephone, Internet, telex and computers.
- The purpose of the foreign exchange market is to facilitate the transfer of a specific amount of money denominated in the currency of one country to another country.
- The political environment of a country has a great impact on the operations of international business units.
- The rate of inflation in a country is inversely proportional to the purchasing power of the consumers. The rate of inflation in a country also influences the cost of production. If the rate of inflation is high in a country, then the cost of production will also be higher.
- The social environment is concerned with the social attitudes and cultural values or different societies.
- Material culture such as tools and artifacts — the material or physical objects — in a society, excluding the physical objects found in nature unless they undergo some technological procedure is seen all around us.
- Language is an important cultural tool for effectively conducting international business in the host countries.
- Social institutions play a significant role in nurturing the cultural heritage, which is reflected in individual behaviour.
- The financial objectives of the multinational companies are aimed at measuring the performance on the capital employed.
- Capital employed is the sum of all assets along with the accumulated reserves, including provision for depreciation.
- The policy of the Government of India is liberal with regard to the remittance of profits, dividends, royalties, etc., but the Government is cautious of excessive remittance while approving foreign investment proposals and collaboration agreements.
- After World War II, country risk became an issue of prime concern for the international financial community.
- Counter-trade is a sort of bilateral trade where one set of goods is exchanged with another set of goods.

- Licensing is an arrangement by which a firm transfers it intangible property such as expertise, know-how, blueprints, technology and manufacturing design to its own unit, or to a firm, located abroad.
- Franchising is a form of technical collaboration, the franchiser is the entrant and the franchisee is the host country entity.
- In a turnkey project agreement, a firm agrees to construct an entire plant in a foreign country and make it fully operational.
- Foreign portfolio investment does not involve the production and distribution of goods and services.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. The economic policy which regulates the export-import activities of any economy is known as the trade policy.
2. The term disinvestment is defined as the shrinkage of capital investment which is caused by the failure of a firm to maintain or replace its capital assets which are being used-up or by the sale of the capital goods by the firm, such as the equipment owned by it.
3. Basic problems in Disinvestment: Increase in managerial efficiency, Political Instability and Security Scam, Rate of return.
4. An economic system can be defined as the set of principles and techniques by which a society decides and organizes the ownership and allocation of different types of economic resources.
5. Culture refers to the distinctive way of life of a group of people-their complete 'design for living'.
6. Counter trade is a sort of bilateral trade where one set of goods is exchanged with another set of goods.
7. Licensing is an arrangement by which a firm transfers it intangible property such as expertise, know-how, blueprints, technology, and manufacturing design to its own unit, or to a firm, located abroad.
8. In a turnkey project agreement, a firm agrees to construct an entire plant in a foreign country and make it fully operational.

TEST YOURSELF

1) Explain the concept of Trade policy.
2) Discuss objectives of EXIM Policy.
3) What do you mean by Disinvestment?
4) Write a short note on Disinvestment in India.
5) Explain the process and methods of Disinvestment.
6) What is the present disinvestment policy?

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7) Discuss various problems in Disinvestment.

8) What is the impact of Political and Economic Environment in International Business?

9) Discuss the influence of Cultural Environment on Trade and Investment Patterns.

10) What is the relation between cultural variables and International Business Environment?

11) Write a short note on Cultural influence on marketing mix.

12) What do you mean by management of Finance by MNC?

13) Discuss various International Business Modes.

14) Discuss the difference between Greenfield Investment and M&As

15) Write short notes on:

- Licensing
- Franchising
- Turnkey Projects

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5 Technological & Global Environment

The Chapter Covers :

Introduction to Technological Environment

Technological environment refers to the state of science and technology in the country and related aspects such as rate of technological progress, institutional arrangements for development and application of new technology, etc.

According to the well known economist J.K. Galbraith, Technology means, "systematic application of scientific or other organized knowledge to practical tasks".

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Technology comprises both machines (hard technology) and scientific thinking (soft technology) used to solve problems and promote progress. It consists of not only knowledge and methods required to carry on and improve production and distribution of goods and services but also entrepreneurial expertise and professional know how.

UNCTAD has described technology as "systematic knowledge for the manufacture of a product, for the application ofa process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods".

Features of Technological Environment

The Main features of technological environment are as follows:

1) Technological environment like political, social or other types of environment is a component of macro or indirect action environment.
2) Technology is changing very fast. In fact technological change has come so fast that people find it difficult to tolerate it and cope with it. This has caused a 'future shock'. The timelag between generation and implementation of new ideas is decreasing fast.
3) Technology has far reaching effects. People cannot escape technological change whether they are prepared for it or not.
4) Technology feeds on itself, i.e., it is self-reinforcing. Technology acts as a multiplier to encourage its own development. An invention in one place leads to a sequence of inventions in other places. For **example,** the invention of steam power led to several other inventions.
5) Technology is different from science though the two are inter-dependent. Science means systematized body of knowledge whereas application of such knowledge is called technology. Advances in science help develop new technologies. Similarly, need for new technologies and products provide the drive for new scientific discoveries.

Technology

Technology is knowledge of methods to perform certain tasks or solve problems pertaining to products or services. The information on product design, production techniques, quality assurance measures, human resource development and management systems form the basic elements of technology continuum.

Science and technology enabled man to conquer distances; control birth rate; save lives; generate, preserve and distribute energy; discover new materials and substitutes to existing ones; introduce machines to do the work of human beings; substitute mental work with computers; probe deep into the seas and space in search of new treasures; provide himself with lot of leisure and comfort ad infinitum.

Features of Technology

1) The first feature of technology is its change and then more change. Technology forces change on people whether they are prepared for it or not. In the modern

society, it has brought so much change that it creates what is called future shock, which means that change comes so fast and furiously that it approaches the limits ofhuman tolerance and people lose their ability to cope with it successfully.

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2) Another feature of technology is that its effects are widespread, reaching far beyond the immediate point of technological impact. Technology ripples through society until every community is affected by it. The shock waves push their way into even the most isolated places. People cannot escape it.

3) An additional feature of technology is that it is self-reinforcing. This self-reinforcing principle implies that technology acts as a multiplier to encourage its own faster development. It acts with other parts of society so that an invention in one place leads tpa sequence of inventions in other places. Thus, invention of the wheel led rather quickly to a dozen or more applications. These applications, in turn, have affected 50 other parts of the system and led to several additional inventions that similarly influenced society as technology multiplies.

Transfer of Technology

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

Among the types of transfer transactions that may be used, the draft TOT code by UNCTAD has listed the following:

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

2) The provision of know-how and technical expertise in the form of feasibility studies, plans, diagrams, models, instructions, guides, formulae, basic or detailed engineering designs, specifications and equipment for training, services involving technical advisory and managerial personnel, and personnel training;

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

4) The provision of technological knowledge necessary to acquire, install and use machinery, equipment, intermediate goods and7or raw materials which have been acquired by purchase, lease or other means;

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

The list excludes non-commercial technology transfers, such as those found in international cooperation agreements between developed and developing states. Such agreements may relate to infrastructure or agricultural development, or to international; cooperation in the fields of research, education, employment or transport.

Broadly, there are two forms of TT, *viz.*, internalized and externalized forms of technology transfer. Internalized forms refer to investment associated TT, where control resides with the technology transferor. The transferor, normally, holding the majority or full equity ownership. Externalized forms refer to all other forms, such as joint ventures with local control, licensing strategic alliances and international subcontracting.

The distinguishing feature between these two modalities of resource transfer is that in internalized TT. the transferor has a significant and continuing financial stake in the success of the affiliate, allows it to use its brand names and to have access to its global technology and marketing networks, exercises control over the affiliate's investment, technology and sales decisions, and sees the affiliate as an integral part of its global strategy. Externalized forms lack one or all of these features, with repercussions on the TT process. Over time, the array of TT arrangements has diversified and particular modes have also become more flexible. Thus, the dividing lines between externalized and internalized modes are becoming less easy to draw.

A typical manufacturing technology transfer matrix indicating the nature of technology and the means to be adopted is given in **table.**

Table : Manufacturing Technology Transfer Matrix

	Documentation		Training					
Type of Technology	Manuals and documents	Regular reports	Formal on the job training	Informal on the job training	Conference and Seminars	Visits and exchanges	Equipments selection	Communication problems
Proposal and planning	—	—	—	—	—	—	—	—
Product Design	—	—	—	—	—	—	—	—
Manufacturing Technology	—	—	—	—	—	—	—	—
Quality Assurance	—	—	—	—	—	—	—	—
Plant Design and Construction	—	—	—	—	—	—	—	—
Start up	—	—	—	—	—	—	—	—
Value engineering	—	—	—	—	—	—	—	—
Product development	—	—	—	—	—	—	—	—
External support	—	—	—	—	—	—	—	—

— Indicates the requirement

Factors for the Choice of Technology

The main factors to be considered in the selection of technology are:

1) Product competitiveness and market potential,
2) Customer preferences,
3) Speed of introduction of new products and processes,
4) Comparative studies of technology gap between India and outside,

5) Availability of technology for import in strategic areas,

6) Suitability of technology in context to organizational culture, and

7) Outflow of resources, foreign exchange, etc.

Impact of Technology on Business

1) **Higher Productivity:** Technology has resulted in increased productivity both in terms of quantity and quality. Improvements in productivity lead to reduction in the costs and price of products and services. Real wages of employees also tend to increase due to gains in productivity.

2) **Global Competitiveness:** Technological progress helps to improve the competitiveness of business firms due to reduction in costs and improvement in quality level. Research and development has become, therefore, an important means of gaining market share in global competition.

3) **Changing Job Profile:** Jobs tend to be upgraded or become more intellectual with advancements in technology. **For example,** with computerization of banks and post offices a clerical job can no longer be handled by an unskilled employee. A computer literate and competent employee is required. Introduction of new technology requires retraining of employees and rehabilitation of unattainable and displaced people. Technological progress makes jobs more challenging and rewarding. Technology influences workflow which in turn determines interactions among people in the organization. Thus, technology indirectly determines what individuals in work groups feel and think about one another and about their work situation.

4) **Need for Multi-skilling and Multi-tasking:** Modern business requires managers who possess multiple skills and can perform from multiple tasks. **For example,** an engineering degree aione is not sufficient for **a** works manager and he needs to possess in addition a degree in management. Technological progress has led to more complex and more demanding business. That is why corporates now prefer people for managerial jobs who have expertise in both technology and management.

5) **Difficulty in Motivation:** Due to increasing percentage of knowledge workers, financial incentives are no longer enough for motivating the staff to work hard. Technocrats need jobs which provide job satisfaction and opportunities for growth and achievement. It is also more difficult to retain knowledge and professional employees. Job hopping has increased and quick promotions and participatory decision making are required.

6) **Increasing Need for Capital:** Modern technology requires huge amount of funds for invention, innovation and training. Business firms have to exploit all possible sources to raise the needed funds. Rational allocation and utilization of funds is also necessary. Qualified and honest managers are required to ensure efficient and honest management of financial affairs ofbusiness organizations.

7) **Increasing Obsolescence:** New technology creates new products and businesses. But it also destroys existing products and businesses. Life cycles **of**

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products have become shorter requiring regular creation and development of new products. Existing equipment and technical skills also become obsolete on account of changes in technology. Modernization or technological upgradation and retraining programs are necessary for sustaining efficiency and quality.

8) **Organizational Restructuring:** Changing technology requires more flexible and organic structures like matrix which are characterized by short line of command and wide span of control. Organizations have to be more decentralized.

9) **Resistance to Change:** New technology often faces psychological resistance to change. Adopting new technology is expensive and risky.

10) **Social Implications:** Technological advancements help to make the society more affluent. More affluent consumers have higher expectations from business. Technology makes the social system more complex. Technological changes cause social change. Population in a region might get uprooted and pattern of social life may get disturbed. An invention may create newjob opportunities and smoothen out social differences.

OVERVIEW OF GLOBAL ENVIRONMENT

The global business environment is very significantly influenced by the World Trade Organization (WTO) principles and agreements. They also affect the domestic environment. **For example,** India has had to substantially liberalize imports, including almost complete removal of quantitative import restrictions.

The liberalization of imports implies that domestic firms have to face an increasing competition from foreign goods. Liberalization of foreign investment can result in growing competition from local outfits ofMNCs.

These liberalizations, on the other hand, also provide new opportunities for Indian firms as the foreign markets become more open for exports and investments.

The liberalization also enables Indian firms to seek foreign equity participation and foreign technology. This could help them to expand their business or improve competitiveness.

Further, the liberalization facilitates global sourcing by Indian firms so that they can improve their competitiveness. Indian suppliers can benefit from global sourcing by foreign firms.

Firms will have to be efficient and dynamic to survive the global competition. Inefficient firms may go out of business.

Consumers stand to benefit significantly from **the** liberalization.

Nature of Global Environment

The 1990s and the new millennium clearly indicate rapid internationalization and globalization. The entire globe is passing through a transition period at a dramatic pace. Today, international trade is in a position to analyze and interpret the global social, technical, economic, political, and natural environmental factors more clearly.

Conducting and managing international business operations is a crucial venture due to variations in political, social, cultural, and economic factors from one country to another. **For example,** most African consumers prefer less costly products due to their poor economic conditions, whereas the German consumers prefer high quality and high-priced products due to their higher ability to buy. Therefore, the international businessman should produce and export less-costly products to most of the African countries and *vice versa* to the most of the European and North American countries. **For example,** high-priced and high-quality Palmolive soaps are marketed in the European countries and economically priced Palmolive soaps are exported and marketed in developing countries like Ethiopia, Pakistan, Kenya, India, and Cambodia:

1) International business houses need accurate information to make appropriate decisions. Europe was the most opportunistic market for leather goods particularly shoes. Based on accurate data, The Bata Shoe Company could make the appropriate decision to enter various European countries.

2) International business houses need not only accurate but timely information. Coca-Cola could enter the European market based on timely information, whereas Pepsi entered later. Another example is the timely entrance of Indian software companies into the US market compared to those of other countries. Indian software companies also made timely decision In the case of Europe.

3) The size of the international business should be large in order to have an impact on the foreign economies. Most multinational companies are significantly large in size. In fact, the capital of some of the MNCs is more than India's annual budget and the GDPs of the some African countries.

4) Most international business houses segment their markets based on the geographic market segmentation. Daewoo, e.g., segmented its markets as North America, Europe, Africa, Indian sub-continent, and Pacific.

5) International markets present more potential than the domestic markets. This is due to the fact that international markets are wide in scope, varied in consumer tastes, preferences and purchasing abilities, size of the population, and so on. **For example,** IBM's sales are more in foreign countries than in USA. Similarly, the sales of Coca-Cola, Procter & Gamble, and Satyam Computers are more in foreign countries than in their respective home countries.

Trends in World Trade and Economic Growth

The international trading system has for long continued to suffer from gross inequalities and imbalances among the different strata of economies. The global economic environment, characterized by intermittent recessions during the last two decades, has further widened the disparities in the world trading system. Mounting debt burdens, balance of payments problems and deteriorating terms of trade of developing countries, formation of powerful economic and trade blocs, rollback from multi-laterism to bi-laterism, growing protectionism and restricted market access in the developed countries are a few manifestations of the unjust international commercial order. These negative features constitute a mammoth destabilizing force and their alarming dimensions threaten the collapse of multilateral economic cooperation.

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Notwithstanding these constraints and limitations, a large number of developing countries have started opening up thcir economies, exposing them to international competition, in their efforts to integrate with the global economy.

Developing countries, whose share in international business today is very low, are expected to play a greater role in future. The GDP and exports of the developing countries are projected to grow much faster than that of the developed countries. The developing countries, which number about 170 and have about 85 per cent of the world population, account for only about 20 per cent of the world GDP and 22 per cent of the exports.

However, the projections are that in the next decade, the developing countries will increase their share in world income and trade. In fact, their GDP and exports have grown faster than those of the developed countries for sometime now. According to a World Bank Staff Report, during 1995-2004 the real GDP of the world would grow at an annual rate of 3.3 per cent, which will be composed of an annual average growth rate of 2.8 per cent for high-income economies and 4.9 per cent for developing economies.

This does not mean that all developing countries will grow at high rates. While the estimated average annual rate for the developing countries is nearly 5 per cent, East Asia and South Asia in the developing world would grow at an annual rate of 7.7 per cent and 5.4 per cent respectively, but the performance of sub-Saharan Africa,

North Africa, the Middle East, and several countries of the former Soviet Union may be very poor.

According to the World Bank Report 1995, the share of the developing countries in the world output is estimated to increase from 21 per cent in 1994 to 27 per cent in 2010. This share was about 22 per cent during the 1980s; it is estimated to rise to 38 per cent during 1995-2010.

General Agreement on Tariffs and Trade (GATT)

The GATT was signed at Geneva on 30th October, 1947 by 23 nations who negotiated to prevent protectionism and to revive their economies from the recession. It came into force on 1 st January, 1948.

Objectives of GATT

The basic aim of GATT was to expand international trade and bring about all round economic prosperity by liberalizing trade rules and regulations.

The other objectives of GATT are as follows:

1) To raise standard of living;

2) To ensure full employment and a large and steadily growing volume of real income and effective demand;

3) To develop the full use of the resources of the world; and
4) To expand production and international trade.

World Trade Organization (WTO)

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The World Trade Organization (WTO) was established on 1st January 1995. Governments had concluded the Uruguay Round negotiations on 15th December, 1993 and ministers had given their political backing to the results by signing the Final Act at a meeting in Marrakesh, Morocco in April 1994. The 'Marrakesh Declaration' of15th April 1994, affirmed that the results of the Uruguay Round would "strengthen the world economy and lead to more trade, investment, employment, and income growth throughout the world". The WTO is the embodiment of the Uruguay Round results and the successor to the General Agreement of Tariffs and Trade (GATT).

Check Your Progress

1. What is Technology?
2. What do you mean by the term Liberalization?

The WTO has larger membership than GATT, the present number of member's stands at 144. India is one of the founder members of WTO.

Objectives of WTO

1) To improve standard of living of people in the member countries.
2) To ensure full employment and broad increase in effective demand.
3) To enlarge production and trade of goods.

   The above three objectives were also included in GATT, but WTO also included some other objectives which are:

4) To enlarge production and trade of services.
5) To ensure optimum utilization of world resources.
6) To accept the concept of sustainable development.
7) To protect environment.

ENVIRONMENTAL SCANNING

Meaning and Definition of Environmental Scanning

The Dictionary meaning of the word scanning is to look carefully into or to examine. The term Environmental Scanning in business means to "Carefully analyze the various factors influencing the business".

Environmental Scanning is not once and for all; rather it is a continuous process. As the business environment is continuously changing, management has to continuously analyze and diagnose the environment. It is a process by which the organizations monitor their relevant environment to identify opportunities and threats affecting their business.

"Environmental Scanning is used **as an** overview **of** wide range of phenomenon in the environment, projected usually in a time period beyond the typical formula planning range and designed to stimulate thinking of managers and staff about potential events that will have an important impact on company affairs".

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Scanning can also refer to short range projections. It can also be future studies, future research, Scenarios, foresight activities and monitoring to name a few. in his study of the information gathering practices of managers, defined scanning as the systematic collection of external information in order to lessen the randomness of information flowing into the organization and provide early warnings for managers of changing external conditions.

According **to Jauch and Glueck,** "Environmental analysis is the process by which strategists monitor the environmental factors to determine opportunities for and threats to their firms. Environment analysis also consists of managerial decisions made by assessing the significance of the data (opportunities and threats) of the environmental analysis".

According to B.W. Denning, "The advocates of systematic corporate planning (strategic management process) **base** their case on the view that the determination of the future can be improved by a systematic analytical approach which reviews the business as **a** whole in relation to its environment".

Brown and Weiner defined environmental scanning as "A kind of radar to scan the world systematically and signal the new, the unexpected, the major and the minor".

Environmental analysis consists of analyzing as well **as** synthesizing process. Analyzing process divides the system into parts for having its microscopic details whereas synthesizing process is correlating and collaborated the parts into whole. While analyzing business environment on the one hand, minute details are considered whereas on the other hand, the total view that incorporates social, political, cultural and other dimensions is considered.

Nature /Characteristics of Environmental Scanning

The environment of an organization is dynamic in nature. Therefore, it is necessary for a business firm, operating in uncertain environment, to cope up with these uncertainties.

There are the following three important characteristics of the process of environmental analysis:

1) **Continuous Process:** Environmental analysis is a continuous process rather than an intermittent scanning system. A continuous vigil may be useful in making distinction between scanning and monitoring aspects of environmental analysis. Periodical analysis may not give a true and reliable indication of the situation, just as the 'bleep' registered on the radar screen after **a** few sweeps of the horizon may not reveal a true picture of the horizon.

2) **Exploratory Process:** The environmental scanning is an exploratory process. In this process, emphasis is given on choosing the alternatives available for future. Keeping in mind the assumptions about the future, these alternatives are analyzed to draw the useful conclusions. A large part of the process seeks to explore the unknown terrain, the dimensions of possible futures, what could happen, not necessarily what will happen.

3) **Holistic Exercise:** Environmental analysis is an exercise in the sense that it comprises total view of the environment rather than piecemeal viewing. The corporate radar must scan the whole circumference of its environment in order to minimize the chance of surprises and maximize its utility as an early warning system.

Scope of Environment Scanning

Environmental scanning is one of four activities comprising external analysis. As shown in **figure below,** external analysis is the broader activity of understanding the changing external environment that may impact **the** organization.

In describing external analysis, Fahey and Narayanan suggest that organizations scan the environment to identify changing trends and patterns, monitor specific trends **and** patterns, forecast **the** future direction of these changes and patterns, and assess their organizational impact. Merged with internal analysis of the organization's vision, mission, strengths and weaknesses, external analysis assists decision-makers in formulating strategic directions and strategic plans.

The goal of environmental scanning is to alert decision-makers to potentially significant external changes before they crystallize so that decision-makers have sufficient lead time to react to the change.

Consequently, the scope of environmental scanning is broad. It can be assessed as follows:

1) The scope of environmental scanning is concerned with the type of information scanned in response to environmental change or factors.

2) It also shows the purpose of scanning the environment.

3) Scope of environmental scanning can be seen from two dimensions; that are the task environment and the general environment. The former consists of sectors that are involved in direct interactions with the decision made (e.g., suppliers, customers and competitors), whereas latter includes sectors defined as remote environment, having indirect interactions with the decision (such as the government, economic conditions, technology and socio-cultural factors).

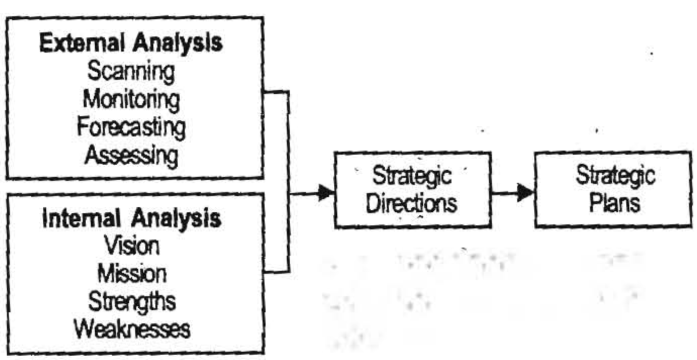

Figure : Role of External Analysis in Strategic Planning

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4) The variable that will be used for the scope of environmental scan will follow Daft *et al.* and Sawyer, where the environment is sub-divided into six sectors: political/legal, economic, technology, socio-cultural, and competition/industry, customer/market. The first four sectors make up the general environment and the last two, the task environment.

Approaches to Environmental Scanning

Environmental scanning can be done through the adoption of any of the following three approaches:

1) **Systematic Approach:** In this approach, formats for various issues are developed and scanning is done systematically in a step-by-step fashion. The information related to various factors, *viz.*, regulatory, social, economic, technological, resources, etc., is collected which has direct bearing on the working of company. Data on various factors is continuously collected and updated and their effect on various elements pertinent to the organization is studied. The variance of various factors is analyzed and their swing is worked out to estimate the impact of the changes. A system of assessment of the environment is prepared by the strategy manager followed by all the line managers in the organization.

2) **Process Information Approach:** Information on environment and its various factors is available from trade papers, trade magazines, etc., many organizations prepare summary of relevant information to keep them updated. The processed data is made available to the strategy management group for processing and drawing inferences based on which corrective actions may be taken by a company.

3) **Ad Hoc Approach:** Some companies collect specific information on selected environmental factors by conducting special studies. Such studies are usually conducted when a company wants to launch a special project. The impact of a project on various environmental factors is studied within the framework of a specially designed study program and results are obtained through analysis using computer software of changes and developments may be studied using pilot projects and results extrapolated for use by strategy managers.

Sources of Information for Environmental Scanning

The various sources of information, which are tapped for collecting data for environmental scanning, could be classified in different ways. There could be formal and informal sources. Then there could be written as well as verbal sources. In terms of origin, data sources could be external and internal.

Some of the important types of sources of information are:

1) **Documentary** or **Secondary Sources:** These sources of information include different types of publications. These could be newspapers, magazines, journals, books, trade and industry association newsletters, government publications, annual reports of competitors, companies, and so on.

2) **Mass Media:** It includes radio, television and the internet.

3) **Internal Sources:** It takes into account company files and documents, management information systems, databases, company employees, and so on.

4) **External Agencies:** These are customers, marketing intermediaries, suppliers, trade associations, government agencies, and so on

5) **Formal Studies:** It includes formal studies conducted by employees,market research agencies, consultants and educational institutions

6) **Spying and Surveillance:** It means spying and surveillance through ex-employees of competitors, industrial espionage agencies, or by planting 'moles' in rival companies.

Strategists use different information sources depending on their needs for environmental scanning. Government publications - though a rich and comprehensive source of information - are usually available after a considerable time lag. Private sources, though relevant and timely, are quite expensive to tap. Therefore, whenever a particular information source is used, it should be checked for its reliability, time frame, methods of data collection and analysis used, form of presentation, and so forth.

A number of publications in India provide valuable information and forecasts relating to environmental conditions:

1) Economic survey published annually by the Ministry of Finance (Economic Division), Govt. of India.

2) Guidelines to industries in two volumes published by the Union Ministry of Industries.

3) Five-year plans and mid-term survey reports on planned developed published by the Planning Commission.

4) Decennial Census Reports, Govt. of India.

5) Reserve Bank of India Bulletins (monthly) and Annual Reports on Currency and Finance.

6) ICICI Portfolio Studies (Annual).

7) Business Intelligence and Data published by the center for Monitoring Indian Economy.

8) The State of the Nation Report (Annual); Quarterly Survey of Industries; and Economic Scene (monthly) published by the Tata Economic Consultancy Services.

9) Indian Trade Journal (Weekly) published by the Directorate General of Commercial Intelligence and 3 Statistics, Calcutta.

10) Economic Trends (fortnightly) published by the Federation ofIndian Chambers of Commerce and Industry, New Delhi.

11) Yojana (fortnightly) published by the Planning Commission.

12) Economic Times (Mumbai, New Delhi), Financial Express O^ew Delhi), and Business Standard (Calcutta) - dailies. ,

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13) Business India (fortnightly), Mumbai; Business World (fortnightly), Calcutta; Capital (fortnightly), Calcutta; Commerce (Weekly), Mumbai

14) Bombay Stock Exchange Directory.

15) Foreign Trade (monthly) published by the Indian institute of Foreign Trade, New Delhi.

Factors Affecting Environmental Appraisal

Given the same environment conditions, no two strategists or two organizations would appraise the environment in a similar fashion. This is due to many factors that affect the process of environment appraisal Aspects of the environment relevant to any industrial or trading concern may involve varying dimensions depending on the size of the enterprise and its mission and objectives.

Environmental factors have been differently categorized by different analysts. Some of these factors are as follows:

1) **Strategist-Related Factors:** There are many factors related to strategist, whichaffect the process of environment appraisal. Since strategist plays central role in the formulation of strategies, their characteristics such as age, education, experience, motivation level, cognitive styles, ability to withstand the time pressure and strain, etc., have an impact on the extent to which they are able to appraise their organizations environment and how well they are able to do it. Apart from these factors, related to strategists as individuals, group characteristics too have an impact on how environmental appraisal is done. Such group characteristics could be the interpersonal relations between the different strategists involved in appraisal, team spirit, and the power equations operating between them.

2) Age **of** the **Organization:** The age of the organization may also determine the type of information that can be sought by it. The organizational growth over the period of time requires different type of interaction with its environment. Generally older is the age of the organization with the more experienced managers, the narrower will be the focus on the environment information because with the experience, managers may be able to distinguish what is relevant or irrelevant for the organization. The necessary information may be sought and unnecessary will be screened out. Since the information can be tested to determine the organizational effectiveness by the managers, they can easily know the relevance of a particular piece of information.

3) **Size and Power of Organization:** Large organizations have to interact regularly with various environmental forces and its environmental search will have to be more intensive. Because of greater risk exposure and frequency of taking on new ventures, or diversifying its activities, these organizations have to provide

high weightage to trends in economic and competitive environments. They also have to respond to various laws, which apply particularly to large organizations. In our country various laws as Industries (Development and Regulation) Act and MRTP Act are applicable to large organizations. The management of small enterprises need not be affected by these laws.

4) **Geographic Dimension of the Organization:** The geographic dimension of the organization affects the type of interaction, which the organization has with its environment. Generally greater is the area of organization's operation, more will be its informational requirement because the environmental factors may differ from place to place. If an organization is localized, it may require information about various aspects of the environment only as relevant to this area. However, when the area operation increases, it may require information for those areas also. **For example,** the information requirement of multinationals, or organizations involved in international business is much more than that of local organizations.

5) **Type of Business:** The type of business the organization is in or intends to be in determines the nature of information sought. Moreover, how an organization defines its business also becomes an important factor determining the information requirements. If the organization has defined its business narrowly, it will focus on the narrow aspect on the environment. Thus a highly diversified company may require diverse types of information. Similarly, if an organization is conglomerate, its area of information search may be much broader.

6) **Influence of Business Organization:** The more power an organization has in relation to environmental forces, the lower will be its need for appraisal of such forces. **For example,** a monopolistic organization such as BHEL or ONGC, need not analyze the competitive environment. Similarly, organizations not dependent on fiscal and financial facilities of Government and financial institutions will lay less emphasis on political environment than those who depend heavily on them. In the same way, the management of organizations, which have alternative sources of supply of factors of production, considers the supplier aspect of external environment less important. The less dependent the enterprise is on one or a few customers, the less it will focus on the customer sector of the environment.

7) **Volatility of Environment:** Emphasis on environmental study and type of information needed by an organization are also dependent upon the nature of the environment. If the business environment is highly volatile and tuibulent, the management must be greatly concerned with the external environment and they would attempt to gather as much information as possible. This will further reinforce that the environmental forces are not homogenous. However, where the environment shows less fluctuation, central manager shows less concern towards the economic and technological components of the environment and focus their environmental analysis on competitors. This is more so when environmental analysis is on competitors. This is more so when environmental forces are relatively more homogenous and clustered.

8) **Managerial Caliber:** Organizations employing highly qualified executives show greater concern for environmental scanning than those devoid of such expertise. One of the factors contributing to the comprehensive and systematic environmental study by large and multinational organizations is that they are rich in managerial skills and technical knowledge.

Process of Environmental Scanning

Environmental scanning involves five steps. These are detailed as hereunder:

1) **Assess the Nature of the Environment:** It is useful to take a view of the nature of the organization's environment in terms of how uncertain it is. h? it relatively static or does it show signs of change, and in what ways; and is it simple or complex to comprehend? This helps in deciding what focus of the rest of the analysis is to take.

2) **Audit Environmental Influences:** The aim is to identify which of the many different environmental influences have affected the organization's development or performance in the past. It may also be helpful to construct pictures - or scenario - of possible futures to consider the extent to which strategies might need to change.

3) **Identify Key Competitive Forces through Structural Analysis:** It aims to identify the key forces at work in the immediate or competitive environment and why they are significant.

4) **Identify Strategic Position**: It means to analyze the organization's strategic position, i.e., how it stands in relation to those other organizations competing for the same resources, or customers, as itself. This may be done in number of ways:

   i) Competitor analysis,

   ii) Strategic group analysis, in terms of similarities and dissimilarities of the strategies they follow,

   iii) The analysis of market segments and market power,

   iv) Building on growth/share analysis, and

   v) Attractiveness analysis.

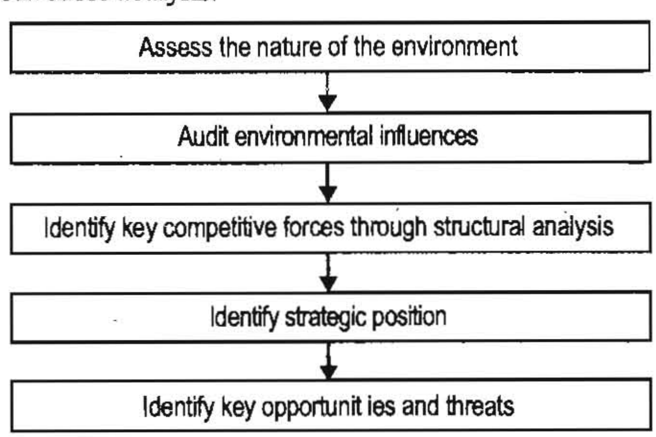

Figure : Process of Environmental Scanning

5) Identify **Key** Opportunities **and** Threats: Develop the understanding of opportunities which can be built upon the threats which have to be overcome or circumvented. An understanding which needs to be considered in terms of the resource base of the organization and which will contribute to strategy choice is very important.

Importance of Environmental Scanning

The importance of environmental scanning can be assessed through the following:

1) **Effective Utilization of Resources:** The key to business success is the most effective utilization of the company resources, existing resources as well as the additional resources it can mobilize. AH this involves the evaluation of the company's strengths and weaknesses in the light of the environmental threats and opportunities and taking appropriate measures to harness the opportunities or to combat the threats and formulation of strategies accordingly. Companies which fail to do so are doomed to failure. **For example,** Binnys which was once a great name in textiles is not so significant in the Indian market now, whereas Reliance which is of comparatively recent origin is a force to be reckoned with today.

2) **Helps in Converting Threats into Opportunities**: Environmental scanning allows the strategists to anticipate opportunities and plan design optional or alternative responses to these opportunities. This is somewhat easy. When opportunities exist, selection is not a problem. What important is that environmental scanning, if done scientifically, helps in preventing the threats or develop strategies that can turn the threats to opportunities for the benefit of organization. Both these opportunities and threats are first traced and then threats are reduced to opportunities. However, one cannot take for granted that threats can be converted into opportunities. This requires a tenacity and endurance to develop the ability to scan the environment. If all the companies were able to do that, then every company would have earned good profits, growth and reputation.

3) **Changing Color of Environment:** The business environment changes are not only quick but constantly taking place. These changes create an imbalance in the organization's state of balance or equilibrium. The changing color of the organization have to be traced by the strategists as to what causes are at work that create an imbalance in the environment, and therefore, the imbalance forced upon the organization so that what new opportunities are thrown open by the changed environment along with the threats. It enables the firms to develop those strategies which will help in encasting on opportunities and converting the threats into opportunities. The changes in package of opportunities and threats are to be accepted and worked upon under the broad spectrum of organizational objectives. Even it can call for changes or amendment of strategies with a view to attain the basic objectives of the organization.

4) **Narrowing Down the Alternatives:** An in-depth and meaningful environmental scanning assists the strategists to reduce the range of available alternatives and eliminate options that are totaling inconsistent with forecast opportunities or

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threats. Environmental scanning is an exercise that makes available good number of alternatives to deal with opportunities and threats. Of these alternatives and options, which is the most viable and promising has to be traced out. It is strategists who are to work on this based on the managerial skills and experience. This is needed because the valuable time which is more than money can be saved and same can be better utilized for more pressing and important alternatives.

5) **Strategic Management Starts with Environmental Scanning:** Environmental scanning is the starting point of strategic management strategy formulation and strategy implementation are the outcome of environment scanning. What the environment has for the organization in terms of opportunities and the threats caused by changes in the environment. To implement the strategy, the first thing is formulation of strategy. Again this strategy formuLation is based on what impact the environment has on organization in terms of opportunities and threats. Only when the strategists trace the opportunities and threats they can proceed to develop the right strategy to encase on opportunities or converting threats into opportunities. Thus, the surfing the changing environment and tracing the opportunities and threats is the very preface to the tall task of strategy formulation and implementation.

6) **Constant Monitoring of the Environment:** Environmental scanning provides a clear cut idea about the existing environment. Without environmental scanning it would not be possible to know the change in customer's tastes and preferences, competitors' moves, latest innovations, latest policy developments, etc. Constant monitoring ofthe environment will not be possible without environmental scanning.

7) **Useful for the Managers:** Managers have found much value in environmental analysis in many ways. If we compare the overall economic performance of the companies that made environmental assessments with those who did not, we will find out that those that did make such assessment out performed those who did not.

8) **Prediction of Future:** Predicting future has become one of the most important functions and skills of the management. Future managers have to be more anticipative than reactive and problem-solvers. Thus, by scanning environment managers can discharge their functions in a better way.

Role of Environmental Scanning in Organizations

Properly used environmental scanning can help to ensure organizational success. The specific organizational roles or functions to ensure this success, however, can vary drastically from organization to organization.

Three such roles are as follows:

1) **Function-Oriented Role:**

The main purpose of function-oriented environmental analysis is to improve organizational performance by providing environmental information concerning effective performance of specific organizational functions. This type of environmental analysis is normally undertaken to enhance the performance of a particular function or major organizational activity at either the corporate or the divisional level.

2) **Integrated Strategic Planning Role:**

The main purpose of this kind of environmental analysis is to improve organizational performance by making top managers and divisional managers aware of issues that arise in the firm's environment, by having a direct impact on planning and by linking corporate and divisional planning.

3) **Policy-Oriented Role:**

The main purpose of a policy-oriented environmental analysis is to improve organizational performance by simply keeping top management informed about major trends emerging in the environment.

The policy-oriented role is broadest in scope and is most loosely related to formal organizational planning. On the other hand, the function-oriented role seems to be most specifically targeted at particular organizational issues. More than the other two roles, the integrated strategic planning role seems to emphasize a close relationship between environmental analysis and formal organizational planning.

Techniques of Environmental Analysis:

Several techniques are used for analyzing and diagnosing the environment. Two such techniques are given below:

1) SWOT analysis, and 2) ETOP Study.

SWOT Analysis

SWOT Analysis is a strategic planning method used to evaluate the Strengths, Weaknesses, Opportunities, and Threats involved in a project or in a business venture. It involves specifying the objective of the business venture or project and identifying the internal and external factors that are favorable and unfavorable to achieving tr^t objective. The technique is credited by **Albert Humphrey,** who led a research project at Stanford University in the 1960s and 1970s using data from Fortune 500 companies.

The aim of any SWOT analysis is to identify the key internal and external factors that are important to achieving the objective.

SWOT analysis groups key pieces of information into two main categories:

1) **Internal Factors:** The strengths and weaknesses internal to the organization.
2) **External Factors:** The opportunities and threats presented by the external environment.

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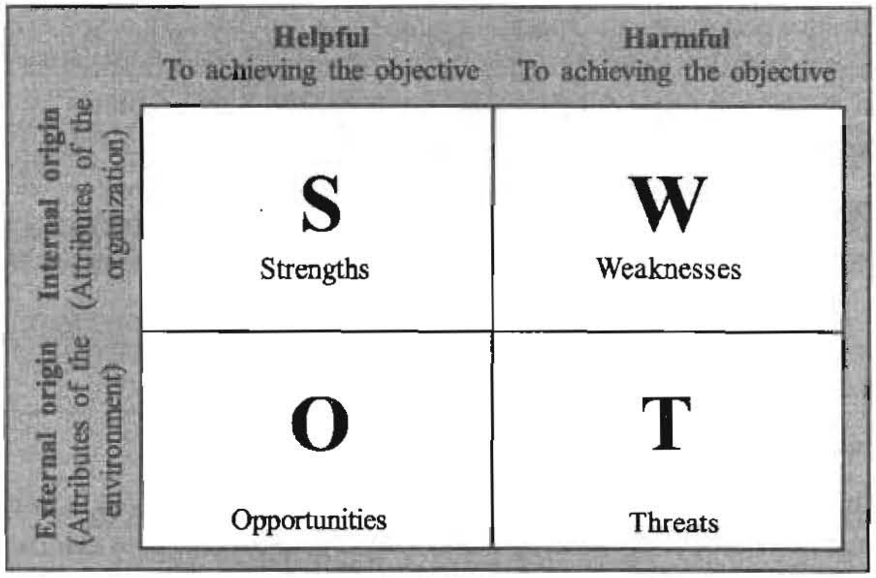

Figure : SWOT Analysis

Strength and weakness are relative terms. Resources available in plenty may appear to be a strength but if not utilized may cease to be a strength. Corporate strength is a competitive advantage and through other competencies, a company may exert change mechanisms in an industry. A corporate weakness refers to constraints or hindrances that tend to stop movement of a company in certain directions decided as strategic directions for the company and also inhibit a company to achieve core competencies.

Criteria

Various criteria can be used to define whether specific corporate capability is a weakness or strength. These are given as follows:

1) **Historical Criteria:** In historical criteria analysis, a specific characteristic is seen in the light of the history and past performance and is evaluated based on certain indices like sales, profits, market share, etc., to determine whether it had been a strength or a weakness.

2) **Normative Criteria:** hi normative criteria a particular characteristic is seen in the light of what it ought to be from the point of view of experts, based on which norms can be developed to categorize it as a weakness or strength.

3) **Competition Equality Criteria:** In competition equality criteria, it is assumed that the characteristic selected should be at least at par with the competitors and based on a comparative yardstick it may be considered as a weakness or strength.

Example:

The extent of matching of internal capabilities and environmental conditions is reflected in the following schematic view of the position of Reliance Textile Industries Ltd:

Internal Capabilities	Environmental Factors
i) Modern plant and machinery: Production and technological capabilities of a high order. Design capabilities to provide diversity of designs as also frequency of change.	i) Growing demand for high quality fabrics in different categories of blends
	ii) Awareness of foreign fashion and wide range of designs of international standards.
ii) Financial strength derived from: – Ability to generate foreign match exchange, – Tax planning, and – Cash generation on account of exports and yarn sales.	iii) Willingness of consumers in various segments to pay high price to the quality requirements.
	iv) Restrictions on imports of fabrics.
	v) Necessity of providing full range of fabrics under one roof catering to 'family purchase.'
iii) Voluntary equity participation dealers resulting in assured commitment.	vi) Need for identifying design changes to cater to 'shifts' in fashion.

Strengths

Strength is a resource, skill or other advantage relative to competition and the needs of markets a firm serves of anticipates serving. Strength is a distinctive competence that gives the firm a comparative advantage in the market place.

Examples of Strengths are as follows

1) Established manufacturing base for machine tools technology supported by tooling, accessories, mechanical electronic subsystems and peripheral manufactures.
2) Well-established R&D set-ups with CAD facilities, proven track record of indigenous development of high technology machine tools.
3) Availability of large pool of engineers and technicians with experience in foundry, manufacturing, assembly, product development, system integration and application engineering.
4) Well-established customer support service network all over the country to respond to user needs at the shortest notice, a definite advantage over international machine tools builders.
5) Experience in offering metal cutting, metal forming and plastic processing technologies, including application and tooling selectivity.
6) All the major machine tools manufacturers accredited with ISO 9001 certification.
7) Significant international presence through technical tie-ups with internationally reputed manufacturers and exporters.

Check Your Progress

3. Define Environmental Scanning.
4. What is SWOT Analysis?
5. Discuss ETOP study.

Measurement of Strengths

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The strengths and weakness occur in various forms and degrees. Various methods are used to give objectivity to measurement of weaknesses and strengths that are discussed below:

1) A list of attributes of a company may be prepared. Each of these attributes or characteristics may contribute to the growth of the company through distinctive competitive advantage due to a definite degree of presence of an attribute that would indicate the extent to which a specific attribute is a strength or weakness. Usually, a unit of measurement is quite difficult. However, a scale must be chosen and classifications made.

2) Statements on health care education, training etc. of their employers or statements reflecting leadership, innovation, R and D, etc., show that a company values these attributes as their strengths.

3) For certain statements like shared values, congenial climate and culture, managerial competence, initiative, human relationship skills, etc., no specificity can be attached and it may be difficult to measure their efficiency or effectiveness and only a subjective evaluation of these factors can be made.

4) It is easier to measure the functions at SBU level like market share, cash flow, finances, productivity of systems, etc.

Weakness

A weakness is a limitation or deficiency in resources, skills and capabilities that seriously impedes effective performance. Examples include facilities, financial resources, management capabilities marketing skills, etc.

1) Sources of Outfit

i) If the bulk of the profit comes from a single product, that itself is a form of weakness.

ii) What is its status in the life cycle? What is the status of competition? What is the status of industry sale? Product quality? Is the market share currently enjoyed commensurate with quality, competition, and price status? Is their scope for further growth in sale through product development?

iii) What is the scope for developing other profit yielding products?

iv) Is the technology continuing to be up-to-date or is there a risk of better technology appearing in the near future? What is the danger of substitution?

v) Is the product itself having any danger of becoming obsolete in the near future?

2) **Risks:** The possible risks may be

i) The product having danger of obsolescence,

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ii) The danger of being priced out.

iii) The danger of substitution.

iv) The danger of new competition coming.

v) Inadequate measures viewed against product/market scope.

Opportunities

An opportunity is a major favorable situation in the firm's environment. The industry should build on its production capacity to meet the upward moving demand, both for domestic and international markets.

The following opportunities can be harnessed because of this feature:

1) Sub-supplier development and sub-contracting.
2) Franchising of tail-end products.
3) Mutual sharing of capacities.
4) Product range specialization.
5) Product division and linkages between manufacturers.
6) Tapping capital market for funds.
7) Mature pricing policies to improve margin and generate cash for R&D and export promotion.
8) Consolidation of efforts to build up better infrastructure.

Threat

A threat is a major unfavorable situation in the firm's environment. It is key impediment to the firm's current or desired future positions. The entrances of a new competitor, slow market growth, major technological change, and appearance of a substitute product are examples. Following are the major threats to the domestic industry:

1) Customs duty on finished machines at par with components; inverted duty structure,
2) Competition, and
3) Influx of second-hand machinery.

Applications of SWOT Analysis

The analysis can be used in at least three ways in strategic choice situations:

i) The most common application provides a logical framework guiding systematic discussion of the business situation, alternative strategies, and ultimately, the choice of strategy.

ii) In a second application of SWOT analysis, key external opportunities and threats are systematically compared to internal strengths and weakness in a structured approach.

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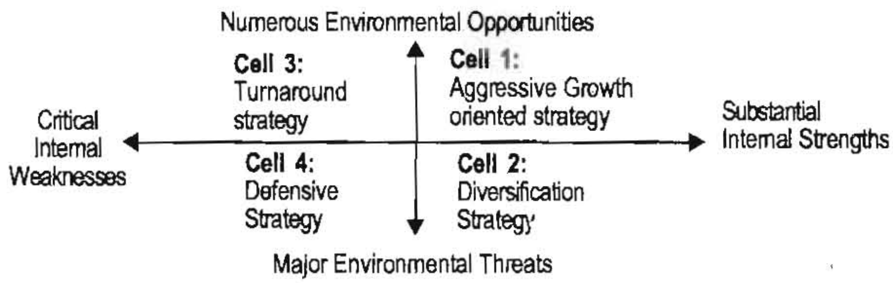
SWOT Analysis can be applied in different ways in the choice of strategy:

1) It provides a logical framework to be used for systematic discussion of various issues bearing on the business situation, alternative strategies, and finally the choice of strategy. Indeed, it ranges across all aspects of a firm's situation.

2) Another application of SWOT analysis is the structured approach whereby key external threats and opportunities may be systematically compared with internal strengths and weaknesses. Thus, the firm's internal and external situations can be matched so as to form distinct patterns, and the strategy chosen on the basis of the situation reflected in a pattern, as shown on the figure.

   There are four cells in the diagram:

   Cell 1: It may be said to represent the most favorable situation with numerous environmental opportunities and substantial internal strengths. Aggressive growth-oriented strategies are indicated in this type of situation.



Figure

Cell 2:

It represents a mixed situation with substantial internal strengths combined with major environmental threats. Diversification strategies are indicated for this type of situation involving the use of current strengths of exploit long-term opportunities in other product-markets. A mixed situation of another kind is represented by Cell **3:** A firm facing this situation has environmental opportunities but constraints of severe internal weaknesses do not permit immediate gains to be derived from the opportunities. A two-fold strategy is thus indicated - eliminating the weaknesses along with more effective pursuit of market opportunities.

Cell 4:

The situation represented by Cell 4-the most unfavorable one - calls for strategies involving withdrawal or reduced operation in the product-markets. The least favorable situation is obvious in Cell 4 with major environmental threats and critical internal weaknesses indicating defensive strategies.

3) The Cell-wise situations in which firms have to be actually placed often pose problems to the strategists. A business may have several opportunities but also face some serious threats in the environment. It may have likewise several

weaknesses along with one or two major strengths. In such situations, the SWOT analysis guides the strategist to visualize the overall position of the firm, and helps to identify the major purpose of the grand strategy being considered.

ETOP Study

Structuring the environmental appraisal is a difficult process, as environmental issues do not lend themselves to a straightforward classification into neat categories. Strategists have to use their experience and judgment to place the different environmental issues where they mainly belong so that clarity can emerge.

There are many techniques available to structure the environmental appraisal. One such technique, suggested by Glueck, is that of preparing an environmental threat and opportunity profile (ETOP) for an organization.

As a summarized depiction of the environmental factors and their impact on future conditions the profile is a convenient means by which attention of top management may be drawn to the most critical factors and "their potential impact on the strategy of the firm as a whole and key aspect of its operations".

The preparation of ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization. A comprehensive ETOP requires sub-dividing each environmental sector into sub-factors and then the impact of each sub-factor on the organization is described in the form of a statement. Forthe sake of simplicity, a summary ETOP may only show the major factors.

Example:

Table provides an example of an ETOP prepared for an established company in the bicycle industry. The main business of the company is in sports cycle manufacturing for the domestic and exports market. This example relates to a hypothetical company but the illustration is realistically based on the current Indian business environment.

Table : ETOP for a bicycle company

Environment		Impact
Social	1	Customer preference for sports cycles which are fashionable, easy to ride and durable
Political	→	No significant impact
Economic	↑	Growing affluence among urban consumers, export potential high
Regulatory	↑	Bicycle industry a thrust area for exports
Market	↑	Industry growth rate for sports cycles is high at 30 per cent
Technological	↑	Technological upgradation in progress
Up arrows (↑) indicate favorable impact (opportunity), down arrows (↓) indicate unfavorable impact (threat) while horizontal arrows (→) indicate a neutral impact		

An illustrative profile is given below on the basis of environmental analysis carried out by Bharat Heavy Electricals Ltd.

BHEL: Environmental Threat and O pportunity Profile (ETOP

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Environmental Sector	Impact (+) Opportunity (-) Threat
Socio-economic	(+) Continued emphasis on infrastructural development which includes power supply for industry, transport, and domestic consumption. (–) Severe resource constraints.
Technological	(+) High growth envisaged in industrial production and technology upgradation.
Supplier	(–) Sources of technology will become scarce due to formation of technology cartels.
Government	(+) Liberalization of technology import policy.
Competition	(–) Customers will become more discerning in their requirements due to an increasing role of power plant consultants. (–) Public sector will find it increasingly difficult to retain specialists and highly qualified personnel.

Prerequisites of ETOP

Before the formulation of strategies can be undertaken, strategists have to assess whether the organization has the required strengths to succeed, or whether it has weaknesses which can affect its capability to take advantage of the opportunities. This assessment is done through an analysis of the strengths and weaknesses of an organization and forms a part of the SWOT analysis.

Outcomes of ETOP

i) The preparation of an ETOP provides the strategists with a clear picture of which sectors (and the different factors in each sector) have a favorable impact on the organization.

ii) By means of an ETOP, the organization can see where it stands with respect to its environment.

Such an understanding can be of great help to an organization in formulating appropriate strategies to take advantage of the opportunities and counter the threats in its environment.

Dimensions of ETOP

The strategic managers should keep focus on the following dimensions:

1) **Issue Selection:**

   Focus on issues which have been selected should not be missed since there is a likelihood of arriving at incorrect priorities. Some of the important issues may be those related to market share, competitive pricing, customer preferences, technological changes, economic policies, competitive trends, etc.

2) **Accuracy of Data:**

Data should be collected from good sources otherwise the entire process of environmental scanning may go waste. The relevance, importance, manageability, variability and low cost of data are some of the important factors, which must be kept in focus.

3) **Impact Studies:**

Impact studies should be conducted focusing on the various opportunities and threats and the critical issues selected. It may include study of probable effects on the company's strengths and weaknesses, operating and remote environment, competitive position, accomplishments of mission and vision, etc. Efforts should be taken to make assessments more objective wherever possible.

4) **Flexibility in Operations:**

A lot of uncertainties exist in a business situation and so a company can be greatly benefited by devising proactive and flexible strategies in their plans, structures, strategy, etc. The optimum level of flexibility should be maintained.

Some of the key elements for increasing the flexibility are as follows:

i) The strategy for flexibility must be started to enable managers adopt it during unique situations.

ii) Strategies must be reviewed and changed if required.

iii) Exceptions to decided strategies must be handled before hand. This would enable managers to violate strategies when it is necessary.

iv) Various available options for achieving defined targets within the framework of policies and on justifiable grounds must exist. This enables employees to choose a course of action. Flexibility may be quite costly for an organization in terms of changes and compressed plans; however, it is equally important for companies to meet urgent challenges.

CASE STUDY:

MARUTI UDYOG LTD

When Indian car market was opened for new private players, Maruti Udyog limited, which had till then enjoyed an enviable position in the market, suddenly faced severe market erosion. Even though Maruti is the market leader and has the largest range of products, cheaper cars, good service network and better cost structures, it has been steadily losing its market share for the last three years and the valuation of the company has halved in 4 years time from Rs. 80 bn in 1996 to Rs. 40 bn in 2000.

A Marjti udyog rival: What MUL did to Premier Automobiles and Hindustan motors is now being done lo it.

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Empire under siege

Jagdish Khattar, MD MUL was a man in trouble. He was facing what was the biggest setback ever for the company. With all strategies backfiring, he seemed to be fighting a losing battle.

Problems were aplenty - the Maruti 800 segment was facing demand - erosion, Zen and its arch-rival Santro were very close in terms of volumes, Esteem was losing ground, Baleno, Wagon R and Alto were yet to prove themselves, while Gypsy was smugly ensconced in its niche. [Gypsy was not generating many volumes needed for MUL]

Despite the fact the fact that MUL had the biggest range of products, the cheapest cars in the market and a service network and cost structures that were better than anyone else, it had steadily lost market share - down from 82.62 percent in 1998 to 52 per cent in 2000. With the impending disinvestments, [Government's. policy of disinvestments in Public sector units includes MUEL also along with other profit making PSUs.] MD was facing flak from the government as well. With market share declining, MUL's valuation had also come down drastically. While it was valued at Rs. 80 bn in 1996, by December, 2000, the figure had touched Rs. 40 bn.

The building blocks

MUL was the largest car manufacturer in India with a market share of over 52 per cent. It was a joint sector corporation set up by the government of India and Suzuki Motor Corporation, Japan. MUL was incorporated in 1981 to take over the assets of the erstwhile MUL set up in June 1971 and wound up by a High Court order in 1978. The assets of MUL were then acquired buy the Government under MUL Acquisition and Transfer of Undertakings Act, 1980. In 1982, the Government signed a joint venture agreement with Suzuki of Japan. Suzuki's stake increased from 26 to 40% in 1987, and to 50.25% in 1992. The company was a significant exporter with exports to over 50 countries. The company manufactured passenger cars at its factor in Gurgaon, Haryana, with an installed capacity of 350,000 vehicles. The first product, Maruti 800 was launched in 1984, followed by the all-terrain vehicle Gypsy in 1985. Over the years, MUL expanded its portfolio with the launch of the Maruti 1000 [1990]; the Zen and the Esteem [1993]; Zen Diesel [1998]p Baleno, Wagon R and the Alto [2000].

MUL was known for its 'value for money pricing' strategy, which had been made possible due to the high levels of indigenization of its vehicles. While the Maruti 800, Zen, Esteem, and Omni were indigenized to the extent of over 90%, the Gypsy was indigenized to the extent of 82% and the Alto to the extent of 76%. The company had a network of about 375 vendors and had several joint ventures with some of them to source its raw material requirements It's sales [comprising 112 dealers and sales outlets in 86. locations] and service [comprising 1010 service workshops covering 412 locations] network was one of the largest in the country.

The Stumbling blocks

Till October 1998, MUL enjoyed a market share of 83.6% reacting to the increasing number, of players, its-MD commented, "Obviously, our market share will decline with the entry of new manufacturers and models in percentage terms, but not in actual volumes."

With cars ranging from Rs. 0.21 mn to s. 0.67 mn, problems associated with an ever-expanding product portfolio 'constantly plagued MUL. Besides the declining market share, cannibalization was another issue the company could ill-afford to ignore. Forced to take stock of what went wrong, MUL realized that it was dependent to a large extent on a single product - the Maruti 800.

The 800, along with the Omrii [build on the same platform accounted for 75% of units sales in the car. market in 1998; it had always been the 'breadwinner' for MUL. One of the biggest success sagas in Indian automobile history, the 800 started losing its sheen in the 1990's as newer players emerged in the market. The entry-level segment ceased to be the center of action as easy car finance availability and the lure of new cars made the Rs. 0.3 inn to Rs. 0.4 mn segment the most attractive one. The fact that MUL made only minor changes in the models over the years led to the perception that MUL was selling old models.

To tackle these problems, MUL adopted a two-pronged strategy. One, to introduce new models; two, it decided to increase the number of variants rapidly, offering a new model with every increase of Rs. 25000. MUL also revamped its engines and took the 800 to semi-urban and rural areas, to compensate for the declining urban sales. The company was aiming to move entry-level prices up without losing out on volumes by launching cars in the segment just above the 800. As part of this, Baleno, Wagon R and Alto were launched in quick succession. [Alto was launched in the same league as the 800. Industry observers contended that Alto's launch in the 800-cc category signaled the beginning of a gradual phasing out of the 800. However, MUL sources were quick to deny this- and-asserted that the 800 would be retained:] However, despite favourable reviews, these cars did not go on to become the saviors of MUL was hoping for.

The engine-revamp exercise for the 800 had pushed its price close the base model of rival Daewoo's Matiz, eroding the price advantage on which the model survived. As a final resort, MUL decided to play what it thought was its trump card - price reduction. The move was also justified on the gorunds that the company was following Product Pyramid Profit model. [The Product Pyramid incorporated the distinct customer segments and their varied purchase -behaviour in terms of style, colour, feature and price preferences. The base of the Pyramid was occupied by low price, high volume product s. like the 800, where the margins were slim. The apex of the Pyramid was occupied by high-price, low volume products such as the Maruti Esteem VX. Although -profits were concentrated near the top, the base played a crucial role as it created an entry-barrier for competitors, and insulated the profitable area near the top from competition. In the specific case of cars, the most common model was the new product profits model. Thus, the profits associated with a car followed the "s" curve of its life cycle, and declined as the product neared the end of the maturity. phase. MUL's decision to drop the prices of all the versions of the Maruti 800 came at this stage].

MUL reduced the prices of Maruti 800 and Zen by about Rs. 24000 and Rs. 51000 respectively in December, 1998, This resulted in a drop of Rs. 3 bn in net profit for the year 1998-99. The MD justified die price cuts, saying that MUL wanted to make up for the increase in the 800's price due to higher sales tax figures for the period. The move was described as an attempt to "redefine the price-value equation." MUL sources claimed that they expected lower prices to bring an incremental growth of 25% over the next 12 months. However, despite the price cuts, by March 1999, the company's market share decreased to 54.57%

In early 2000, MUL announced that it would pass on the cost of installing Euro-II compliant engines with Multi-point fuel Injection [MPFI] to its customers. There was a rush in the market for the 800. as many first-time consumers who did not want to bear the hike, hastened their purchase. MUL had to increase the price of the 800 from. Rs. 0,18 mn to Rs. 0.22 mn. Around the same time, MUL decided to meet the competition head-on by having a model or variant with every increase of Rs. 25000. The idea was to give the customer the widest choice possible. By mid-2000, the company offered 43 models in a market, which had only 127 models.

In June 2000, sales of the 800 stood at 5296 cars compared to the 11000 plus cars it had been selling per month for the previous few years. MUL had no option but to again slash prices of various models by Rs. 25000 to Rs. 30000, to bring back the sales to normal levels. Other changes initiated by the'-company included a transformation in its customer - interface and a revamped branding strategy with the new cars [Wagon R and Baleno] coming with the Suzuki prefix. The price cuts, however, only added to the declining bottom line problem. MUL reported a loss of Rs. 6792. II on every car sold between April and October 2000. MUL sources, however, attributed this to the fact that MUL had not passed on the cost of up-gradation to meet the Euro;I and Euro II emission norms to its customers.

The industry strikes back

The Indian car market of the early 21s1 century was a burgeoning one with over 127 models on the roads, and many more in the pipeline. Increased competition had radically transformed the market, manifested clearly in carmaker's pricing strategy overhaul. Manufacturers were breaking the conventional rules of auto pricing by moving from cost-based to value-based pricing and the market soon, became a buyer's market.

When the new players entered the market, there were no doubts that the main artillery for the companies in the car-wars would be the pricing strategies. It was not just a case of competition forcing a downward revision; the players were even ready to forego profits in the short run. Brand building and technology / feature driven campaign were to be add-ons to the above plan. Industry observers were quick to point out that MUL would have to get entangled in the price reducing game.

A Business India report pointed : No one is better equipped to fight a price war than Maruti. Its phenomenal profitability, cash reserves and efficiency in manufacturing will allow it to slash prices on all its models without feeling the pinch as much as others.

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However, Hyundai was the first company to introduce what came to be known as, pricing based on customer's value perceptions. It introduced the base model of Santro at Rs. 0.29 mn, while two other versions were priced at Rs. 0.34 and Rs. 0.37 mn. The basic version was targeted at buyers of the 800, and the other at the Zen. Thereafter, hunches in the Rs. 0.2 mn to Rs. 0.6 mn segment by Ford and Hyundai showed highly innovative pricing strategies being adopted. Soon after, Ind Auto dropped the price of the Fiat Uno Diesel by Rs. 64867 and Premier Automobiles Ltd lowered the prices of the four versions of the Premier Padmini by Rs. 5000 to make it Rs. 53000.

MUL had adopted a skimming strategy for Esteem. Launched in 1993, it was positioned as a luxury car. This continued till the arrival of Daewoo's Cielo in 1996, which started eating into Esteem's share. In 1999, the segment saw the arrival of Fiat Siena, Opc-1 Corsa, Ford lko.n and the Hyundai Accent. MUL resorted to price slashing and brought the prices down. While the top end version's price was reduced to Rs. 0.52 mn, from Rs. 0.59 mn, the basic version was brought down to Rs. 0.44 mn from 0.46 mn. However, this was possible only because it enjoyed substantial margins over costs, being the first mover in the market.

MUL also followed the- same modus operandi for Zen, albeit in a different manner. The company increased the number of Zen variants to 10, with prices ranging hom Rs. 0.3 mn to Rs. 0.43 mn. The price stood reduced for the Rs. 0.3 mn variant in terms of stripping down the model's features.

The competition responded with similar moves. Daewoo offered price-variants for Matiz, Ind Auto offered seven variants of Fiat Uno, ranging from Rs. 0.27 mn to Rs. 0.41 mn. Hyundai's Santro offered six variants between Rs. 0.29 mn and Rs. 0.37 mn; Telco's Indica came in the range of Rs. 0.25 mn to Rs. 0.38 mn with four models. NK Goila, VF Honda - Sicl cars, aptly summed up the situation : It is important to be present with grade - variation and a range to cover the range of potential customers being targeted. The price - points in the car market were replaced by price - bands. The width of a price band was a function of the size of the segment being targeted besides the intensity of competition. The thumb rule being, the higher the intensity, the wider the price-band.

Ford's research, before the launch of the Ikon, a car made for the/Indian market, revealed that over the previous two three years, the 800 segment had graduated to the next level of Zen, Santro, Matiz, Uno and Indica. Ford's research on the existing market segments and the consumer response to new cars revealed that beyond the Zen segment, the choice of the consumer was limited. Models like the Esteem and Cielo had had a long innings outside the country and were not exactly contemporary. The other options were Escort, Lancer and Honda, which were priced above Rs. 0.7 mn Between them and the Rs. 0.45 - 0.5 run range of the Esteem and Cielo, thee was a vacuum. The gap was identified by General Motors' Corsa and Fiat's Siena as well. All three competitors plugged the gap by offering several versions at various price points. Ford first launched Ikon 1.6 but later came up with a lower engine capacity Ikon I.3CLXI at a lower price. GM and Fiat also followed the same approach.

About price reduction

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The fact that 82% of the Indian market was accounted for cars priced below Rs. 0.43 mn, proved how strongly price influenced volumes. Moreover, with domestic car sales dropping by 15.01% in November 1998 over November, 1997 manufacturers had to turn towards price to resuscitate demand. In the prevailing conditions, the 'Second P of aulo marketing' price reduction, seemed to be (he only factor able to rejuvenate the stagnant demand.

However, not every player had the financial-muscle to play the price card. Instead of cutting the price of Matiz, Daewoo Motors introduced an enhanced version with product features like power steering, and product-plus features like better service and customer-care. Players like Hyundai and Telco did not opt for price reduction, as they simply did not have the economies of scale to profit from such moves. Such strategies worked best for companies with offering in several segments of the market. Higher volumes from the combined sales of products across segments enabled them to drive harder bargains with their suppliers; unit marketing and distribution costs decreased; and the higher margins on products positioned near the top compensated for the pared margins on the basic product.

The players who chose to stay out of the race to cut prices had to convince their customers that the higher prices they charged were justified by the greater value they offered. A product and promotional mix had to be specifically designed to convey the above message. Most manufacturers of mid-size cars, including General Motors, Ford, Honda-Siel, adopted this strategy rather than cut costs to increase sales. They argued that because of the 'snob-value' of a costlier car, buyers in this segment were not that susceptible to be swayed by price cuts.

They cited the Cielo price reduction fiasco as an example. When sales of Daewoo's Cielo went down from a peak of 2260 cars in September 1956 to 314 in December 1997, the company slashed the price of its base model Rs. 0.13 inn in January, 1998. Daewoo also introduced zero-interet finance schemes and its dealers gave unofficial discounts ranging from Rs. 0.08 mn to Rs. 0.10 mn, Sales increased by 300% to 906 and 1102 by March, 1998. However, this was far below the company's capacity of 6000 ears per month. Daewoo launched an upper end version, Cielo Executive and an upgraded versions, Nexia at higher price points. However, the market had discounted Daewoo by then and sales did not pick up further, falling to a low of 148 by February, 1999.

Companies realized that only when competing brands were perceived to be equal in all other aspects, would price be a deciding issue. As the target segment became more affluent, upgrades as well as first time buyers did not necessarily start at the lowest price level. Applied as a brand level strategy, price helped the auto marketers win over only the entry level customer.

The biggest price a manufacturer would have to pay for playing the price game continuously was undoubtedly the loss of customer loyalty. The world over, automobile brands succeed on the basis of their relationship with fiercely loyal customer communities, built around sharp brand images and unique value proportions. By choosing to shift the focus to price, MUL risked the loss of damaging its customer relations and brand valuation, as it ended up antagonizing the buyers who had bought MUL cars just before the price reduction. This led to a feeling of betrayal among MUL loyalist. When these customers replaced their cars, it was doubtful whether they would turn back to MUL or go in for a rival car with a vengeance.

Much ado about nothing?

As the Indian automobile market moved from monopoly to free competition, market share comparisons from the old era seemed to have lost relevance. The alarm over MUL's declining market share somehow did not seem fully justified. In its heyday, huge waiting lists for its products ensured that Maruti's market share was directly linked to the supply side of the equation. In other words, if MUL had an 80% share of the market, that was also its share of the total industry capacity. By the late 1990's, things changed radically with over 12 car manufacturers having a presence in the country, with a total capacity of about 1,250,000 cars, of which MUL produced about 400,000 [33%]. Khattar commented tell me, if we have market share of 50% out of a capacity that is 33% [of the industry], are we doing badly? Why don't you ask the others who together have a capacity of 800,000, but cannot match our sales? All said and done, MUL was still the leader in early -2001. It still had its early mover advantages. Provided Khattar plays his cards right, MUL can still rule the roost for years to come. Whether this will happen for real, is a question too early to be answered.

SUMMARY

- Technological environment refers to the state of science and technology in the country and related aspects such as rate of technological progress, institutional arrangements for development and application of new technology, etc.
- Technology is knowledge of methods to perform certain tasks or solve problems pertaining to products or services.
- Technology transfer is the process by which commercial technology is disseminated.
- The global business environment is very significantly influenced by the World Trade Organization (WTO) principles and agreements. They also affect the domestic environment.
- The basic aim of GATT was to expand international trade and bring about all round economic prosperity by liberalizing trade rules and regulations.
- The main objectives of WTO are to enlarge production and trade of services, to ensure optimum utilization of world resources, to accept the concept of sustainable development, to protect environment.
- The term Environmental Scanning in business means to carefully analyze the various factors influencing the business.

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- Techniques of Environment Scanning: SWOT Analysis, and ETOP Study.
- SWOT Analysis is a strategic planning method used to evaluate the Strengths, Weaknesses, Opportunities, and Threats involved in a project or in a business venture.
- The preparation of ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. Technology is knowledge of methods to perform certain tasks or solve problems pertaining to products and services.
2. The liberalization of imports implies that domestic firms have to face an increasing competition from foreign goods. Liberalization of foreign investments can result in growing competition from local outputs of MNCs.
3. Environment scanning is the process by which strategists monitor the environmental factors to determine opportunities for and threats to their firms.
4. SWOT Analysis is a strategic planning method use to evaluate the strengths, weakness, opportunities and threats involved in a project or in a business venture.
5. The preparation of ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization.

TEST YOURSELF

1. What do you mean by Technological Environment?
2. Explain various features of Technological Environment.
3. What are the factors for the Choice of Technology?
4. Discuss the effect of Technology on Business.
5. Describe the introduction of Global Environment.
6. Write a short note on:
   (i) General Agreement on Tariffs and Trade (GATT)
   (ii) World Trade Organization (WTO)
7. What do you mean by Environmental Scanning?
8. Explain characteristics of Environmental Scanning
9. Discuss the scope of Environment Scanning.
10. What are different factors affecting Environmental Appraisal.
11. Explain different techniques of Environmental Analysis.

FURTHER READING

- *Business Environment by Cherunilam. F*
- *Business Environment by Justin Patil*
- *Essentials in Business Environment by Aswathappa*

6 International Monetary Fund

The Chapter Covers :

Introduction:

The International Monetary Fund (IMF) is an organization, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

With its near-global membership of 187 countries, the IMF is uniquely placed to help member governments take advantage of the opportunities—and manage the challenges—posed by globalization and economic development more generally. The

IMF tracks global economic trends and performance, alerts its member countries when it sees problems on the horizon, provides a forum for policy dialogue, and passes on know-how to governments on how to tackle economic difficulties.

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The IMF provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.

Marked by massive movements of capital and abrupt shifts in comparative advantage, globalization affects countries' policy choices in many areas, including labor, trade, and tax policies. Helping a country benefit from globalization while avoiding potential downsides is an important task for the IMF. The global economic crisis has highlighted just how interconnected countries have become in today's world economy.

Key IMF activities

The IMF supports its membership by providing

1. Policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
2. Research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
3. Loans to help countries overcome economic difficulties;
4. Concessional loans to help fight poverty in developing countries; and
5. Technical assistance and training to help countries improve the management of their economies.

Original aims of IMF

The IMF was founded more than 60 years ago toward the end of World War II. The founders aimed to build a framework for economic cooperation that would avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s and the global conflict that followed.

Since then the world has changed dramatically, bringing extensive prosperity and lifting millions out of poverty, especially in Asia. In many ways the IMF's main purpose—to provide the global public good of financial stability—is the same today as it was when the organization was established. More specifically, the IMF continues to

- provide a forum for cooperation on international monetary problems
- facilitate the growth of international trade, thus promoting job creation, economic growth, and poverty reduction;
- promote exchange rate stability and an open system of international payments; and

- lend countries foreign exchange when needed, on a temporary basis and under adequate safeguards, to help them address balance of payments problems.

An adapting IMF

The IMF has evolved along with the global economy throughout its 65-year history, allowing the organization to retain its central role within the international financial architecture

As the world economy struggles to restore growth and jobs after the worst crisis since the Great Depression, the IMF has emerged as a very different institution. During the crisis, it mobilized on many fronts to support its member countries. It increased its lending, used its cross-country experience to advice on policy solutions, supported global policy coordination, and reformed the way it makes decisions. The result is an institution that is more in tune with the needs of its 187 member countries.

- **Stepping up crisis lending.** The IMF responded quickly to the global economic crisis, with lending commitments reaching a record level of more than US$250 billion in 2010. This figure includes a sharp increase in concessional lending (that's to say, subsidized lending at rates below those being charged by the market) to the world's poorest nations.
- **Greater lending flexibility.** The IMF has overhauled its lending framework to make it better suited to countries' individual needs. It is also working with other regional institutions to create a broader financial safety net, which could help prevent new crises.
- **Providing analysis and advice.** The IMF's monitoring, forecasts, and policy advice, informed by a global perspective and by experience from previous crises, have been in high demand and have been used by the G-20.
- **Drawing lessons from the crisis.** The IMF is contributing to the ongoing effort to draw lessons from the crisis for policy, regulation, and reform of the global financial architecture.
- **Historic reform of governance.** The IMF's member countries also agreed to a significant increase in the voice of dynamic emerging and developing economies in the decision making of the institution, while preserving the voice of the low-income members.

The IMF's main goal is to ensure the stability of the international monetary and financial system. It helps resolve crises, and works with its member countries to promote growth and alleviate poverty. It has three main tools at its disposal to carry out its mandate: surveillance, technical assistance and training, and lending. These functions are underpinned by the IMF's research and statistics.

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Surveillance

The IMF promotes economic stability and global growth by encouraging countries to adopt sound economic and financial policies. To do this, it regularly monitors global, regional, and national economic developments. It also seeks to assess the impact of the policies of individual countries on other economies.

This process of monitoring and discussing countries' economic and financial policies is known as bilateral surveillance. On a regular basis—usually once each year—the IMF conducts in depth appraisals of each member country's economic situation. It discusses with the country's authorities the policies that are most conducive to a stable and prosperous economy, drawing on experience across its membership. Member countries may agree to publish the IMF's assessment of their economies, with the vast majority of countries opting to do so.

The IMF also carries out extensive analysis of global and regional economic trends, known as multilateral surveillance. Its key outputs are three semiannual publications, the World Economic Outlook the Global Financial Stability Report and the Fiscal Monitor. The IMF also publishes a series of regional economic outlooks.

The IMF recently agreed on a series of actions to enhance multilateral, financial, and bilateral surveillance, including to better integrate the three; improve our understanding of spillovers and the assessment of emerging and potential risks; and strengthen IMF policy advice.

Technical assistance and training

IMF offers technical assistance and training to help member countries strengthen their capacity to design and implement effective policies. Technical assistance is offered in several areas, including fiscal policy, monetary and exchange rate policies, banking and financial system supervision and regulation, and statistics.

The IMF provides technical assistance and training mainly in four areas:

- Monetary and financial policies (monetary policy instruments, banking system supervision and restructuring, foreign management and operations, clearing settlement systems for payments, and structural development of central banks);
- Fiscal policy and management (tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and management of domestic and foreign debt);
- Compilation, management, dissemination, and improvement of statistical data; and
- Economic and financial legislation.

Lending

IMF financing provides member countries the breathing room they need to correct balance of payments problems. A policy program supported by financing is designed by the national authorities in close cooperation with the IMF. Continued financial support is conditional on the effective implementation of this program.

In the most recent reforms, IMF lending instruments were improved further to provide flexible crisis prevention tools to a broad range of members with sound fundamentals, policies, and institutional policy frameworks.

In low-income countries, the IMF has doubled loan access limits and is boosting its lending to the world's poorer countries, with loans at a concessional interest rate.

Research and data

Supporting all three of these activities is the IMF's economic and financial research and statistics. In recent years, the IMF has applied both its surveillance and technical assistance work to the development of standards and codes of good practice in its areas of responsibility, and to the strengthening of financial sectors. These are part of the IMF's continuing efforts to strengthen national and global financial systems and improve its ability to prevent and resolve crises.

History of IMF

During the Great Depression of the 1930s, countries attempted to shore up their failing economies by sharply raising barriers to foreign trade, devaluing their currencies to compete against each other for export markets, and curtailing their citizens' freedom to hold foreign exchange. These attempts proved to be self-defeating. World trade declined sharply, and employment and living standards plummeted in many countries.

This breakdown in international monetary cooperation led the IMF's founders to plan an institution charged with overseeing the international monetary system—the system of exchange rates and international payments that enables countries and their citizens to buy goods and services from each other. The new global entity would ensure exchange rate stability and encourage its member countries to eliminate exchange restrictions that hindered trade.

The Bretton Woods agreement

The IMF was conceived in July 1944, when representatives of 45 countries meeting in the town of Bretton Woods, New Hampshire, in the northeastern United States, agreed on a framework for international economic cooperation, to be established after the Second World War. They believed that such a framework was necessary to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression.

The IMF came into formal existence in December 1945, when its first 29 member countries signed its Articles of Agreement. It began operations on March 1, 1947. Later that year, France became the first country to borrow from the IMF.

The IMF's membership began to expand in the late 1950s and during the 1960s as many African countries became independent and applied for membership. But the

Cold War limited the Fund's membership, with most countries in the Soviet sphere of influence not joining.

Par value system

The countries that joined the IMF between 1945 and 1971 agreed to keep their exchange rates (the value of their currencies in terms of the U.S. dollar and, in the case of the United States, the value of the dollar in terms of gold) pegged at rates that could be adjusted only to correct a "fundamental disequilibrium" in the balance of payments, and only with the IMF's agreement. This par value system—also known as the Bretton Woods system—prevailed until 1971, when the U.S. government suspended the convertibility of the dollar (and dollar reserves held by other governments) into gold.

By the early 1960s, the U.S. dollar's fixed value against gold, under the Bretton Woods system of fixed exchange rates, was seen as overvalued. A sizable increase in domestic spending on President Lyndon Johnson's Great Society programs and a rise in military spending caused by the Vietnam War gradually worsened the overvaluation of the dollar.

End of Bretton Woods system

The system dissolved between 1968 and 1973. In August 1971, U.S. President Richard Nixon announced the "temporary" suspension of the dollar's convertibility into gold. While the dollar had struggled throughout most of the 1960s within the parity established at Bretton Woods, this crisis marked the breakdown of the system. An attempt to revive the fixed exchange rates failed, and by March 1973 the major currencies began to float against each other.

Since the collapse of the Bretton Woods system, IMF members have been free to choose any form of exchange arrangement they wish (except pegging their currency to gold): allowing the currency to float freely, pegging it to another currency or a basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.

Oil shocks

Many feared that the collapse of the Bretton Woods system would bring the period of rapid growth to an end. In fact, the transition to floating exchange rates was relatively smooth, and it was certainly timely: flexible exchange rates made it easier for economies to adjust to more expensive oil, when the price suddenly started going up in October 1973. Floating rates have facilitated adjustments to external shocks ever since.

The IMF responded to the challenges created by the oil price shocks of the 1970s by adapting its lending instruments. To help oil importers deal with anticipated current account deficits and inflation in the face of higher oil prices, it set up the first of two oil facilities.

Helping poor countries

From the mid-1970s, the IMF sought to respond to the balance of payments difficulties confronting many of the world's poorest countries by providing concessional financing through what were known as the Trust Fund. In March 1986, the IMF created a new concessional loan program called the Structural Adjustment Facility. The SAF was succeeded by the Enhanced Structural Adjustment Facility in December 1987.

The oil shocks of the 1970s, which forced many oil-importing countries to borrow from commercial banks, and the interest rate increases in industrial countries trying to control inflation led to an international debt crisis.

During the 1970s, Western commercial banks lent billions of "recycled" petrodollars, getting deposits from oil exporters and lending those resources to oil-importing and developing countries, usually at variable, or floating, interest rates. So when interest rates began to soar in 1979, the floating rates on developing countries' loans also shot up. Higher interest payments are estimated to have cost the non-oil-producing developing countries at least $22 billion during 1978–81. At the same time, the price of commodities from developing countries slumped because of the recession brought about by monetary policies. Many times, the response by developing countries to those shocks included expansionary fiscal policies and overvalued exchange rates, sustained by further massive borrowings.

When a crisis broke out in Mexico in 1982, the IMF coordinated the global response, even engaging the commercial banks. It realized that nobody would benefit if country after country failed to repay its debts.

The IMF's initiatives calmed the initial panic and defused its explosive potential. But a long road of painful reform in the debtor countries, and additional cooperative global measures, would be necessary to eliminate the problem.

The fall of the Berlin wall in 1989 and the dissolution of the Soviet Union in 1991 enabled the IMF to become a (nearly) universal institution. In three years, membership increased from 152 countries to 172, the most rapid increase since the influx of African members in the 1960s.

In order to fulfill its new responsibilities, the IMF's staff expanded by nearly 30 percent in six years. The Executive Board increased from 22 seats to 24 to accommodate Directors from Russia and Switzerland, and some existing Directors saw their constituencies expand by several countries.

The IMF played a central role in helping the countries of the former Soviet bloc transition from central planning to market-driven economies. This kind of economic transformation had never before been attempted, and sometimes the process was less than smooth. For most of the 1990s, these countries worked closely with the IMF, benefiting from its policy advice, technical assistance, and financial support.

By the end of the decade, most economies in transition had successfully graduated to market economy status after several years of intense reforms, with many joining the European Union in 2004.

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Asian Financial Crisis

In 1997, a wave of financial crises swept over East Asia, from Thailand to Indonesia to Korea and beyond. Almost every affected country asked the IMF for both financial assistance and for help in reforming economic policies. Conflicts arose on how best to cope with the crisis, and the IMF came under criticism that was more intense and widespread than at any other time in its history.

From this experience, the IMF drew several lessons that would alter its responses to future events. First, it realized that it would have to pay much more attention to weaknesses in countries' banking sectors and to the effects of those weaknesses on macroeconomic stability. In 1999, the IMF—together with the World Bank—launched the Financial Sector Assessment Program and began conducting national assessments on a voluntary basis. Second, the Fund realized that the institutional prerequisites for successful liberalization of international capital flows were more daunting than it had previously thought. Along with the economics profession generally, the IMF dampened its enthusiasm for capital account liberalization. Third, the severity of the contraction in economic activity that accompanied the Asian crisis necessitated a re-evaluation of how fiscal policy should be adjusted when a crisis was precipitated by a sudden stop in financial inflows.

Debt relief for poor countries

During the 1990s, the IMF worked closely with the World Bank to alleviate the debt burdens of poor countries. The Initiative for heavily indebted poorer countries was launched in 1996, with the aim of ensuring that no poor country faces a debt burden it cannot manage. In 2005, to help accelerate progress toward the United Nations Millennium Development Goals (MDGs), the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative.

The IMF has been on the front lines of lending to countries to help boost the global economy as it suffers from a deep crisis not seen since the Great Depression.

For most of the first decade of the 21st century, international capital flows fueled a global expansion that enabled many countries to repay money they had borrowed from the IMF and other official creditors and to accumulate foreign exchange reserves.

The global economic crisis that began with the collapse of mortgage lending in the United States in 2007, and spread around the world in 2008 was preceded by large imbalances in global capital flows.

Global capital flows fluctuated between 2 and 6 percent of world GDP during 1980-95, but since then they have risen to 15 percent of GDP. In 2006, they totaled \$7.2 trillion—more than a tripling since 1995. The most rapid increase has been

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experienced by advanced economies, but emerging markets and developing countries have also become more financially integrated.

The founders of the Bretton Woods system had taken it for granted that private capital flows would never again resume the prominent role they had in the nineteenth and early twentieth centuries, and the IMF had traditionally lent to members facing current account difficulties.

The latest global crisis uncovered fragility in the advanced financial markets that soon led to the worst global downturn since the Great Depression. Suddenly, the IMF was inundated with requests for stand-by arrangements and other forms of financial and policy support.

The international community recognized that the IMF's financial resources were as important as ever and were likely to be stretched thin before the crisis was over. With broad support from creditor countries, the Fund's lending capacity was tripled to around $750 billion. To use those funds effectively, the IMF overhauled its lending policies, including by creating a flexible credit line for countries with strong economic fundamentals and a track record of successful policy implementation. Other reforms, including ones tailored to help low-income countries, enabled the IMF to disburse very large sums quickly, based on the needs of borrowing countries and not tightly constrained by quotas, as in the past.

Management of IMF

The IMF is led by a Managing Director, who is head of the staff and Chairman of the Executive Board. The Managing Director is assisted by a First Deputy Managing Director and three other Deputy Managing Directors. The Management team oversees the work of the staff and maintains high-level contacts with member governments, the media, non-governmental organizations, think tanks, and other institutions. The current Managing Director of IMF is Christine Lagarde, a French national, joined the IMF as Managing Director in July 2011. Before coming to the IMF, she was France's Minister for Economy, Finance and Industry.

Special Drawing Rights

The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries.

The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations.

SDR allocations to IMF members

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Under its Articles of Agreement, the IMF may allocate SDRs to members in proportion to their IMF quotas, providing each member with a costless asset. However, if a member's SDR holdings rise above its allocation, it earns interest on the excess; conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall.

There are two kinds of allocations:

General allocations of SDRs. General allocations have to be based on a long-term global need to supplement existing reserve assets. Decisions to allocate SDRs have been made three times: in 1970-72, for SDR 9.3 billion; in 1979–81, for SDR 12.1 billion; and in August 2009, for an amount of SDR 161.2 billion.

Special allocations of SDRs. A special one-time allocation of SDRs through the Fourth Amendment of the Articles of Agreement was implemented in September 2009. The purpose of this special allocation was to enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that countries that joined the Fund after 1981—more than one-fifth of the current IMF membership—had never received an SDR allocation.

With the general SDR allocation of August 2009 and the special allocation of September 2009, the amount of SDRs increased from SDR 21.4 billion to SDR 204.1 billion (currently equivalent to about $317 billion).

SDR's value

The value of the SDR is based on a basket of key international currencies—the euro, Japanese yen, pound sterling and U.S. dollar. The U.S dollar value of the SDR is posted daily on the IMF's website. The basket composition is reviewed every five years by the Executive Board to ensure that it reflects the relative importance of currencies in the world's trading and financial systems.

The SDR interest rate provides the basis for calculating the interest charged to members on regular (non concessional) IMF loans, the interest paid and charged to members on their SDR holdings, and the interest paid to members on a portion of their quota subscriptions. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term debt in the money markets of the SDR basket currencies.

I) International Bank for Reconstruction and Development

The International Bank for Reconstruction and Development (IBRD) aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services. Established in 1944 as the original institution of the World Bank Group, IBRD is structured like a cooperative that is owned and operated for the benefit of its 187 member countries. IBRD raises most of its funds on the world's financial markets and has become one of the most established borrowers since issuing its first bond in 1947. The income that IBRD has generated over the years has allowed it to fund development activities and to ensure its financial strength, which enables it to borrow at low cost and offer client's good borrowing terms.

At its Annual Meeting in September 2006, the World Bank — with the encouragement of its shareholder governments — committed to make further improvements to the services it provides its members. To meet the increasingly sophisticated demands of middle income countries, IBRD is overhauling financial and risk management products, broadening the provision of free-standing knowledge services and making it easier for clients to deal with the Bank.

Founded in 1944 to help Europe recover from World War II, the International Bank for Reconstruction and Development (IBRD) is one of five institutions that make up the World Bank Group. IBRD is the part of the World Bank (IBRD/IDA) that works with middle-income and creditworthy poorer countries to promote sustainable, equitable and job-creating growth, reduce poverty and address issues of regional and global importance.

Structured something like a cooperative, IBRD is owned and operated for the benefit of its 187 member countries. Delivering flexible, timely and tailored financial products, knowledge and technical services, and strategic advice helps its members achieve results. Through the World Bank Treasury, IBRD clients also have access to capital on favorable terms in larger volumes, with longer maturities, and in a more sustainable manner than world financial markets typically provide.

Specifically, the IBRD:

- supports long-term human and social development needs that private creditors do not finance;
- preserves borrowers' financial strength by providing support in crisis periods, which is when poor people are most adversely affected;
- uses the leverage of financing to promote key policy and institutional reforms (such as safety net or anticorruption reforms);
- creates a favorable investment climate in order to catalyze the provision of private capital;
- provides financial support (in the form of grants made available from the IBRD's net income) in areas that are critical to the well-being of poor people in all countries.

Middle-income countries, where 70 percent of the world's poor live, have made profound improvements in economic management and governance over the past two decades and are rapidly increasing their demand for the strategic, intellectual and financial resources the World Bank has to offer. The challenge facing the IBRD is to better manage and deliver its resources to best meet the needs of these countries.

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Check Your Progress

1. What are financial institutions?
2. What are special drawing rights?

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To increase its impact in middle-income countries, IBRD is working closely with the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), the International Monetary Fund (IMF) and other multilateral development banks. In the course of its work, IBRD is also striving to capitalize on middle-income countries' own accumulated knowledge and development experiences and collaborates with foundations, civil society partners and donors in the development community.

How RBI is Financed

IBRD raises most of its funds on the world's financial markets. It has become one of the most established borrowers since issuing its first bond in 1947 to finance the reconstruction of Europe after World War Two. Investors see IBRD bonds as a safe and profitable place to put their money and their cash finances projects in middle-income countries.

IBRD became a major player on the international capital markets by developing modern debt products, opening new markets for debt issuance, and by building up a broad investor base around the world of pension funds, insurance companies, central banks, and individuals.

The World Bank's borrowing requirements are primarily determined by its lending activities for development projects. As World Bank lending has changed over time, so has its annual borrowing program. In 1998 for example, IBRD borrowing peaked at $28 billion with the Asian financial crisis. It is now projected to borrow between $10 to 15 billion a year.

IBRD borrows at attractive rates on the capital markets thanks to its triple-A status that it has had with credit rating agencies since 1959. This has enabled it to borrow in U.S. dollars, for example, at an overall funding cost that comes close to that of the U.S. Treasury. IBRD enjoys its high credit rating because it is backed by the capital commitments of its 186 shareholder governments. It is also the result of IBRD's strong balance sheet, prudent financial policies, and its expected treatment as a preferred creditor when a country has difficulty in repaying its loans. IBRD has also profited from anticipating shifts in investor preferences and investing in the risk management and systems to take advantage of those trends.

IBRD has to its credit a string of firsts in its borrowing program. These include the first currency swap in international markets in 1981, through to the introduction of the first global bond in 1989, to the first fully integrated electronic bond offering via the Internet in 2000. In 2003, the World Bank executed the first fully electronic swap auction. Innovations by IBRD have also supported its goal of promoting development. Although much of its borrowing is in U.S. dollars, IBRD has over the years offered bonds in more than 40 different currencies. Its issues in nascent capital markets have often been a catalyst for improving market infrastructure and efficiency.

IBRD's earns an income every year from the return on its equity and from the small margin it makes on lending. This pays for IBRD's operating expenses, goes into reserves to strengthen the balance sheet and also provides an annual transfer to the International Development Association (IDA). IBRD has raised the bulk of the money loaned by the World Bank to alleviate poverty around the world. This has been done at a relatively low cost to taxpayers, with governments paying in $11 billion in capital since 1946 to generate more than $400 billion in loans.

International Finance Corporation

The **International Finance Corporation** (**IFC**) promotes sustainable private sector investment in developing countries.

IFC is a member of the World Bank Group and is headquartered in Washington D.C United States of America. Established in 1956, IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world. It promotes sustainable private sector development primarily by:

1. Financing private sector projects and companies located in the developing world.
2. Helping private companies in the developing world mobilize financing in international financial markets.
3. Providing advice and technical assistance to businesses and governments.

Ownership and Management

IFC has 182 member countries, which collectively determine its policies and approve investments. To join IFC, a country must first be a member of the International Bank for Reconstruction and Development (IBRD). IFC's corporate powers are vested in its Board of Governors, to which member countries appoint representatives. IFC's share capital, which is paid in, is provided by its member countries, and voting is in proportion to the number of shares held. As of June 30, 2010 and 2009, IFC's authorized capital (the sums contributed by its members over the years) was $2.45 billion, of which $2.37 billion was subscribed and paid in.

The Board of Governors delegates many of its powers to the Board of Directors, which is composed of the Executive Directors of the IBRD, and which represents IFC's member countries. The Board of Directors reviews all projects.

The President of the World Bank Group, Robert Zoellick, also serves as IFC's president. IFC's CEO and Executive Vice President, Lars H. Thunell, is responsible for the overall management of day-to-day operations. He was appointed on January 15, 2006.

Although IFC coordinates its activities in many areas with the other institutions in the World Bank Group, IFC generally operates independently as it is legally and financially autonomous with its own Articles of Agreement, share capital, management and staff.

Funding

The IFC's equity and quasi-equity investments are funded out of its paid-in capital and retained earnings (which comprise its net worth). Strong shareholder support, triple-A ratings and a substantial capital base allow the IFC to raise funds on favorable terms in international capital markets.

Activities of IFC

Within the World Bank Group, the World Bank finances projects with sovereign guarantees, while the IFC finances projects without sovereign guarantees. This means that the IFC is primarily active in private sector projects, although some projects in the public sector (at the municipal or sub-national level) have recently been funded.

Private sector financing is IFC's main activity, and in this respect is a profit-oriented financial institution (and has never had an annual loss in its 50-year history). Like a bank, IFC lends or invests its own funds and borrowed funds to its customers and expects to make a sufficient risk-adjusted return on its global portfolio of projects.

IFC's activities, however, must meet a second test of contributing to a reduction in poverty in line with its mandate. In practice, this is broadly interpreted, but considerable time and effort is devoted to both (i) selecting projects with positive developmental outcomes, and (ii) improving the developmental outcome of projects by various means.

IFC provides both investment and advisory services. IFC also carries out technical cooperation projects in many countries to improve the investment climate. These activities may be linked to a specific investment project, or, increasingly, to broader goals such as improving the legislative environment for a specific industry. IFC's technical cooperation projects are generally funded by donor countries or from IFC's own budget.

IFC's Advisory Services focus on five core areas: Access to Finance, Business Enabling Environment, Environmental & Social Sustainability, Infrastructure Advisory, and Corporate Advice. Advisory services to expand access to finance (A2F) often accompanies IFC's financial investments, and includes assistance to banks and specialized financial institutions in improving their ability to provide financial services to micro, small, and medium enterprises.

After successful pilots in several countries, the World Hotel Link project was successfully spun off from the IFC on 31 March 2006 and is now a private company with global reach helping locally owned small scale travel service providers in developing-world destinations overcome market access barriers.

CommDev (The Oil, Gas and Mining Sustainable Community Development Fund) is a funding mechanism for practical capacity building, training, technical assistance, implementation support, awareness-raising, and tool development. Operating flexibly and efficiently, CommDev serves as an integral component of an extractive industry project, enhancing, accelerating, and extending the value-added support given to communities beyond the compliance requirements of IFC investment projects and World Bank loan.

Critics have questioned the sustainability of some IFC-funded projects. The IFC recently invested $9 million in the upgrading of a slaughterhouse facility in the Amazon region owned by Brazil's biggest beef producer, despite opposition from local NGOs and the Sierra club. In 2009 an internal audit found that the IFC had ignored its own environmental and social protection standards when it approved nearly $200 million in loan guarantees for palm oil production in Indonesia.

ASIAN DEVELOPMENT BANK

The Asian Development Bank aims for an Asia and Pacific free from poverty. Approximately 1.8 billion people in the region are poor and unable to access essential goods, services, assets and opportunities to which every human is entitled.

Established in 1966, ADB is a major source of development financing for the Asia and Pacific region. With more than $17.5 billion in approved financing, and 2,800 employees from 59 countries, ADB - in partnership with member governments, independent specialists and other financial institutions - is focused on delivering projects that create economic and development impact.

Whether it is through investment in infrastructure, health care services, financial and public administration systems, or helping nations prepare for the impact of climate change or better manage their natural resources, ADB is committed to helping developing member countries evolve into thriving, modern economies that are well integrated with each other and the world.

The main devices for assistance are loans, grants, policy dialogue, technical assistance and equity investments.

ADB is at the forefront of development thinking and practice, spreading information through regional forums, a growing online presence and the publication of specialized papers, serials and books.

Economists, sociologists, engineers, gender experts and environmental scientists are amongst the hundreds of professions at the bank working together to reduce poverty, and ensure growth across the Asia and Pacific region is sustainable and inclusive.

ORGANIZATION

The highest policy-making body of the bank is the *Board of Governors* composed of one representative from each member state. The Board of Governors, in turn, elect among themselves the 12 members of the *Board of Directors* and their deputy. Eight of the 12 members come from regional (Asia-Pacific) members while the others come from non-regional members.

The Board of Governors also elects the bank's *President* who is the chairperson of the Board of Directors and manages ADB. The president has a term of office lasting five years, and may be reelected. Traditionally, and because Japan is one of the largest shareholders of the bank, the President has always been Japanese. The current President is Haruhiko Kuroda.

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ADB's Effectiveness

Given ADB's annual lending volume, the return on investment in lesson learning for operational and developmental impact is likely to be high and maximizing it is a legitimate concern. All projects funded by ADB are evaluated to find out what results are being achieved, what improvements should be considered, and what is being learned.

There are two types of evaluation: independent and self-evaluation. Self-evaluation is conducted by the units responsible for designing and implementing country strategies, programs, projects, or technical assistance activities. It comprises several instruments, including project/program performance reports, midterm review reports, technical assistance or project/program completion reports, and country portfolio reviews. All projects are self-evaluated by the relevant units in a project completion report. ADB's project completion reports are publicly disclosed on ADB's Internet site. Client governments are also required to prepare their own project completion reports.

Independent evaluation is a foundation block of organizational learning: it is essential to transfer increased amounts of relevant and high-quality knowledge from experience into the hands of policy makers, designers, and implementers. ADB's Independent Evaluation Department (IED) conducts systematic and impartial assessment of policies, strategies, country programs, and projects, including their design, implementation, results, and associated business processes to determine their relevance, effectiveness, efficiency, and sustainability following prescribed methods and guidelines. It also validates self-evaluations. By this process of evaluation, ADB demonstrates three elements of good governance: (i) accountability, by assessing the effectiveness of ADB's operations; (ii) transparency, by independently reviewing operations and publicly reporting findings and recommendations; and (iii) improved performance, by helping ADB and its clients learn from past experience to enhance ongoing and future operations.

Operations evaluation has changed from the beginnings of evaluation in ADB in 1978. Initially, the focus was on assessing after completion the extent to which projects had achieved their expected economic and social benefits. Operations evaluation now shapes decision making throughout the project cycle and in ADB as a whole. Since the establishment of its independence in 2004, IED reports directly to ADB's Board of Directors through the Board's Development Effectiveness Committee. Behavioral autonomy, avoidance of conflicts of interest, insulation from external influence, and organizational independence have made evaluation a dedicated tool—governed by the principles of usefulness, credibility, transparency, and independence—for greater accountability and making development assistance work better. *Independent Evaluation at the Asian Development Bank* presents a perspective of evaluation in ADB from the beginnings and looks to a future in which knowledge management plays an increasingly important role.

In recent years, there has been a major shift in the nature of IED's work program from a dominance of evaluations of individual projects to one focusing on broader and more strategic studies. To select priority topics for evaluation studies, IED seeks input from the Development Effectiveness Committee, ADB Management, and the heads of ADB departments and offices. The current thrusts are to: (i) improve the quality of evaluations by using more robust methodologies; (iii) give priority to country/sector assistance program evaluations; (iv) increase the number of joint evaluations; (v) validate self-evaluations to shorten the learning cycle; (vi) conduct more rigorous impact evaluations; (vii) develop evaluation capacity, both in ADB and in DMCs; (viii) promote portfolio performance; (ix) evaluate business processes; and (x) disseminate findings and recommendations and ensure their use. IED's work program has also been reinterpreted to emphasize organizational learning in more clearly defined results architecture and results framework. It entails (i) conducting and disseminating strategic evaluations (in consultation with stakeholders), (ii) harmonizing performance indicators and evaluation methodologies, and (iii) developing capacity in evaluation and evaluative thinking. All evaluation studies are publicly disclosed on IED's website (some evaluations of private sector operations are redirected to protect commercially confidential information). IED's evaluation resources are displayed by resource type, topic, region and country, and date. Learning's are also gathered in an online *Evaluation Information System* offering a database of lessons, recommendations, and ADB Management responses to these. Details of ongoing evaluations and updates on their progress are made public too.

Beginning 2006, acting within the knowledge management framework of ADB, IED has applied knowledge management to lesson learning, using knowledge performance metrics.

Learning Lessons in ADB sets the strategic framework for knowledge management in operations evaluation. Improvements have been made that hold promise not only in IED but, more importantly, vis-à-vis its interfaces with other departments and offices in ADB, developing member countries, and the international evaluation community. In the medium term, IED will continue to improve the organizational culture, management system, business processes, and information technology solutions, community of practice, and external relations and networking for lesson learning. Among the new knowledge products and services developed, *Learning Curves* are handy, two-paged quick references designed to feed findings and recommendations from evaluation to a broader range of clients *Evaluation News* report on events in monitoring and evaluation. *Evaluation Presentations* offer short photographic or PowerPoint displays on evaluation topics. *Auditing the Lessons Architecture* highlights the contribution that knowledge audits can make to organizational learning and organizational health.

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Check Your Progress

3. What is ADB stands for?
4. What are the various activities of ADB?

Of the 1,106 ADB-funded projects evaluated and rated so far, 65% were assessed as being successful, 27% partly successful and 8% as unsuccessful.

International Development Association

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The **International Development Association (IDA)** is the part of the World Bank that helps the world's poorest countries. It complements the World Bank's other lending arm — the International Bank for Reconstruction and Development — which serves middle-income countries with capital investment and advisory services.

IDA was created on September 24, 1960 and is responsible for providing long-term, interest-free loans to the world's 78 poorest countries, 39 of which are in Africa. IDA provides grants and credits (subject to general conditions), with repayment periods of 35 to 40 years. Since its inception, IDA credits and grants have totaled $161 billion, averaging $7–$9 billion a year in recent years and directing the largest share, about 50%, to Africa. While the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of the richer member countries. Additional funds come from IBRD income and repayment of IDA credits.

IDA loans address primary education, basic health services, clean water supply and sanitation, environmental safeguards, business-climate improvements, infrastructure and institutional reforms. These projects are intended to pave the way toward economic growth, job creation, higher incomes and better living conditions.

Funding

In addition to the funds received by the International Bank for Reconstruction and Development for the IDA's efforts of global aid, its more developed and economically sound member countries provide substantial amount of monetary resources. Approximately half of the IDA's resources come from the 45 donating countries. In its early years of establishment, the IDA received most of its replenishments from the United Kingdom and United States, but because they were not always reliable sources of funding during that time, other developed nations began to step in to fill the economic gaps not met by these two countries. Today, every three years, member nations that provide monetary funds to the IDA gather together to replenish the IDA's resources. These funds primarily come from well developed countries including the United States, Japan, France, Germany, and the United Kingdom; with 58% from the US, 22% from France, and 8% from the UK. Although the IDA's funds are now regularly replenished, this does not happen without some financial and political challenges for the donating countries.

Global Aid

The main purpose of the International Development Association (IDA) is to provide developing countries with interest-free loans that can help elevate their economic status and lessen social strain and thus, raise their standard of living by aiding in their development. Currently, the IDA provides aid to 81 underdeveloped countries with a substantial amount of their funds being sent to countries in Africa, particularly regions in the Sub-Sahara. The amount of aid that is allocated to a given country is determined by two factors: the country's overall per capita level of income (which must be less that $1,135), and how they have utilized previous aid given to them by the IDA. One of the main goals of the IDA is to provide funds to countries so that they can establish social resources aimed at improving the standard of living through institutions and resources such as education, healthcare, sanitation, food, and clean drinking water

UNCTAD

Meaning

The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 as a permanent intergovernmental body. It is the principal organ of theUnited Nations General Assembly dealing with trade, investment, and development issues.

The organization's goals are to "maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to into the world economy on an equitable basis." (from official website). The creation of the conference was based on concerns of developing countries over the international market, multi-national corporations, and great disparity between developed nations and developing nations.

In the 1970s and 1980s, UNCTAD was closely associated with the idea of a New International Economic Order (NIEO).

The United Nations Conference on Trade and Development was established in 1964 in order to provide a forum where the developing countries could discuss the problems relating to their economic development. UNCTAD grew from the view that existing institutions like GATT (now replaced by the World Trade Organization, WTO), the International Monetary Fund (IMF), and World Bankwere not properly organized to handle the particular problems of developing countries.

The primary objective of the UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The Conference ordinarily meets once in four years. The first conference took place in Geneva in 1964, second in New Delhi in 1968, the third in Santiago in 1972, fourth in Nairobi in 1976, the fifth in Manila in 1979, the sixth in Belgrade in 1983, the seventh in Geneva in 1987, the eighth in Cartagena in 1992 and the ninth at Johannesburg (South Africa)in 1996. The Conference has its permanent secretariat in Geneva.

One of the principal achievements of UNCTAD has been to conceive and implement the Generalised System of Preferences (GSP). It was argued in UNCTAD, that in order to promote exports of manufactured goods from developing countries, it would be necessary to offer special tariff concessions to such exports. Accepting this argument, the developed countries formulated the GSP Scheme under which manufacturers' exports and some agricultural goods from the developing countries enter duty-free or at reduced rates in the developed countries. Since imports of such items from other developed countries are subject to the normal rates of duties, imports of the same items from developing countries would enjoy a competitive advantage.

Currently, UNCTAD has 194 member States and is headquartered in Geneva, Switzerland. UNCTAD has 400 staff members and an bi-annual (2010-2011) regular budget of $138 million in core budget expenditures and $72 million in extra-budgetary technical assistance funds. It is also a member of the United Nations Development Group.[1] There is a list of non-governmental organizations participating in the activities of UNCTad

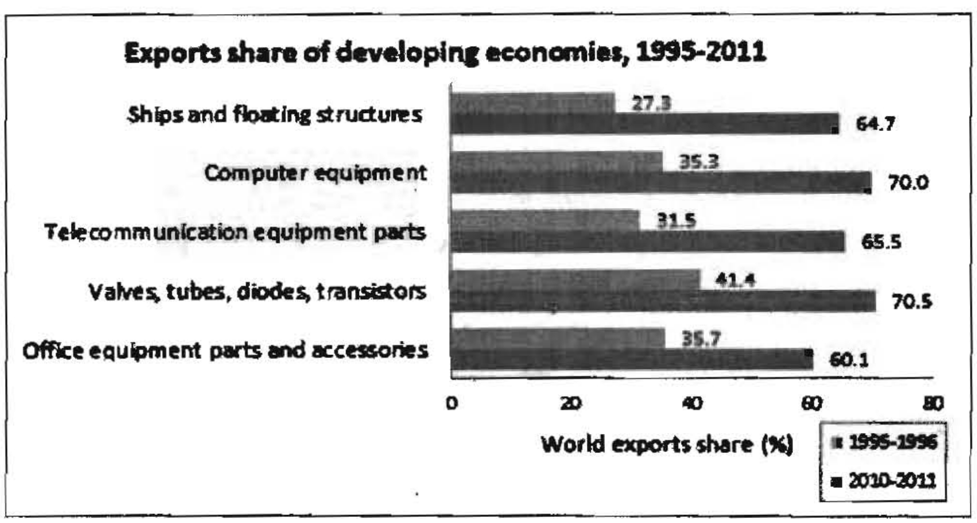
UNCTAD Statistics

Statistics is an inherent part of UNCTAD. Being the United Nations' focal point for the integrated treatment of trade and development and the interrelated issues in the areas of finance, technology, investment and sustainable development, UNCTAD compiles, validates and processes a wide range of data collected from national and international sources. Most of the time series cover long periods, with some dating back to 1948, for almost all economies of the world.

Statistics at a Glance December

Share of developing countries in world exports continues to climb

Led by industrialized Asian economies, developing countries have steadily increased their contribution to world exports over the last decade. In 2011, such countries' exports of manufactured goods accounted for up to 40.4 per cent of the global total. Their share of the most heavily exported manufactured products - including computer equipment, telecommunication equipment parts, valves, tubes, diodes, transistors, and office equipment parts and accessories - came to more than 60 per cent of the world total for the calendar years 2010-2011. That was a gain of more than 30 percentage points compared to 1995-1996.



Source: UNCTAD secretariat calculations based on UNCTADstat

The most rapid rise in export share for developing economies has occurred in the field of ship construction. In 2010-2011, ships and floating structures (cruise and cargo ships, barges, and other vessels) built in developing economies grew to 64.7 per cent of the global total - a climb of 37.4 percentage points from 1995-1996. The principal net exporters were the Republic of Korea, China and India. The main destinations were Singapore, China, and Hong Kong (China), as well as "open registry" countries such as, notably, Liberia, the Marshall Islands, and Panama.

Developing countries' exports of ships and floating structures have grown in each of the past 10 years, even during the global financial crisis of 2008 and 2009. This compensated downturns or stagnation in a number of developed countries

IMPORATNCE OF UNCTAD

There is no denying the fact that, as UNCTAD's mandate has become multidimensional, so its achievements have therefore been of different kinds. The most significant achievements included. a) the agreement on Generalized System of Preferences(GSP) 1971; b) the setting up of the Global System of Trade Preferences among developing Countries(1989); c) negotiation of International Commodity Agreements; d) the establishment of transparent market mechanisms in the form of intergovernmental commodity expert and study groups, involving consumers and producers; e) the negotiation of the Common Fund for Commodities(1989); f) the adoption of the resolution on the retroactive adjustment of terms of Official Development Assistance debt of low-income developing countries; g) the establishment of guidelines for international action in the area of debt rescheduling(1980); h) the Programme of Action for Least Developed Countries for the 1990s and I) the negotiation of convention in the area of maritime transport. In addition to above UNCTAD made some contributions on matters for implementation in other forums. For example, it has contribution in the improvement of the Implementation compensatory facility for export earnings shortfalls of developing countries; the creation of the Special Drawing Rights by IMF; the reduction of commercial bank debt for the highly indebted countries promoted by the World Bank. UNCTAD had also some contribution in the area of code of conduct for the transfer of technology, computerized systems in the area of customs and debt management.

Although for many limitations as I mentioned earlier UNCTAD could not fulfil all expectations but it has tried and still trying with its limited resources to do its work. For the cause of the developing countries the role of UNCTAD should be strengthen. To make it more dynamic and effective some measures should be taken like as follows:

a) The Third World countries should minimize their differences and have to sacrifice their own interest for the sake of other developing countries. It will be easier for UNCTAD to work in a co-operative atmosphere than of conflict.

b) UNCTAD should give emphasis those issues in which it possesses considerable expertise. Here the proposal is not to alter its earlier position, but to focus more strongly on specific matters which are covered little if at all by other organiza-

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tions. In trade field UNCTAD should give importance on consensus building. As UNCTAD provides a universal forum for policy analysis, so for consensus on trade policy issue it can help to prepare ground for later negotiations within WTO. UNCTAD and WTO should co-operate with each other in the field of international trade. It is encouraging that two organization has already started their co-operation. In their joint meeting held in 8th Oct. 1996 WTO Director General said "the convergence between WTO and UNCTAD was evidenced in regular meetings between the heads of the two organizations, joint research projects, co-ordinated technical assistance and generally a more intense working relationship at all levels of the organizations." As the main functions of WTO are the implementation and negotiation of contractual trading rules and discipline, there is considerable scope for complementarity between WTO and UNCTAD.The policy analysis and consensus building functions of UNCTAD can make essential contribution to the intergovernmental consideration of trade issues to the point where they can be fruitfully negotiated in WTO.

d) In post cold war economic environment, the need for collective action by the Third World countries to meet the evolving challenges is more important than ever. UNCTAD is the only body in the UN which has some scope to deal with global economic issues from a development perspective. UNCTAD should be equipped for that purpose.

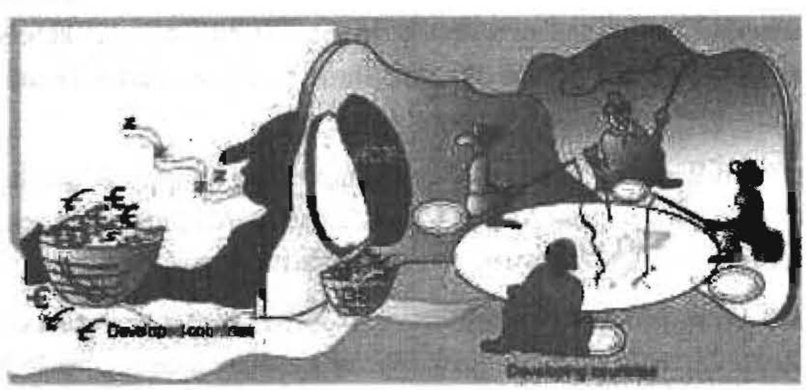
e) UNCTAD's monitoring and analytical capacities should be increased sufficiently.

f) Its efficiency in the area of foreign investment, technology transfer, competition policy regarding Multinational Corporation should be strengthening.

g) UNCTAD should prepare its answer for Third World country regarding liberalization and regional groupings.

Since it has been reorganized to make it more efficient there is no need to dismantle it. Because it still serves a primary purpose to achieve international co-operation in solving international problems of an economic nature. And UNCTAD is the only organization in the world which gives the impression of being trade and development in an integrated way which is very important.

Why do the rich not take Unctad seriously?



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EVER since the World Trade Organisation came into being in 1995, the United Nations Conference on Trade and Development (Unctad) has been under attack from the rich countries for doing excellent work for the developing countries in the international trading system.

First, let us take a look at Unctad's history. Often people have wondered as to why it is called a "conference". An anomaly, which no one has corrected till now. It is not just a conference but also an UN body like many others, such as the UN Environment Programme. It is a derivative of the first conference which was held in 1962 in Geneva.

At that meeting nearly 4,000 official delegates from 119 countries, along with representatives of numerous international organisations had participated with a view to look at the linkages of trade and development. It was, perhaps, the largest international event ever held on any subject. In the 1990s, many more international meets did take place with a larger audience.

Unctad, more than a `conference'

However, the first conference decided to make it into a permanent forum with a review meeting to be held after every three years. But one does not know as to why a proper name was not adopted. Unctad has become a standing body, and more than a "conference". While it continues to do good work - of providing policy analyses and capacity building to developing countries, it has become an unwieldy bureaucracy. As a result, some have even interpreted it as "Under No Circumstances Take Any Decisions".

Humour apart, in the run up to the Unctad XI (June 13 to 18) there was quite a tussle between the North and the South about the Declaration. The US and the EU felt that Unctad should focus on capacity building, rather than on policy analysis. However, the South felt differently. And the Sao Paulo Consensus that emerged carried both the issues as Unctad's agenda. But refrain was sounded at the Sao Paulo meeting.

The British Minister for Trade and Investment, Mr Mike O' Brien, clearly hinted that Unctad is not an alternative negotiating forum. He said, "Unctad should avoid doing what other (WTO) institutions are doing. We need institutions focussed firmly on their core mandate". Further, he reiterated that Unctad is not a negotiating forum and should focus on technical assistance, capacity building, policy consulting and provide scope for thoughtful discussion

Even at earlier meetings, refrain had been sounded. At the Xth meeting at Midrand, South Africa, Mr Harriet Babbitt, a Deputy Administrator at USAID said: "An operational role for Unctad in trade negotiations would involve a confusion of institutional roles and a diversion of limited resources to activities for which Unctad is not the best suited organisation."

Check Your Progress

5. Define UNCTAD
6. Clearify importance of UNCTAD

The rich countries have not only tried to curb Unctad's role in the international trade arena, but over time have continued to show their increasing indifference. One can

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see that from their participation at the meetings. While most developing countries send their Cabinet-level ministers to Unctad meets, participation of ministers of equal rank from OECD countries has been declining. During the three earlier Unctad meetings in 1992, 1996 and 2000 only 12 of the 28 rich countries sent Cabinet ministers. In 2004, the figure dropped to half, that is, only six Cabinet level ministers attended.

Stronger Unctad

Why does the South want a stronger Unctad? A good answer is available in what a senior government of India official said at the IX Session of Unctad: "If there are new issues, they should be subject to very careful examination and analytical work in Unctad on all the implications, and the balances of advantages and disadvantages analysed and disseminated to the people interested in it. There should be a complete embargo on new issues in the WTO agenda unless it has been subject to very careful examination in Unctad". As usual this reflects the North-South conflict of interest in directing the future work of Unctad. The North's attitude towards Unctad has evolved due to several reasons.

One, for example, Unctad has always been critical of IMF and World Bank policies. In the last few years when both the Bretton Woods twins are trying to be more legitimate Unctad issued a report in late 2002 criticising their new approaches to reduce poverty in Africa. Mr Rubens Ricupero, Secretary-General, Unctad, also has been quite critical of the role of developed countries in pushing their agenda in the WTO rounds. In 2001, Mr Ricupero criticised the tariff structure of developed countries and their lip service to the Doha Development Agenda. He said: "The average tariffs that were effectively applied by the US, taking into account all imports, was 1.5 per cent. But the average tariff on goods from Bangladesh was above 12 per cent, while that on goods from France was less than 1.1 per cent. Why is that so? The average hides the fact that there are tariff peaks concentrated on exports, such as those exported by Bangladesh, such as garments. Tariffs are not the most important component of protectionist policies."

After the WTO Ministerial Conference in Doha, Mr Ricupero noted: "I myself have refrained from using the description of development round, because I do not see in any sense that it will be conducive to this result - the first condition, of course, is that unequal countries should be treated unequally. The weakest and most vulnerable must receive special and more favourable conditions."

The Unctad Research Reports also have often criticised the blatant exaggerations of the merits of liberalisation, freer trade and deregulated capital markets, all of which the West swears by a la the Washington Consensus Hence, most developed countries have identified Unctad as being an organisation, which primarily caters to needs of the South, and one that is far from providing a balanced platform for both the North and the South.

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Agreement on Generalised System of Preferences

But the role played by Unctad in pushing for a more democratic international trading system cannot be undermined.

The agreement on Generalised System of Preferences (GSP) introduced in 1971 was negotiated under Unctad and not GATT. This agreement helped developing countries' exports to an extent of $70 billion to receive preferential treatment in most developed markets every year.

Besides the GSP, Unctad was also responsible for the successful negotiations on the Global System of Trade Preferences in 1989, a scheme of preferential tariffs among developing countries only.

In 1980, Unctad successfully pushed for the adoption of the Set of Multilaterally Agreed Principles for the Control of Restrictive Business Practices.

One of the most important contributions of Unctad is in the field of negotiating International Commodity Agreements, including those for cocoa, sugar, natural rubber, jute and jute products, tropical timber, tin, olive oil and wheat; and the negotiation of the Common Fund for Commodities (1989), set up to provide financial backing for the operation of international stocks and for research and development projects in the field of commodities.

Today the North is talking of reducing Unctad's scope to a mere capacity building institution. Unctad is probably the only international organisation that is pushing for equity and space for a fair trading system.

However democratic the WTO may seem, it is always the pressures behind the scene that influence the outcomes. This is exactly where Unctad comes into picture; trying to make the world a better place to live in!

WORLD BANK

The World Bank is an international financial institution that provides loans[3] to developing countries for capital programs.

The World Bank's official goal is the reduction of poverty. According to the World Bank's Articles of Agreement (as amended effective 16 February 1989), all of its decisions must be guided by a commitment to promote foreign investment, international trade, and facilitate capital investment.[4]

The World Bank differs from the World Bank Group, in that the World Bank comprises only two institutions: the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), whereas the latter incorporates these two in addition to three more:[5] International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), and International Centre for Settlement of Investment Disputes (ICSID).

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What Is the World Bank?:

The World Bank provides financial and technical assistance to emerging m market countries. The World Bank is not actually a bank in the common sense. Instead, it consists of two development institutions -- the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA)-- owned by 186 member countries.

The Bank is closely affiliated with three other organizations --the International Finance Corporation (IFC), the Multilateral Guarantee Agency ,

(MIGA), and the International Centre for the Settlement of Investment Disputes tICSID) -- that support its goal of reducing worldwide poverty. The five organizations make up the World Bank Group.

What Is the Purpose of the World Bank?:

The World Bank provides low-interest loans, interest-free credits and grants to developing countries. In the past, this usually occurred when they were in danger of sovereign debt default, itself often a result of overspending and extensive borrowing. Many countries then devalued their currencies, which resulted in hyperinflation. To combat this, the Bank often required austerity measures, where the country must agree to cut back on spending and support its currency.

The World Bank loans are usually to invest in education, health, and infrastructure. The loans can also be used to modernize a country's financial tictcr. agriculture, and natural resources management. The Bank's goal is to "bridge the economic divide between poor and rich countries, to turn rich cot sin, resources into poor country growth and to achieve sustainable poverty reduction."

To achieve this goal, the Bank focuses on six areas:

1. Overcome poverty by spurring growth in the poorest countries, focusing on Africa.
2. Offer reconstruction to poor countries emerging from war, a major contributing factor to extreme poverty.
3. Provide a customized development solution to help those middle-income countries overcome problems that could throw them back into poverty.
4. Spur governments to act on preventing climate change, controlling communicable diseases, (especially HIV/AIDS and malaria), managing international financial crises, and promoting free trade.
5. Work with the League of Arab States to improve education, build infrastructure and provide micro-loans to small businesses in the Arab world.
6. Share its expertise with developing countries, and its knowledge with anyone via reports and its interactive online database.

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World Bank History:

The World Bank was created at Bretton Woods in 1944 to lend to European countries to help them rebuild after World War II. It was the world's first multilateral development bank, and was funded through the sale of World Bonds. Its first loans were to France and other European countries, but soon lent money to Chile, Mexico and India to build power plants and railways. By 1975, the Bank also lent money to countries to help with family planning, pollution control and environmentalism.

Who Runs the World Bank?

Robert ZoeHick has been President of the World Bank since 2007. Zoellick got his start working for President Ronald IZ(.m;an's Treasury Secretary, James Baker. Zoe!lick also worked in executive positions in Fannie Mae (1993-1997), the Office of Trade Representative (2001-2005), the State Department (2005-2006) and Goldman Sachs (2006-2007). He reports to a 25-member Board of Directors, five of whom represent major contributors France, Germany, Japan, the UK and the U.S., while the other countries are represented by the remaining 20 directors. For this reason, and the fact that the U.S. always selects the President, many members complain that the Bank represents the interests of the developed world, not the poor countries it is supposed to help. The Bank has more than 10,000 employees from over 160 countries. Two-thirds work in Washington, DC, with the rest stationed in 100 country offices in the developing world.

World Bank Statistics and Reports:

The World Bank provides a wealth a downloadable data for more than 200 countries. In 2010, the Bank launched a new Open Data website. It provides free access to 298 major indicators, including

- Climate change, the environment and energy,
- Health, such as life expectancy,
- Urban development and infrastructure,
- labor, income and education,
- Government, economic policy and sovereign debt,
- Demographics such as poverty, gender and aid effectiveness,
- Business, agriculture and financial areas.

The Bank also does in-depth analyses of development issues, including the annual World Development Report. A variety of research reports examine global trends in trade, financial flows, and commodity prices, and their impacts on developing countries. Other reports include the World Development Indicators, Global Development Finance, Little Data Book, Little Green Data Book and The World Bank Atlas.

Objectives of World Bank

The World Bank was established to promote long-term foreign investment loans on reasonable terms. The, purposes of the Bank, as set forth in the 'Articles of Agreement' are as follows:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purpose including;

(a) the restoration of economies destroyed or disrupted by war;

(b) the reconversion of productive facilities to peaceful needs; and

(c) the encouragement of the development of productive facilities and resources in less developing countries;

(ii) To promote private investment by means of guarantee or participation in lo s and other investments made by private investors.

(iii) When private capital is not available on reasonable terms, to supplement private investment by providing on suitable conditions finance for productive purpose out of its own capital funds raised by it and its other resources.

(iv) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living, and conditions of labour in their territories.

(v) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(vi) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to peacetime economy.

IMF And The World Bank

History

The plans were laid in July of 1944, while fighting was still raging in the European and Pacific theatres. At a mountain resort in New Hampshire called Bretton Woods, financial representatives from the 44 allied nations devised institutions to alleviate the impediments to international financial growth that had arisen as a result of the war. The International Monetary Fund (IMF) was created to restore the volume of international trade that had dropped due to instability since the 1930s, when countries had abandoned the gold standard. A pool of currencies would be contributed by member states from which any member country could draw upon in order to correct any balance of payment problems. The US dollar was the universal standard, and this was freely convertible with gold at a fixed price.

In December 1945, the IMF and The International Bank for Reconstruction and Development, also known as the World Bank, were officially established. The original purpose of the World Bank was to grant loans to rebuild Europe after the war. Both institutions worked in conjunction with the Marshall Plan for the redevelopment and economic stabilization of Europe.

Description of The IMF

In summary, the stated purpose of the IMF is the following:

- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economy policy.
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- To assist in the establishment of a multilateral system of payments in respect to current transactions between members and in the elimination of foreign exchange restrictions which hampers the growth of world trade.

The IMF is currently considered a specialized agency of the United Nations.

Membership

Currently there are 179 members of the IMF., the most recent being South Africa. The highest authority of the Fund is the Board of Governors, on which each country has 2 representatives: a Governor and an Alternate Governor. This board meets once a year, and occasionally votes are taken by mail. There is also a 24-member Board of Executive Directors which oversees the day-to-day operations of the Fund. The five largest contributors to the Fund (USA, United Kingdom, Germany, France and Japan) each appoint one Executive Director, while the other 19 are elected to represent several nations. For example, the Executive Director from Iran also represents Afghanistan, Algeria, Ghana, Morocco, Pakistan and Tunisia. Meetings are held behind closed doors, excluding the public and media to access of the proceedings and minutes.

Decision-making

Decision-making power is based on a proportional system of evaluating a member nation's quota. The quota is related to national income, monetary reserves, trade balance and other economic indicators. Besides being the factor which decides how much voting power a nation will carry, it also decides how much that nation must contribute to the Fund. By far the nation with the largest quota, and thus decision-making power, is the USA with nearly 18%. Germany, Japan, France and United Kingdom follow with approximately 5% each, while Saudi Arabia holds about 3.5%. Thus, the 6 leading nations in the IMF have about 40% of the decision-making power. Meanwhile, the entire continent of Africa comprises less than 5% of the decision-making power.

Tasks

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One of the main tasks performed by the IMF is the provision of short-term (1 to 3 years) loans, which are made contingent on the imposition of structural adjustment programs (SAPs). These are usually designed to correct a deficit, and can involve any of the following measures: abolishing or liberalizing foreign exchange and import controls; reducing growth in the domestic money supply; increasing taxes and reducing government spending; abolishing food, fuel, and transportation subsidies; cutting government wages and seeking wage restraint from labor unions; dismantling price controls; privatizing publicly owned firms; reducing restrictions on foreign investment; and depreciating the currency.

Description of The World Bank

The World Bank was originally instituted to aid in the reconstruction of post-war Europe; its current purpose is to assist the economic development of nations by making loans where private capital is not available. Its stated goals are the reduction of poverty in developing countries, the protection of the environment, and the promotion of both private sector and human resource development. The World Bank is currently considered a specialized agency of the United Nations.

Membership

There are 177 member countries of the World Bank, the most recent of which is South Africa. Only members of the IMF may be considered for membership. There is a Board of Governors, which consists of one representative from each country, that meets each year. The day to day operations are run by a board of 24 Executive Directors, which is a body appointed much like that of the IMF (see above).

Decision-making

Most decision-making is delegated by the Governors to their specific Executive Directors. Formal votes by the Directors are rare, for most decisions are made by consensus. Thus, the Directors consider and decide on Bank policy and on all loan and credit proposals. They present to the governors at the annual meetings an audit of accounts, an administrative budget, and any other pertinent issues. The current president and chairman of the Executive Directors is Lewis T. Preston from the USA.

Tasks

The World Bank works closely in conjunction with the IMF in performing its tasks. It makes available loans, which are on a long-term basis, repayable in up to 15 years. They are usually made for projects which are likely to offer a commercially viable rate of return. Recently, the World Bank has begun structural adjustment lending, which instead of financing specific projects, supports changes in economic structure. The Bank's programs for alleviating poverty have two main elements: the compiling of country-specific assessments, and the formulation of country-specific strategies which ensure that the Bank's projects support and complement the programs of the country in question.

Criticism

Considering the state of the world's economy and the disparity between rich and poor nations, the Bretton Woods institutions have come under much criticism. This criticism has come from the entire spectrum of political thought, ranging from the "aid is imperialism" school, which believes that foreign aid has been used as a tool of coercion by the rich against the poor countries, to the more conservative critics who believe that foreign aid gets in the way of the market forces that will be the ultimate rectifier of poverty.

"50 Years is Enough"

Approximately 400 non-governmental organizations worldwide have mounted a campaign which calls for major restructuring and reevaluation of the Bretton Woods institutions' policies. As 1994 is the 50th anniversary of the Bretton Woods conference where the IMF and World Bank were formed, the campaign is called "50 Years is Enough." Some of the criticisms listed in the campaign's platform are:

Societal Factors

The IMF lacks the expertise to deal with social and environmental issues, and does not adequately accommodate the widely differing economic situations in each country. The lack of country-specific policies has hindered the stabilization of economies, and has rendered the IMF sometimes ineffective at the realization of its own goals. By aiming to focus only on correcting short-term balance-of-payment problems, the IMF has harmed the social fabric of the countries they claimed to have helped.

Some recent examples are in Eastern Europe. In 1986, the IMF imposed a SAP in Yugoslavia which devalued the dinar. The resultant inflation is considered a contributing factor to the already tense environment of ethnic tension and nationalism which has led to the current conflict throughout the region. In Russia and other former Soviet bloc countries, the IMF imposed "economic shock therapy" measures, which involved the sudden introduction of capitalism into what were previous command economies. The result has been widespread unemployment, and in the case of Poland going from 0% in 1990 to 15% in 1993. This has also led to the devaluation of pensions and large cuts in social services. In Russia, similar conditions are commonly attributed to the rise in popularity of ultra-nationalism, and the rise of Vladimir Zhirinovsky.

The Environment

More than half of the World Bank's $24 billion annual lending supports projects in environmentally sensitive areas. According to the campaign, the record of lending in these areas has been characterized by "needless environmental destruction and missed opportunities for economically more efficient and environmentally more friendly alternatives." As an example, between 1986 and 1993, 15% of World Bank loans were for projects (such as dams) which forcibly displaced 2 million people.

No Public Access

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The campaign points out the problems of secrecy with which the two institutions operate. In the case of the World Bank, decisions that are made by the management are sometimes kept secret from the Bank's Executive Directors. Those citizens of the country who will be most affected by the decisions are left out of the decision-making process, with the exception of community meetings with World Bank officials which the campaign deems as public relations-driven window dressing. It was discontent with this culture of secrecy that led to the recent resignation of Herman Daly, formerly the Senior Economist of the Bank's Environment Department.

Not Addressing the Root Causes of Poverty

The World Bank has, according to the campaign, failed to address the structural problems of poverty, and these problems are exacerbated by SAPs. The Bank is "throwing good money after bad" by creating poverty situations, which lead to the necessity of further loans to attack the symptoms of the disease.

Perpetuation of the Debt Crisis

Currently, $278 billion is owed to the World Bank and the IMF. The pressure of the debt, as well as export-oriented SAPs and collapsing global prices for exports, have put many countries on an accelerating treadmill, forcing them to sell their assets, mine their natural resources and cut spending. Often this debt occurred because of loaning to corrupt regimes, such as that of Marcos in the Phillippines, Mobutu in Zaire and Somoza in Nicaragua. While many commercial banks and creditor nations have agreed to some debt reduction and rescheduling, the IMF and World Bank refuse to reschedule or reduce debt payments.

Destructive Agricultural Practices

The emphasis on World Bank agricultural lending programs is the development of export crops. The result is farming practices which emphasize chemical-intensive methods which are designed to achieve high economic rates of return. This includes hybrid seeds requiring intensive watering, chemical fertilizer, and pesticide use. Environmental problems stemming from these methods include soil degradation, limited and contaminated water supplies, loss of crop genetic diversity and deforestation. While the emphasis on export crops is designed to alleviate debt, food production for local consumption has fallen behind demand in some countries.

According to the World Bank's own evaluation process, of 82 agricultural projects, 45% were considered unsatisfactory. In a 1990 evaluation report, it was found that projects in the Northeast of Brazil benefited 100,000 owner companies while excluding most of the targeted 3 million low-income families from credit and agricultural services, as well as from the design of projects. An internal report on projects in India in 1991 reported that "project performance and economic viability have been poor all along for most projects" for many reasons, including cost and time overruns, declining construction and maintenance standards, and environmental degradation.

Aid as Deterrent to Market Forces

Other criticism of the Bretton Woods institutions, and foreign aid in general, comes from advocates of market forces. The belief is that much foreign aid is transferred from government to government, leaving people short-changed and bureaucrats and politicians, some corrupt, the beneficiaries. This promotes a disastrous politicization of life in developing countries, as well as Western-type heavy industries rather than small firms using indigenous technology. This over-stressing of the role of government discourages private market development and curtails the flow of private capital.

This process prolongs a country's dependence on official assistance, while only contributing at best a small fraction of investment. Examples of the commercial export development in West Africa and Malaysia in the early 80s are held up as models of private enterprise performing what foreign aid could not.

The World Bank and WHO developmental goal :

The WHO Health for All by the year 2000 program was very ambitious and had a tight deadline. The success of the program may be questionable but it did help many countries to start formulating health goals for the population, rather than planning all health care activities on treatment indicators. The Millennium Development Goals follow this tradition. This time the goals are fewer and less detailed and some of them have a deadline (2015). All the stated goals are related to health, some by targeting health determinants, others more directly by targeting child mortality, maternal health and certain infectious diseases. The health goals will be achieved if social inequalities within and between countries are reduced by improving the conditions for the poor. Some of the health goals can even be reached should that not be the case. [Evans et al, 2005a; Evans et al, 2005b]

The IEA support these goals. Our ideas about the priority may vary but we believe that achieving these goals would be a victory for public health.

How could epidemiologists help and can the IEA do anything to support the program?

We can do something and we are doing something. Epidemiologists are needed to monitor burdens of disease, and should focus their research on areas that shorten life expectancy and contribute to growing social inequalities in health. Epidemiologic training is needed. Formal education in how best to work with epidemiologic problems is unfortunately shortest in supply where it is needed the most. Many universities and schools of public health have trained many epidemiologists from low and middle income countries. Unfortunately, they often remain in the countries were they received their training or they go back home and take administrative jobs, because the conditions for doing epidemiology in their homeland are too poor. We suggest

Check Your Progress

7. Clarify World Bank.
8. Write objectives of World Bank.

a new research structure that may bring some of these epidemiologist back to the countries where their epidemiologic skills are most needed.

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Our WCE and especially our regional meetings in poor countries are important in keeping these people in touch with the health problems they left. The meetings also provide new inputs to these regions and make it possible for epidemiologists from within and outside the regions to meet and establish collaborative work.

We have decided to use of our experience from the Florence EEPE/IEA course to set up an annual summer course on epidemiological research methodology for developing countries. The proposed course will be held in a different region of the world each year. We believe that short term courses not only serve to raise awareness of the importance of epidemiology for developing countries, but are also an effective method for identifying and selecting people who are candidates for more long term training within a university program.

It has been a common belief that we can use causal models and preventive strategies, developed in affluent societies and apply these strategies to countries with a completely different infrastructure, social context and life style factors. Such technology transfer will often fail, even for some of the vaccination programs. Given the contextual importance of "upstream" determinants of chronic disease risk factors, it would be unreasonable to expect technology transfer to work for prevention of cardiovascular diseases or other life style related diseases that more and more will dominate the disease profile in developing countries.[WHO, 2005; Strong et al, 2005]

High quality, large scale evaluation studies will be needed to learn how we best prevent these diseases in developing countries.[Ebrahim & Smeeth, 2005] There is a scientific and public health need that should be met with ambitious research plans. Such plans could make it attractive for skilled epidemiologists to return to their home regions in order for them to make better use of their training. Too much research money in developing countries has been spend on short term projects, performed by people with limited epidemiological skills and with limited logistic support.

We suggest using the model of cancer research to coordinate large scale studies in epidemiology with the capacity to incorporate biological tools with modern epidemiologic methods. We suggest that an International Agency for Epidemiologic Research on Chronic Diseases is established and placed in a developing country. Like IARC (the International Centre for Research on Cancer), this centre should refer to WHO and the donor countries or donor orgnisations. Initially, its main topics for research should be the chronic diseases with the highest impact on quality of life like cardiovascular diseases and mental disorders. The Agency should address these diseases aetiology and the preventive strategies in developing countries. The centre should coordinate research, intervention programmes and maintain databases. It should have a small permanent staff but have room for external experts that will be assigned to specific research programs. The Centre should undertake training programs as well

Definition of 'Foreign Direct Investment - FDI'

An investment made by a company or entity based in one country, into a company or entity based in another country. Foreign direct investments differ substantially from indirect investments such as portfolio flows, wherein overseas institutions invest in equities listed on a nation's stock exchange. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made. Open economies with skilled workforces and good growth prospects tend to attract larger amounts of foreign direct investment than closed, highly regulated economies.

Introduction

Indian markets, across all industries, are considered as viable long-term investment options as the country stands strong amid global financial turmoil. India is considered to be the third most favoured destination for investment after China and the US for major global companies, according to UNCTAD's World Investment Report 2012. The report anticipates that foreign investments in India could increase by over 20 per cent in 2012-13.

International majors, dealing in diverse businesses, are keen to partner with Indian conglomerates in a bid to tap fresh markets and increase their global market share. Various deals and developments pertaining to foreign direct investment (FDI) in India are discussed hereafter.

Key Statistics

- India received FDI worth US$ 1.47 billion in July 2012 while cumulative inflows for April-July 2012-13 stood at US$ 5.9 billion, according to latest data released by the Department of Industrial Policy and Promotion (DIPP)

  The sectors which attracted huge FDI inflows during the April-July 2012-13 are: services (US$ 1.65 billion), pharmaceuticals (US$ 478 million), construction (US$ 421 million), metallurgical industries (US$ 334 million), power (US$ 237 million) and automobile (US$ 234 million)

  Mauritius infused highest inflows worth US$ 1.97 billion, followed by Singapore (US$ 886 million), Netherlands (US$ 616 million), the UK (US$ 421 million), Japan (US$ 417 million) and Germany (US$ 276 million)

- Private Equity (PE) companies have invested about US$ 2.5 billion through 97 deals during the July-September 2012 quarter, according to a report by research firm Venture Intelligence. The investment saw a quantum jump from the previous year's quarter (when US$ 2, 415 million were invested through 120 transactions) as well as from the immediate previous quarter (when US$ 1, 909 million were invested across 105 deals)

- Similarly, the country's mergers and acquisitions (M&As) activities intensified in July-September 2012 quarter wherein deals worth US$ 9 billion were recorded; marking a stupendous growth of 310 per cent over April-June 2012. This took the total M&A deal value to US$ 28 billion in 2012

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- Foreign exchange reserves stood at US$ 294.81 billion for the week ended September 28, 2012 wherein the value of gold reserves was recorded at US$ 28.133 billion and that of foreign currency assets (FCAs) was at US$ 259.96 billion, according to the Reserve Bank of India (RBI)'s weekly statistical supplement. The value of special drawing rights (SDRs) was US$ 4.45 billion and the country's reserve position with the IMF was at US$ 2.27 billion

Key Developments

The Government has recently cleared 14 FDI proposals worth Rs 113.35 crore (US$ 21.38 million) based on the recommendations of Foreign Investment Promotion Board (FIPB). Major proposals include an equity increase of Rs 68.22 crore (US$ 12.87 million) by the UK-based Dashtag to conduct business of pharmaceuticals specialising in dermatology, anti-histamines, antibiotics and oncology products.

Prime Surgical Centers Private Ltd's proposal to set up a Limited Liability Partnership (LLP) also got a nod from FIPB wherein the company would establish and manage short stay surgery centres in India with its flagship centre in Pune by investing around Rs 14 crore (US$ 2.64 million). Neo Capricorn Plaza Ltd and Pipavav Defence and Offshore Engineering Company Ltd were also among other companies which recieved permission to bring in FDI in the country.

- Japanese auto major Nissan intends to introduce 10 new passenger car models by the end of March 2016 in a bid to boost its volumes in India. The company also aims to double its vehicle sales in 2012-13 from last year's 33,000 units and eventually gain 8 per cent of the market pie by 2016
- United Nations Industrial Development Organisation (UNIDO), Austria has appointed Ramky Enviro Engineers Limited (REEL) as its strategic partner to work on a project for the Bhilai Steel plant wherein the project focuses to offer 'Sound Environmental Management and Final Disposal of Polychlorinated Biphenyls (PCBs)' in compliance with the Stockholm Convention

  This is a turnkey US$ 4.2 million-project, to be funded by UNIDO under Global Environmental Facility (GEF) and first-of-its-kind in India
- Mahindra Finance's subsidiary Mahindra Insurance Brokers (MIBL) has formed a venture with LeapFrog Investments wherein the latter's subsidiary, Inclusion Resources Singapore, would infuse Rs 80.41 crore (US$ 15.17 million) for a 15 per cent stake in MIBL
- Italy-based agricultural machinery producer Maschio Gaspardo Group has ventured in India by establishing a new facility at Ranjangaon near Pune which entailed an investment of Rs 200 crore (US$ 37.72 million). The company plans to invest additional Rs 100 crore (US$ 18.86 million) over 2012-17. With an annual capacity of 20,000 units, the Pune plant would initially manufacture rotary tillers, mulchers and seeders for the domestic market

- Dubai-based KEF Company plans to invest Rs 1,600 crore (US$ 301.58 million) for three projects in Kozhikode which include a luxury hotel, integrated manufacturing facilities with pre-cast concrete technology and a super speciality hospital. Faizal Kottikollon, Chairman of the company, has stated that these projects would create 5,000 to 10,000 jobs in the State

Policy Initiatives

In a much-awaited decision, the Government has finally given its nod to 51 per cent FDI in multi-brand retail. The decision will pave way for retail giants like Walmart, Tesco and IKEA to enter into Indian market and make footprints in the US$ 450 billion-retail-industry. Moreover, the Government has relaxed sourcing norms for single-brand retailers and has permitted them to buy at-least 30 per cent of the goods from Indian industry, rather than particularly from Indian small and medium enterprises (SMEs) as per earlier stipulation.

In case of civil aviation, the Government has allowed foreign carriers to buy up to 49 per cent stake in their Indian counterparts.

Further, to sustain the momentum of the above stated reforms, the Government would take more decisions to attract overseas investors. The measures being considered include raising the ceiling for foreign borrowings, easing curbs on portfolio investors, and liberalising norms for overseas borrowings.

The annual ceiling for External Commercial Borrowings (ECBs) is likely to be incremented by US$ 10 billion from the current US$ 40 billion, to encourage capital formation while the foreign institutional investors (FIIs) and non-resident Indians (NRIs) could be permitted to invest in exchange-traded currency futures markets subject to the participation being limited to their rupee exposure in India.

Road Ahead

With the Government of India laying intense focus on increasing the country's share in the global FDI space from 1.3 per cent in 2007 to 5 per cent by 2017 by relaxing and un-complicating the FDI norms, it is expected that foreign majors would invest aggressively in the flourishing Indian markets.

Exchange Rate Used: INR 1 = US$ 0.01885 as on October 15, 2012

In the last two decades world has seen an extensive inflow of FDI or foreign direct investment into developing countries. More and more developing countries are competing with each other to attract this investment. Restrictions which were earlier in place on these investments are now being removed as the importance of FDI is being realized.

FDI has a major role to play in India's economic development. The total FDI inflow in our country was US$27 billion in 2010-11. Over the past few years, many sectors have seen the growth of foreign investment. The Government is also coming out with new reforms to promote more and more of this investment.

What is FDI?

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It refers to an investment made by a foreign individual or a company in the productive capacity of another country. It can be considered as the movement of capital across national frontiers in a manner that allows the investor to have a control over the investment. Firms that provide FDI are referred to as MNCs. The investors can invest in existing industries/business or can promote new industries. There can be two types of FDI- inward and outward. The cumulative of two, results in net FDI inflow. FDI is freely allowed in all the sectors except a few sectors, though in certain sectors FDI is not allowed beyond a ceiling.

Why is FDI needed?

FDI plays a major role in developing countries like India. They act as a long term source of capital as well as a source of advanced and developed technologies. The investors also bring along best global practices of management. As large amount of capital comes in through these investments more and more industries are set up. This helps in increasing employment. FDI also helps in promoting international trade. This investment is a non-debt, non-volatile investment and returns received on these are generally spent on the host country itself thus helping in the development of the country.

Some of the sectors that attract high FDI inflows in India are the hotel and tourism industry, insurance sector, telecommunication, real estate, retail, power, drugs, financial services, infrastructure and pollution control etc. FDI is not permitted in the following sectors:

- Railways
- Atomic energy
- Defence
- Coal and lignite

An investor has to take a decision regarding the following aspects while investing:

- **Exchange Rate** - The stronger the foreign currency is in comparison to that of the host country, lesser will be the amount of investment required. In other words, depreciation of currency in the host country will lead to more investments.
- **Market Size** - This refers to the GDP growth. Developing and emerging countries are more likely to attract investments.
- **Infrastructure** - Investors will invest in a country if they think that the country has suitable infrastructure to support the business.
- **Tax regime** - MNCs are subject to tax in both the parent as well as host country. The host country which attempts to reduce this double taxation of MNCs will attract more FDI.

- **Labour market conditions** - The educational levels of the labour as well as the wage rates also play a major role in determining the flow of FDI.
- Financial and economic stability
- Political stability

Following are some of the sectors in our country which attract massive FDI investments:

Retail Sector

This industry accounts for 13% of country's GDP. Retail outlets acts as an interface between the producers and the consumers of a good. Indian government liberalized FDI in 2005 in this sector to 100%, thus enabling foreign investors to set up retail companies in India.

Retail industry is divided into organised and unorganised sectors. Organised sectors include hypermarkets and retail chains whereas unorganised sector include local kirana shops (mom and pop stores). The latter is more prevalent in India. Due to massive development taking place, organised sector is increasing its foothold in the country. Since advanced technology and management structure is used with foreign investments the price of the goods in the organised retail industry falls and productivity of the firm increases. Today modern retail outlets provide everything from basic amenities to luxury goods. They also provide consumer with a wide variety. They have become the one-stop shop for customers. This trend is destroying the sales of unorganised retail sector. Therefore on one hand FDI helps in reducing prices of the manufactured goods and on the other, it is rendering our unorganized retail sector paralyzed. The government has recently made it mandatory for foreign investors in multi-brand retail sector to do their bulk sourcing from small farmers. With this move government is preventing wipe-out of shopkeepers and small retailers.

Manufacturing Sector

Government has allowed 100% FDI in this sector except in defence industry and cigarette manufacturing. Foreign investments in this sector will help in employment of semi-skilled labour by providing them with access to developed technology.

Real Estate, Construction Development and Tourism

Any country's growth and development is determined by its infrastructure. Due to increasing population and migration of people from rural to urban areas, the real estate sector is booming. Tourism industry is one of the major earners of foreign exchange for the country. It has a huge potential for our economy. It is also one of the major sectors in employment. Large amount of investments are needed to build roads, bridges, infrastructure so as to promote overall economic development of the country.

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Power Sector

Power is considered most crucial sector for development. Since public sector alone was not able to meet the demands, investments from private and foreign investors was encouraged. Power generation, transmission and distribution are main areas of consideration. India has a vast scope of development in hydel power, nuclear power, solar power, thermal energy as well as in wind energy. Renewable sources of energy require vast amount of investments for research and development.

Conclusion

FDI, thus on one hand helps in increasing the output through usage of advanced technology and management techniques and on the other it is a threat to local companies in the country. Government should take steps in the direction of integrating foreign investors with local businesses. This will help in overall economic development as well as preservation of country's heritage. MNCs should be allowed to set up in such a manner that they help increase the standard of living of our country instead of sole profit making.

FDI in India Advantages and Disadvantages

Overview

First of all, FDI means Foreign Direct Investment which is mainly dealings with monetary matters and using this way they acquires stand alone position in the Indian economy. Their policy is very simple to remove rivals. In beginning days they sell products at low price so other competitor shut down in few months. And then companies like Wall-Mart will increase prices than actual product price.

They are focusing on national and international economic concerns. There are four main working pillars of FDI. They are financial collaborations, technical collaborations and joint ventures, capital markets via Euro issues, and private placements or preferential allotments.

There are two types of FDI, one is inward FDI and second is outward FDI. Ongoing news suggests that largest retailer Wal-Mart has demanded for 51% of international dealings in FDI in Indian markets which had called nationwide strike. From positive and negative aspects FDI has its own advantages and disadvantages.

Advantages

- Increase economic growth by dealing with different international products.
- 1 million (10 lakh) employment will create in three years - UPA Government.
- Billion dollars will be invested in Indian market.
- Spread import and export business in different countries.
- Agriculture related people will get good price of their goods.

- Will affect 50 million merchants in India.
- Profit distribution, investment ratios are not fixed.
- An economically backward class person suffers from price raise.
- Retailer faces loss in business.
- Market places are situated too far which increases traveling expenses.
- Workers safety and policies are not mentioned clearly.
- Inflation may be increased.
- Again India may become slave because of FDI in retail sector.

Chapter Summary

International financial institutions (IFIs) are financial institutions that have been established (or chartered) by more than one country, and hence are subjects of international law. Their owners or shareholders are generally national governments, although other international institutions and other organizations occasionally figure as shareholders. The most prominent IFIs are creations of multiple nations, although some bilateral financial institutions (created by two countries) exist and are technically IFIs. Many of these are multilateral.

Answers to check your progress

1. Financial institutions are the bodies that look after financing issues of various countries around the world.
2. The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries.
3. ADB stands for Asian Development Bank
4. Activities of ADB involve financing, reconstructing, lending, monetary support etc.
5. The organization's goals are to "maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to into the world economy on an equitable basis." (from official website). The creation of the conference was based on concerns of developing countries over the international market, multi-national corporations, and great disparity between developed nations and developing nations.

   In the 1970s and 1980s, UNCTAD was closely associated with the idea of a New International Economic Order (NIEO).

   The United Nations Conference on Trade and Development was established in 1964 in order to provide a forum where the developing countries could discuss the problems relating to their economic development. UNCTAD grew from the view that existing institutions like GATT (now replaced by the World Trade Organization, WTO), the International Monetary Fund (IMF), and World Bankwere not properly organized to handle the particular problems of developing countries.

The primary objective of the UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The Conference ordinarily meets once in four years. The first conference took place in Geneva in 1964, second in New Delhi in 1968, the third in Santiago in 1972, fourth in Nairobi in 1976, the fifth in Manila in 1979, the sixth in Belgrade in 1983, the seventh in Geneva in 1987, the eighth in Cartagena in 1992 and the ninth at Johannesburg (South Africa)in 1996. The Conference has its permanent secretariat in Geneva.

6. There is no denying the fact that, as UNCTAD's mandate has become multidimensional, so its achievements have therefore been of different kinds. The most significant achievements included. a) the agreement on Generalized System of Preferences(GSP) 1971; b) the setting up of the Global System of Trade Preferences among developing Countries(1989); c) negotiation of International Commodity Agreements; d) the establishment of transparent market mechanisms in the form of intergovernmental commodity expert and study groups, involving consumers and producers; e) the negotiation of the Common Fund for Commodities(1989); f) the adoption of the resolution on the retroactive adjustment of terms of Official Development Assistance debt of low-income developing countries; g) the establishment of guidelines for international action in the area of debt rescheduling(1980); h) the Programme of Action for Least Developed Countries for the 1990s and I) the negotiation of convention in the area of maritime transport. In addition to above UNCTAD made some contributions on matters for implementation in other forums. For example, it has contribution in the improvement of the Implementation compensatory facility for export earnings shortfalls of developing countries; the creation of the Special Drawing Rights by IMF; the reduction of commercial bank debt for the highly indebted countries promoted by the World Bank. UNCTAD had also some contribution in the area of code of conduct for the transfer of technology, computerized systems in the area of customs and debt management.

7. The World Bank is an international financial institution that provides loans[3] to developing countries for capital programs.

   The World Bank's official goal is the reduction of poverty. According to the World Bank's Articles of Agreement (as amended effective 16 February 1989), all of its decisions must be guided by a commitment to promote foreign investment, international trade, and facilitate capital investment.[4]

   The World Bank differs from the World Bank Group, in that the World Bank comprises only two institutions: the International Bank for Reconstruction and

Development (IBRD) and the International Development Association (IDA), whereas the latter incorporates these two in addition to three more:[5] International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), and International Centre for Settlement of Investment Disputes (ICSID).

8. **Objectives of World Bank**

The World Bank was established to promote long-term foreign investment loans on reasonable terms. The, purposes of the Bank, as set forth in the 'Articles of Agreement' are as follows:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purpose including;

  (a) the restoration of economies destroyed or disrupted by war;

  (b) the reconversion of productive facilities to peaceful needs; and

  (c) the encouragement of the development of productive facilities and resources in less developing countries;

(ii) To promote private investment by means of guarantee or participation in lo s and other investments made by private investors.

(iii) When private capital is not available on reasonable terms, to supplement private investment by providing on suitable conditions finance for productive purpose out of its own capital funds raised by it and its other resources.

(iv) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living, and conditions of labour in their territories.

(v) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(vi) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to peacetime economy.

9. Definition of 'Foreign Direct Investment - FDI'

An investment made by a company or entity based in one country, into a company or entity based in another country. Foreign direct investments differ substantially from indirect investments such as portfolio flows, wherein overseas institutions invest in equities listed on a nation's stock exchange. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made. Open economies with

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skilled workforces and good growth prospects tend to attract larger amounts of foreign direct investment than closed, highly regulated economies.

10. Advantages

- Increase economic growth by dealing with different international products.
- 1 million (10 lakh) employment will create in three years - UPA Government.
- Billion dollars will be invested in Indian market.
- Spread import and export business in different countries.
- Agriculture related people will get good price of their goods.

Disadvantages

- Will affect 50 million merchants in India.
- Profit distribution, investment ratios are not fixed.
- An economically backward class person suffers from price raise.
- Retailer faces loss in business.
- Market places are situated too far which increases traveling expenses.

Test yourself

1. Enumerate the functional machinery of various financial institutions of the world.
2. What are the basic aims of International Monetary Fund?
3. What are Special Drawing Rights and how they are issued to fellow member countries?
4. Throw a light on the key activities of International Finance Corporation.
5. UNCTAD and explain its importance.
6. Clarify world Bank. Explain its history and objectives.
7. Define Foreigh Direct Investment.
8. Describe types of Foreign Direct Investment.
9. Explain its advantages and disadvantages.

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7 International Trade

The Chapter Covers :

INTRODUCTION

It is important to understand that the global, political environment has a great role to play in all business and economic matters. The political environment of a country comprises the international, host-country and the home-country environment. Dealing with problems in the political arena is the principal challenge facing international managers in developing pro-political strategies to run the business successfully in the host country. The international political strategies to run the business successfully in the host country. The international political environment involves political relations among the countries of common ideologies. The foreign firm has to maek adjustments with the host country's international relations, no matter how non-aligned it may try to be. This unit will discuss how political interventions affect the marketing mix functions of the firm in the host country. You will also learn about expropriation, domestication and nationalization. The unit will also discuss the significance of tariff barriers and anti-dumping laws in international marketing.

INTERNATIONAL POLITICAL ENVIRONMENT

The international political environment includes political relations among the countries of common ideologies. The foreign finr, has to make all adjustments with the host country's international relations. no matter how non-aligned it may try to be. Such strategic adjustments in tune to the international en vironment of the host country are required as its operations are frequently related al so to the neighbouring countries. either on the supply or demand side or both. Another critical factor affecting the political environment is the diplomatic relations ofthe host countries \vial others in the region or beyond. If a country is a member of a regional organization, such as the EU, NAFTA, ASEAN. etc., its political identity influences the firm'scperational and expansi(n opportunities. If a country has specific friendly or hostile relationship with a particular nation, the organization has to .ievelon its international strategies to conform to the trade policy of that country anc! take into consideration the particular conditions of demand and supply in that nation, For example, the United States imposs restrictions trade with various countries. and Arabian countries do not entertain any business activities with Israel. The participation of the host country in the re gional trade agreements or with the international trade organizations may affect patents, communication, transportation. and other items of interest to the international marketer. As a rule. the more international organizations a country belongs to, the more regulations it accepts, and the more dependable is its economic, political and legal environment.

The political environment at home is also an important indicator fora firm to decide its entry into the host country. However, an adverse environment therein may restrict its international as well as internal projects. The best-known instance ofthe home-counny political situation affecting international projects is South Africa. Home-country political pressures induced more than 200 American firms to leave that country altogether. In the private sector, the bottom line is shareholder value. In government, the objectives can be harder to pinpoint as they may be clouded by political agendas. turf battles, special interests and economics. Some of the key issues in reference to measurin g the performance of the government in the given political environment of the home country may he considered by the firm as:

- **Measuring performance:** The government has to gauge performance by what has been achieved. Leaders should understand the real results that are being delivered, and how much real progress is being made.
- **Improving through competition:** The government's position is often perceived to be precarious vis-a-vis social pressures. The issues of trade pro-

tection, allowing foreign companies to participate in the host country, repatriation of profits and other economic issues are subject to the prevailin g political ideology in the host cow itry.

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- **Streamlining operations:** It is necessary for a foreign firm to examine the conduct of government activities in the home country. Many government operations can be performed by third parties often at lower cost and with equal or higher quality.
- **Promoting efficiency:** Most government employees are skilful diligent people. But like any workforce, their behavioural pattern is extremely by the organization's rewards and incentives.

Many multinational companies face uncertainty in political environment due to instability of political leadership. coalitions and external pressures influenced. Even if the home country and the host country give them no problems, they can face threats in the neighbouring markets. Firms that do not have problems with their home government or tlle. host government may be bothered or boycotted in neighbouring countries. Escalation ofpolitical conflict in many developing countries and their impact on economic development has been a topical issue in recent development literature. The overwhelming emphasis on 'ethnic conflicts' in this literature has, however, precluded looldig at political conflict in the wider context of the development process, going beyond the ethnic dimension. In particular, because of the preoccupation with the ethnic roots as the prime source of these conflicts, reverse causation running from economic policy to political conflict has then virtually ignored in the debate.'

Factors determining the effectiveness of a political system

- *Democratic effectiveness:* ably to deepen democracy and democratic citizenship
- *Policy effectiveness:* able to tackle fundamental developmental problems of poverty and social equality
- *Cogflict-management effectivencss:* able to channelize conflicts and render them less destructive.

  Political conflict in general coulc be referred to as dynamic and manifest conflict processes comprising particulai sta ges. In this case the term 'conflict' is used in a more specific way apolitical process (dynamic situation) in which engaged political parties have incompatible attitudes and behaviours. National as well as international conflicts have three interrelated elements:

- Conflict situation. manifested in expressing various political targets or interests that cannot be simultaneously resolved, and for that reason can be qualified as mutually exclusive
- Conflict behaviour (in the first place aimed at accomplishin g the aforementioned political aims)

- Conflicting attitudes and views having an emotional response (feeling of anger, mistrust, fear, scorn, hatred. etc.) as well as an element related to the cognitive domain

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Many countries in different parts of the world undergo political conflict such as turmoil, internal war, and conspiracy that can be irregular, revolutionary, andior sporadic. Turmoil refers to instant upheaval on a massive scale against an established political regime. The internal unrest in a country refers to large-scale, organized violence against a government, such as guen'ill a warfare. Some examples are Vietnam's actions in Cambodia, and internal vio!ence by the self proclaimed people's groups li :e in the north-eastern states of India.

Political change in a country sometimes leads to a more favourable economik. and business climate. For example, Sukarno's departure from the Indonesian scene improved the business climate there. The political ideology in India after the governance of Late Rajiv Gandhi, the Indian Prime Minister in 1991, became highly favourable for international business as the policy of globalization was adopted and US multinationals found India an am active place to do business. The factors associated with political conflicts and their impact on trade is exhibited in Figure 4.1. The political conflict in a country may lead to unstable conditions, but those conditions may or may not affect business. Therefore, political risk may or may not result from political unrest. International business houses must analyze chronologically the occurrence of political conflicts and assess the likelihood of its impact on the business environment.

South Korean agriculture is highly inefficient, and rice farmers feel particularly vulnerable as quotas on imports are gradually In early 2004, after months of delay the national assembly approved the trade agreement with Chile as thousands of farmers battled riot police outside, The South Korean government signed tie free trade agreement with Chile a year ago. The deal \vas finally ratified in February 2004 after months of bitter argument and a series of violent clashes with fanners. Under the agreement, Chile will lift tariffs on South Korean cars, mobile phones, and electronic goods. In return, South Korea will open its markets to Chilean copper and agricultural goods, including wheat, wool, tomatoes and fish. The fanners have been offered a generous packg.e of subsidies and debt relief, but the say it won't be enough.'

Often political unrest is temporarily focused on the international policies of the government. There have been anti-globaliza tion protests in many countries during the international political movements on persuading the delveloping countries to join the World Trade Organization. It is important to understand the nature of political conflict in foreign countries an the motivation behind government actions. If a change in government policy is only symbolic without any indications cf the change in implementation process, it represents less risk to foreign firms.

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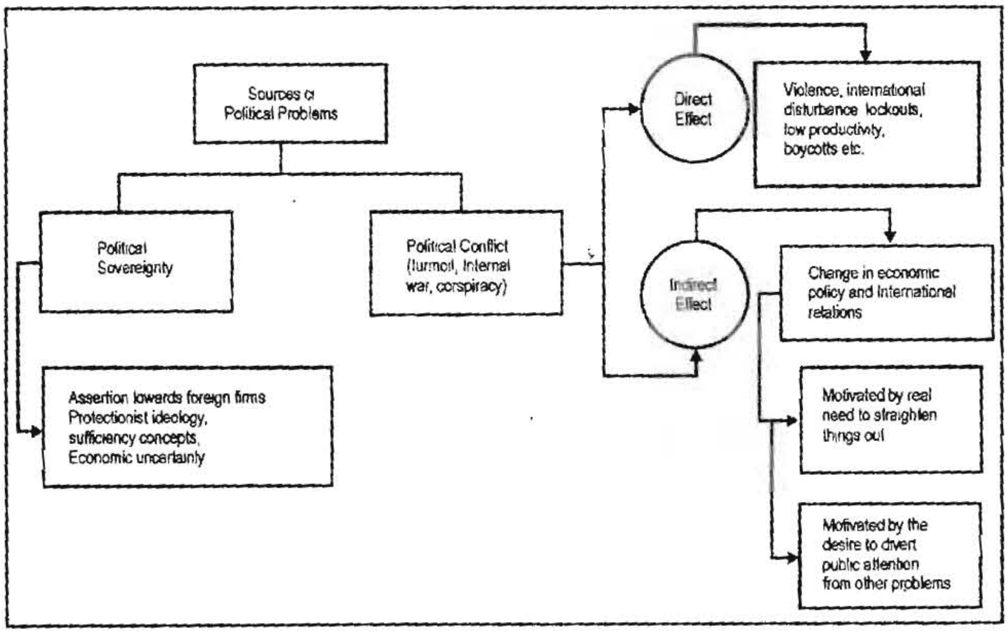
POLITICAL INTERVENTIONS

Political intervention may be described as a decision taken by the government of the host country intended to force a chan ge in the operations, policie and strategies of a foreign firm in the interest of the country. Such interventions may range from enforcing control to complete takeover, or annexation of the foreign enterprise. The magnitude of intery ention varies according to the company's business existing in the host country and the nature of political decisions taken there f. In countries where foreign investment plays a significant role in the economy, the possibilities of political interference in the operations of foreign firms would be hi gher and more strin gent. Besides, the political system of a country be it democracy, communism or mixed economies, also indicates the nature of intervention. If a foreign company is prominent in the economy of a developing country such as Zambia, Guinea, Iran, and Tanzania, the possibilities of government intervention are relatively greater in reference to the public policies of the country.



Factors affecting associated with Political Conflicts and their Impact un Trade

Political intervention may affect the marketing-mix functions ofa firm in the host country in several ways. The inter vention may be observed in a host country to the extent of local content law, technology content, restrictions on the sale of some products, products' functional -ange, design of products, useful life, and adaptability to local conditions, patent life, local manufactusring and assembling leading to amendment of product strategies of a foreign firm. The political directions may also govern the funLtions related to transfer pricing, price ceiling and price floor, price contracts, price paid for local raw materials and price paid for imported raw materials to be used in production in the host country. Besides, the activities ofdistribd on and product retailing may also be subject to political interventions in many deg :loping countries.Advertising and communication is another important area for a foreign firm that is affected by political interference in a country. Of these, local production of commercials, local artists, type of message, tnpe of copy, availability ofmedia and time restrictions on the use of certain media are significant political interventions faced by a foreign

Expropriation, Domestication and Nationalization

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Developina countries izenerally intereene directly in the operations of Ibreiim firms engaged in business, in order to pursue the snecial interests of their country. Of the many different forms of political intervention. expropriation. domestication. exchange control, import restrictions. market control, tax control. price control. and labour restrictions are the most common ones. Expropriation is one of tile most stringent and pervasive political interventions that a foreign firm may face in a host country. It may be described as official seizure of foreign property by a host country whose intention is to use the seized property in the public interest. Such intervention is recognized by international law as the right of sovereign states. provided the expropriated firms are uiven prompt compensation, at fair market value, in convertible currencies.' The act of expropriation without offering any compensation to the foreign or local firms may be described as confiscation. In .. legal terms, it rim: be explained that exprop:iaticii occurs when a government takes over pro-perty for a purpose deemed to he in the public interest, even though the owner of the pro-perty may not be xvillint.t to sell it. Any interest in land. plant and machinery and/or value additions thereof. such as permanent constructions. may be expropriated. The business capital may also be subject to expropriation in many countries. However, technolou can serve as the defence against expropriation, if the technology of the eraerprise cannot be transferred to or duplicated by the host country or despite transfer of technology it cannot he made operational by the expropriators. Further if a firm is not holding an independent status in the host country and is vertically integrated with the parent firm wherein the supplies for productic n or the market for the product is controlled by the parent firm located elsewhere. such firms are unlikely to be targeted for - expropriation. Domestication is another form ofexpropriation, which may also he conceived as creeping expropriation. In this process of political intervention, the controls and restrictions placed b y the host country authorities on the foreign film, gradually reduce the control of owners. Domestication is thus a slow process of expropriation and a foreign firm may lose its control in all financial, operational and management areas over a period Vtime. Domestication involves several measures, includin g, gradual transfer of ownership to nationals, promotion of a large number of nationals to higher levels ofmannemert. greater decision-making powers accorded to nationals, more proa.cts produced locally rather than imported for assembly and specific export regulations designed to dictate participation in world markets.

Traditionally expropriation (in the foreign investment sense) referred to the seizure of property by the host government, e.g., forced *nationalization* of propert) or firm. In recent years. more expansive definitions of expropriation have come up. such as 'creeping expropriation', 'regulatory takin g over and 'measures tantamount to expropriation', which can sometimes be used as a Arategy against government policy that might simply dent a tOreign investor's benefits. The clause on 'measures

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tantamount to ex propriation' has been particularly controversial in the investment-related details of NAFTA. The clause argues that expropriation may not necessarily be a takin g over of the companies in public interest as it may be unreasonable and does not just i fy po:.itieal interference. However, the regional trade agreements stress on the investor: ri ghts to protect the undue losses to the investing companies in the host country. The governments of countries (Canada, USA and Mexico) under NAFTA are required to compensate the investor for the full market value of the property.

On the contrary. *nationalization* may be described as the takin g over of assets into state ownership the process of nationalization refers the transfer of an entire industry within the country from private to public o wnership with no discrimination to the forei gn or local ownership of firms. This may be explained as a policy of bringin g a country's fundamental services and industr; es under public ownership. It was pursued, for example, by the Labour party mien government in the United Kingdom during 1945-51. Assets belonging to the forei gn governments or lams may also be nationalized: for example, Iran's oil industry and US-owned fruit plantations in Guatemala. during the 1950s. The Communist states of Eastern Europe nationalized industrial and agricultural sector completely in the period following World War H. Under the Labour Government of the period 1945-51, Great Britain nationalized a large number of important industries, including coal, steel. and transportationm non-communist countries it has been a common practice to compensate the owners of nationalized properties, at least in part; however, in the Communist countries. where privatization of industries is opposed in principle. there usually has not been -sucli compensation. Nationalization of foreip properties has occurred. especially in underdeveloped nations, where there is resentment of foreign control of major industries. Instances include Mexico's seizure of oil properties owned by US corporations (1938). Iran's nationalization of the Anglo- Iranian Oil Company (1951 the nationalization of the Suez Canal Company (1956) -- by Egypt, and Chile's nationalization of its foreign-owned copper-mining industry i 971). The GO \ eminent of India nationalized fourteen major private commercial banks in 1969 and six more in 1980. Nationalization forced private banks increasingly to meet the credit needs of the weaker sections of the nation and to get rid of monopolization by vested interests of large industry, trade, and agriculture. However, a major issue in nationalization is whether the private owner is properly compensated for the value of the organization.

Exchange Control

In addition to expropriation and domestication. there are other means ofgovernment intervention in foreign enterprise. usually in the forni of legislative action or a decree enacted in the best national interest. It has been observed that many countries exercise restrictions on foreign exchange in order to discourage the free and flexible operations offoreign firms. Such strategy may be described as a government policy evolved to restrict the outflow of domestic currency and establish a delicme balanced state of payments by cent rolling the amount of forei gn exchange that can

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be obtained or held by domestic citizens. Ofteniesulting from overvalued exchange rates, the process of exchange cc ntrol emerges as a process of controllin ,, inflows and outflows of foreign exchange: strategies include licensing multiple currei icies, quotas, auctions, limits, levies and surcharges. Many countries face serious deficits in the balance of payments arid have dearth of foreign exchange. Hence, they restrict the use of foreign convertible currency according to their priorities. Foreign firms may be low on that priority list and have difficulty gettin g foreign exchange for necessary imports or profit repatriation.

Exchange control regulations are generally introduced by the monetary authorities of governments to control the flow of money. The restrict i on on the free use of foreign exchange is generally imposed by the countries having imbalances in the import—export ratio leadin g to problems in the balance of trade. Such countries may enforce restrictions on the remittances from the country involving internaticrinl convertible currency like US dollars, euros and pounds. This type of exchange control may also be to encourage domestic industry. The exchange-control measures have two major consequc nces on foreign business in terms of repatriatiol of profits and capital to the parent c(mpany at will afid free imports of raw materials, machinery, spare parts, and the like from other destinations for operating purposes. Foreign exchange restrictions are also imposed 'by some countries for the offshore investment by firms of home countries. Tne State Administration of Foreign Exchange (SAFE) of China has implemented the ceiling on forei gn exchange administration in pilot cities to examine foreign exchange sources. It has been found that upon imposing such restrictions in foreign exchange transactions, the domestic investment' increased from US $1 million to US $3 million in 2003.

Import Restrictions

Import restriction is a type of political intervention that is primarily intended to support the native industries. Consider a foreign apparel manufacturing company traditionally importing certain synthetic yam and dyes from the parent company. If the host country places restrictions on imports, the company may be forced to depend on local sources of supply for 'hese new materials. The import restrictions would help the country to encourage domestic industry as a matter of industrial policy; however, such measures tend to jeopardize the functions of foreign business. Globalization, and the birth of a new international trade order with the emergence of World Trade Organization has reduced the occ tirrence of import restrictions in many countries. The Chinese government had authorized only a limited number of companies to act as agents for restricted import and export of steel, natural rubber, wool, acrylic fibers and plywood till 2004. After joining WTO in 2001, the Chinese government is gradually relaxing the import restrictions and the above products have been opened for the free trade as an obligation to the WTO agreements.

The general agreements on WTO have emphasized the elimination of import restrictions on all competitive goods and services. Accordingly, in the member countries of WTO, the tariffs on all agricultural products are now restricted. Almost all import restrictions that did not take the form of tariffs, such as quotas, have been converted to tariffs: this process is referred to as 'tariffieation'. This has made markets substantially more predictable for ag riculture. Previously more than 30 per cent of agricultural produce had faced quotas or import restrictions.' However, intervention of WTO in pursuing the member countries towards eliminating the import restrictions had mixed impact in the trade environment of Romania. The development of textile and clothing exports has benefited from link-ups between Romanian production units and companies in France, Germany - - and Italy. The external environment also became more favourable due to the , elimination of long-standing import restrictions by the European Union and Norway; Canada and the United States are two potentially large markets, but they still restrict imports from Romania.' The non-tariff barriers imposed by a country also discourage firms from importing goods. The country's quotas and tariffs limit a firm's ability to import equipment, components, and products, forcing a higher level of local procurement than it may require.

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Market Control

The government ofa country sometimes imposes market control to prevent foreign companies from competing in certain markets. Market control may be imposed by a country at various phases of the business operations ofa foreign form. If an organization is permitted to enter the domestic market ofa country, it may face certain restrictions on the kinds of industries it may own. The firm may be restricted from acquiring a national organization; though, it may share ownership with a national firm. The firm may also be restricted by the government to choose its areas of operation and sell its products. It has been observed that Japanese government indirectly discourages foreign firms from doing business in the country. Until the end of the twentieth century, Japan prohibited foreign companies from selling high technology communications equipment to the Japanese government. Thus, AT&T, GTE-Sylvania, and ITT could only function in a limited way in Japan. Besides the operational controls in the market, one of the most common controls that foreign firms may face is price controls, which limits the profitability of foreign firms in - inflationary situations in the host country. Gerber left Venezuela because a decade of price controls put obstacles in the way ofa profitable project. Other laws may influence other practices of the firm such as advertising or marketing.

Sometimes the conflicting political ideologies also let the countries exercise the market controls without strong economic arguments. One of the examples, may be that of the Arab countries which boycott companies that do business with Israel. The Arab states had not accepted Israel's right to exist and hoped that the boycott would eventually bring about its collapse, which does not seem to be realistic. In April 1998, China ordered all direct-sales operations to cease immediately. The ban on direct sales hal outlawed the direct-sales operations of companies including Avon, Amway. Maryl;.a . Cosmetics and Sara Lee. However China announced provisional plans to phase out the ban on direct ';elling imposed during 1998 by the year 2003. The elimination of such a ban on direct sales iscontingent upon the development of direct- selling regulations. The eonsiderarion of Chinese government on lifting the ban or direct selling has been thought faller the US support in World Trade Organization negotiations.'

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Tax and Human Resources Controls

Some countries may also impose tax control by means of excessive and nontraditional taxes on foreign firm: . For example, a new tax imposed on foreign film would he that of an excessive levy on volume of production. for which there is no precedent. Imposin g such taxes on the foLeign husiness houses may be backed by reasons like an out-of-the-way monetary burden on foreign companies, to explore additional sources ofrevenue to meet the fiscal deficit of the country without putting , pressure on the citizens oldie countr y and to construct a tax barrier as a retaliatory measure against the international nolicies or general dissatisfaction in diplomatic relations w ith other countries. In r lan n countries like China, labour unions play a significant ro le in political decisions and have great political clout. In such countries labour restrictions are an effective brill of government intervention. Traditionally. labour unions in America have been able to prevent layoffs. plant shutdowns. and the like, even when business could not afford to meet their demands.

POLITICAL AND RESIDUAL RISKS IN INTERNATIONAL BUSINESS

Political, economic, religious and other tensions can shift at a moment's notice and disrupt business operations for exporters, traders, investors, banks and other organizations involved in international commerce. Companies can be subject to the discriminatory actions—or inaction —of for eip governments and third parties, potentially leading to forced shutdowns, relocations and other unexpected expel ises. The political risks in international business are developed with ille gitimate use of political power. The way political power is exercised determines government action and the degree of risk that has a negative impaet on a firm's value. For instance, a dramatic political development may cause some risk to a global organization, while invisible policy changes have an enormous influence on the success of the projects belongin g to a firm. Firm-specific political risks are the risks directed at a particular organization in reference to its country of origin. nature of activities in the host country. social and economic goals, etc., and such risks are by nature discriminatoly. The risks specific to firms may be concerned w ith the governmental policies as well as due to the instability in the political system governing the countiy. The following risks may emerge from such situations:

Risks due to political instability Government policy-based risk

- Discriminatory regulations
- 'Creeping' expropriation
- Breach of contract
- National security
- Structural adjustment
- Internal economic policies

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- Sabotage
- Civil unrest
- Anti-globalization movements
- Firm-specific boycotts
- International relations of the host county

On the contrary, the country-specific political risks are not aimed at a firm, but are nationwide, and may influence the success of an organization. An example in this context may be the decision of the government to prohibit the transfer of currency, or the outbreak of a civil war within the host country. Political risks also include government risks and stability risks. Government risks are those that emanate from the policies of a governing authority, in reference to the use of authority. A legally enacted tax hike or an extortion ring that is permitted to proceed and is led by a local police officer are included in government risks. Actually, a 1 number of government risks, specifically those that are firm-specific, involve an obscure mix of legal and illegal components. The risks caused by political instability, on the other hand, emanate from the struggle for political power. These conflicts might be among the political factions of a aovemment struggling for succession, or mass riots as a result of det2riorating social conditions. The county, level risk in reference to the government policies and political instability may vary in its intensity. However, the following factors may affect the risks due to government policies and political instability in a country:

Government policy-based risk

- Mass nationalizations
- Regulatory changes
- Currency inconvertibility

Risks due to political instability

- Labour unrest
- Urban rioting
- Protest on international relations
- Civil wars
- People's movement on diplomatic moves

Besloides the apparent political risk, a foreign firm may also get exposed to a bundle of different risks. Many of these risks are not unique to the assets owned by a firm but reflect broader possibilities, such as that the stock n arket average will rise or fall, that interest rates will be cut or increased, or that the growth rate will change in an entire economy or industry. Residual risk, also known as alpha, is what is left after the firm takes out all the other shared risk exposures. An expostuv to such risk

Check Your Progress

1. What is International Political Environment?
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can be reduced by the firm through strategic diversification decisions. The comprehensive political risks in a country may have many dimensions as exhibited in Table.

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Area	*Risk Factors*
Demography	Size and occupational distribution, economic growth and per capita income population growth and control, income eistribution
Human Resources	Size arid composition, sectoral and geographic distribu tion, productivity, migration and urban unemployment
Politicoeconomic	Natural resources, economic diversification, topography and infrastructure, economic sources and structure of govern ment .-evanues, size and growth of the budget deficit, social expenditure, price indices, wage rates, interest rates, money supply. etc.
International economics and Trade related Risk	Current account balarco Ind composition, income and price elasticity of exports andimports, price stability of major Imports and exports, terms of trade, geographic composition of trade, outstanding foreign debt, absolute and relative lev els, terms and maturity profile, debt servicilg to income and exports, size and relative importance, capital account, re serve position, exchange rates (official and unof ficial)
Culture and Religion based Risk	Underlying cultural values and beliefs, religious and moral values, sense of alienation with foreign or modem influences, constitutional principles and conflicts, resilience of national institutions
Leadership, international alignment and diplomatic internal	Key leaders' backgrouno and attitudes . main beneficiaries of the status quo, role and power of the internal securty a pparatus, strength, sources of support effectiveness or opposit ion political parties, level and frequency of distur bances, riots and terrorist acts, bureaucracy and extent of relations official corruption, international treaties and align ments, position an international; issues, preferential economic and trade linkages, border disputes, diplomatic or commer cial conflict with home country

Hence, political risk assessment (PRA) is necessary for foreign firms in order to identify countries that may turn out to be unsafe tomorrow and to identify the actual situation in various countries, avoiding any bias. For example, doing business in Vietnam and Haiti now may not he that unsafe as was felt earlier. Assessing the political risk of a country may also provide a framework to identify the degree cfpolitical risk in the selected countries for a firm's entry. The political risk May be assessed through some effective methods. In one of the PRA methods, an executive or a team of executives is advised to visit the country in which investment is being considered. A preliminary market research is done to support the visit of the executives in the country. Upon arrival, there are usually meetings with government officials and local businesspersons. This approach is known as legrand tour. The results emerging out of this approach may be very shallow, representing only selected pieces of infomiation at,d therefore possibly eamouflaging undesirable aspects of the market. The other method relies on the advice of an outside consultant or a person deemed to be an expert. Usually such persons are seasoned educators, diplomats, local politicians. or businesspersons. The capabilits, and expel fence of the advisor determines the quality of this report. This approach of political risk assessment, is termed the old hand. In another similar approach known as the Delphi technique. a few selected experts are asked to share their opinions i ndependently on a given problem, in a form that can be scored in order to produce a statistical distribution of opinion. The experts are shown the resultint; distribution and given the chance to alter their original views.

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In the process of the study, the experts are asked to rate the different political factors such as the stability of government, internal and external security issues of the country, and the existing political conflicts. The process is repeated several times and then the results are synthesized. Based on the final expert opinion, the !inn takes an entry decision. In addition to the above methods many films conduct an inquiry into the risk factors in a country using quantitative methods. In such studies, the statistical analy sis is done on the basis of the time series data collected on identified variables. Multivari ate anal ysis, correlations and trend analysis are conducted to measure the magnitude an direction of political risk i n a country. The foreign firms decide on the basis of the trend of political risk in a country and its ma gnitude, which emerges out of the quantitative studies. However, while assessing political stability, the legitimacy of political authority, the capacity of that authority to impose and enforce laws, the level of corruption that extends through the various political and burencratic systems and the degree of political divisions that are present ought to be tl, e pu imary center of attention. While assessing the impact of economic policy, the center o 'attention should be the the level of government participation in an economy. the external debt burden of the government, and the extent tc which various parties concerned can be successful in hindering the decision-making process.

LEGAL OUTLOOK ON INTERNATIONAL BUSINESS

An addition to the political environment in a country, the legal environment comprising local laws, civil and criminal laws and trade regulations also influences the operations of a foreign firm. It is important for a foreip firm to know the regulatory provisions in each market, as such legal environment constitutes the 'rules of the game.' At the same time, the firm must know the political environment because it determines how the laws are enforced and indicates the direction of new legislation.

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Thus the legal environment of international marketin g has a dyadic relationship with political and regulatory systems in a country. Accordingly, it is necessary for an international firm to acquaint itself with host country laws, international law, and domestic laws in each of the firm's foreign markets. Multinational enterprise in its global exercise must cope with widely differing laws. The legal barriers in most c ithe countries include antidumping laws, taritistructures, horizontal price fixing among competitors, market division by agreement ainong competitors, and price discrimination. Hence, international .... should also understand the abritration procedures as an alternative to legal recourse. Traditionally, two types of legal systems may be distinguished: common law and code law. Common law is based on precedents and practices established in the past and interpreted over time. Common law was first developed in England, and most of the commonwealth countries follow this system. Code law is based on detailed rules for all eventualities. Code law was developed by the Rol:Ian empires and is popularly practiced by a number of free world countries such as Italy, France, Germany, Mexico taxi Switzerland. The distinction between common law and code law may be best illustated with an example in context to the right to proprietary issues such as trademarks. A country exercising common law would largely depend on the chronological use of the property. Under common law, the judicial decision would go in favour of the party actually using the trademark on its package and in its advertising campaign, despite not having formally registered the trademark. On the contrary, accordin g to code law, the right of property would rest with the party which has actuallyregisterecl the trademark.

Business firms may encounter major problems when a country : respects more than one legal system and generates conflicting values. If a business contract contains a clause specifying the jurisdiction, stipulating which country's le gal system should be used to settle disputes, the matter can be settled accordingly: However, in absence of any such a provision, disputes cannot be settled choosing a legal system of any country in particular. An example could be that of an accidental leak of the poisonous gas methyl isocyanate that occurred in a chemical plant at Bhopal (India) belonging to Union Carbide. a company of United States of America, causing over 2,000 casualties in 1984. In this situation, the Indian government would have preferred to settle the issue of compensation to the survivors in the US court of law than in Indian courts as the decision in Indian courts would consume more time. On the other hand, the American judiciary is considered to be liberal in awarding such strictures on humanitarian grounds. Simultaneously, the Union Carbide management might have preferred to get the issue settled in the Indian courts in its own economic interest. However, it took over a decade to settle the compensation issues to the survivors of the Bhonai tragedy. An out-of-ccurt compromise was worked out between the Government of India and the company.

Tariff Barriers

Host country laws affect the business operations of a foreign firm. Such regulations may adversely affect the entry of a firm into the host country and may appeal in many forms, including tariff, anti-dumping laws, exportimport licensing, investment regulations, legal incentives and restrictive trading laws. A tariff may be defined as government levies on exports and imports. The tax on exports may be determined as export duty while the tax on imports is known as import duty or customs duty. The objective for a country of imposing an export duty is to discourage selling overseas so as to maintain adequate supply at Ito :l Heavy import duty is levied in order to protect home industry from penetration by cheap imports, to gain a source of revenue for the government, and to prevent the dilution of foreign exchange balances.

Reasons to impose tariff barriers

- Control the outflow of national money
- Protect home market products and services
- Equalize the cost of production
- Discourage low cost imports that affect market stability and quality of goods and services in the home market
- Ensure better home products and sei vices with available technology and manpower
- Protect wages and employment
- Implement anti-dumping measures
- Bargaining and retaliation on tariff
- Protecting the infant industr y and nal ional security in the home country
- Seeking adjustments in terms of trade and fiscal deficits through optimal tax levies

A country may have a single tariff system for all goods from all sources, which may be termed as unilinear or single column tariff. Another category of tariff may be described as general-conventional tariff, which applies to all the countries in general except the nations that l ave signed special tax treaties with a particular country or a group of countries. A t Tiff that is determined on the basis of a tax pennit may b2 classified as special duo: and a fixed percentage of the value of invoices may be levied as an valorem duty. It may sometimes happen that both special and ad valorem duties are levied in a country as a combined duty. The v ays to control the penetration of foreign goods and services into the home country without imposing

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the financial compensation or taxes may be categorized as nontariff barriers. Such non-tariff barriers include quotas, import equalization taxes, road taxes, laws giving preferential treatment to domestic suppliers, administration of anti-dumping measures, exchange controls, and a variety of invisible tariffs that impede trade. These measures are comprehensively discussed as:

- Specific limitations on trade comprising quotas, licen , ing, proportionate restrictions on foreign goods to domestic goods, minimum price limitations on imported goods, and embargos that ban the import of specific products from restricted countries.
- Customs and entry procedures include valuation of imports, anti-dumping measures, tariff classifications of imported goods, imposing complex and lengthy documentation procedure involving bureaucratic requirements, comprehensive service by service fee structure.
- Standards include undue discrimination towards health, sanitation, hygiene, safety, and imposing higher standards on imported goods than on domestic products. Also applying packaging, labelling, and marketing standards of the country to imported goods in an excessively stringent and discriminatory way.

Besides the above non-tariff harriers, a country may directly intervene in trade activities with the objective of comprehensively discouraging imports as well as participation of foreign finns in the home country, in any manlier.' Under such measures, the government involves itself indirectly in trade activities through procurement policies favowing the products ofthe home country over the products of other countries. The government may also impose export subsidies in terms of tax incentives to the domestic firms and lavying countervailing duties that may be described as taxes designed to protect domestic products from low-priced imported products that had been given expert subsidy by the exporting country's government. A country may also proceed to levy various types of other charges on imports to make them less competitive a gainst domestic goods. Such non-tariff measures include prior import deposit requirement, administrative fee, supplementary duties and other variable levies.

Anti-dumping Laws

The act of exporting a product by an intel national firm at a market price lower than the price it generally charges in its own domestic market is defined as 'dumping' the product. Dumping is a type of pricing strategy for selling products in foreign markets below cost, or below the price charged to domestic customers. Such strategy is c .dopted to capture a foreign market and to damage rival foreign national enterprises. The legal definitions are more precise, but broadly the WTO agreement allows governments to act against dumping where there is genuine (`material') injury to the reting domestic industry. In order to do that, the affected country's government shows that dumping is taking place, calculates the extent of dumping in terms of how much lower the export price is compared to the exporter's home market price, and shows that the dumping is causing injury or threatening to do so. The subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods are prohibited under the WTO agreement because they are specifically designed to distort international trade, and are therefore likely to hurt other countries' trade.' The agreement further specifies to the member countries that the countervailing duty, which is parallel to anti-dumping tax may be imposed only after the importing nation makes a detailed and extensive research just like the one needed for anti-dumping task. The argument against dumping is largely on the price differentials that are intended strictly to weaken competition and, over the long run, uproot the native products from the market. Hence, all countries pass anti-dumping laws to secure their home markets from any undue forays by foreign firms. Anti-dumping measures have been taken by most countries.

Though dtunping is not commonly rtearded as a healthy business strateg: for foreign firms, there are sometimes good management reasons for doing so. A typical case describing the positive sale of this strategy may be occasioned by the need to survive in a vast competitive market by selling at very low prices. Another case is when a firm has overproduced and would like to sell the product in a market where it has no brand franchise to protect. However, if firms have indulged in dumping, they can well reverse it. The 'reverse dumping' refers to the lesscommon practice of selling products in domestic market at prices below cost. This wood be done in extreme cases where the share at home needs to be protected while monopolistic market positions abroad can be used to generate surplus funds. Nonetheless, dumping is considered to be illegal since it is destructive of trade, and competitors can take an offender to court to settle a dumping case. The usual penalty for manufacturers whose products are found to violate the anti-dumping laws is a counterbalancing duty, an assessment charged on the foreign producer that brings the prices back up over costs of production and also charges a fine.

By the end of 2000, there were 450 anti-dumping cases involving tens of billions of US dollars against Chinese producers, and the number was expected to increase with China's entry to WTO. One problem has been that without a true market economy, the cost basis for determining potential dumping practices does not exist. Foreign governments have used third world country prices to arrive at a proper cost figure. The argument is that in China, where state-owned exporters receive subsidies and bank loans they never have to repay, under a system that is largely secret, there is no basis with which to assess costs. Most countries and regional groupings have established their own particular version of anti-dumping regulations. Under the trade laws coordinated by *WTO, the anti-dumping* rules that are to apply to all members are more liberal than usual, making penalties more difficult to assign. The new rules, evolved with the intention to help emerging exports, feature stricter definitions of harm higher minimum dumping levels needed to trigger imposition of duties, mc ,- e rigorous legai formalities for petition, and exemption from the duty on dumping for new shippers.

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Import Licensing

Many countries have laws on their books that require exporters and importers to obtain licenses before getting into international deals. Import licensing is imposed by nations to control the unnecessary purchase of goods from other countries. Such restrictions help governments to conserve foreign exchange balances for ' other important purpcses. like the import of pharmaceuticals, chemicals, and machinery. India, for example. has strict icensing requirements against the import of cars and other luxury goods. Amember country of WTO may put legal restrictions on imports of a product or service for some time as a measure to safeguard its own interests if its national market and industry is harmed or jeopardized import. Here, the harm ought to be of a threatening nature. Safeguard measures were always available under GATT (Article 19). However, they were infrequently used. - some governments preferring to protect their domestic industries through 'grey area measures using bilateral negotiations outside the aegis of GATT; they persuaded exporting countries to restrain exports 'voluntarily' or to agree to other means of sharing markets. Agreements ofthis kind were reached for a wide range of products, for example automobiles, steel, and semiconductors.' It has been envisaged in the directives of the new agreement that member countries must not seek, take or maintain any voluntary export restraints. , orderly marketing arrangements or any other similar measures on tne. export or the import side. Those bilateral measures that were not subjected to modification to conform to the agreement were phased out at the end of 1998. Countries were permitted to keep one of these measures an extra year (until the end of 1999), but only the European Union—to hinder the imports of cars from Japan—utilized this provision. This type of agreement is referred to as and contains what are called safeguards.

The agreement sets out the criteria for computing whether 'serious harm' is resulting or threatening the national market and the factors which must be included in the detennination of the influence of imports on the domestic industry. When imposed. a safeguard measure should be applied only to the extent necessary to prevent or remedy serious injury and to help the industry concerned to adjust. Where quantitative restrictions (quotas) are imposed, they normally should not decrease the quantities of imports below the annual average for the last three representative years for which statistics are available, unless clear justification is given that a different level is desired to prevent or remedy serious harm. Import I licensing systems are subject to regulations by the WTO. The Agreement on Import Licensing Procedures says import licensing should be simple, transparent and predictable. For example, the a greement requires governments to publish adequate data for enterprises to know how and why the licenses are granted.

Cyber Law

Cyber law refers to the law that governs the use of communication technology, mainly the Internet. It is a mix ofall laws concerning intellectual property, freedom of expression, privacy and jurisdiction. When it comes to the Internet, the lack of clarity with regard to geographical boundaries and jurisdictions can pose a problem. For example in just a single deal three different states jurisdictions could be involved:

(a) The laws of the state or country which the user belongs to

(b) The laws of the state or country applicable to the individual or organization with whom the deal has been struck

(c) The laws of the state or country where the host server is located.

In other words, a single transaction could he subject to the laws of three countries at a time. The jurisdiction in one particular country may consider the contents of a website legal whereas the same contents may be declared illegal by the jurisdiction of another geographical area or location. There is no uniform law that can be applied internationally.

Another problem lies in the fact that it is difficult to decide whether the Internet should he treated as a separate world altogether or whether it should be considered as a physical space and be subject to the laws of a particular jurisdiction. With no possibility ofhaving a uniform jurisdictional code, issues related to conflict of law are bound to arise.

Apart from these, there are many other factors that affect cyber law–

1. **Net Neutralit :** Any data that is sent or received by users on the Net. passes through transmission media owned by individuals companies or public entities, for example, governments. telecommunication companies and universities. This affects the regulation of the infrastructure of the Internet, that is, laws that are in force in one jurisdiction can have dramatic effects in another, thus affecting the host servers and telecommunication com' anies.

2. **Freedom of Speech:** As opposed to the print media, cyber space is relatively more accessible and anonymous. Any person with a Net connection can publish his thoughts to be read by millions of people, without spending any money. Therefore, issues regarding the legalities involved in this kind of freedom of speech arise. For example, issues related to the limits of objectionable postings, filtration and surveillance of speech, state control on search engines and government's role in limiting access to information.

3. **Judicial Concerns:** The Internet is not dependent on geographical location. Although heman beings are involved in accessing the Net and transmitting information, they have the power to conceal their true identities. In such circum-

stances, it is not possible to apply national laws to Net-related issues that are independent of geographical boundaries. The Net needs to be treated as a different sovereign nation governed by its own laws.

However, monitoring of Net access is already being practised in China and Saudi Arabia. In fact, these two nations have been able to successfully regulate access to the Net by their citizens. In the US too, there are some laws to restrict access to specific content on the Net but these laws do not actually filter the Net.

In India, both the houses of the Parliament passed the Information Technology Bill in the year 2000. It received the approval of the President and came to be known as the Information Technolog) Act, 2000. This Act also contains cyber laws.

The Act attempts to provide a legal framework for e-commerce. It aims to provide legal sanctity to activities carried out by electronic means. According to this Act, any acceptance of contract expressed through electronic means of communication would be considered valid in the eyes of the law.

The IT Act allows authentication if an electronic record by the use of digital signatures. Such a record can be verified using a public key of the subscriber. It provides legal recognition to the digital signature and lays down standards and conditi ins that govern the cerlifying authorities. It details the provisions for the issue of licenses to issue digital signature certificates. The Act also talks about penalties for various offences such as damage to computer, computer systems. etc. It mentions the establishment of the Cyber Regulations Appellate Tribunal and lays down regulations regarding the k vel of officers who can investigate cyber offences. The IT Act also provides for the constitution of the Cyber Regulations Advisor Committee to advise the government with regard to any rules or A C. related issues.

Intellectual Property Rights

In the language of law, intellectual property is a term used to refer to certain legal claims, rights or dues in relation to certain invent i ons, names or titles, written and recorded media.

The people who own these le gal entitlements may exercise rights that are specific to the subject or content of the intellectual property. As is clear from the use of the word 'intellectual', IP is concerned with the mind or something that is the result of a mental process. By using the I'Zrrli 'property', we imply that the ideas generated through such mental processes are comparable to the creation of concrete or tangible objects.

The laws related to intellectual property vary according to the jurisdiction. However, effort has been made to nring about some amount of harmony through treaties including WTO (World Trade Organization), TRIPs (Agreement on Trak lerelated aspects of intellectual property rights), etc. A proper uniform or inflexible international system cannot really be put in Mace owing to various kinds of disagreements related to medical arid software patents and the level of enforcement of copyright.

Laws related to intellectual property do not really pertain to the ideas or concepts per se. Instead, they pros ide special rights to protect the specific way in which the ideas are expressed or information is presented. In other words, `intellectual property' here refers to the rights held by authors, inventors or creative people and not their intellectual w ork as such.

Intellectual property rights are meant to protect different forms of subject matter.

1. **Copyright:** For boot s, movies, music, paintings, photographs and software, a copyright is put in place providing the holder the right to check the adaptation of his or her creation or work of art for a specific time period. In other words, the copyright ensures that the copyright holder's creative work is not reproduced by anybody during the period specified. This period may differ from jurisdiction to jurisdiction.

2. **Patent :** Patents are assigned to inventions or novel creations of great utility. A patent provides the holder the right to stop others from using his or her invention NNi' hout his permission in the form of a license or legal permit, during a specific period.

3. **Trademark:** A trademark refers to n distinct / unique logo, emblem or a sign that helps distinguish the product of one company or business from that of another.

   Trademarks have their share of controversies. Although trademark rights prevent others from using the trademark, it does no t really prevent others from pnAlucing similar goods or items or offering similar services under a di fleicnt tradet lark.

4. **Industrial design right:** This right helps to secure or protect the design, pattern, appearance or style of any industrial or commercial product, for example, mobile designs, spare parts, accessories. furniture, etc.

5. **Trade secret :** This refers to a secret or some confidential information which is not meant to be made public. The information would usually concern the commercial practices of a business, which, if exposed may endanger the business or amount to breach of la v.

All the above may together be referred to as **industrial property** since they pertain to commercial or industrial activities.

OVERVIEW OF EXIM POLICY

The main objective of the Export Import Policy is usually to give a fillip to the country's exports. However, it is also designed keeping in mind the agriculture as well as the cottage sectors. It is meant to promote cottage-sector exports and diversification of agriculture.

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This unit explains the significance of the Export—Import Policy in international marketing and discusses major issues in the new Export—Import Policy. It also describes factors affecting the evolution of the new policy. Finally, this unit focuses on the critical aspects of the EXIM Policy and underlines the major push that is required in the current international marketing scenario.

Most Third World countries have a colonial past marked by extensive and intensive exploitation of their economies by the colonial power. One of the important instruments of this exploitation has been the instrument of foreign trade. This was due to the declining prices of primary goods and the increasing prices of manufactured goods causing the terms of trade to deteriorate considerably over time for the underdeveloped countries (which were exporters of primary goods). Therefore, many underdeveloped countries that won Independence in the post- World War II period viewed foreign trade and investment with a certain amount of suspicion. They turned their economies and reduced their dependence for manufactured goods on the developed countries. Therefore, the emphasis was on inward- oriented policies. As far as foreign trade was concerned, this meant lanrescale import substitution (thorough extensive protection of domestic industries), direct control on imports and investments, and overvalued exchange rates. As far as the export sector was concerned, it was marked by extreme pessimism. For instance, after Independence, the widely prevalent view in the Indian government circles was that Indian exports faced a stagnant world demand and nothing could he done to increase them.

However. things have changed radically. Many developing countries adopted programmes of import liberalization and export promotion in the 1960s and achieved remarkable success. These include Japan, Singapore, Hong Kong, South Korea and Taiv.un. The success of these co _entries has prompted many economists and international agencies (most prominent among them being the IMF and the World Rank) to advocate import liberalization and export promotion as a panacea fOr many economic ills facing developing countries lie India. Acting upon their advice, the Government of India opted for a policy of trade liberalization in the 1990s am.: has been increasingly dismantling im pot/ controls over the last few years.

Evolution of EXIM Policy

Import Policy

The import policy of the Government of India prior ,o the 1980s had two important constituents: (1) import restrictions, and (2) import substitution. It was formulated keeping in view the limited foreign exchange reserves of the country, shortage essential consumer goods in the economy, the requirements of capital good, machinery, spare parts and components for the building of heavy, basic industries, and the role and scope of import substitution in the country. The 1980s were characterized by massive import liberalization: the need being to enhance the export competitiveness of large sections of the Indian industry.

During the immediate post-Ir dependence pe-riod, the import policy was liberal and was designed to meet th demand released after the Second World War. However, this resulted in heavy deficit in the imports from hard currency areas. The rupee was devalued in September 1949. As a consequence. restric dons on imports were considerably curtailed. The approach towards imports was liberal throughout the period of the First Plan as the go vernment had substantial sterling balance to fall back upon.

Import Restrictions

The Mahalanohis strategy of development encouraging the large-scale industrialization of the country was initiated in the Second Five Year Plan (which started in 1956-571. Under this strategy of develo pment the government had to import capital equipment, machinery, components, spare parts. industrial raw materials, intermediate goods, technical know-how, and so on. in large quantities and this led to a substantial increas r.! in foreign. exchange expenditure. The government also had to resort to the import of food grains from time to time to overcome its shortage. As against this, the earning continued to be stagnant. Thus the government had no option but to severely curtail import expenditure. Therefore, the history of severe import restrictions in the country started since the years 1956- 57. As the foreign exchange difficulties continued to mount, more and more items were brought under import restrictions over a period of time. Imports were classified under the categories o f banned items, restricted items. canalized items and items under Open General license (OGL). Canalized items were those items that were canalized through the public sector agencies like State Trading Corporation (STC) And Minerals and Metals Trading Corporation (MMTC). Severe restrictions were imposed on the import of non-essential goods. so that foreign exchan ge resources could be released for the import of capital goods and other essential imports. A policy of import restrictions was rigorousi n, pursued by the government for two decades ri ght up to 1977-78. However, there was a brief period of import liberalization after the devaluation of 1966. Followin g the devaluation of the rupee by 36.5 per cent in terms of gold in June 1966, imports were somewhat liberalized. Such liberalization was offered to 59 priority industries consisting of export industries, capital buildin g industries and industries catering to the needs of the common people (like su gar and cotton textiles). The year 1966 also saw the initiation of new agricultural strategy and the government resorted to large scale import of fertilizers, seeds, pesticides and insecticides to implement the new strategy.

Import Substitution

The two broad objectives of the pro gramme of import substitution in India were: (a) to save scarce foreign exchange for the import of more important goods, and

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(h) to achieve self-reliance in the production of as many goods as possible. The policy in India has gone through various phases. Broadly speaking. we can discern three distinct phases: (i) in the first stage, import substitution mostly took the form of domestic production of consumer goods; (ii) in the second stage, emphasis shifted to the replacement of the import of capital goods and (iii) in the third stage. emphasis was on decreasin g the dependence on imported technology by developing and encouraging the use of indigenous techniques. As a result of the policy of import substitution, the construction of imports has undergone important changes. Many items which were previc usi imported are now being produced in the country itself As a result of this policy, the country has been able to increase the production of many industrial products like iron and steel. automobiles, railway wagons. machine tools, diesel engines and power transformers, and in the case of many other products it has achieved a level of self-sufficiency

Import Liberalization in the 1980s

The year 1977-78 initiated a new era of import liberalization in the country. This process was carried forward in the 1980s. The annual import policies of 1980-81 to 1984-85 followed the liberal approach of providing necessary imported inputs for the industrial sector. However, the thrust in the direction of liberalization was provided from 1985 onwards when the system of formulating long term (three year) policies was adopted.

Export Policy

Dr Bimal Jalan classifies the export policy of the Government of India into three distinct phases: Phase I (up to the first oil shock of 1973), Phase II (covering the period from 1973 up to i 983), and Phase III (the period after 1983).

Phase I can be divided into two sub-periods: (a) 1952-66, and (b) 1966-73. The first sub-period covers the first three Five Year Plans and was characterized an essentially passive export policy though some steps to increase exports were undertaken in the Third Plan. Except for a pew items such as iron ore stagnation of export earnin gs in this period is to be largely attributed to domestic policies which often led to the falling share of India's traditional exports.

The second sub-period in Phase I starts with the devaluation of the rupee by 36.5 per cent in terms of gold in June 1965. The government expressed the hope that the devaluation would lead to expansion in export earnings as Indian goods would now be cheaper in international markets. On the other hand, imports will decline as the prices of imported goods would increase. In addition, many foreign investors would seek encouragement to invest capital in those fields where we required foreign capital earnestly. Devaluation would encourage foreign tourists into India and discourage Indian tourists abroad.

Check Your Progress

3. What is Tariff?
4. Describe Cyber Law.

Phase II can be considered to h l ye begun in 1973 and lasted for about a decade. 'In this phase, although this is not explicitly stated, it was recognised that import substitution policies by themselves could not bring about viability in India's balance of payments. In this second phase exports were, therefore, accorded a high priority.' The government, accordingly, undertook a number of steps to increase exports.

Phase III (i.e., the recent phase) had seen a more positive approach to export promotion strategy. While incer tives for export production have been enhanced on the one hand, exports themselves are being seen as an integral part of industrial and development policies. Export policy in Phase III has emphasized, technological upgradation, increase in the :iize ofplants, free imports and domestic and international competition for the entire industrial sector as being essential for export promotion.

Major Issues in the New Export-Import Policy

I. New EXIM Policy (2004-2009)

Context

If India wishes to play a major role in global business, an extensive look on complete developmental processes of the national foreign trade is essential. While enhancement in exports is of fundamental significance, we have also to support the imports that are desirable to boost and give an impetus to our economy. The congruity and consistency among trade and other economic strategies and plans is essential to maximize the share of such strategies in developmental activities. Therefore, while continuing the current policy of proclaiming a yearly DUNI Policy, it is essential to move further and evolve an integral strategy to the developmental desires that the growing foreign trade of India has to fulfil. This is the context of the latest developments in Indian foreign trade policy.

Objectives

Trade is a means to economic growth and leads to national development. The main purpose is not to earning of foreign exchange, but to stimulate greater economic activity. The Foreign Trade Policy is built around two major objectives. These are:

- To double the percentage share of global merchandise trade within the next five years.
- To act as an tool for economic growth by boosting employment.

Strategy

To achieve these objectives, the following s trategies need to be adopted:

- Releasing controls and spreading an atmosphere of trust and transparency to encourage the entrepreneurship talents of traders, industrialists and businessmen.

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- Reducing transaction making procedures simple.
- Neuatralizing the incidence of all levies and duties on inputs used in export products on the basis of fundamental principle that levies and duties should not be exported.
- Helping to develop India as a global hub for not just manufacturing but also trading and services
- Identifying focus areas which could be nurtured to generate additional employment opportunities, especially in the rural and semi-urban areas.
- Developing initiatives for each of these.
- Facilitating the upgradation of technology and infrastructure of all economic sectors of India through import of capital goods and equipment, thereby adding value and increasing productivity (and at the same time achieving quality standards that are internationally acceptable).
- Avoiding inverted duty structures and ensuring that our domestic sectors are not disadvantaged in the Free Trade Agreements/Regional Trade Agreements/Preferential Trade Agreements that are entered into to enhance exports.
- Upgrading the infrastructural network to international standards, physically and virtually, in relation to the entire Foreign Trade chain.
- Duly recognizing and redefining the role of the Board ofTrade and inducting experts on Trade Policy.
- Involving the embassies in the export strategy and ensuring that the country's commercial wings in foreign nations are linked via an electronic platform for real-time trade intelligence and enquiry dissemination.

Annual Supplement of New Trade Policy (2004-09)

In the annual supplement to the Foreign Trade Policy 2004-09, the government highlighted that with an annual growth rate of 25 per cent, India's merchandise exports had crossed the magic figure of $ 100 billion in the fiscal year of 2005-06.

In fact, they had touched the 'auspicious figure' of 101 billion dollars. Our imports had grown 32 per cent, and stood at $ 140 billion - but $ 43 billion was our oil bill. Thus, our non-oil imports were $ 97 billion, a full $ 4 billion less than our exports. On the non-oil front, ti terefore, we had a positive balance of trade,'

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- The achievement of that target of exports (doubling exports to $150 billion by 2009-10) was likely to generate 136 lakh (13.6 million.) new jobs (81.57 lakh direct and 54.61 tan indirect) in the economy in the next five yearr. The Policy would focus on services and job creation in rural and semi-urban areas. 'Employment generation is a high priority in the National Common Minimum Programme (CMP) of the government. it is only with a conscious n ulti-pronged, multi-dimensional eftbrt that we can address the massive challenge of finding job opportunities for millions of our unemployed youth,' The int oduction oftwo new schemes to give a push to employmei it generation, particularly in semi-urban and rural areas is a key objective of the Foreign Trade Policy.

- These two schemes are (i) the 'Focus Product Scheme', to give a thrust to the manufacture and export of certain industrial products which could generate large employment. per unit of investment compared to other products, and (ii) the Toc us Market Scheme,' to penetrate market:; to which India's exports were con ipmitively low and which Indian exporters had perhaps been neglecting due to high freight costs and undeveloped networks but which were markets of the future.

- The Focus Product Scheme would allow duty-credit facility at 2.5 per cent of the FOB value of exports on 50 per cent of the export turnover of notified products, such as value-added fish and leather products, stationery items, fireworks, sports goods and toys, and handloom and handicraft items. The Focus Market Scheme, on the other hand, allows duty credit facility at 2.5 per cent of the FOB value of exports of all products to the notified countries. The scrip and the items imported against it for both these schemes would be freely transferable. These two schemes would replace the Target plus Scheme, according to government sources.

- Export-oriented production has a huge potential for generating jobs and the government would take all necessary steps to give a boost to this sector. In the fiscal year of 2004-05, the export sector has generated incremental direct employment of 14 .85 lakh over the previous year, bringing the total employment generated by the export sector in India to 90.06 lakh jobs. 'This is besides the export-related indirect jobs created through backward linkages and in logistics and related sectors which re estimated to add up to another 69.66 lakh jobs. In all, merchandise export activity seems to sustain nearly sixteen million jobs currently'.

- The government also announced steps to promote cottage and village industries, besides making export promotion capital goods schemes more flexible.

- New schemes and incentives fi r services, aviation, gems and jewellery, marine products and auto components are some of the highlights of the second annual review of the policy that runs from 2004 to 2009.
- A number of schemes have also been unveiled for the gems and jewvllery sector—permission to import precious metal scrap for export. re-import rejected goods, reduction in the value-addition norm for importing gold and silver for re-export to 4. per cent to 7 per cent.

'In line with the government's promise ofa stable foreign trade policy regime, this year's supplement does not alter the broad contours of the main policy. But recognizing the dynamic nature of international trade and the need for a periodic realignment of our international trade strategies, contemporary issues have to be addressed from time to time. and this is what this initiative does.' With the services industry today accounting for 52 per cent of the nation's Foss domestic product (GDP), the annual review has propos'd the "Served from India' scheme to encourage services exports.

Auto component manufacturers have also been allowed to import new vehicles for research and development purposes without the procedural hassles of getting them certified.

'This is necessary to give our research and development labs easier access to the latest technologies current in the auto component industry,' The Government highlighted that 'India is on the move, metaphorically as well as literally. We not only have the fastest growing automobile market in the world, but India is fast emerging as an important centre for sourcing auto-components.'

The review has also decided to treat supplies such food, beverages and fuel to international airline .:rompanies as exports to make them qualify for several export promotion schemes.

'Currently, most airlines replenish supplies or refuel at Thailand, Malaysia or Singapore. Since these supplies were not treated as exports in India, the store supplies from India were not competiti , e enough.'

'Because of a rich tradition of craftsmanship, enterprise and availability of skilled, low cost manpower, India has the potential to become an international hub for gems and jewellery.'

Encouraged by over 25 per cent growth in the last three consecutive years, India is targeting an export growth of 20 per cent with additional two million employment generation in fiscal 2006-07.

The new policy envisages merchant exporters and manufacturer exnorters, business and industry as partners of the Government in the achievement of its stated objectives and goals. Prolonged and unnecessary litigation vitiates the premise of partnership. In order to obviate the need for litigation and nurture a constructive and conducive atmosphere, a suitable Grievance Redressal Mechanism will be established which, it is hoped, would substantially reduce litigation and further a relationship of partnership.

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The dynamics of a liberalized trading system sometimes results in injury caused to domestic industry on account of dumping. When this happens, effective measures to redress such injury will be taken.

Roadmap

This policy is essentially a roadmap for the development of India's foreign trade. It contains the basic principles and points the direr_ don in which we propose to go. By virtue of its very dynamics, a trade policy cannot be fully comprehensive in all its details. It would naturally require modification finm time to time. It was proposed to do this through continuous updating, based on the inevitable changing dynamics of international trade. It is in partnership with business and industry that milestones are proposed to be erected on this roadmap.

Agro exports are a thrust area for development and promotion. There is also the need for infusion of new technology and capital in agriculture to enable India to harness the untapped potential in agro exports. Cold chain infrastructure has been the missing link in the process of agriculture, post-harvest storage and transportation in India. The supply chain from production clusters to the markets needs to be strengthened including grading, pre-cooling, packaging, storage and marketing of fresh farm produce. The organized retail both in fresh and processed food products which has started taking share in the metros and other large cities needs to be extended to other towns as well. The FDI, by leading global players for strengthening the backward linkages and infi-,-,structure including the cold chain, can provide a boost to processing and can help in reducing wastage of fruits and vegetables. This will ensure better returns to the farmers for their produce. Agro exports constitute about 9.3 per cent of the total merchandise exports of the coun Total agr) exports through APEDA in 2005-06 amounted to Rs 17,918 crores compared to Rs16, 828 crores in 2004-05.

The new policy also highlighted the importance of adhering to food safety and international standards for trading in food products. The APEDA was complimented for encouraging the adoption of quality certification systems like ISO and HACCP amongst its registered exporters.

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'The Government has introduced an integrated food law, which is expected to help in making the Indian food industry more competitive in the global market. It intends to set up a single line of command from the present multi-level and multi departmental control. There will be a single reference point for all matters relating to food safety and standards, regulations and enforcements.'

Export promotion has been, and continues to be, a major thrust of the trade policy. The New Foreign Trade Policy ONFTP) 2004-09 is a good attempt to accelerate India's trade with the objective of doubling India's share in world exports

from the current 0.82 percent to nearly 2 percent by 2010. The annual supplement projects a higher growth trajectory for the country's exports, expecting them to touch $92 billion this fiscal and $150 billion by 2008-09.

Good Features of Po!iey

- Export growth rate target is realistic because, in the last three years, exports have been growing in excess of 20 per cent. Export growth was 20.3 per cent in 2002-03; 21.1 per cent in 2003-04; and 24 per cent in 2004-05.
- It is good that the Foreign Trade policy has provided a major thrust to employment-oriented sectors such as agriculture, handicrafts, gems and jewellery, leather and footwear to accelerate growth and employment potential. Exports in these sectors are growing. The government is also concerned about the export orientation of sectors such as marine products. export-oriented units and services.
- In this trade policy, the gol, ..Triment has proposed to set up the Services Export Promotion Council. This is a good step. Services have shown great export potential. Currently, the services sector is growing at more than 8 per cent and contributes more than 50 per cent to India's GDP.
- The move toward setting up an inter-State trade council for better policy coordination among the States is also a good step. This will boost international trade. Simultanec usly, the announcement of a package for the modernization of the marine st ctor, given the large and growing exports of marine products, and the removal of export cess on agricultural and plantation commodities are welcome steps to boost exports in this sector.
- To increase the export of gems and jewellery, the government has provided special incentives. These are in the form of one of the top export items (with a share of nearly 15 per cent in the export basket). The extension of Export Promotion Capital Goods scheme would also help in boosting trade.
- The government has announced several measures in this trade policy to reduce transaction costs from 15 per cent to 8-9 per cent. India was not

able to compete effectively with China, as the transaction costs there are between 3 and 4 per cent. This will help Inuian exporters in their competitiveness.

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- This trade policy is also concerned about regional disparities across states The proposed fund of Rs 25.000 to assist backward states in enhancing their export potential is a welcome move. This fund may help in reducing disparities anion states, especially in foreign trade sector. It will help backward states in developing their social and physical infrastructure. This fund would be: Ten for five years.

Drawbacks of policy

- The pharmaceutical sector is, currently, growing very rapidly. This sector also has immense export potential. This is evident as it was able to achieve $ 4 billion domestic sales and over $3 billion exports in 2004-5. The pharmaceutical industry is one of the important sectors with high growth potential. This sector has been neglected. Neither trade policy nor the annual supplement policy has provided any specific incentives to boost their exports.
- India is in the globalization phase and many Indian firms have to compete in global markets with emerging market players. But there are immense procedural hassles that Indian exporters have To face in international trade. These are a major obstacle to India's exports. This policy has not provided any specific guidelines in this direction. Even the proposal for clearing all export procedures online with the hel p of the Directorate General of Foreign Trade (DGFT) has not been implemented so far. This proposal is pending for several years. Although the current policy has announced that the DGFT would move towards a more automated electronic environment for filing. retrieval and authentication of export documents, there are no specific guide maps to achieve this step.
- As was the practice of past policies, in this trade policy as well the total cost of var. ous incentives and sops for exporters arc roughly Rs 40,000 crore. But there is no analysis on how these incentives have benefited our exports.
- No discussion has been held on the effectiveness and implementation of the scherr es, existing and proposed. Another critical problem affecting India's export is infrastructure, especially in world-class ports. It has become imperative to ease the congestion in Indian ports and facilitate better and quicker delivery and offloading of both exports and imports. But the policy does not address this critical issue.

Salient Features of Earlier EXIM Policies

Export import policy (2002-07)

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Special Economic Zones

- Off shore banking units (OBUs) shall be permitted in special economic zones (SEZs). Units in SEZ would be permitted to undertake hedging of commodity price risks, provided the units on stand-alone basis undertake such transactions. This will impart security to the returns of the unit.
- It has also been decided to permit external ccutmercial borrowings (ECIV:) for a tenure f less than three years in SEZs. This will provide opportunities for accessing working capital loan for those units at internationally competitive rates.

Employment Oriented

- Export restrictions such as registration and packaging requirements are being removed on butter, wheat and wheat products, coarse grains, groundnut oil and cashew to Russia..
- Restrictions on export of all cultivated (as opposed to wild) varieties of seeds, except jute and onion, are removed.
- To promote the export of agro and ago-based products, 20 agri-export zones have been notified.
- In order to promote the diversification ofagriculture, transport subsidy shall be available for the export of fruits, vegetables, floriculture, poultry and dairy products.

Cottage sector and handicrafts

- An amount of Rs 5 crore under market access initiative (MAI) has been earmarked for promoting cottage sector exports coming under the KVIC.
- The units in the handicrafts sector can also access funds from MIA scheme for the development of a Web site for the virtual exhibition of their products.— Under the export promotion capital goods (EPCG) scheme, these units will not be required to maintain an average level of exports, while calculating the export obligation.
- These units shall he entitled to the benefit of Export House status on achieving lower average export performance of Rs 5 crore as against Rs 15 crore for others; and .

- The units in the handicraft sect)r shall be entitled to duty-free imports of an enlarged list of items as embellishments up to 3 per cent of the free-onboard (FOB) value of their exports.

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Small- scale industry

With a view to encouraging development of centres of economic and export excellence such as Tir upur for hosiery, Panipat for woolen blankets, Ludhiana for woolen knitwear, the following benefits shall be available to the small-scale sector.

- Common service providers in these areas shall be entitled for facility of EPCG 3cheme.
- Access in the funds under the market access initiative scheme for creating focused technological services and marketing abroad.
- A limit of Rs 5 crore for entitlement of Export-House status

Leather

- Duty-free imports of trimmings and embellishments up to 3 percent of the FOB value hither to confined to leather garments extended to all leather products.

Textile

- Sample fabrics permitted duty-free within the 3 pttr cent limit for trimmings and embellishments
- 10 per cent variation in GSM is allowed for fabrics under advance licence
- Duty entitlement passbook (DEPB) rates for all kinds of blended fabrics permitted

Gems and Jewellery

- Customs duty on impOrt of rough diamonds is being reduced to 0 per cent.
- Licensing regime for rough diamond is being abolished.
- Value addition norms for export of plain jewellery reduced from 10 per cent to 7 per cent. Export of all merchandked unstuddeci jewellery allowed at a value addition of 3 per cent only.

Technology Oriented

(a) Electronic hardware

The electronic hardware technology park (El-1TP) scheme is being modified to enable the sector to face the zero duty regimes under the ITA (Information Technology Agreement)-1

The units shall be entitled to the following facilities:

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- No foreign exchange as percentage of expofts (NF EP) has been positive in 5years.
- No further export obligations for units in EHTP.
- Supplies of ITP I items having zero duty in the domestic market are to be eligible for counting of export obligation.

(b) Chemicals and pharmaceuticals

- Free export of sample without any limit
- Reimbursement of 50 per cent of registration fees for registration of drugs

(c) Projects

- Free import of equipment and other goods used abroad for more than one year

Growth-oriented

(A) Strategic package for status holders

- Licence certificate/ permissions and customs clearances for both import—exports on self-declaration basis
- 100 per cent retention of foreign e :change earners' foreign currency (EEFC) account
- Enhancement in normal repatriation period ft crn 180 days to 360 days

(B) Neutralizing high fuel costs

- Fuel costs to be rebated by standard input output norms (SIONs) for all export products

(C) Diversification of markets

- Setting up of a 'Business Centre.-' in the Indian Mission abroad for visiting Indian exporters/ businessmen.
- ITPO portal to host a permanent virtual exhibition of the Indian export product.
- Focus LAC (Latin Ameii can countries) will be extended to March 2003.
- Focus Africa is launched. The exporters exporting to these markets shall be given the Export House status on export of Rs 5 crore.

- Links with CIS countries to be revived.

(D) North-eastern States, Sikkim and Jammu and Kashmir

- Transport subsidy for exports to be given to units located in the North East and Jammu and Kashmir.

Reduction in transaction time and cost

- With a view to reducing transaction cost, various procedural simplifications have been introduced. These include DGFT.
- A new eight-digit commodity classification for imports has been introduced.
- Same day licensing has been introduced in all regional offices.
- Eight-digit ITC (HS) code has also been introduced.
- The percentage of physical examination of export cargo has already been reduced to less than 10 per cent except for a few sensitive destinations.
- The application for the fixation of brand rate of drawback shall be finalized within 15 days.

Banks

- Direct negotiation of exports documents to be permitted. This will help exporters to save bank charges.
- Keeping up to 100 per cent of foreign exchange earnings is permitted in EEFC accounts.

Duty neutralization instruments

(a) Advance license

Duty exemption entitlement certificwie (DEEC) book is to be abolished. Redemption is on the basis of shipping bills and bank realization certificates.

- Exporters can advance licence fol any value.

(b) Duty-free replenishment certificate (DFRC)

- Technical characteristics to be dispensed with for audit purpose

(c) Duty entitlement passbook (DEPB)

- Value cap exemption granted on 429 items to continue.

(d) Export promotion capital goods (EPCG)

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- EPCG licences of Rs 100 crore or more to have 12-year export obligation (EO) with five year moratorium period.
- EO fulfilment period extended from 8 years to 12 years in respect of units in agro- export zones and in respect of companies under the revival plan of the BIFR.
- Supplies under deemed exports to be eligible for export obligation fulfilment along with deemed export benefit.
- Re-fixations of EO in respect of cases of imports of second hand capital goods under the EPCG Scheme.

Export—Import Policy for 1997-2002

The EXIM Policy has set 'an ambitious target', as pinpointed in the preface of the policy book, 'of attaining an export level of US $ 90-100 billion by the year 2002 and achieving 1 per cent share in world trade'.

The principal objectives of the policy were:

- To accelerate the country's transition to a globally oriented vibrant economy with a view to deriving maximum benefits from expanding global market opportunities
- To stimulate sustained economic growth by providing access to essential raw materials, inputs, capital goods, etc.
- To enhance the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitive strength
- To provide consumers with gocd quality products at reasonable prices

Redeeming Features of the Policy

The major changes that have been brought about in the EXIM Policy are outlined as under:

EPCG Scheme: The scope of export promotion capital goods (EPCG) has been widened.

The following chan ges have been made in file policy:

- The 15 per cent duty with e' port obligation of four times the CIF value of CG in five years has been reduced to 10 per cent.
- The threshold limit for the zero duty schemes against the export obligation of six times in eight years has been kept unchanged. However, in case of agriculture and allied sectors (i.e. aquaculture, animal husbandry, floriculture,

horticulture, pisciculture, viticulture, poultry, sericulture, etc.), the threshold limit has been reduced to Rs 5 crores and export obligation. on NFE basis. to five times (as against six times on FOB basis) in six years.

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- Further, manufacturers/exporters. merchant exporters tied to supporting manufacturers, service providers (covering a wide range of services including hospitals, air cargo, hotels and other tourism relates services) are eligible to import capital goods within the framework of the specified export obligation.
- The domestic suppliers of capital goods, against the EPCG license, will henceforth be treated as deemed exporters.
- Computer systems can also be imported under the F PCG Scheme. This is to boost software exports.
- If the EPCG license holders, under zero duty, are not able to utilize the full value of import (i.e. Rs 20 crores or Rs.5 crores as the case may be), duty exemptie n will be withdrawn and the importer Ain have to pay the full duty pins a 24 per cent interest to Customs.
- Exports towards the fulfilment of export obligations through third parties are also allowed provided the name of the EPCG license holder is also indicated on the shipping bill.
- If a merchant exporter is the importer, then the name of the supporting manufacturer should be mentioned on the shipping bill.
- Where the manufacturer exporter has obtained licences for the manufacture of the same export product under both the EPCG and Duty Exemption Scheme (DES), the physical exports made under the DES and pass book scheme shall also be counted towards the discharge of export obligations under the EPCG Scheme.

Duty Exemption Scheme

This scheme has undergone a major change. Towards an effort to reduce the multiplicity of licensing, only two schemes are being introduced, which are:

- Advance licensing corresponding to Quantity Based Advance Licence (QBAL) and a new Duty Entitlement Passbook Scheme (DEPB)

  In other words. the VAI3AL (Value Based Advance Licence) has been scrapped and the Passbook Scheme modified. The salient features of the new scheme are as follows:

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- Under the DEPB Scheme, exporters would be eligible to clai n credit at a specified percentage of FOB value of exports in freely convertible currency and the credit rate to be notified by the DGFT (and not by the Customs).

  Any item except those on the negative list can be imperted without the payment of basic Customs Duty, Special Customs Duty or the Additional Duty against the credit under DEPB.

- The third party exports will be admissible for a grant of credit. In other words, the scheme covers both manufacturer-exporter as well as met chant exporter.

- The DEPB Scheme will operate on pre and post-export basis.

EOU/EPZ Scheme

- A number of modifications have been introduced in the EOU/EPZ schemes as mentioned below:

- EOUs/EPZs units in ago-based and allied sectors are allowed to sell 50 per cent of their products in the DTA on payment of duty without stipulation of any value ad lition subject to positive net foreign earnings.

- To give a special thrust to the export of computer software, such units would be encouraged to be set up in any of the export-oriented schemes i.e. EOUs, EPZ, EHTP (Electronic Hard" are Technology Park). STP (Software Technology Park), etc.

  Further, software units can. undertake using data communication links or any form of physical exports (including through courier service) as also export of professional services. Software units are also allowed to import capital goods cn loans for clients for a given period for the execution of specified projects.

- As an incentive to exporters—es Decialiy software units those achieving 25 per cent higher than stipulate d export obligations will be eligible for additional SIL. equal to 2 per cent of FOB value of such exports.

- Electronic hardware units in EOUs/EPZs and EHTPs shall have an alternative facility to sell one half of the value of their production on an annual basis, in the domestic market and export the other half of production, in value terms, without any minimum foreign exchange earning stipulation on payment of applicable duties as specifically notified for this facility.

- For software units, sale in the DTA in any mode, including data communication, shall be permissihle up to 25 per cent of their production in value terms.

- The EOU/EPZ units, however, will be permitted to sell finished products which are freely importable under the policy in DTA over and above the levels permissible against payment of full ditties provided they have achieved the stipulated NFEP export obligation.

EOU units now also have the flexibility to debunk and move to EPCG Scheme by paying 10 per cent duty on capital goods imported and undertaking the specified export obligation.

Likewise, the DTA units having export obl igatio:i under the EPCG Scheme may also apply for conversion into an EOU. On such a conversion, the export obligation under the EPCG Scheme will be made concurrently from the export by a unit like an EOU.

Request for debunking the under-zero duty re.zime of the FTCG `chine may 0 so be considered subiect to the units specifying the eligibility criteria and such conditions as may be specified by the BOA (Board of Approval).

- EOU/EPZ/EHTP/STP units can also become eligible to benefits such as deemed export drawback and the refund of terminal excise duties on the production of a disclaimer from the DTA supplier.

This is primarily to itmove procedural hassles or hesitation of DTA units in making supplies to units linder the export oriented schemes. Further, units using predominantly indigenous raw materials (90 per cent or more) are permitted to sub-contract part of their product for job work in DTA or in other like units.

Deemed Export Scheme

- The scope of deemed exports has been widened. The deemed export benefits have been extended to oil and gas sectors in addition to power.
- Further, in a bid to encourage domestic souring of inputs and capital goods, domestic suppliers of capital goods against EPCG licences will also be entitled for deemed export benefits including the drawback facility.

  In case of supply to zero duty licence holders, the supplier can import raw materials,and so on, duty-free under the Special Imprest Licence.

Export Houses, Trading Houses, Star Trading Houses, Super Star Trading Houses

- Eligibility Criteria for reeopdtion of export houses, trading houses, star trading houses and super star trading houses has been revised and made almost double under the FOB criteria and even more than double under the NFE criteria.

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- Apart from revising the eligibility criteria, another significant change effected in the policy is the announcement that every state and union territory will be allowed to nominate a corporation as an export house even if the firm does not meet the new eligibility criteria.

- The benefits accruing to the parent company from exports made by subsidiary companies have not been changed. So also the double weightage accorded , to the export of products manufactured by units in the SSI, tiny and cottage sectors.

- Similarly, double weightage on the FOB value ofexports and triple weightage on the net foreign exchange (i.e. the value of licences deducted from the FOB value) earned by exports from the handloom and handicrafts sector, hand-knotted and silk carpets, and so on, has been retained.

Diamond, Gems and Jes'cl nery Export Promotion Scheme

- In order to promote the export of gold jewellery, the number of nominated agencies permitted to stock gold has been increased in addition to MIMTC, STC, SBI and HHEC, to any agency authorized by the Reserve Bank of India.

- Under the Gems and Jewellery' replenishment (REP) Scheme, third pact,, exports have been allowed so that even the small exporters are able to soli their products in the international market and can claim REP licences based on a disclaimer certificate from the third party and can import essential inputs.

- Further, the facility of bulk licence for the import of rough diamonds has been liberalized to enable the bulk licence holder to import from any source not necessarily from the Diamond Trading Corporation (DTC, London).

- Now any exporter whose annual average FOB value of export of cut and polished diamonds during the preceding three licensing years has not been less than Rs 75 crores woul I also be eligible to apply for bulk licences.

  The eligible person sh 'uld be a limited company registered under the Companies Act. Its 100 per cent owned subsidiary can also apply fbr the bulk licence.

- Diamond imprest licence may be issued in advance for the import of rough diamonds.

Special Provision for Farm Sector

The agricultural sector has been sing l ed out, as ought to be, for special concessions. These include, among others:

- DTA sale by the EOU/EPZs in agricu 'tura] products to the extent of 50 per cent on payment of duty but without insistence of any value addition condition.
- Reduction of threshold limit under EPCG Scheme from Rs 20 crores to Rs 5 crores and export obligation on zero duty basis would be only five time., of the net forex earnings in a period of six years.

This has been done to enhance the technological strength and efficiercy of Indian agriculture.

1. Double weightage to agro exports in calculating eligibility for export house, trading house, etc.
2. Additional 1 per cent S11, will be allowed for export of fruits. veget.ibles, and floriculture and horticulture products constituting 10 per cent or more of their total exports.

Other Export Inducing Measures

- SIL, on export of products of small-scale industries, has been increased from 1 per cent to 2 per cent.

  Further, as a special incentive for the export of SSI products and products from North-eastern states, an additional SIL of 1 per cent on total value of exports will be given to export house/trading house, etc. where such exports from the North-eastern stags constitute 10 per cent or more of their total exports.
- Additional SIL will also be available for the exploration of and exports to new markets as also for the export of new products.
- With a view to promoting, quality standards for enhancing global compctitivenes of' flaw expori, SIL c; tillemem of exporters holding ISO 9000 certificates and the like has been enhanced fwm 2 per cent to 5 percent.
- To promote software exports, softwafe units are being allowed to undertake exports using data communication links or in the form of physical exports through the courier service.

Further, software units will be Dermited communication for DTA sales. Software can also use a computer system for commercial training.

Import Liberalization

- As apart ofthe exercise towards further liberalization and globalization, the negative list has been pruned by 542 items. Of these, 292 items have been placed on the free list (OGL). Another i 50 items can be imported under SIL. Sixty items have been moved from SIL to OGL.

Simplification of EXIM Procedures

The new policy has made a definite move towards simplification of procedures, improvement in transparency, reduction in documentation requirements, decentralization of licensing authorities and the like.

It has also attempted, in the process, to keep a check on the misuse of the poi icy and procedures. The following steps, in this regard, are noteworthy:

- Documents required to be subniitted with every application are stated to have been brou ght down to the bare minimum. Acomputerized master document containing company information would be fed into the system.
- The financial power ofthe Regional Licensing Authority for the issuance of licence, where input output norms have already been fi' ed and for the issue of EPCG licence have been enhanced so that the trading community could gee the facility at the nearest point.
- Further, even the export house recognition can now be done at the zonal level instead of at the headquarters.
- Likewise, the value limit of advance licence under the production programme has been enhanced from 25 per cent of average FOB value of exports to 100 per cent of the average FOB value of exports so that the exporter can obtain advance licence in one go for his requirements and does riot have to come to the Regional Licensing Authorities time and again.

Some Essential Export Push Measures

Many of the measures announced in the new policy and procedures are laudable. They will undoubtedly help export growth in varying degrees. W i th a view to achieving a quantum jump in exports, a few suggestions are being offered.

Promoting High Value Added and Branded Products

The new EXIM Policy has no doubt initiated soine measures for augmenting valueadded exports of agricultural products as also of electronic products including hardware and software.

It is hoped that the supply side constraints, which often come in the way of agri-exports, would be taken care of. Similarly, the exports of software are beset with non-tariff barriers such as restrictions on the entry of Indian professionals in the developed market economies.

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The Policy, however, should provide some effective and tangible benefits for promoting high value-added al d branded products in almost all sectors. This can be done, as suggested earlier by FICi, by granting SI in a progressive form based on value addition i.e. the higher the value addition, the larger the SIL entitlement.

Sharing of Export Benefits across the Produczion Line

In the EXIM Policy of 1992-97, the re was a provision to extend deemed export benefits to the suppliers of intermediate goods and to holders of advance license under duty exemption scheme.

However, the deemed export benefits, w Itich include refund of tenninal excise duty and drawbacks etc., have not proved to be of any tangible attraction as the claiming of refund or duty drawback of excise duty is a cumbersome process.

Further, in case of many products, especially garments such as woollen suits, the foreign buyers are reported to be interested in the import of high quality woollen fabrics and low cost Indian manpower. This kind of a deal even in the new EXIM Policy is beset with many procedural hurdles.

It is therefore, suggested that some mechanism be evolved either in the form of a policy provision or some kind of guidelines to facilitate sharing of export benefits all along the production line- by the raw material suppliers and also the ultimate exporter.

For example, a raw material supplier should be eligible for export belie tits up to the value of raw material and the ultimate exporter should get the benefit for the conversion of raw materials into finished products and exporting the same outside the country.

A clear provision for sharing of export benefits would help involve each segment in the production operating in export promotion effort. The Shipping Bill of Expo] is should bear the names of ultimate exporters, intermediate and raw material suppliers.

Such an arrangement will not result in any loss of revenue or other constraints to the government but will definitely help boost exports.

Using India's Bulk Buying Power to Push up Exports

This is yet another area, which requires focused attention. The EXIM Policy should have a built-in proviso to e,annark apart of the canalized items including the petroleum products for counter trading by the private sector exporting enterprises, especially the status holders, along with their puf lic sector counterparts. Such a step will help take advantage of the bulk buying power to push up export growth.

Searching for New Markets

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Despite the end of colonialism, our trade pattern still reflects a North/South colonial pattern of trade. Most of our exports go to the north; the US and European countries along with a siunficarit proportion to the Council for Mutual Economic Assistance (CMEA).

At present, only aboi it 8-10 percent of our exports go to Japan and about an equivalent magnitude go to all other East Asian countries combined—Singapore, Hong Kong, Taiwan, South Korea and the ASEAN countries.

There must be an attempt at promotion of trade with other Asian countries and it must be based on mutual advantage.

Intensive study would have to be made of market opportunities that are emerging in these countries, in order to understand how be:;t. India could utilize its existing comparative advantage in filling or creating market niches for itself.

The main reason for the sluggishness in South/South trade has perhaps been the similarity of manufactured products exported by developing countries.

The vast majority of exports of manufactured products from developing countries fall in a few product groups such as textiles and garments, consumer electronics and light engineering goods; all products which involve high labour intensity in their production.

Developing countries are therefore competitors in their quest for markets in the countries of the north and they have traditionally had little to offer to each other - in the realm of manufactured goods. As a result, the old established North/South colonial pattern o f trade has persisted despite the end of colonialism.

Now that the rapid economic growth of East Asian countries has. over the last two decades, altered the traditional equilibrium of the world economy and increased the share of this region in total world purchasing power, India should I also try to concentrate in these markets for enhancing its trade share in total composition of trade.

- Any firm choosing to operate in another country, should make all possible adjustments with the host nation's international relations.
- The effectiveness of a political s: stem is gauged in terms of democratic effectiveness, policy effectiveness and contlici-management effectiveness
- Developing countries intervene in the operations of foreign companies so that the special interests of their country can be pursued.
- Expropriation, domestication, exchange control, import restrictions, market control, tax control, price control and labour restrictions are the commoi

forms ofpolitical intervention.

- Imposing tax control through excessive and non-traditional taxes on foreign firms is also a technique used by some countries.
- The operations of a foreign firm are also influenced by the legal environment comprising local laws, civil and criminal laws and trade regulations
- The EXIM policy is usually created to give a boost to the exports of a country.

CASE STUDY:

Deep Water Harvest

Founding a diving services business at the start of a massive boom in WA caused plenty of headaches for one entrepreneur. But surviving the boom has brought great results.

The Divex Asia-Pacific Story

Serendipity is a powerful force in many lives. Take Doug Austin, now managing director of the successful international diving services company, Divex Asia-Pacific. He slipped into the diving industry by accident. "I left uni penniless in 1982 and walked into the first job that was offered to me. It was with a gas company in Scotland that manufactured the specialty breathing gases used deep underwater by commercial divers."

Austin quickly developed a passion for the industry. Think: 20,000 Leagues Under the Sea and Flipper. "I got hooked on the whole idea of commercial diving, building diving bells and putting people down to fantastic water depths."

In 1998 Austin began working in the diving industry in Australia. He soon spotted a potential market for a smaller, light-weight version of the North Sea deep-diving systems he had experience with in Scotland.

The two main commercial markets for diving services are: oil field diving (providing equipment for divers working on the seabed, installing pipelines and offshore platforms) and military diving operations (such as mine countermeasures and maritime counter-terrorism).

Austin contacted his former employer, Divex Ltd (where he was sales director from 1987 to 1998), and persuaded them to invest with him in a joint venture to set up a diving services operation. Austin kicked in 20% and Divex UK 80% to form Divex Asia-Pacific in 2003.

The Challenge

Establishing Divex Asia-Pacific in Australia.

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The Solution

Austin may have spotted the opportunity for Divex services in Australia but that didn't make it the logical headquarters for a new Asia-Pacific operation. Divex UK's directors, clients and subcontractors were unanimous: set up the business in Singapore. It was regarded as the regional hub of the diving industry because of its relatively low fabrication costs and proximity to big clients.

But Austin thought the start-up should be located in Australia. He knew that the expertise, land, subcontracting skills and marine experience available at the Australian Marine Complex in Henderson, WA, were unmatched. He also argued that the business could be more cost-efficient in Australia. He had reasons of the heart too. "Somewhat selfishly I also wanted to continue living here."

After about six months of negotiation, agreement was reached to locate Divex Asia-Pacific in Australia. The initial strategy was to act as a commercial outlet for Divex UK's products, which worked well.

Within 18 months the Australian company had developed its own design capability and begun making products specifically for local and regional markets. It developed rebreathers that allow military divers to stay safely underwater for long periods without leaving columns of tell-tale bubble traces. Users can swim undetected to a target from a long way out because of the set's endurance. The product was tailored to meet specific clients' needs.

As the oil and gas industry took off in 2006, Divex Asia-Pacific was well positioned to take advantage of an increase in demand for deep-sea products and services. Over the next three years, it won seven multi-million-dollar projects for mobile modular deep diving systems, which allow divers to operate up to 300 metres below sea level. The units are typically installed on a large vessel and can accommodate twelve divers who live inside the system for up to two weeks.

But the boom in WA had a severe downside: a desperate shortage of skilled labour. Austin says: "It was difficult for many of our subcontractors to hold onto enough employees to build our project. It was a significant challenge for a long time and caused us project delays and contractual difficulties with clients." Austin says he communicated regularly and openly with clients about completion of the contracts.

To overcome the labour shortage, Divex Asia-Pacific spread its work among many subcontractors, although that soaked up much more management time. To retain its own staff, Divex Asia-Pacific had to pay wage annual increases of up to 25%.

official seizure of foreign property by a host country ... use the seized property in the public interest.

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- Nationalization may be described as the taking over of assets into state ownership. The process of nationalization refers the transfer of an entire industry within the country from private to public ownership with no discrimination to the foreign or local ownership of firms.
- The government of a country sometimes imposes market control to prevent foreign companies from competing in certain markets.
- Market control may be imposed by a country at various phases of the business operations of a foreign firm. If an organization is permitted to enter the domestic market of a country, it may face certain restrictions on the kinds of industries it may own.
- Political, economic, religious and other tensions can shift at a moment's notice and disrupt business operations for exporters, traders, investors, banks and other organizations involved in international commerce.
- Government risks are those that emanate from the policies of a governing authority, in reference to the use of authority. A legally enacted tax hike or extortion rings that is permitted to proceed and is led by a local police officer are included in government risks.
- The legal environment comprising local laws, civil and criminal laws and trade regulations also influences the operations of a foreign firm.
- The legal barriers in most of the countries include antidumping laws, tariff structures, horizontal price fixing among competitors, and market division by agreement among competitors, and price discrimination.
- A tariff may be defined as government levies on exports and imports. The tax on exports may be determined as export duty while the tax on imports is known as import duty or customs duty.
- The EXIM policy is usually created to give a boost to the exports of a country.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. The international political environment includes political relations among the countries of common ideologies.
2. Political interventions may be described as a decision taken by the government of the host country intended to force a change in the operations, policies, and strategies of a foreign firm in the interest of the country.

Austin says: "We had to pay the going rate." These costs had to be built into the projects. Clients had to be convinced that these remained good value for money.

Austin believes that the decision to locate in Australia was the right one. "Although the cost of manufacturing in Australia is about 15-20% higher than in Singapore, the quality of workmanship in Australia is significantly higher. In a market where high quality, reliability and safety of equipment are paramount, this has provided Divex Asia-Pacific with its strategic competitive advantage."

Higher labour costs in Australia have been partly offset by reduced spending on property and facilities, with overhead costs as much as 75% lower than in Singapore.

The Result

Divex Asia-Pacific's turnover increased from $3.5 million in 2002-03 to $28 million in 2007-08 to about $40 million in 2008-09. A new office was opened in Sydney to support Australian Defence Force clients on Australia's east coast. The combined employee head count has climbed from two to 66 in six years.

Divex Asia-Pacific's profits grew by more than 30% in each year of its first five years. Its success has been liberally spread among WA fabricators and suppliers who have lapped up more than $20 million in subcontracts in the past two years.

Divex Asia-Pacific has won various awards including the Australian Exporter of the Year in the category of small to medium-size manufacturer for 2008. Austin was named the 2009 Western Region Ernst & Young Entrepreneur of the year in the Technology and Emerging Industries category.

SUMMARY

- The international political strategies aim to run the business successfully in the host country.
- The international political environment involves political relations among the countries of common ideologies.
- Some factors determining the effectiveness of a political system like Democratic effectiveness, Policy effectiveness, Conflict-management effectiveness.
- Political intervention may be described as a decision taken by the government of the host country intended to force a change in the operations, policies and strategies of a foreign firm in the interest of the country.
- Expropriation is one of tile most stringent and pervasive political interventions that a foreign firm may face in a host country. It may be described as

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3. A tariff may be defined as government levies on exports and imports. The tax on exports may be determined as export duty while the tax on imports is known as import duty or customs duty.

4. Cyber law refers to the law that governs the use of communication technology, mainly the internet. It is a mix of all laws concerning intellectual property, freedom of expression, privacy and jurisdiction.

TEST YOURSELF

1) What do you mean by International Political Environment?

2) Explain Political Interventions.

3) What are the political and residual risks in International Business?

4) Discuss legal outlook on International Business.

5) Briefly describe the evolution of EXIM policy.

6) Write short notes on:

   i. Duty Exemption Scheme

   ii. EOU/EPZ Scheme

   iii. Deemed Export Scheme

7.17 References & Suggestive readings

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