B.B.A.

Second Year

Paper No. 6

BUSINESS ENVIRONMENT

BHARATHIAR UNIVERSITY

SCHOOL OF DISTANCE EDUCATION

COIMBATORE – 641 046

CONTENT

(Syllabus)

BUSINESS ENVIRONMENT

UNIT – I

Meaning definition international environment external environment : macroenvironment : environmental change : techniques for environmental analysis – strategic management.

UNIT – II

BUSINESS AND SOCITY : Changing concept and objectives of business professionalisation; Business ethics, Business and culture social responsibility to shareholders; employees, consumers, community.

UNIT – III

ECONOMIC SYSTEMS : Capitalism – socialism – mixed economy – the mixed economy of India. Economic roles of government regulatory role – promotional role – entrepreneurial role – planning role.

UNIT – IV

INDUSTRIAL SICNESS : Definition of sick units – magnitude – weak units causes of sickness – governments policy – sick industrial companies act – sick small scale units. Financial institution and industrial sickness. MRTP Act – MRTP Objectives – Amendments – MRTP – Commission.

UNIV – V

INDUSTRIAL FINANCIAL INSTITUTIONS : IDBI, IFCI, ICICI, IRBI, SHCI, DFHI, UTI, LIC, GIC.

FOREIGN CAPITAL AND TECHNOLOGY : Role of foreign capital – private foreign capital imitations and dangers of foreign capital, government policy.

UNIT - I

UNIT - I

CONTENT

AIM AND OBJECTIVES

In this unit, we discuss the significance of Business Environment. After going through this lesson, you will be able to understand:

I. Under stand the meaning of business environment
II. List the features of business environment
III. Differentiate the types of business environment
IV. Importance of business environment
V. Concept and importance of environmental analysis in strategic management

LESSON-1

1.0 INTRODUCTION TO BUSINESS ENVIRONMENT

Every business enterprise consists of a set of internal and is confronted with a set of external forces. The success of a business firm depends on its innate strength and its adaptability to the environment.

Business environment means the aggregate of all forces, factors and institutions which are external to and beyond the control of individual business enterprise but exercise significant influence on the functioning and growth of the enterprise. According to Bayord. O.Wheeler, business environment is defined as "The total of all things external to firms and industries which affect their organisation and operation".

1.1 FEATURES OF BUSINESS ENVIRONMENT

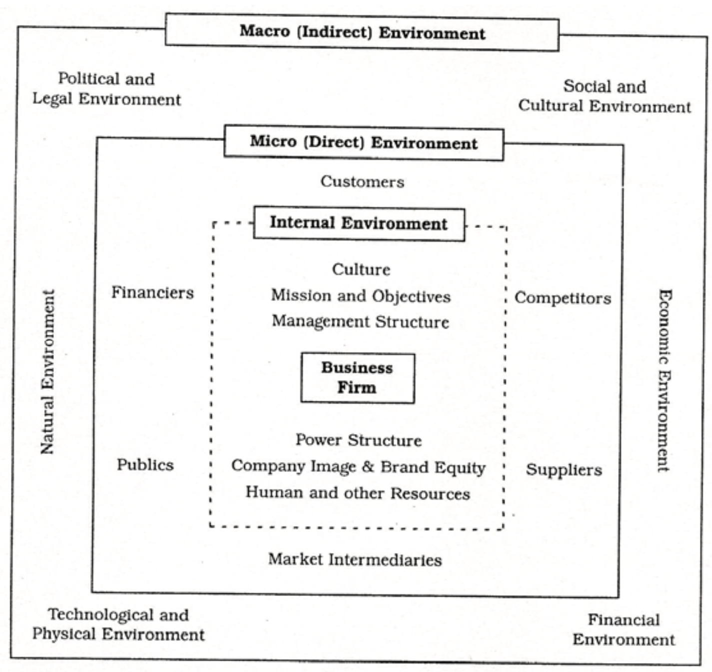
Business Environment is characterized by the following features:

1. The external forces act as an aggregate force on the enterprise.
2. The different elements of Business environment are closely interrelated and interdependent. A change in one element affects the other elements.
3. It is a relative concept differing from country to country
4. It is a dynamic concept as it changes over time.
5. As the environment is volatile, Business environment is largely uncertain.

LESSON-2

1.2 TYPES OF BUSINESS ENVIRONMENT

There are two types of Business environment namely internal environment and external environment.



1.2.1 INTERNAL ENVIRONMENT

Internal environment refers to the factors existing within a business firm. The internal factors are also called controllable factor because the enterprise has control over these factors. These factors can be altered as it relates to personnel, physical facilities, organisation and its operations. The main internal factors that influence business decisions are as follows:

1. The values, beliefs and attitudes of the top management of the company
2. The mission and objectives of the company
3. The composition of the board of directors' degree of professionalisation of management and organisation structure
4. The extent to which management enjoys the support of share holders and employees
5. The image of the company
6. The competence, morale and motivation of the employees

1.2.2 EXTERNAL ENVIRONMENT

External environment comprises of factors beyond the control of the company. It includes economic factors, social factors, legal factors, demographic factors etc. The success of any firm depends on the extent of adaptability to the external factors by adjusting its internal factors. The external environment of business comprises of micro environment and macro environment.

1.3 SIGNIFICANCE OF BUSINESS ENVIRONMENT

The study of business environment is essential for enterprises for the following reasons:

1. To take early advantage of opportunities over competitors.
2. Early indication of forthcoming threats and crisis so that the firm can minimize its adverse effects.
3. To focus on customer needs and expectations.
4. Provides information for strategy formulations.
5. Acts as a change agent.
6. Improves public image by showing their responsiveness to the needs of the public.
7. Helps in process of continuous learning.

Check Your Progress-1

A. List the characteristics of business environment

B. Discuss the significance of understanding the environment of business

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

1.4 MICRO ENVIRONMENT

Micro environment or task environment refers to those individuals, groups and agencies with which the organizations come into direct and frequent contact in course of its functioning. These factors directly influence the operations of the enterprise. Micro environment consist of the following factors:

1.4.1 CUSTOMERS

A business exists to create and satisfy customers. A firm may have different types of customers like individual households, Government departments, commercial establishments etc. In order to be successful the company must understand and meet the needs and expectations of its customers. A can select target customer group based on factors like profitability, demand, competition and growth prospects.

1.4.2 COMPETITORS

A firm may have many types of competitions which include not only the other firm which market same or similar products but also all those who compete for discretionary income of the consumer. Direct competitors are other firms which offer same or similar products and services. Indirect competitions come from firms vying for discretionary income is termed as desire competition. The competition among alternatives which satisfy a particular category of desire called generic competition. The competition between different models of a product is called product form competition. Competition between different brands of same product form is called brand competition. Further competitive actions include new products, customer service, price changes, promotions etc.

1.4.3 SUPPLIERS

Suppliers refer to the people or group of people who supply raw materials and raw materials to the company. They enable the company to carry on uninterrupted operations and minimize inventory carrying cost. They also influence quality levels and cost of manufacturing. Multiple sources of supply help to reduce risk like strike, lock-out or any other problem of the supplier. Vendor development importance when the resources are scarce.

1.4.4 MARKETING INTERMEDIARIES

Marketing intermediaries help a company in promoting, selling and distributing its products to the consumers. Middlemen like agents wholesalers and retailers serve as a vital link between the company and its customers. Transportation firms and warehouses help in the physical distribution of products. Advertising agencies, marketing research agencies, insurance companies, consulting firms, media firms etc also assist in marketing operations.

1.4.5 PUBLICS

Publics include all groups who have actual or potential in the company. Media groups, environmentalist, non-government organizations are examples of publics. These publics can have positive or negative impact on the firm.

1.5 MACRO ENVIRONMENT

Macro environment refers to the general or remote environment within which a business firm and forces in its micro environment operate. They are uncontrollable factors that create opportunities or pose threats to the company. Therefore, success of an enterprise depends on its ability to adapt to the macro environment.

1.5.1 ECONOMIC ENVIRONMENT

Economic conditions, economic policies, economic systems, economic planning etc are the important factors that constitute economic environment of business. These factors exercise most significant impact on business as business is itself an economic institution. The components of economic environment are as follows:

a) Nature of economic system-capitalist, socialist or mixed economy
b) Economic structure-occupational distribution of labour force, structure of national output, capital formation, investment pattern, composition of trade, balance/imbalance between different sectors
c) Economic policies-industrial policy, export-import policy, monetary policy, fiscal policy etc
d) Organisation and developments of capital markets-banking system, securities market etc
e) Economic indices-gross national product, per capita income, rate of savings and investment, price level, balance of payment position etc
f) Economic infrastructure

The economic conditions of a country are the important determinants of business strategies. In a developing country, the low income may be the reason for very low demand for the product. Hence, it may have to reduce the price of the product to increase the sales. The reduction in the cost of production may facilitate price reduction. It may even be necessary to develop a new low cost product to suit low income market. In countries where the investment and income are steadily and rapidly rising, business prospects are bright. In developed countries, replacement demand contributes to considerable part of total demand. The economic policy of the government has a great impact on business. Some categories of business are favorably affected by the government policy in terms incentives, subsidies etc. Some may be adversely affected in form of disincentives or restriction imposed by the government. The economic system and policy is a very important determinant of scope of private business.

1.5.2 POLITICAL AND LEGAL ENVIRONMENT

Political environment consists of elements related to government affairs. Legal environment serves as a regulatory framework of business. It is closely linked with the economic environment and has a tremendous impact on business. The main constituents of a country's political and legal environment are as follows:

a) The constitution of the country.
b) Political organisation-organisation and philosophy of political parties, ideology of the Government, nature and extent of bureau-curacy, influence of primary groups, business donations to political parties, political consciousness, etc.
c) Political stability – structure of military and police force , election system, law and order situation ,President's rule, foreign infiltrations etc.
d) Image of the country and its leader.
e) Foreign policy – alignment or not alignment.
f) Defense and military policy.
g) Laws governing business.
h) Flexibility and adaptability of the laws
i) Effective judicial system

Political and legal system has close relation ship with the economic system and economic policy. In most countries, apart from laws that control investment related matters, there are a number of laws that regulate the conduct of business. Regulations to protect consumer interest, purity of environment and preserve the ecological balance have assumed great importance in many countries. Many countries have laws to regulate competition in the public interest. Certain changes in the government policies such as industrial policy, fiscal policy, EXIM policy etc may have profound impact on business. Thus government is a powerful force that decides the nature and size of business. In order to survive and grow, business must continuously change and adapt to the changing political environment.

1.5.3 SOCIAL AND CULTURAL ENVIRONMENT

Social environment refers to characteristics of the society in which a firm exists. Cultural environment consists of customs, attitudes, beliefs and values of the society. The socio-cultural variables are an important environmental factor that should be analyzed while formulating strategies. Social and Cultural Environment consists of the following:

a) Demographic forces-size, composition, mobility and dispersal of population
b) Social institution and groups
c) Caste structure and organisation
d) Education system and literacy rates
e) Customs, beliefs, values and life styles.
f) Tastes and preferences of people.

The socio-cultural factor is an important environmental factor that should be analyzed while formulating business strategies. Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use etc vary so much that the product attributes, method of presentation, positioning or promoting the product may have to be varied to suit the characteristics of different markets. The differences in language, values and beliefs vary significantly between different cultures. Demographic factors affect the demand for goods and services. Markets with growing population and income are growth markets. The occupational and mobility of population have implications for business. Thus the marketing efficiency and management of people depends largely upon socio-cultural factors.

1.5.4 TECHNOLOGICAL AND PHYSICAL ENVIRONMENT

Technological environment refers to the amount of systematic application of science put into practice. Physical environment refers to the geographical factors. These factors have a significant impact on the production and distribution system of the firms. The main elements of technological and physical environment are the following:

a) Rate of change of technology
b) Approaches to production of goods and services
c) New processes and equipments
d) Research and development systems

Business prospects depend on the availability of certain physical facilities. Some products like many consumer durables have certain facility characteristics. For example, the demand for electrical appliances is affected by the extent and reliability of power supply. Technological factors may sometimes pose problems. A firm which is unable to cope with the technological changes may not survive. Further, the differing technological environment of differing markets or countries may call for product modification. The fast changes in technologies also create problems for the enterprises as they render plants and products obsolete quickly.

1.5.5 NATURAL ENVIRONMENT

These factors have significant impact on the factors of production, cost of production, production processes and distribution of products. The main natural forces are as follows:

a) Climatic conditions
b) Ecological systems
c) Natural resources
d) Levels of pollution
e) Government policy on conservation of environment

Geographical and ecological factors influence the location of certain industries. Topographical factors may affect the demand pattern. The depletion of natural resources, environmental pollution and the disturbances of ecological balances has caused great concern. These concerns have resulted in an increase of cost of production thereby causes problems for business.

1.5.6 GLOBAL ENVIRONMENT

In recent times, globalization has become a fact of life. International environment has a great significance for global companies or industries directly dependent on exports and imports. International agencies, international conventions, treaties and agreements, economic and business conditions in other countries etc are the important factors taken into consideration.

With liberalization and globalization, no economy can stand alone and immune from developments that takes place abroad. The lowering of international trade barriers and privatization encourages foreign trade. Mobility of skilled resources and entrepreneurial skills also encourage globalization. But globalization may also render many companies sick in the process.

Check Your Progress-2

A. Explain the various components of business environment

B. Distinguish between internal and external environment

C.

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-3

1.6 ENVIRONMENTAL CHANGE

Business environment is dynamic. Many elements in the environment undergo changes. Technological changes are frequent. Tastes and preferences of the people change. When the competitive situation changes, demographic and economic factors under go changes. Government policies and regulations also changes. All these factors indicate that a business policy should be dynamic to be successfully adaptable to the changing environment.

The success of a business depends on its ability to foresee the environmental changes and to modify its business strategies appropriately. An exact prediction of the future events is very difficult. However, reasonably reliable forecasts are possible in many areas. There are a number of forecasting techniques which can be used depending in the characteristic features of the situation. Such forecast of changes in business environment facilitates the formulation of appropriate business strategies.

1.6.1 ENVIRONMENTAL ANALYSIS

Environmental Analysis is the process through which an organisation monitors and comprehends various environmental forces so as to determine the opportunities and threats that lie ahead. It is a continuous process with the following objectives:

a) To provide an understanding of current and potential changes taking place in the environment

b) To provide inputs for strategic decision making

c) To bring about suitable changes in the organization

1.6.2 PROCESS OF ENVIRONMENTAL ANALYSIS

The process of Environmental Analysis consists of following stages:

1. Environmental Scanning

Scanning is the process of analyzing the environment for identifying the factors which may influence the business. Its purpose is to identify the emerging trends or warning signals. It alerts the organisation so that suitable initiatives are taken before these forces become critical for the organisation.

2. Environmental Monitoring

At this stage information from the relevant environment is collected. Several techniques are used to collect the relevant facts about the environment. Company records, publications, spying and verbal talks etc are the main sources of data.

3. Environmental Forecasting

Forecasting is the process of estimating relevant events of future based on the analysis of their past and present behavior. Several techniques are used for the purpose of forecasting.

4. Diagnosis or Assessment

Environmental factors are assessed in terms of their impact on the organisation. The degree of impact may also vary from one factor to another. Techniques of Environmental Analysis like SWOT analysis, ETOP etc are used for the purpose.

LESSON-4

1.7 TECHNIQUES OF ENVIRONMENTAL ANALYSIS

Several techniques are used for analyzing and diagnosing the environment.

1.7.1 SWOT ANALYSIS

SWOT is the acronym for strengths, weakness, opportunities and threats. While strength and weakness are identified from internal environment, opportunities and threats are identified by analyzing external environment.

Strength- A strength is an inherent capability of the company which it can use to gain strategic advantage over the company.

Weakness- A weakness is an inherent limitation of the company which create strategic disadvantage to it.

Opportunity- An opportunity is a favorable condition in the company's external environment which enables it to strength its position.

Threats- A threat is an unfavorable condition in the company's external environment which causes a risk or damage to its position.

SWOT analysis is helpful in the formulation of an effective strategy that can capitalize on the opportunities and neutralize the threats faced by an organisation.

1.7.2 ETOP

ETOP is the acronym for environmental threats and opportunities profile. The environmental factor for a business is listed down. Their impact on business is indicated through arrow marks as follows:

- Upward arrow indicates favourable impact
- Downward arrow indicates unfavourable impact
- Horizontal arrow indicates neutral impact.

1.7.3 BENEFITS OF ENVIRONMENTAL ANALYSIS

Environmental Analysis offers the following benefits:

1) To keep business dynamic
2) To develop long term strategies of the firm
3) To develop plans to deal with technological advancements
4) To foresee the impact of socio-economic changes on the firm's stability
5) To counter the strategies of the competitors

1.7.4 LIMITATIONS OF ENVIRONMENTAL ANALYSIS

Some of the limitations of Environmental Analysis are

1) Environmental Analysis does not eliminate uncertainty for any organisation but reduces uncertainty
2) There is a possibility of error is usage of forecasting techniques
3) It is a time consuming and expensive process
4) It does not guarantee organisational effectiveness

Check Your Progress-3

Discuss the significance of environmental analysis and techniques used for environmental analysis

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-5

1.8 STRATEGIC MANAGEMENT

Strategy is defined as" a unified, comprehensive and integrated plan relating the strategic advantages of the firm to the challenges of the environment". Strategic management involves formulation, implementation, review and control of strategies for achieving the company's objectives and mission. Strategic management is also referred to as business policy. Glueck defines strategic management as " a stream of decisions and actions which leads to the development of an effective strategy or strategies to help to achieve corporate objectives".

Environmental analysis plays important role in the strategic management process or the formulation of business policy. Strategic management process involves ascertaining the objectives, analysis of the environmental threats and opportunities, appraising the strength and weakness of the firm to tap the opportunities or to combat the threats, formulating the strategies to achieve the objectives, choosing the most appropriate strategy, implementing of the strategy and reformulation of the objectives or strategy, if needed.

1.9 STRATEGIC MANAGEMENT PROCESS

The strategic management process consists of the following steps:

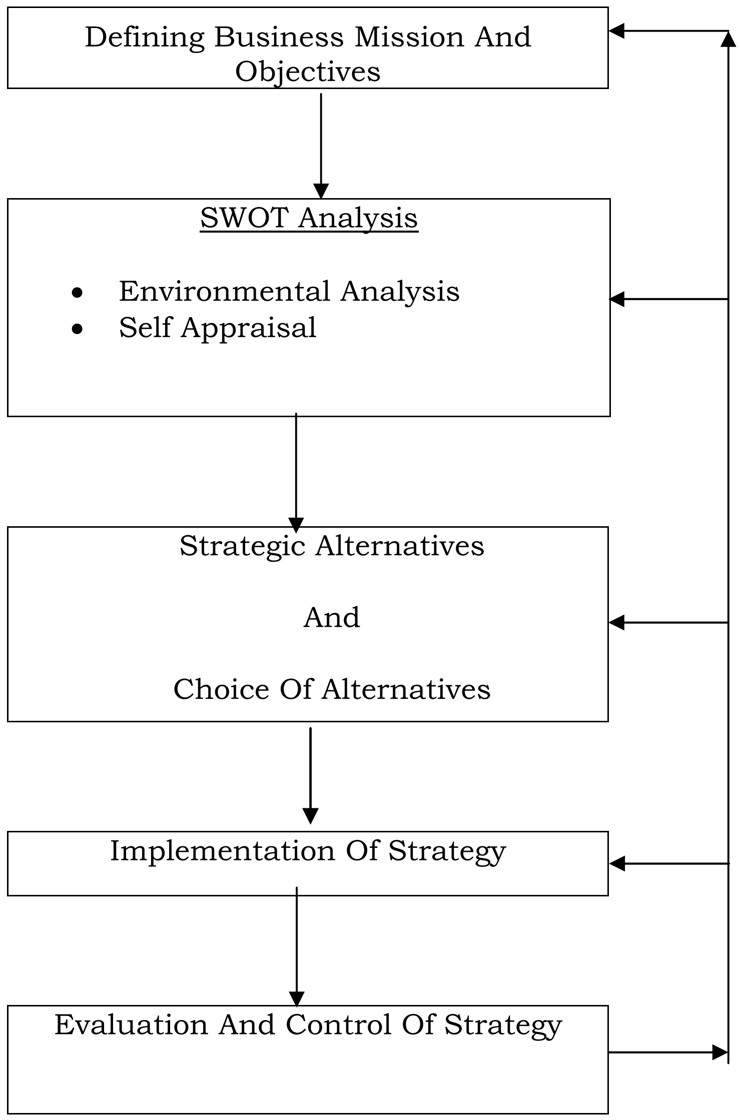
- **Defining Business Mission and Objectives**

Strategic management process begins with formulation of mission and objectives of the organisation. Mission represents business philosophy and implies the image which the company is trying to project. Corporate objectives are the end results which are to be realized for achieving the mission. Strategy is the means of achieving these objectives. In order to clearly define its mission and objectives, they relate the organisation to the society and state what the organisation stands for. With changes in the external and internal environment, the objectives need to be modified or redefined. A company must time to time assess how well its objectives tap its resources and opportunities before it. A company can have multiple objectives with assigning of relative priorities. A short run objective may be the means to achieve a long run objective.

- **SWOT Analysis**

Corporate analysis and environmental analysis are the two constituents of SWOT analysis. Corporate analysis reveals the organization's strength and weaknesses. Environmental analysis reveals the opportunities and threats before the organisation. Opportunities should be availed of and the impact of the threats neutralized in order to capitalize on organisation strength and minimize weaknesses. To estimate the company's strength and weaknesses an internal resource audit is conducted for the internal factors like finance, technology, production facilities, personnel and marketing capabilities.

The environment might entail several opportunities but the organisation might not have the strength to exploit all the opportunities. Similarly, a company might lack the strength to face environmental threats. In such a situation the company might give up the line of business in which it is not competent to survive and concentrate on such business in which the firm is most competent.



- **Strategic Alternatives and Choice of Strategy**

The next stage in this process is strategy generation and the choice of most appropriate strategy. There may be many alternatives before the organisation, e.g., continue same business or get out of it or expand existing business or enter a new business, etc. No organisation can choose all the alternatives. Therefore, the organisation has to consider some of the promising alternative in light of its mission and objectives, its strength and weakness, environmental opportunities and threats. After evaluation and comparison of various alternatives, the most suitable one is chosen.

- **Implementation of Strategy**

A good strategy alone cannot lead to success its effective implementation is essential. Detailed plans of action are prepared and the necessary systems and resources are prepared to put the chosen strategy into action. In a business unit, there are two levels of strategies, namely, corporate level strategy and functional level strategy. Corporate level strategy refers to the master strategy to achieve the overall corporate objectives. Functional level strategy refers to the operational strategy adopted to achieve the corporate strategy. The task of implementation involves mobilization and deployment of resources, including personnel, needed for implementation, organizing and assigning tasks to various elements of the organisation.

- **Evaluation and Control of Strategy**

In this last stage, the top management ascertains whether the strategic choice implemented is achieving the objectives of the organisation. The chosen strategy may fail to meet the objectives due to poor implementation, unforeseen changes in the environment or inappropriate strategic choice. The corrective actions will depend upon causes of failure. This is a continuous process because continuous monitoring is required for taking suitable action in time whenever something goes wrong. Evaluations provide the feedback for modifications whenever there is a change in any one of the factors affecting strategy.

1.10 LET US SUM UP

In this unit we have touched upon the following points:

I. The totality of forces influencing business is business environment

II. Its nature is aggregative, interrelated, relative, uncertain and contextual.

III. It is differentiated into internal or controllable and external or uncontrollable factors.

IV. It is important as an early warning signal, focus on customers, strategy making, change agent etc

V. External environment is further differentiated into micro and macro.

VI. Micro environmental variables are customers, competitors, suppliers, market intermediaries, financiers, publics

VII. Macro environment consists of political and legal, social and cultural, economic and financial, technological and physical, natural and global.

VIII. Environmental analysis is the process of monitoring, analyzing and understanding environmental forces and trends

IX. Environmental analysis is a important aspect of strategic management process.

1.11 LESSON-END ACTIVITY

Choose any two similar firms from the same industry, conduct a SWOT analysis and compare them

1.12 MODEL ANSWERS FOR CHECK YOUR PROGRESS

1. Its nature is aggregative, interrelated, relative, uncertain and contextual.

   It is important as an early warning signal, focus on customers, strategy making, change agent etc.

2. Business environment is classified as internal and external. External environment is further differentiated into micro and macro. Internal factors are also called controllable factor. These factors can be altered. External environment comprises of factors beyond the control of the company. Hence they are called uncontrollable factors.

3. Environmental Analysis is a continuous process with the following objectives:

   a) To provide an understanding of current and potential changes taking place in the environment

   b) To provide inputs for strategic decision making

   c) To bring about suitable changes in the organisation

Several techniques are used for analyzing and diagnosing the environment like SWOT and ETOP Environmental Analysis offers the following benefits: To keep business dynamic, to develop long term strategies of the firm, To develop plans to deal with technological advancements, To foresee the impact of socio-economic changes on the firm's stability and to counter the strategies of the competitors.

4. The strategic management process consists of the following steps:

- Defining Business Mission and Objectives
- SWOT Analysis
- Strategic Alternatives and Choice of Strategy
- Implementation of Strategy
- Evaluation and Control of Strategy

Suggested Readings

1. Francis Cherunilam-Business Environment
2. C.B.Gupta- Business Environment

UNIT- II

UNIT - II

CONTENT

AIM AND OBJECTIVES

In this unit, we discuss the significance of Business Environment. After going through this lesson, you will be able to understand:

I. Changes taking place in business
II. Significance of ethics and professionalisation
III. Relationship between business and culture
IV. Social responsibility of business

LESSON-6

2.0 INTRODUCTION

From this unit we would able to understand the reasons underlying the fact those welfare goals is given equal importance as the economic goals by the firms. Apart from earning profits, business firms also provide various facilities for the welfare of the society. The economic and social objectives of business are complimenting each other and a trade-off between them becomes essential. Professionalisation has contributed to the social orientations of the business.

The close relationship between business and culture can be better understood. The organization and adaptation of culture and its importance are explained in this unit. Further what are the responsibilities of the firm towards the members of the society have been explained in detail.

2.1 CHANGING CONCEPTS OF BUSINESS

Traditionally, the term business commonly refers to the commercial activity or functions of an individual or organisation aimed at making profits. This is a narrow concept of business because it covers only the private sector of economy and focuses only on profit motive. Later business was considered as a system composed of several subsystems which are interrelated and interdependent. Business system operates in a wider system i.e. business system is subsystem of a broader economic and social system. Business enterprises do not aim at maximizing profits but at reasonable profits.

The concept of business has been gradually changing over years. Today, business is considered as a social institution which performs social function and has significant influence on the people live and work together. The modern concept of business is wide. It is regarded as a organ of the society to help attain the social goals. A business can earn profits only by serving the society. Business is expected to process and develop economic values for the society.

According to Davis and Blomstorm, business society relationship involves three main issues.

1. Values

Like any social institution, business develops certain beliefs and values which drive business activities. These values motivate the people involved in business and guide their activities. Business beliefs and values stem from different sources, such as mission of business, its location, the type of industry in which it operates and nature of its employees.

2. Viability

Viability means the drive to live and grow, to accomplish the latent potential, and to achieve everything which a living system can achieve. In order to be a viable social institution, business must shape the social environment instead of merely adapting to the social changes. Without taking initiative for social change, business cannot create opportunities for itself.

3. Public Visibility

The extent to which the activities of business enterprise are known to the outsiders is called public visibility. It is different from public image which means what people think about the enterprise. Public visibility is important because unless the activities of business are known, society cannot examine, discuss and judge them.

LESSON-7

2.2 OBJECTIVES OF BUSINESS

According to classical economists, profit maximization is the sole objectives of business as it a true criterion for measuring its success. But this is no longer a universally valid business objective. Now, it has been recognized that firms may limit their profits to discourage potential competition, to avoid potential criticism and government intervention, to restrain from higher wage demands of the labor, to maintain customer goodwill and so on. The general outlook of large business corporations has undergone a change. As a result of the recognition of the social responsibility, business objectives have transcended the profit motive.

George Goyder has classified the objectives of business into two broad categories namely primary and secondary objectives.

2.2.1 PRIMARY OBJECTIVES

The principle objectives of business are as follows:

a) To extend, develop, improve company's business and build up its financial independence
b) To pay fair and regular dividend to the share holders
c) To pay fair wages under the best possible conditions to the workers
d) To reduce the prices charged to the consumers

2.2.2 SECONDARY OBJECTIVES

A responsible company has secondary objectives as well. These include the following:

a) To enhance labour welfare
b) To enhance customer service and goodwill
c) To assist and developing and promoting the amenities in the locality
d) To assist in developing the industry in which the firm operates
e) To contribute to the national goals

The economic and social objectives of business are complimentary to each other. A proper trade-off between economic and social objectives may be necessary. The important factors that affect the choice of objectives are environmental forces, resources and capabilities of the organisation, internal power relationships, and value system of the top executives and awareness of management.

Check Your Progress-1

Comment on the changing objectives of business

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-8

2.3 PROFESSIONALISATION AND BUSINESS ETHICS

2.3.1 PROFESSIONALISATION

The growth of management education and training has contributed to the growing professionalisation of management and professionalisation has contributed to the social orientations of the business. Professionalisation imparts social; responsibility and dignity to management. A professional is one who possesses systematic knowledge and skill to perform certain responsible functions with the authority and who is bound by certain ethics in use of his knowledge and skill. A professional in other words, is private in the sense that he is autonomous and not subject to political or ideological control. But he is public in the sense that the welfare of his clients sets limits to his deeds and words.

A professional has enormous responsibilities. He shall not use his skill, knowledge and authority unscrupulously. He shall not knowingly do harm to his customers. He is socially bound by the ethics of his profession. Hence it is clear that professionalisation of business management means that business should be managed by people,

- Who have formally acquired specialized knowledge and skill for management
- Who have authority and freedom to take the right decision
- Who have on bias in discharge of the functions
- Whose decisions and actions are guided by certain ethical consideration

In business circles, there has been a growing awareness of the need for professionalizing management. Professionalisation makes business more efficient, dynamic and socially responsible. The growth of management education has contributed to the professionalisation of the business field.

2.3.2 BUSINESS ETHICS

Ethics refers to the moral standards used to govern behavior and to determine right or wrong, good or evil. Business ethics may be defined as a set of moral standards which people owning and managing business is expected to follow. It indicates what right conduct to business matters. Business ethics change over o\time and are important in all types of business. Business ethics requires behaviour which is socially desirable even if not legally binding. The main elements of Business ethics are values, rights and duties. Values are the moral beliefs held by an individual, an organisation and a society. Rights are the claims of the individual or organisation. Duties are the obligations of a person or an organisation. Ethical standards originate and develop from various sources like societal attitudes, competitive pressures, legal environment etc.

The most important professional ethics is expressed as follows:

1. Do not destroy or distort competition
2. Do not deceive or cheat customers by selling substandard or defective products or by any other means
3. Do not resort to black-marketing or profiteering
4. Do not tarnish the image of competitors by unfair practices
5. Ensure sincerity and accuracy in advertising, labeling and packaging
6. Make accurate business record available to all business persons
7. Pay taxes and discharge other obligations promptly
8. Do not control production, price etc detrimental to common interest
9. Refrain from bribing administrators, politicians and others
10. Ensure fair wages and fair treatment to employees

Ethical considerations are important in management as in any other occupation. Ethical considerations are significant for the managers for the following reasons:

- Business values become the values of the society as a whole
- They act as motivating factors
- It helps the organisation to build its image and gain market share
- Job values helps a person to be healthy and happy

Sources of Business Ethics

Managers in every society are influenced by three repositories of ethical values, religion, culture and law; These repositories contain unique systems of values that exert varying degrees of control over managers. A common thread, the idea of reciprocity or mutual help, runs through all the value systems. This idea reflects the central purpose of all ethics which is to bind the vast majority of individuals in society into a co-operative whole. Ethical values are a mechanism that controls behaviour in business and in the other walks of life. Ethical restraints are more effective than are cruder controls such as police, law suits or economic incentives. Ethical values channel individual energy into pursuits that are benign to others and beneficial to the society.

Religion

One of the oldest source's of ethical inspiration is religion. More than 100,000 different religions exist across the globe. But despite doctrinal differences, the major religions converge on the belief that ethics is an expression of divine will that reveals the nature of right and wrong in business and other areas of life. The world's great religions are also in agreement on fundamental principles which are similar to the building blocks of secular ethical doctrine. The principle of reciprocity towards one's fellow human beings is found in all major religions such as Hinduism, Buddhism, Christianity, Islam, Judaism and Confucianism. The great religions preach the necessity for an orderly social system and emphasise social responsibility in such a way so as to contribute to the general welfare. Built upon such verities are many other rules of conduct.

Cultural Experiences

Culture, as was stated earlier, refers to a set of values, rules and standards transmitted among generations and acted upon to produce behaviours that fall within acceptable limits. These rules and standards always play an important part in determining values, because individuals anchor their conduct in the culture of the group. Civilisation itself is a cumulative cultural experience in which people have passed through three distinct phases of moral codification. These stages correspond to the changing economic and social arrangements in human history.

For millions of generations in the hunting and gathering stage of human development, ethics was adapted to conditions in which our ancestors had to be ready to fight, face brutal foes and suffer the hostile forces of nature. Under such circumstances, a premium was placed on pugnacity, appetite, greed and sexual readiness, since it was often the strongest who survived. Trade ethics in the early civilisations were frequently conducted by brute force and violence.

Civilisation passed into an agricultural stage approximately 10,000 years ago, beginning a time when industriousness was more important than ferocity, thrift paid greater dividends than violence, monogamy became the prevailing sexual custom because of the relatively equal numbers of the sexes and peace, came to be valued over wars, which destroyed crops and animals. These new values were codified into ethical systems which even guide the managers today.

Two centuries ago, society entered an industrial stage of cultural experience, and ethical systems once more began evolving to reflect the changing physical, cultural, institutional and intellectual environment. Large factories and corporations, population growth, capitalist and socialist economic doctrines and technologies have all assaulted the ethical standards of the agrarian stage. Industrialism has not created a distinct ethics, but it has created tensions with old ethical systems based on the values of agricultural societies. It does this by changing values related to what is good and bad. For example, the copious outpouring of material goods from factories has encouraged materialism and consumption at the expense of older virtues such as moderation and thrift. Managers run an industrial enterprise on the cutting edge of cultural experience. The tensions their actions create make business more ethically complex. For instance, the widespread use of computers for data storage and communication raises new issues of privacy and individual expression unlike those present in the agrarian societies.

The Legal System

Laws are rules of conduct, approved by legislatures, that guide human behaviour in any society. They codify ethical expectations and keep changing as new evils emerge. But laws cannot cover all ethical expectations of society. Law is reactive; new statutes and enforcement always lag behind the opportunity for corporate expediency.

Whatever ethics that law codifies, it is binding on business. Society expects business to abide by law and obeying law is presumed to be ethical behaviour.

Although society expects business to be law abiding, seldom does the business adhere to the rules. Law breaking in business is common. Taxes are evaded, hundreds of employees die because of occupational diseases, many die because of industrial accidents and million others receive disabling injuries on the job. The blame for these deaths and injuries can be shared by careless employees and by employers who fail to adhere to occupational health and safety laws.

Consumers suffer because of poor quality and high priced products supplied by businessmen. And business causes misery to the society by damaging the environment, disregarding environment protection laws.

Ethics is important to business for several reason as stated below:

(i) Ethics corresponds to basic human needs.

It is a human trait that man desires to be ethical, not only in his private life but also in his business affairs where, being a manager, he knows his decisions may affect the lives of thousands of employees. Moreover, most people want to be part of an organisation which they can respect and be publicly proud of, because they perceive its purpose and activities to be honest and beneficial to the society. Most top managers would like to respond to this need of their employees; and they (managers) themselves feel an equal need to be genuinely proud of the company they are directing. These basic ethical needs compel the organisations to be ethically oriented.

(ii) Values create credibility with the public.

A company perceived by the public to be ethically and socially responsive will be honoured and respected even by those who have no intimate knowledge of its actual working. There will be an instinctive prejudice in favour of its products, since people believe that the company offers value for money. Its public issues will attract an immediate response.

(iii) Values give management creditability with employees

Values are supposed to be a common language to bring leaderships and its people together; Organisational ethics, when perceived by employees as genuine, create common goals, values and language. The management has credibility with its employees precisely because it has credibility with the public. Neither sound business strategy, nor a generous compensation policy an fringe benefits can win employee credibility and perceived moral and social uprightness can.

(iv) Values help better decision making.

Another point of great important is that an ethical attitude helps the management make better decisions. i.e. decisions which are in the interest of the public, their employees and the company's own long term good, even though decision making is slower. This is so because respect for ethics will force a management to take various aspects economic, social and ethical in making decisions.

(v) Ethics and profit Ethics profit go together

A company which is inspired by ethical conduct is also profitable one. Value driven companies are sure to be successful in the long run, though in the short run, they may lose money.

(vi). Law cannot protect society, ethics can

Ethics is important because the government, law and lawyers cannot do everything to protect society. Technology develops faster than the government can regulate. People in an industry often know the dangers in a particular technology better than the regulatory agencies. Further, government cannot always regulate all activities which are harmful to society. Where law fails, ethics can succeed. An ethical oriented management takes measures to prevent pollution and protect workers health even before being mandated by law.

Check Your Progress-2

Write a note on business ethics and professionalization

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-9

2.4 BUSINESS AND CULTURE

Business and culture are closely connected. There are very varying definitions of culture. Culture, in its broadest definitions, refers to that of the total repertoire of human action (and its product) which is socially, as opposed to genetically, transmitted. A very popular definition is that of E.B Taylor: Culture of civilization is that complex whole which includes knowledge, belief, art, morals, law, custom, and other capabilities and habits acquired by man as a member of society. Kluckhohn has defined culture very simply as the total life – way of a people.

On the basis of the, various definitions of culture Francis Merill formulates of the concept of culture as follows. Culture, he says,

a) Culture is the characteristically human product, of social interaction

b) Culture provides socially acceptable patterns for meeting biological and social needs

c) Culture is cumulative, for it is handed down from generation to generation in a given society

d) Culture is meaningful to human beings because of its symbolic quality

e) Culture is learned by each person in the course of his development in a particular society

f) Culture is, therefore, a basic determinant of personality; and

g) Culture depends for its existence upon the continued functioning of society but is independent of any individual or group.

Culture consists of both material culture and non-material culture. Material culture involves man-made things (e.g., automobile, television, telephone, etc.) and man-made alterations in the environment Non-material culture includes such factors as language, ideals, beliefs, values, music, etc.

2.4.1 ELEMENTS OF CULTURE

Culture, the sum total of societal behaviour, includes at least three elements namely, knowledge and beliefs, ideals and preferences.

- **Knowledge and Beliefs:**

The knowledge and beliefs refer to peoples prevailing notions of reality. They include myths and metaphysical beliefs as well as scientific realities. As Rose remarks. One of the features of culture in general that is of special sociological interest is the shared quality of a belief system. People who share a given culture tend to take a, hostile towards those with in their midst who cannot, or will not, accept conventional definitions of fact.

- **Ideals:**

Ideals refer to the societal norms which define what is expected, customary, right or proper in a given situation. Norms are enforced by sanctions. i.e. by rewarding the right behaviour and punishing the wrong behaviour.

Folkways and mores are important aspects of every culture. Folkways are norms of proper behaviour (like the proper way to greet a friend) that are informally enforced. But mores are norms of obligatory behaviour considered vital to the welfare of the group.

- **Preferences:**

Preferences refer to society's definitions of those things in life which are attractive or unattractive as objects of desire. Preferences may differ between cultures. Interestingly enough, the judgments of the ideal or the proper do not always correspond to our judgments of the pleasant or enjoyable. An example in point is the temptations - (not proper but desirable). Things I really like to do are immoral, illegal or fattening, said Alexander Woollcott.

A culture tends to provide the standards of tastes in specific lines of human activity. Taste in the most liberal sense varies greatly with the food consumption preferences of different cultures. But there is also taste is clothing, housing sexual practices and in an endless variety of possessions and activities. What is tasteful in one culture may be highly distasteful –in another".

Cultural characteristics are very important in the formulation of pragmatic business strategies. The cost of ignoring customs, traditions, taboos, tastes and preferences, etc. can be very high. For example, in Italy, a US company that set up a com-processing plant found that its marketing effort failed because Italians thought of com as pig food. The Nestle Company brews more than 40 varieties of instant coffee to satisfy different national tastes. We have already made some reference to the values and beliefs attached to colour

2.4.2 ORGANISATION OF CULTURE

The term organisation of culture refers to the social structure and, the integration of traits, complexes and patterns that make up the cultural system.

That cultures are organized or integrated does not mean that every single item of each culture is neatly and precisely integrated with everything else. It means rather that it is normal for the parts to be somewhat organized, and that culture traits receive their significance and meaning out of their relation to the rest of the culture.

The social structure the web of organized relationships among individuals and groups that defines their mutual rights and liabilities together with traits, complexes and patterns, reflects the organisation of a culture.

Stratification, i.e., differentiation based on criteria such as age, sex, caste, occupation, education, income and so on, is an important. Aspect of the social structure arid cultural organisation. Each stratum is assigned or supposed/expected to have a certain rank or position role or limitations etc in the societal set-up.

The organisation of a culture is determined to a large, extent by major social institutions. According to Maciver and Page, institutions are established forms or conditions of procedure characteristic of group activity. The group which performs these standardized, actions has been termed by them an association. According to Biesanz arid Biesanz, institutions are clusters of norms organized and established for the pursuit of some need or activity of a social group, supported by the group's know ledge, beliefs, and values, as well as by the meaningful aspects of material culture. The important common institutions of modern cultures are:

The economic system; the political administrative system; the educational system; religion, family, expressionistic; aesthetic and recreational institutions, etc. Such institutions have been established to meet society’s common needs of a biological, sociological, psychological, economic, and political nature the type and nature of institutions reflect the common goals, aspirations and the ways of achieving them, definition and regulation of roles, positions, inter-relationships, etc., of the individuals and sub-groups and groups and the overall organisation of the culture.

Culture traits, complexes and patterns also help us to understand the organisation of a culture. A trait is a unit of observation. It may be a unit of normative behaviour, like shaking hands or saying namaste; or it may be all aircraft, like a culture object such as a wooden bowl. As Lumby observes: A culture trait is the simplest acquired material or activity pattern known; and these traits are the bricks, so to speak, of which the whole culture of the society is constructed. Most traits are re1ated to others and fit into larger meaningful wholes called trait complexes. For example, the various traits involved in-greeting and receiving a guest forms a trait complex. A complex, thus, is a system of interrelated traits that function together as a unit number of complexes, in turn come together to form a culture pattern. A culture pattern is a specific and enduring system of trait complexes. The organisation of culture may, thus, be looked upon from the point of view of a meaningful integration of different traits into interrelated complexes-and complexes in turn into patterns. The term culture pattern is sometimes used to designate the overall organisation of the culture; but sometimes it is used to refer to the major segments of the culture, like the religious pattern of the Todas.

2.4.3 CULTURAL ADAPTATION

The term cultural adaptation refers to the manner in which a social system or an individual fits into the physical or social environment. The social system may be a small group, such as the family or a larger collectivity, such as an organisation, or even a total society, like a tribal society.

Adaptation is an essential quality for the survival of the individual and society. Culture, a uniquely human attitude, is something which, man interposes between himself and his environment in order to ensure his security and survival. As such, culture is adaptative. Leslic A. White speaks of culture as a specific and concrete mechanism employed by a particular animal organism, in adjusting to its environment", and Ralph Piddington holds that culture is essentially an adaptative mechanism, making possible the satisfaction of human needs, both biological and social.

As MacIver and Page observe, the correspondence of life and environment is amply illustrated in the case of social groups. Just as every region of a country is in some respects different from every other, so also are the inhabitants of each region. The difference in some way is relative to the environment in which they respectively dwell. Common observation tells us that as people change from country to city, from agriculture to industry, from mountain to plain, from hot to temperate climates, they become adjusted to the new conditions, undergoing a process of change as their environment changes. It is obvious that a well-to-do group has a different environment from a poor one, a coloured urban group from a white one, a professional class from an artisan class. Take the largest effective community: we can find, whether that of a nation or of a whole area of civilization, and its character is seen to be in some significant way related, to that of the total environment within which it has grown. Or take the smallest group, such as the individual family, and there too the correspondence between life and environment is manifested.

Adaptation is essential for survival. The type of clothing, food and dwelling, suitable for the climatic and weather conditions, are forms of adaptations. Cultures are many times compelled to adapt to outside forces or environmental changes. Take the case of some of the tribe societies in India. The invasion of the outsiders destroyed or damaged their environment, making it impossible or very difficult for them to survive with the traditional ways of life. Hence, now they take up wage employment outside and have changed their life styles, including their-food habits and dress. Some of them live in the houses provided by the Government which are quite different from, their traditional dwellings.

Cultural adaptation can be viewed in a very wide, context. We have, adapted to the energy crisis caused by the oil price hikes by modifying our energy policy and intensifying oil exploration, developing alternative source of energy and. restricting oil consumption. Humanity adapts to contagious diseases by - immunization.

Adaptation is relevant at the individual level as well. An individual who joins or accepts a new religion has to adapt himself to the beliefs and ways of that religion. A worker who becomes a member of a trade union has to fit into the objectives, rules and ways of the union. A woman who lives with her husband's family would- have to fit into that family culture. An - Indian who settles in the U.S.A. has to adjust to the social and physical, environments there. A person who wants to enter a Hindu temple has to adapt himself to the culture (for example, the footwear has to be removed; in some cases, only a specified, type of clothing shall be used; a person who wants to make pilgrimage to Sabarimalai has to adapt himself by strictly adhering to the religious regulations in operation there).

Environmental changes sometimes produce cultural shock a feeling of confusion, insecurity, and anxiety caused by the strangeness of the new environment. For example, if an youngster, born and brought up in a large city, is posted to a bank office in aren1ote village, he may experience a cultural shock. Similarly, a villager may experience a cultural shock when he takes up a job in a large modern company in a far-away metropolitan city. They have, however, to adapt to the new culture in due course if they want - to survive.

In short, every difference of environment means a difference in our habits, our ways of living. On the other hand, our habits, our ways of living, in so far as they differ, create for us a different environment, a different selection within it, and a different accommodation- to it. Through a process of constant selection and constant adaptation, the moving equilibrium of life is maintained.

Sometimes it is necessary to know the process and nature of the cultural environment - for a successful formulation of business strategies. For example, while introducing new ideas, techniques, products; while segmenting the market; while fOrri1ulating the product and promotion mix strategies; one should consider the extent to which different categories of consumers adapt to the new things or environment and the factors favouring and disfavouring adaptations (and - also the general attitude of society to the new ideas and environment and their impact on different categories of consumers).

2.4.4 CULTURAL TRANSMISSION

Avery important character of culture is its transmissive quality. The elements of culture are transmitted among the members of the culture, from one generation to the next, and to the new members admitted into the culture. Some of the aspects of a culture may be transmitted to other cultures, also.

The transmissive quality of culture makes it cumulative. Every, generation inl1eritsa stock of cultural elements, many of which have been accumulated over a long period of time. As time goes on, cultures accumulate more techniques, ideas, products and skills. It is also quite obvious that certain old elements are dropped as new ideas and traits are acquired.

Cultural accumulation, facilitated by cultural transmission, enables man to build upon the achievements of the past.

Much cultural behaviour is handed down by one's parents, teachers and other elders. The reference groups play an important role in handing down new traits and ideas. Some cultural behaviour, are, however, handed up to the elders. It is not uncommon to come across elders imitating or adopting some of the new traits of the youngsters who are the trend-setters. Culture transmission is not only downward and: upward; a lot of transmission takes place among contemporaries, too, e.g., styles of dress; recreational fads; reading and .learning habits; political, social and economic views, These are often transmitted among contemporaries Cultural transmission, thus, takes place horizontally as well as vertically.

The process of cultural transmission involves teaching and learning. One hardly acquires a behaviour pattern spontaneously. One rather learns it. However, as Cuber points out, much of the learning process, both for the teacher and the learner, is quite unconscious, unintentional, or accidental; but it is learning and teaching nevertheless.

Cultural transmission takes place, by means of symbolic communication. A symbol is any sign, signal or word that conveys a meaning. The great importance of language in cultural transmission is quite clear. Literature, film, TV and some other electronic gadgets, social institutions, advertising and marketing techniques, and so on, play very important roles in cultural transmission.

Transmission also facilitates cultural diffusion, i.e., the spread of cultural elements from one area to another. Cultural transmission and diffusion are easy in a culture with high educational levels and a well organized communication system. An effective communication system and high educational levels facilitate socio-economic change through better cultural transmission and diffusion, for new ideas and innovations are easily and quickly transmitted, diffused and absorbed in such a culture. In the context of the generally low literacy rates in India, the government has realized the importance of the media, such as film, television and radio, in transmitting useful information such as better: agricultural practices and techniques, market information, the concept and importance of family planning, and so on.

The nature and process of cultural transmission and diffusion in a society is important to business decision-making. For example, to formulate a promotional policy for a product, a service or an idea, it is important to identify the relevant elements of transmission, to evaluate the relative effectiveness of alternative communication media, to identify the reference groups and the extent of their influence, to identify the channel of influence on the reference groups, and so on.

2.4.5 CULTURAL CONFORMITY

Individuals in a culture tend either to conform to the cultural norms or to deviate from them. If the culture endures as it is, most people would conform to the norms. As Inkeles observes, the social order depends on the regular and adequate fulfillment of the role obligations incurred by the incumbents of the major status-positions in a social system. It follows that the most important process in society is that which insures that people do indeed meet their role obligations.

A student who abides by the rules of his school discipline, does his home works promptly and studies properly is conforming to his role obligations. Similarly, an employee who works properly is conforming to his role obligation. And an employee who strikes work for a reasonable cause in response to a strike call by his union is also conforming to his role as a member of the union. When an individual has incorporated within himself the know ledge and appropriate skills necessary to the fulfillment of a role, and when he accepts the value or appropriateness of the action, sociologists speak of his having internalized the role and its psychological underpinnings". Such internalization helps achieve cultural conformity.

As Biesanz and Biesanz remark: Conformists may be so thoroughly -socialized that it never occurs to them to question the norms. They may repress contrary impulses, or may sublimate them into approved kinds of activity. On the other hand, conformists may be aware of impulses to deviant behaviour but may not give in to them for any of the following reasons:

i. Through the process of self-interaction, they exercise self control, knowing that the cost of deviant behaviour would be guilt, shame, and loss of self-esteem.
ii. They want to keep the approval of their significant others.
iii. They may fear punishment, ostracism, loss of their jobs, citizenship, freedom, or life.
iv. They may see no point in deviating from the straight and narrow if the rewards of deviants do not seem glamorous.
v. They may simply have no opportunity for deviant behaviour despite fantasies and impulses towards it.

Conformity to role obligations is enforced largely by means of sanctions, i.e. rewards and punishments. The negative sanctions range from very mild punishment to sentence of death. Today, greater stress is laid on education and motivation than on negative sanctions to induce the incumbents to conform to their status positions.

Certain kinds of conformity, however, are not good from the point of the long-term interest of society, for they stifle the constructive innovation that produces the necessary social changes. For example, blind conformity to the status quo, yielding to group or strong individual pressures against one's better judgment may prove to be detrimental. Some measure of courage and inclination to deviance on the part of the individual according to his conscience and judgment are necessary for social change and progress. It may be recalled that deviances such as civil disobedience and strong protest against foreign rule led by Gandhiji helped win independence for India. .

Knowledge of the nature -and extent of cultural conformity and deviance will sometimes be helpful in business decision-making. If a society is, by and large, characterized by blind conformity, it would be very difficult to market new revolutionary ideas (including products and techniques) in, such a society. Special efforts may be required in such a society to change the attitudes of the people in favour of unconventional ideas. It is also important to understand the extent and nature of the snow-balling effects of initial deviations in a society.

Impact of Culture on Business

1. Culture Creates people

The concept of culture is of great significance to business because it is the culture which generally determine the ethos of the people. It trains people along particular lines, tending to put a personality stamp upon them. Thus, we have Indians, Japanese, Americans, Germans, Britishers and so on. It was not that all people are alike in a particular culture. There are sub cultures within a culture. When people with different cultural backgrounds promote, own and manage organizations themselves tend to acquire distinct cultures. Thus, the culture of the Tata group of companies is different from that of the enterprises owned by the Birlas.

2. Culture and Globalisation :

As business units go international, the need for understanding and appreciating differences across various countries is essential. Work motivation, business goals, negotiating styles, attitudes towards the development of business relationships, gift giving customs, greetings, significance of body gestures, meaning of colours and numbers, and the like vary from country to country.

3. Culture Determines Goods and services:

Culture broadly determines the type of goods and services a busines8 should produce. The type of food people eat, the clothes they wear, the beverages they drink and the building materials they use to construct dwelling houses vary from culture to culture and from time to time within the same culture. Business should realise these cultural differences and bring out products accord

4. People’s Attitude to Business

Attitude of people towards business is largely determined by their culture. Business systems are a product of beliefs, mores and customs of the society in which they exist. Indeed, their very existence depends upon social philosophies which conduct and support various kinds of business actions. Businessmen (whether they realise it or not) must have some basic set of philosophies to guide their actions. Beliefs and value systems concerning what is right and what is wrong are basis to all business activities and serve as a justification for doing or not doing something in a particular value system by which actions of businessmen and other groups are judged. Usually, these actions are judged by how well they contribute to the net social well-being throughout the whole system.

5. Attitude to Work

How a worker looks at his work in a factory depends on his culture. Motivation, morale and other related aspects of human resource management are based on the workers attitude to their work. Attitudes to leisure vary from country to country. Higher incomes may produce more work or more spare time. The work ethic means, in effect, that preoccupation with work is considered a virtue in some parts of the world and a vice in others. As a result, different types of appeal, reward and penalty are effective in different cultures.

6. Collectivism and Individualism

The spirit of collectivism and individualism is related to such personnel aspects as employee morale, multiplicity of trade unions and inter and intra-union rivalries. It is said that our culture, unlike Christianity, stresses individual salvation and negation of the world. Behind a small charity or a good deed, it is pointed out, there is the motive of self, rather than society's welfare. This is the main reason for the low morale of our workers, multiple unions and the rivalries among them.

7. Ambitious or Complacent

An individual's ambition to grow or remain complacent depends on his cultural ethos. And ambitious individual is highly motivated, is wealth acquisitive, has a strong urge to excel, is prepared to change organization and even take risks. Economy becomes vibrant if a large proportion of the population comprises ambitious people.

8. Education

The close interface of business and higher education is a new development. Centuries ago, each had a somewhat hands-off attitude towards the other. A relatively small section of the intellectual elite maintained their seclusion in university halls, educating a few selected students to become intellectual and social leaders of their nation. Education was not for the masses who laboured in factories, fields and stores. University education had little interest in business and businessmen had little interest in education. Each lived in a different world. Many educators showed an elitist disdain for businessmen who were perceived as less nobly motivated than educators. Most businessmen admitted that the disdain was mutual since men in the ivory tower had little that was practical to offer to business.

9. Family

Basic to all types of social organizations is the family, the institution which concern itself with love, sexual relationship, marriage, reproduction, socialization of the child and the various levels of status and roles involved in kinship organization. Little wonder that the family is referred to as a remarkable institution.

10. Authority

The exercise of authority varies according to the management styles, but different styles are likely to be present in different cultures. One research relevant to this has produced a measure of the cultural differences-the power distance measure. This is defined, as a measure of inter-personal power of influence, between a boss and a subordinate, as perceived by the least powerful of the two, while the distance is seen as the extent to which either participant can influence the behaviour of the other. It is suggested that the distance is to a considerable extent determined by their natural culture. The evidence for this statement has been provided by research in 39 countries in which questions were asked on such subjects as the fear subordinates have of expressing disagreement with their bosses (answers expressed by I am afraid very frequently through to I am afraid seldom). The answers have been assembled in a series of tables showing power distance index values varying 94 (very often afraid) for the Philippines to 11 (very seldom afraid) for Austria.

11. The View of Scientific Method

It is said that, unlike Western society, our society is steeped in fatalism and the theory of Karma. The followers of our religion do not appreciate the logic of things-logic of wealth, rainfall, demand, supply, mechanisation and related phenomena. It is also said that they believe in preserving traditional mores and are not adaptive to things modern.

12. Ethics in Business:

Ethics refers to the code of conduct that guides an individual in dealing with others. A formal definition of ethics is that it deals with personal conduct and moral duty and concerns human relations with respect to right and wrong. Ethics concerns morals and philosophy. It deals with the behaviour of individuals and the standards governing the interrelationship between individuals.

Check Your Progress-3

Explain the importance of cultural adaptation and cultural conformity

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-10

2.5 SOCIAL RESPONSIBILITY OF BUSINESS

Today the operations of business enterprises affect a wide spectrum. The resources they make use of are not limited to those of the proprietors and the impact of their operations is felt also by many a people who are in no way connected with the enterprises. The shareholders, the suppliers of resources, the consumers, the employees, the local community and society at large are affected-by the way an enterprise functions. Hence a business enterprise has to be socially very responsive so that a social balance may be struck between the opposing interests of these groups.

Society has become increasingly aware of their interdependence between business and its environment. There has been a growing acceptance of the plea that business should be socially responsible in the sense that the business enterprise, which makes use of the resources of society and depends on society for its functioning, should discharge its duties and responsibilities in enhancing the welfare of the society of which it is an integral part. Business organizations are no longer viewed as totally private bodies free to pursue their goals. Instead they are increasingly expected to contribute to the society. As business firms grow in their size and power, society expects more from them.

According to Keith Davis, "Social responsibility is the obligation of the decision makers to take decisions which protect and improve the welfare of the society as a whole along with their own interests." H.S. Singhania classifies the nature of the social responsibility of business into two categories.

(a) The manner in which a business carries out its own business activity; and

(b) The welfare activity that it takes upon itself as an additional function.

The first involves the acceptance of the fact that business is not merely a profit-making occupation but a social function which involves certain duties, and requires that appropriate ethics are followed. For example, a business must obey all the laws, even when they are disagreeable; it should produce the maximum goods of good quality, ensure smooth supplies at competitive prices, pay taxes, shun malpractices, pay a fair wage to employees and a reasonable dividend to shareholders. It is also the duty of a business to undertake new investment and promote the dispersal of economic activity through ancillarisation and the setting up of industries in backward areas so as to spread enterprise and take employment to the doorsteps of labour. In addition to its commercial activity, business also plays a role in promoting social welfare activity, even directly.

2.5.1 RESPONSIBILITY TO SHAREHOLDERS

The responsibility of a company to, its shareholders, who are the owners, is indeed a primary one. The fact hat the shareholders have taken great risk in making investment in a business should be adequately recognized.

To protect the interests of the shareholders and employees, the primary business of a business is to stay in business. To safeguard the capital, of the shareholders and to provide a reasonable dividend, the company has to strengthen and consolidate its position. Hence, it should develop and improve its business and build up its financial independence.

Needless to say, to provide dividend, the company should earn a sufficient profit. Adequate reserves should be built up so that it will be able to declare a reasonable dividend during a lean period as well.

If a company continuously suffers losses, not only will it not be able to pay dividends, but the value of its shares will fall and. result in the erosion of the shareholders capital. Hence, to discharge its responsibilities to the shareholders, a company shall earn sufficient profit.

If a company fails to cope with changes in a changing and dynamic world, its position will be shaken, and the shareholders' interests will be affected. By growth, innovation and diversification, the company should consolidate and improve its position and help strengthen the share prices.

The shareholders are interested not only in the protection of their investment and the return on it but also in the image of the company. It shall, therefore, be the endeavor of the company to ensure that its public image is such that the shareholders coo feel proud of their company.

It may be mentioned here that the shareholders also have certain responsibilities which they have to discharge to protect their own interests. They shall not only offer whole-hearted support and co-operation in the positive efforts of the company but shall also guide and control properly its policies and activities. At the same time they shall appreciate the responsibility of the business to other sections of society - to the workers, consumers and the community.

2.5.2 RESPONSIBILITY TO THE EMPLOYEES

The success of an organisation depends to a very large extent on the morale of the employees and their whole – hearted co-operation. Employee morale depends to a large extent on the discharge of the company's responsibilities to them and the employer-employee relationship. The responsibility of the organisation to the workers includes:

(i) The payment of fair wages;

(ii) The provision of the best possible working conditions;

(iii) The establishment of fair work standards and norms;

(iv) The provision of labour welfare facilities to the extent possible and desirable;

(v) Arrangements for proper training and education of the workers;

(vi) Reasonable chances and proper system for accomplishment and promotion;

(vii) Proper recognition, appreciation and encouragement of special skills and capabilities of the workers;

(viii) The installation of an efficient grievance handling system;

(ix) An opportunity for participating in managerial decisions to the extent desirable.

The Committee that conducted the social audit of Tata Iron and Steel, Company (TISCO) observes that not only should the company carry out its various obligations to the employees as well as the larger community as a matter of principle, but this has also led to a higher degree of efficiency in TISCO works and an unparalleled performance in industrial peace and considerable team spirit and discipline which have all resulted in high productivity and utilization of capacity. Thus, by discharging its responsibilities to the employees, the business advances its own interests.

It may, however, be pointed out that the expenditure on labour welfare, etc., should have relevance to the financial position of the company and the economic conditions of the nation. This aspect has to be particularly taken note of by public sector enterprises. Such expenditure shall not exceed the socially and economically warranted limits and shall not cause undue burden on the consumers or the general public. It shall not result in the formation of islands of affluence or comfort in the midst of poverty and suffering at the expense of society.

2.5.3 RESPONSIBILITY TO CONSUMERS

According to Peter Drucker, the famous writer on management, there is only one valid definition of business purpose; to create a customer. Drucker observes; the customer is the foundation, a business and keeps it in existence. He alone gives employment. To supply the wants and needs of a consumer, society entrusts wealth-producing resources to the business enterprise.

It has been widely recognized that customer satisfaction shall be the key to satisfying the organisational goals. Among the important responsibilities of the business to the customers are:

(i) To improve the efficiency of the functioning of the business so as to (a) increase productivity and reduce prices, (b) improve quality, and (c) smoothen the distribution system to make goods easily available;

(ii) To do research and development, to improve quality and, introduce better and new products;

(iii) To take appropriate steps to remove the imperfections in the distribution system, including black marketing or profiteering by middlemen or anti-social elements;

(iv) To supply goods at reasonable prices even when there is a seller's market;
(v) To provide the required after-sales services; ,
(vi) To ensure that the product supplied has no adverse effect on the consumer;
(vii) To provide sufficient information about the products, including their adverse effects, risks, and care to be taken while using the products;
(viii) To avoid misleading the customers by Improper advertisements or otherwise;
(ix) To provide an opportunity for being heard and to redress genuine grievances;
(x) To understand customer needs and to take necessary measures to satisfy these needs.

Despite the popularity of the marketing concept and the growing awareness of consumer rights, consumers allover the world are, by and large, dissatisfied. Consumerism, which is an organized endeavour of the, consumers to protect their rights, is a manifestation of this fact. In shortage economies like India's, many businessmen pay scant attention to their responsibilities to consumers. To protect consumer rights and to make the business discharge its responsibilities to them, the consumers should give up, their indifferent attitude and build up a strong consumer movement.

2.5.4 RESPONSIBILITY TO THE COMMUNITY

A business has a lot of responsibility to the community around its location and to the society at large. These responsibilities include:
(i) Taking appropriate steps to prevent environmental pollution and to preserve the ecological balance;
(ii) Rehabilitating the population displaced by the operation of the business if any;
(iii) Assisting in the overall development of the locality;
(iv) Taking steps to conserve scarce resources and developing alternatives, wherever possible;
(v) Improving the efficiency of the business operation;
(vi) Contributing to research and development;
(vii) Development of backward areas;
(viii) Promotion of ancillarisation and small-scale industries;
(ix) Making possible contribution to furthering social causes like the promotion of education and population control;
(x) Contributing to the national effort to build up a better Society.

The scope of private business and the extent of government regulation of economic activities depend to a very large extent on the nature of the economic system, which is an important part of the business environment. This chapter is intended to provide an outline of the general features of-the broadly distinctive economic systems.

2.5.5 GUIDELINES FOR SOCIAL RESPONSIBILITY

Keith Davis has laid down the following guidelines for the managers to show their social responsiveness:

1. The decisions of the businessmen have social consequences.
2. Open disclosure of operations and open receipts of inputs from society are essential.
3. When a cost-benefit analysis is under taken, social cost should be included.
4. Social cost should be included in the ultimate price of the price or service.
5. Managers and other business people should contribute their talents to help to solve social problems.

2.5.6 LIMITATIONS TO SOCIAL RESPONSIBILITIES

There are inevitable constraints on the acceptance of social responsibilities by the businessmen.

1. While assuming social responsibility, a business enterprise must ensure its profitability and viability.
2. In the pursuit of social responsibilities, the management should confine itself to the areas of its competence.
3. Business management should not encroach upon the government and other social institutions.
4. Social responsibility should be balanced with the socio-economic power of business.
5. The concept of social responsibility is reciprocal.
6. No action should be taken to erode profit motive of business.

Check Your Progress-4

What are the responsibilities of business towards shareholder and consumers

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

2.6 LET US SUM UP

Business system operates in a wider system i.e. business system is subsystem of a broader economic and social system. A business can earn profits only by serving the society. . The general outlook of large business corporations has undergone a change. As a result of the recognition of the social responsibility, business objectives have transcended the profit motive. The growth of management education has contributed to the professionalisation of the business field and has lead to the orientation towards the society.

Culture consists of both material culture and non-material culture. The organisation of a culture is determined to a large, extent by major social institutions. Cultural Adaptation is essential for survival of business. The process of cultural transmission involves teaching and learning. Special efforts may be required in such a society to change the attitudes of the people in favour of unconventional ideas.

Society has become increasingly aware of their interdependence between business and its environment. The business has certain responsibilities towards shareholders, employees, consumers and community. It provides benefits as well as hindrances for the business.

2.7 MODEL ANSWERS FOR CHECK YOUR PROGRESS

1. Business is expected to process and develop economic values for the society. Business society relationship involves three main issues-Values, Viability, Public Visibility. The general outlook of large business corporations has undergone a change. As a result of the recognition of the social responsibility, business objectives have transcended the profit motive.

2. Professionalisation imparts social; responsibility and dignity to management. Professionalisation makes business more efficient, dynamic and socially responsible. Ethics refers to the moral standards used to govern behavior and to determine right or wrong, good or evil. Ethical considerations are significant for the managers as enlisted above.

3. The term cultural adaptation refers to the manner in which a social system or an individual fits into the physical or social environment. Adaptation is an essential quality for the survival of the individual and society. Every difference of environment means a difference in our habits, our ways of living. Individuals in a culture tend either to conform to the cultural norms or to deviate from them. It follows that the most important process in society is that which insures that people do indeed meet their role obligations. Knowledge of the nature -and extent of cultural conformity and deviance will sometimes be helpful in business decision-making.

4. Responsibility to Shareholders- To safeguard the capital, to provide dividend**,** strengthen the share prices, to ensure the public image etc

   Responsibility to Consumers-To satisfy the consumers by all means, To improve the efficiency of the functioning of the business so as to (a) increase productivity and reduce prices, (b) improve quality, and (c) smoothen the distribution system to make goods easily available.

Suggested Readings

1. Francis Cherunilam-Business Environment
2. C.B.Gupta- Business Environment

UNIT – III

UNIT - III

CONTENT

AIM AND OBJECTIVES

In this unit, we discuss the significance of Business Environment. After going through this lesson, you will be able to understand:

I. Different types of economic systems
II. Their merits and demerits
III. Economic system of India
IV. Different roles of the government

LESSON-11

3.0 INTRODUCTION TO ECONOMIC SYSTEMS

Business is a part of the economic system and operates within the framework of the country's economic system. Business firms carry out their production and distribution activities according to the nature and type of the country's economic system which has been adopted to utilize the available resources for meeting the society's needs. The economic system designed by a nation to utilize her resources for the purpose of satisfying the needs and wants of the people. Economic system embodies the nature of property rights, ownership of resources, market mechanism, role of state etc.

The basic purpose of an economic system is to ensure maximum possible satisfaction for the people of the country. Economic systems differ from country to country according to the nature of economic institution which a country chooses for satisfying the people's wants. There three main forms of economic systems.

3.1 CAPITALISM

The capitalist system is one characterized by the private ownership of the means of production, individual decision making, and the use of the market mechanism to carry out the decision of individual participants and facilitate the flow of goods and services in markets.

In a capitalist economy, households and firms are the basic production units. Each individual household is the owner of productive factors. These factors include the household's own labour and may also include land, capital and raw materials. Each household sells the services of its factors to the basic production unit, the firm. Private firms, organized by individuals, combine these productive factors to produce goods. The difference between revenues and costs constitutes profits, which then form the income of the firm's organizers. The income earned from the sale of a household's productive factors enables it to purchase the finished products of the firms.

The capitalist system is also known as free enterprise economy and market economy. Two types of capitalism may be distinguished, viz.,

(i) The old, laissez-fair capitalism, where government intervention in the economy is absent or negligible; and

(ii) The modern, regulated or mixed capitalism, where there is a substantial amount of government intervention.

3.1.1 FEATURES

The principal characteristics of a pure capitalist system are:

(i) Private Ownership:

In a capitalist economy, the factors of production-land, labour and capital- are privately owned, and production occurs at private initiative. Individuals have their property rights protected and are usually free to use their property as they like as long as they do not infringe on the legal property rights of others. Private property, however, is protected, controlled and enforced by law.

(ii) Free Enterprise:

Free enterprise, an essential feature of the capitalist system, is merely an extension of the concept of property rights. The term free enterprise implies that private firms are allowed to obtain resources, to organize production and to sell the resultant product in any way they choose. In other words, there will not be any government or other artificial restrictions on the freedom and ability of the private individuals to carry out any business.

(iii) Consumers Sovereignty:

Consumers sovereignty is at its best in the capitalist system where consumers have complete freedom of choice of consumption. The production decisions in the tree market economy are based on the consumer desires which are reflected in the demand pattern. Frederic Benham remarks: Under capitalism, the consumer is the king.

(iv) Freedom of Choice of Occupation:

In a capitalist economy, the individual is free to choose any occupation he is qualified for. This freedom of choice enables the worker to make the best possible bargain for his labour. This implies that the employers have to competitively bid for labour. Freedom of occupational choice, however, does not mean guarantee of the job a worker opts for; the choice is practically limited by the extent of availability of the jobs.

(v) Freedom to Save and Invest:

The freedom to save is implied in the freedom of consumption, for savings depend on income and consumption. The term saving implies the sacrifice of consumption. As George Halm observes: The right to save is supported by the right to transmit wealth, so that the choice between present and future consumption is not limited to the adult life of one person. The freedom to save, inherit, and accumulate wealth is, therefore, a right which is perhaps more typical for the private enterprise system than is free choice of consumption and occupation.

(vi) The Market System:

The market mechanism is the key factor that regulates the capitalist economy. A market economy is one in which buyers and sellers express their opinions about how much they are willing to pay for or how much they demand of goods and services. Prices guide the purchase decisions of the consumers. At the same time, while they decide to buy or not to buy a product, consumers vote for or against the product by using their money. Thus, market prices, which reflect the desires of millions of consumers, provide guidance to investors and other business persons. The market system, also called the price system, may, therefore, be regarded as the organising force in a capitalist economy.

(vii) Competition:

Competition among sellers and buyers is an essential feature of an ideal capitalist system. Competition reduces market imperfections and associated problems. Therefore, in a free market economy, a sufficient amount of competition is considered necessary if the whole production and distribution process is to be regulated by market forces. Competition is necessary in a private enterprise economy to keep initiative constantly on alert, to protect the consumer, and to maintain a sufficiently flexible price system.

(viii) Absence of a Central Plan:

As is clear from the features mentioned above, the capitalist system is essentially characterized by the absence of a central plan. That is, the activities of the numerous economic units in a capitalist system are not guided, coordinated or controlled by a central plan. Freedom of enterprise, occupation and property rights rule out the possibility of a central plan. Resource allocation and in vestment decisions in a free market economy are influenced by market forces rather than by the State.

(ix) Limited Role of Government:

The absence of a central plan does not mean that the Government does not play any role in a private enterprise economy. Indeed, Government intervention is necessary to ensure some of the essential features and smooth functioning of the capitalist system. For example, Government interference is necessary to define and protect property rights, ensure freedom of entry and exit, enforce contractual agreements among private entrepreneurs, ensure the satisfaction of certain community wants, etc. However, Government interference in the system is comparatively very limited.

The pure capitalist system which has been described above is a highly idealized system. There is hardly any pure capitalist of free enterprise system in the real world today. The capitalist economies of today are characterized by state regulation in varying degrees.

3.1.2 MERITS OF CAPITALISM

Most of the developed countries like USA, Great Britain and France have become rich through the capitalist economic system. The main merits of capitalism are as follows:

1. Incentive:

In the capitalist economic system, entrepreneurs have sufficient incentive to undertake enterprise and bear risks. The profit motive induces them to invest money even in those industries which involve great risks. Employers are motivated to work hard in order to make more profits. Employees work hard to earn higher wages.

2. Efficient Utilization of Resources:

Under capitalism, the scare resources of the country are used most economically and with minimum waste. Every business firm wants to minimize costs so that it can compete in the market. In order to minimize costs producers attempt to utilize factors of production in the best possible manner. Firms which cannot make optimum use of resources have higher costs of production. They cannot stand the competition and are forced to go out of business. Self-interest and free mobility of factors of production also help in rational allocation and better utilization of resources.

3. Rapid Economic Growth:

The capitalist system helps in rapid economic growth due to incentive and initiative. Countries operating under the capitalist system have achieved a considerable increase in per capita income. Rapid economic growth enables people to enjoy a high standard of living.

4. Capital Formation:

People have the incentive to save money and invest it in order to earn larger incomes in future due to the right of private property and inheritance. Every individual wants to create wealth so that he can leave behind more wealth for the children. High rates of public savings and investment lead to a higher rate of capital formation in the country. Institution of private property and profit motive also facilitate growth of new entrepreneurs.

5. Flexibility and Adaptability:

Capitalism has an inherent ability to change according to changing requirements and circumstances. It is a dynamic system and can be adapted to the changing environment. That is why capitalism has survived for centuries.

6. Democratic Nature:

People enjoy full economic freedom under capitalism. The entrepreneurs, the consumers, the workers and the owners of capital are all free to do work as they like to fulfill their needs and wants. Individual freedom makes capitalism democratic.

Innovation:

In order to survive in a competitive market, entrepreneurs introduce new products, new techniques of production and distribution and other improvements. They introduce new innovations to increase profits. These innovations generally lead to improvement in the techniques of production. As a result the costs of production decline and goods become cheaper. Great technological progress has been achieved in the capitalist countries through innovations.

3.1.3 DEMERITS OF CAPITALISM

The capitalist form of economic system suffers from the following evils:

1. Concentration of Economic Power:

Right to private property and the law of inheritance result in the concentration of wealth in a few hand~. The concentration of wealth and property in the hands of a few persons lead to-extreme inequalities in the incomes of people. On the one hand, a few enjoy luxurious living and on the other a large section of society is deprived of even the basic necessities of life.

2. Economic Instability:

Capitalism does not provide stability of the price level. Free working of market mechanism results in business cycles wherein business booms are followed by business depression. Cyclical fluctuations in the levels of economic activity cause great suffering to the people. During inflation poor people having limited incomes suffer greatly. Depression causes Widespread unemployment and human suffering. Market mechanism results in business cycles because savings and investment are not coordinated as these are determined by two different classes of people.

3. Lack of Maximum Social Satisfaction at Minimum Social Cost:

Maximum social satisfaction can be achieved when goods produced are made available to those consumers who will get the maximum satisfaction from them. But in the capitalist system goods go, in the hands of the people who can offer the best prices. In other words, goods are distributed according to the ability to pay rather than according to the needs of people.

4. Social Waste:

Cut-throat competition among business firms results in unnecessary expenditure on advertising and ruthless exploitation of natural and human resources of the nation. There is mal-allocation of the country's resources because producers are guided by profit motive. They produce those goods which rich people can afford to buy rather than those which poor people actually need.

5. Rise of Monopoly:

Big business and giant corporations dominate the country's economy in a capitalist system. They weaken the forces of competition and reduce consumer sovereignty. They influence public opinion and life styles to suit their business. Free play of market mechanism is distorted.

6. Social Discrimination:

Capitalism leads to the division of the society into two classes: haves (rich) and have nots (poor). The rich exploit the poor. Thus, capitalism may benefit a few at the cost of many.

7. Loss of Human values:

Capitalism promotes materialistic attitudes in the people. The lust for profits and wealth gives rise to several social evils. It is alleged that capitalism has no conscience, its God is gold. It contains the seeds of its own destruction.

Check Your Progress-1

What are the features of capitalism?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-12

3.2 SOCIALISM

Under this system the state owns and controls all means of production. Decisions pertaining to production and distribution are made through central planning. The state dictates the consumption pattern.

3.2.1 FEATURES

The salient features of a socialist system are:

(i) Government Ownership/Control:

In socialist countries, the major means of production are either owned by the Government or their use is controlled by the Government. In communist countries like the USSR and China, the means of production are mostly owned by the State. In some socialist economies, the private sector also plays a very important role. In such cases, the Government directs and regulates investment allocation and production pattern in accordance with national priorities. In some countries, such as India, some of the basic sectors, including a major part of institutional finance, are in the public sector so that the resource allocation and investment pattern of the private sector may be regulated by regulating the flow of the basic inputs to the private sector. When the state owns almost the whole of the means of production, it is much easier to achieve the desired pattern of resource allocation. Stale cap1talism, of course, has its own defects. Communist countries like China have now wide opened their doors to foreign private capitalists to foster development.

(ii) Central Authority:

The socialist economies generally have a central authority like the central planning agency to formulate the national plan for development and to direct resource mobilization, allocation and investment to achieve the plan targets. Socialist economies arc sometimes called command economies because the central planning authority commands the pattern of resource utilization and development. They are also called centrally planned economies. Centrally planned economics include the USSR, China, the German Democratic Republic (East Germany), Poland, Romania, etc.

(iii) Restriction on Consumption:

In communist countries, there is no consumer sovereignty because the state decides what may be made available to consumers, unlike in the market economics where the consumers have the freedom to choose from a wide variety. The consumers in a communist system, thus, have to content themselves with what the state thinks is sufficient for them.

(iv) Restriction on Occupation:

The freedom of occupation is absent or restricted in socialist countries. An individual may not have the freedom to choose any occupation he is qualified for. Similarly, individual freedom of enterprise is absent or regulated.

(v) Fixation of Wages and Prices:

The wage rates and prices in a, communist economy are fixed by the Government and not by market forces. Non-communist socialist countries may also fix wages and prices or regulate them by certain means.

(vi) Distribution of Income:

An equitable distribution of income is an important feature of the socialist system. This does not mean, however, that socialist systems aim at perfect equality in income distribution. Wage & differentials, depending, on the nature and requirements of the job, are recognized in socialist countries. The objective of equitable income distribution may be achieved by fixing the wage rates and other economic rewards or by means of fiscal and other appropriate measures.

We have mentioned above the important theoretical features of socialism. In the real world, there is a variety of socialist systems; but all of them have one thing in common, namely, greater government control of the means of production than in the capitalist systems.

3.2.2 TYPES OF SOCIALISM

The traditional socialism emphasized government ownership of factors of production. But a number of today's socialist systems are based on government control of the means of production rather than pure state capitalism. Even the Euro-communism has a more liberal view than the Russian and Chinese systems. However, the Chinese and Russian systems are becoming some what liberal.

Socialist Command Economy

The command economy is characterized by public ownership of the means of production, collective determination of economic decisions, and the allocation of resources by commands issued by the planning elite. The primary feature of the command economy is the centralization of decision making. There is no horizontal communication between producing and consuming units. All communication is vertical, i.e., between the individual economic unit and the planning agency.

In a command economy, there is no individual freedom of choice of consumption and employment. The state determines what shall be produced in what quantities and by what methods. Similarly, the state determines the assortment and the amount of goods and services that may be consumed by individuals.

Just as there is no pure capitalist economy in the world, there is no pure command economy. However, some economies, like the Soviet economy, come near to this system, and they are generally regarded as command economics. However, as mentioned earlier, changes appear to have begun.

Market Socialism

Market socialism is characterized primarily by the public ownership of the means of production. Decisions with reference to the allocation of resources are made both collectively and by individual producing and consuming units. Prices and markets are the primary mechanisms used to facilitate the exchange of products. The Yugoslav economy contains many of the elements of market socialism.

While the state control of economy is a universal phenomenon, the extent and nature of the control vary widely between nations depending upon the nature and stage of development of the economy, the behaviour of the private sector, the political philosophy, social attitudes administrative system etc.

3.2.3 MERITS OF SOCIALISM

The chief advantages of socialism are as follows:

1. Social Justice:

Under socialism, there is a just and equitable distribution of national income. Nobody is allowed to receive large unearned incomes. Inequalities of income are reduced to the minimum. All children whether born of poor parents or rich parents are provided equal opportunities to get necessary education and training and develop their talents. No discrimination is made on the basis of caste, class or religion.

2. Economic Stability:

The problems of overproduction, underproduction, idle capacity and business cycles are eliminated because the Central Planning Authority takes all major economic decisions. Violent fluctuations in economic activity are prevented by balancing aggregate supply with aggregate demand.

3. Rational Allocation of Resources:

The Central Planning Authority decides the allocation of resources keeping in view the basic needs and preferences of people. Resources are directed towards the production of goods which the society requires rather than those which will yield greater profits. Wastage of resources and duplication of efforts are avoided because decisions are made after a comprehensive survey of the society's needs and the country's resources.

4. Higher Economic Growth:

Economic planning facilitates optimum utilization of resources thereby leading to rapid economic growth. A planned economy works in a systematic and coordinated manner. All competitive wastes like needless varieties and advertising are eliminated. Economies of scale are available due to concentration of production in a few large units. Superior techniques of production are made available to all producing units.

5. Absence of Class Struggle:

On account of State ownership of productive resources and social distribution of income, there is no struggle between haves and have not's. Exploitation of one section of society by another section is also avoided.

3.2.4 DEMERITS OF SOCIALISM

A socialist economy suffers from several evils:

1. Concentration of Economic Power in the State:

Socialism is a totalitarian system because both economic and political power is concentrated in the hands of the Government. State authoritarianism endangers the economic freedom and democratic rights of people. In recent years violent revolutions against such authoritarian rule have taken place in Romania, Yugoslavia and Poland.

2. Lack of Incentive and Initiative:

In a socialist economy, people do not have incentives for hard work, enterprise and efficiency. All people become workers and get wage or salary from the Government which owns the means of production.

3. Loss of Consumer Sovereignty:

In the production of various goods, the wants of consumers are not duly considered. Consumers have limited choice due to less variety of goods. Rationing system is introduced to distribute the goods. The freedom of consumers is curtailed as they get fixed quantities of goods.

4. Loss of Occupational Freedom:

In a socialist economy, people do not enjoy full freedom to choose occupation and employment of their liking. The Central Planning Authority decides the choice of occupation and employment.

5. Inefficiency and Low Productivity:

Bureaucracy and red tapeism in the functioning of State-owned enterprises lead to low productivity. The officials of these enterprises lack initiative and decisions are delayed. Costs of administration are high because a large number of officials are employed to prepare detailed plans and implement them. In the absence of profit motive and competition, resources may not be utilized in an optimum manner.

6. Corruption:

There is great possibility of growth of corruption in a socialist economy. People have often to pay bribe to get work done from the public officials and Government servants who wield considerable power over public.

Check Your Progress-2

Enumerate the merits and demerits of socialism

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-13

3.3 MIXED ECONOMY

Mixed economy is an economic system which combines the features of both capitalism and socialism. Public sector and private sector have been allotted their respective roles in promoting economic and social welfare of the people.

3.3.1 FEATURES

The distinctive characteristics of mixed economy are given below:

1. Co-existence of Public and Private Sectors:

In a mixed economy both public sector and private sector are allowed to co-exist. The public sector is expected to provide necessary infrastructural facilities (power, transportation, communications, etc.) for rapid economic development. It is believed that private sector. being guided by profit motive may not invest resources into projects which are characterized by huge investment, long gestation period and low returns. The private sector is expected to undertake enterprises on the basis of the growth climate created by the public sector. The public sector is to supplement and not substitute the private sector. A mixed economy functions through cooperation between public and private sectors. Private property and social ownership of means of production both are allowed.

2. Classification of Industries:

All industries are classified into two or more categories. Industries of strategic importance are reserved for the public sector. The rest of the industries are left for the private sector.

3. Economic Planning:

The Planning Commission lays down the socioeconomic objectives, sets the physical targets, and specifies the sources and instruments for mobilizing necessary funds and details out procedures for implementing the national economic plan. This is done after taking stock of the political ideology, social aspirations and national resources. The private sector is expected to work within the framework of the objectives and priorities laid down in the Five-Year Plans.

4. Price Mechanism:

The market mechanism is used to help in the formulation and implementation of the National Plan. For example, market may be specified as an instrument of achieving the plan targets. Market prices and profits may be so regulated as to provide necessary incentives to the private sector. Thus, in a mixed economy planning and market mechanism work together.

5. Profit Motive-cum-Social Welfare:

The private sector operates primarily with a profit motive. The public sector seeks to achieve social welfare. Prices and profits are regulated in the interest of the society. Private business is also expected to fulfill its social responsibilities. A mixed economy seeks to achieve simultaneously the twin objectives of economic growth and social justice.

3.3.2 MERITS OF MIXED ECONOMY

Mixed economy is expected to contain the merits of both capitalism and socialism. The main advantages of mixed economy are given below:

1. Individual Freedom:

Mixed economy provides adequate freedom to individuals. Private individuals are free to choose their occupation and employment. Entrepreneurs are allowed freedom of enterprise within the regulatory framework. Consumers are free to buy goods and services from any seller in any quantity.

2. Rapid Economic Growth:

Central planning and market mechanism together help in the rational allocation of resources. Combined efforts of public and private sectors are expected to ensure rapid economic development of the country.

3. Social Welfare:

Government undertakes policies and programmes for the welfare of public. Regulation and controls are exercised to check monopolies and concentration of economic power in a few hands. Equal opportunities for education and employment are made available to all irrespective of class, race and religion.

3.3.3 DEMERITS OF MIXED ECONOMY

Mixed economy suffers from several limitations which are as follows:

1. Economic Instability:

Sometimes, violent fluctuations occur in the level of economic activity due to the fracture of market mechanism or faulty implementation of economic plans.

2. Lack of Freedom:

A mixed economy is a semi-controlled economy. Producers, workers and consumers all get freedom of choice but subject to some constraints.

3. Inefficiency:

When there are two many regulations and controls, private sector cannot function very efficiently. Public sector enterprises do not operate efficiently due to bureaucracy and red tapeism. India's mixed economy is often criticized for its inefficient and corrupt administration.

4. Lack of Coordination:

The public sector and the private sector do not always work in a complementary manner. Some economists even argue that there cannot· be a middle path between capitalism and socialism.

LESSON-14

3.4 DIFFERENCES BETWEEN ECONOMIC SYSTEMS

S.No	Characteristic of the System	Capitalism	Mixed Economy	Socialism
1	Economic Markets	Freedom to compete with right to invest, free competition.	Limited competition with State-owned industries.	Absence of competition, State-owned markets and industries
2	Individual incentives	Profits and wages in relation to one's ability and willingness to work. Goal is personal profit.	Profits , recognised, wages set by State, based on workers' needs. Major gains accrue to State.	Profits not allowed. Workers urged to work for glory of the State. Bonuses for exceeding quotas. All gains accrue to State which distri-butes among individuals.
3	Capital sources	Capital invested by owners who may also borrow on credit. Capital may, be reinvested from profits. Depreciation is legal.	Obtained from owners and from State-issued bonds for State-owned industries. Depreciation permitted.	State provides all resources to start a business owned by the State. No depreciation.
4	Labour	Workers generally free to select an employer and an occupation Independent unions	Workers allowed selecting occupation, State planning encourages employment. Restricted right to unions.	The State determines one's employer and employment. State controls occupational choice and unions.

5	Management	Managers selected on basis of ability. Managers have freedom to make decisions.	Managers in State owned industries must answer to the State. Non-monetary rewards emphasized.	Key managers must be party members to qualify. Absence of freedom to make decisions. Managers appointed by the State.
6	Business Ownership	Individuals have a right to own a business and to contract with others. Private ownership of means of production.	State owns basic industries including steel, mines and transportation. Other businesses may exist privately	State owns all productive capacity including communes.
7	Risk Assumption	Losses assumed by owners; May transfer business risk to other business through insurance.	People assume risks of State-owned industries. Losses taken from taxes.	Economic production owned by the State. Risks assumed by the State, losses reduce standard of living.
8	Central problems	Decided by market mechanism	Decided by a combination of market system and State planning.	Decided by centralized planning by the State.
9	Consumer's sovereignty	Full freedom of choice	Limited freedom of choice.	

Check Your Progress-3

Bring out any six differences between capitalism and socialism

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

3.5 MIXED ECONOMY OF INDIA

In view of the institutional features of systems described, when one attempts to evaluate the nature of the Indian economic system, one finds that India has a very complex mixed economic system.

First, a simple mixed economic system is characterized by the existence of private and public sectors. India has a multiplicity of sectors; private (dominant undertakings, foreign companies, etc.), public, joint, co-operative, workers sector and also tiny sector. We hear of different sectors in different walks of Indian economy: big sector-small, sector, heavy sector-light sector, licensed sector-deli censed sector, national sector, core sector, reserved sector, etc. India is a complex vector of sectors.

Secondly, a simple mixed economy is characterized by complimentarily between planning and pricing; India has a multiplicity of mechanisms at work: five-year-plans, annual plans during plan holidays, pointed economic reform and reconstruction programmes during and after plan vacation, ideas of rolling plans, elaborate system of controls and regulatory measures, attempt towards streamlining and simplification of procedures, private traders and public distributors for the same product and hence a system of dual prices, ceiling prices, floor prices, subsidized prices, statutory prices, retention prices, procurement prices, levy prices, free market prices, contraction monetary policies but expansionary fiscal policies, etc. India is a complex set of liberal rules, strict regulations, control mechanism, planning and a host of prices.

Finally, a simple mixed economy is expected to reach that height of social welfare which is not normally attainable either by pure capitalist system or pure socialist system; and for this task, the profit policies are to be designed according to a social purpose. The Indian social welfare function is defined in terms of multiplicity of objectives which are sometimes conflicting in nature. Since the beginning of five-year plans, India is aiming at efficiency, justice and stability. Productive efficiency in a static sense has reference to allocate efficiency-allocation of given resources. Productive efficiency in its dynamic sense has reference to economic growth-allocation to improve the availability of resources in future. The fruits of economic growth have to be distributed among the masses fairly: social justice is to be so attained as not to endanger stability of prices, incomes, balance of payments, etc. As subsidiary to these objectives of growth, justice and stability, the Indian plans have also emphasized objectives like full-employment of labour, full capacity utilization of plant and equipment and self-sufficiency. In the long run, these objectives may be compatible with each other, but in the short-run sphere of operation, these objectives come in conflict with each other. For example, in order to promote a high rate of growth, heavy industrialization and large investments are undertaken. Such investments increase the flow of money income faster than the flow of output. This generates inflationary forces. Price stability comes in conflict with economic growth. Similarly, economic growth conflicts with social justice. Progressive tax system is used as a means to reduce income inequalities, but the same tax policy hampers private incentives to invest and to generate thereby the growth forces. Foreign exchange remittance helps the country in overcoming balance of payments difficulties, but it increases the domestic money supply and prices. Examples can be multiplied to demonstrate the inherent conflict among the objectives which the mixed economy of India hopes to achieve. On the top of all these, different instruments have been used to attain different target variables-fiscal policies for growth with justice, monetary policies for price stability with growth, price and output controls for price stability with justice. This has introduced further elements of confusion.

To sum up, the so-called mixed economic system of India sometimes gives the impression of a mixed-up economic system characterized by multiplicity of sectors, multiplicity of instruments, multiplicity of objectives and multiplicity of adjustments to resolve the conflict between sectors, the conflict between instruments and the conflict between objectives. To understand the exact nature of mixed economy of India, we must see through its evolution; and then attempt its evaluation.

Check Your Progress-4

Explain the mixed economy of India

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-15

3.6 ECONOMIC ROLES OF THE GOVERNMENT

Governments normally play four important roles in an economy, viz.,

(i) Regulation .

(ii) Promotion

(iii) Entrepreneurship

(iv) Planning

As stated above, the extent and nature of these roles in a given situation depend on a number of factors. Some salient features of these roles are outlined below.

3.6.1 REGULATORY ROLE:

Government regulation of the business may cover a broad spectrum extending from entry into business to the final results of a business.

The reservation of industries to small scale, public and co-operative sectors, licensing system etc. regulate the entry. Regulations of product mix, promotional activities etc. amount to regulation of the conduct of business. Results of business operations may be, regulated by such measures as ceilings on profit margins, dividend etc. The State may also regulate the relationship between enterprises. Examples of this include restrictions on intracorporate investments, interlocking of directors and on appointment of sole selling agents.

Government regulation of the economy may be broadly divided into:

(i) Direct controls; and

(ii) Indirect controls.

Indirect controls are usually exercised through various fiscal and monetary incentives and disincentives or penalties. Certain activities may be encouraged or discouraged through monetary and fiscal incentives and disincentives. For instance, a high import duty may discourage imports and fiscal and monetary incentives may encourage the development of export oriented industries.

The direct administrative or physical control is more drastic in their effect. The distinguishing characteristic of direct controls is their discretionary nature. They can be applied selectively from firm to firm and industry to industry, at the discretion of the- State.

Direct controls have assumed increasing significance in many developing countries, including India. Their justifications are reasons, if that are economic, political and historical in nature; and in most countries, these reasons are often intertwined with one another. Most economic reasons are based on a variety of market failures, including imperfections and high-risk aversion on the part of private entrepreneurs.

Many developing countries have instituted a variety of direct controls, over the economy, including industrial licensing and price and distribution controls. As a World Bank Staff Working Paper points out, the major justification for the industrial licensing system is the belief that the market mechanism is unable to allocate the scare resources in a socially optimal way. The use of industrial licensing is, therefore, justified as the mechanism by, which the state can control industrial investments and allocate resources to conform to pre-determined priorities and plan targets, if any. The common presumption, of course, is that the state is omniscient, and that the resulting allocation of resources will be, socially optimal of socially desirable.

The other objectives of industrial controls include the prevention of the market structure from becoming monopolized, the development of small and new entrepreneurs, balanced regional development, etc.

3.6.2 PROMOTIONAL ROLE:

The promotional role played by the Government is very important in developed countries as well as in the developing, countries. In the USA, although -on a comparative basis the function of assistance is less prominent than it used to be, it is still large one. Thus, considering the whole of its activities, government does more to assist and to help develop industrial, labour, agricultural, and consumer interests than it does to regulate them. If this comes as a surprise, it is measures of the degree to which we take for granted some of the most basic duties of the liberal government, and hence fail adequately to appreciate their value.

In developing countries, where the infrastructural facilities for development are inadequate and entrepreneurial activities are scarce, the promotional role of the Government assumes special significance. The State will have to assume direct responsibility to build up and strengthen the necessary development infrastructures, such as power, transport, finance, marketing, institutions for training and guidance and other promotional activities.

The promotional role of the State also encompasses the provision of various fiscal, monetary and other incentives, including measures to cover certain risks, for the development of certain priority sectors and activities.

3.6.3 ENTREPRENEURIAL ROLE:

In many economies, the State also plays, the role of an entrepreneur - establishing and operating business enterprises and bearing the risks. A number of factors such as socio-political ideologies; dearth of private entrepreneurship; neglect of certain sectors, like the unprofitable sectors, by the private entrepreneurs; absence of or inadequate competition in certain Segments and the resultant exploitation of consumers, etc. have contributed, to the growth of State owned enterprises (SOEs) in many countries.

As a World Bank Report points out; whereas some governments have, an ideological preference for public control, others have traveled the same route for more pragmatic reasons. They may have wanted to rest control of key enterprises from foreign owners (Egypt in 1956 and Madagascar in 1974) or from minority ethnic groups (Uganda in the 1970s); in other instances; enterprises were inherited by the State after independence (Bangladesh in 1972) or a revolution (Portugal in 1974): or as a result of privates' sector bankruptcies. Governments, have used nationalization to capture the rents from the exploitation of minerals and where national security is involved (as in arms manufacture), to exercise direct, military, control. In other instances Governments have decided to take the lead in starting a major new industry in the absence of private investors. It is this last one which represents the true entrepreneurial role. The public sectors in some countries like India have expanded also, by taking over sick private units.

There was a tendency in many developing countries to assign a dominant place to the public sector. Public sector dominance was usually established in capital-intensive projects like steel, capital goods, petro-chemicals, and fertilizers for which investment requirements were very large and the expected private returns, at least in the short run were too low to, provide an incentive for private profitability. In many cases even when 1he private Sector was prepared to undertake the risk and invest, State ownership of such industries existed for one reason or other. However, recently many governments have resorted to privatization in varying degrees, and have redefined the role of thy public sector.

3.6.4 PLANNING ROLE:

Especially in the developing countries, the State plays a very important role as a planner. The need for economic planning, is very, well implied in the famous scarcity definition of Economics. As Robbins, points out in his scarcity definition, the main business of the science of Economics is the optimum allocation of the scarce resources between the competing ends. The modern state is a custodian of the welfare of the society. The welfare government has the responsibility to fulfill the aspirations of the people by bringing about around prosperity. The ends, i.e., the objectives to be achieved and the purpose to be served are many. In the pursuit of this task, the most important problem especially in the case of the less developed countries is the scarcity of resources. The resources that are-readily available are quite in sufficient to meet all the ends. The resource constraints demand that some of the purposes should go unserved. This calls for the determination of the more urgent needs or national priorities and the optimal allocation of the available resources as best to sub serve the common good. And this is the principal objective of national planning.

The importance of planning to a less developed economy was often emphasized by Jawaharlal Nehru, the chief architect of Development Planning in India. He rightly observed: whatever it may be in other countries, in under-developed countries like ours, which have to develop fairly rapidly, the time element is important and the question is how to use our resources to the best advantage. If our resources are abundant it will not matter how they are used. They will go into a common pool of development. But where one resource is limited, one has to see that they are directed to the right purpose so as to help to build up whatever one is aiming at.

Check Your Progress-5

Differentiate between the promotional role and entrepreneurial role adopted by the government

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

3.7 LET US SUM UP

Economic systems differ from country to country. The basic purpose of an economic system is to ensure maximum possible satisfaction for the people of the country. There three main forms of economic systems.

The capitalist system is one characterized by the private ownership of the means of production, individual decision making, and the use of the market mechanism to carry out the decision of individual participants and facilitate the flow of goods and services in markets.

Under socialist system the state owns and controls all means of production. Decisions pertaining to production and distribution are made through central planning. The state dictates the consumption pattern.

Mixed economy is an economic system which combines the features of both capitalism and socialism. Public sector and private sector have been allotted their respective roles in promoting economic and social welfare of the people.

Governments normally play four important roles in an economy. Government regulation of the business may cover a broad spectrum extending from entry into business to the final results of a business. The promotional role played by the Government is very important in developed countries as well as in the developing, countries. In many economies, the State also plays, the role of an entrepreneur - establishing and operating business enterprises and bearing the risks. The optimal allocation of the available resources as best to sub serves the common good. And this is the principal objective of national planning.

3.8 MODEL ANSWERS FOR CHECK YOUR PROGRESS

1. The principal characteristics of a pure capitalist system are: private ownership, free enterprise, consumers sovereignty, freedom of choice of occupation, freedom to save and invest, the market system, competition, absence of a central plan and limited role of government

2. Merits of socialism: social justice, economic stability, rational allocation of resources, higher economic growth and absence of class struggle.

Demerits of socialism: concentration of economic power in the state, lack of incentive and initiative, loss of consumer sovereignty, loss of occupational freedom, inefficiency and low productivity and corruption.

Capitalism	**Socialism**
Freedom to compete with right to invest, free competition.	Limited competition with State-owned industries.
Individual incentives present	Individual incentives absent
Capital invested by owners	Capital invested by the state
freedom of choice of occupation	Restrictions on choice of occupation
Losses assumed by owners	People assume risks of State-owned industries
Full freedom of choice to the consumers	Limited freedom of choice to the consumers

4. Mixed economic system in India is characterized by the existence of private and public sectors. India is a complex set of liberal rules, strict regulations, control mechanism, planning and a host of prices. India is aiming at efficiency, justice and stability. The so-called mixed economic system of India sometimes gives the impression of a mixed-up economic system characterized by multiplicity of sectors, multiplicity of instruments, multiplicity of objectives and multiplicity of adjustments to resolve the conflict between sectors, the conflict between instruments and the conflict between objectives.
5. The State will have to assume direct responsibility to build up and strengthen the necessary development infrastructures, such as power, transport, finance, marketing, institutions for training and guidance and other promotional activities. The promotional role of the State also encompasses the provision of various fiscal, monetary and other incentives, including measures to cover certain risks, for the development of certain priority sectors and activities.

Governments have decided to take the lead in starting a major new industry in the absence of private investors. It is this last one which represents the true entrepreneurial role. The public sectors in some countries like India have expanded also, by taking over sick private units.

3.9 LESSON-END ACTIVITY

Identify the reasons for the failure of socialism

Evaluate the performance of public sector of India in recent years

Suggested Readings

1. Francis Cherunilam-Business Environment
2. C.B.Gupta- Business Environment
3. K. Aswathappa- Essential Of Business Environment

UNIT – IV

UNIT - IV

CONTENT

AIM AND OBJECTIVES

In this unit, we discuss the significance of Business Environment. After going through this lesson, you will be able to understand:

I. Meaning of industrial sickness
II. Reasons for industrial sickness
III. Sick Industrial Companies Act
IV. Prevention and treatment of industrial sickness
V. Details of MRTP act

LESSON-16

4.0 INTRODUCTION

Industrial Sickness is a universal phenomenon. While the- industrial sickness is easily manifested in economies characterized by the existence of the market mechanism, it may be concealed in the economies where the market mechanism does not operate. In a market economy, the competition tests and exposes the strengths and weaknesses of the business enterprises and therefore sickness becomes easily visible.

4.1 DEFINITION OF SICK UNIT

There are different perceptions of the symptoms and characteristics of industrial sickness. Sickness is a relative concept. Further, a given sickness manifests itself in several forms, and at a point of time these forms may not throw unambiguous or clear-cut signals. No wonder, then, that sickness is found being understood, interpreted and measured differently be individuals and even by institutions.

To a layman, a sick unit is-one which is not healthy. To an investor, it is one which skips dividends. To an industrialist, it is a unit which is making losses and tottering on the brink of closure. To a banker, it is a unit which has incurred cash losses in the previous year and is likely to repeat the performance in the current and following years. In terms of the definition evolved by the Reserve Bank of India, an industrial unit is regarded as sick if it has incurred cash loss for one year and in the judgment of the bank, it is likely to continue to incur cash loss in the two following years and it has imbalance in its financial structure such as current ratio being less than 1:1 and worsening debt equity ratio. The Sick Industrial Companies (Special Provisions) Act, 1985, as amended in 1993 defines a sick industrial company as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth. The definition is for the purpose of application of the Act and it covers only registered companies which have been existence for at least five years.

Common symptoms of industrial sickness include failure to pay statutory liabilities like provident fund and E.S.I. contributions, failure to pay timely installment of capital and interest on loans taken from financial institutions and through public deposits, increase in inventories with a large number of slow or non-moving items, high rate of rejection of goods manufactured, low capacity utilization and frequent industrial disputes.

4.1.1 MAGNITUDE

The number of sick units has. Grown considerably from 22,366 at the beginning of 1980 to 2.481akh at the end of March 1992 and the total bank credit blocked up in these units increased from Rs. 1,809 crores to Rs. 11533.3 crores during this period. 99 percent of the sick units were in the small-scale sector. The above figures included 876 non-SSI weak units.

Data for the recent years show that in the large-scale sector, the incidence of sickness was high in industries like engineering, cotton textiles, jute textiles and sugar. It was revealed that the industrially advanced states accounted for a major share of the large sick units.

Viability studies have revealed that nearly 90 percent of the sick units were non-viable. Only about 12 per cent of the total number of the sick units was considered potentially viable and these units accounted for nearly 45 per cent of the total bank credit enjoyed by the sick units. Over 86 per cent of the total numbers of the sick units, accounting for nearly 50 per cent of the bank credit to the sick units were considered as non-viable. The viability of the remaining units, (1.56 per cent of the total number) was not decided.

4.1.2 WEAK UNITS

According to the Sick Industrial Companies (Special Provisions) Act, an industrial unit is regarded as sick only if it has, at the end of any financial year, accumulated losses equal to or exceeding its entire net worth. It is, however, important to detect sickness at the incipient stage and take necessary remedial measures. The Reserve Bank has, therefore, advised the commercial banks to take remedial measures in respects units at the stage of 50 per cent erosion of their net worth. Such units are termed as weak units to distinguish them from sick industrial companies as defined in the Sick Industrial Companies Act. An industrial unit is termed as weak if at the end of any accounting year it has:

(i) Accumulated losses equal to or exceeding 50 per cent of its peak net worth in the immediately preceding five accounting years;

(ii) A current debt equity ratio of less than 1: 1; and.

(iii) Suffers a cash loss in the immediately preceding accounting year.

Signals of Sickness

The following actions of a unit indicate that the unit is sick or going to be sick:

- Continuous irregularity in cash credit accounts; Low capacity utilisation;
- Profit fluctuations, downward trend in sales and stagnation or fall in profits followed by' contraction in the share of the market;
- High rate of rejection of goods manufactured;
- Reduction in credit summations-whenever the companies are in financial difficulty, they open a separate account with another bank and deposit all collections therein;
- Failure to pay statutory liabilities;
- Larger and longer out standings in the bills accounts;

- Longer period of credit allowed on sale documents negotiated through the bank and frequent returns by customers of the same;
- Constant utilisation of cash credit facilities to the hilt and failure to pay timely instalment of principal and interest on the loans and instalment credit;
- Non-submission of periodical financial data/stock statement etc. in time;
- Financing capital expenditure out of funds provided for working capital purposes;
- Decrease in working capital on account of:
  - increase in debtors and particularly dues from selling agents;
  - increase in creditors;
  - increase in inventories which may include a large number of slow or non-moving items;
- A general decline in that particular industry combined with many failures; Rapid turnover of key personnel;
- Existence of a large number of law suits against a company; Rapid expansion and too much diversification within a short time;
- Sudden/frequent changes in management-whether professional or otherwise and/or dominated by one man/few individuals;
- Diversion of funds for purposes other than running the units;
- Any major change in the share holdings.

Effect of Sickness

A sick industrial unit is like a patient at home. A patient, in addition to suffering from the ailment himself, causes inconvenience to others and often, spells ruin to the family, particularly when the treatment is prolonged and expensive. A sick unit too will have serious repercussions on the economy as a whole, besides adversely affecting the interests of people directly connected with it.

Impact of sickness on the economy is easy to guess. In the first place, sickness contributes to high-cost economy. This, in turn, will affect the competitiveness of the economy at home and abroad.

Secondly, industrial sickness is mainly the problem of 88 per cent terminally sick units, investment in which is completely dead. Dead investment is a burden on both bank and budget and ultimately consumers have to pay the high cost.

Thirdly, persistent nature of industrial sickness, especially when policies do not allow flexibility for exit and other forms of adjustment, not only tends to restrict new employment opportunities but also constrict technological innovation, thus keeping the employment stagnant. Unviable units remain closed and employment in these units, in effect, is disguised unemployment.

Finally, industrial sickness worsens the problem of stringency of financial resources in the economy. Money locked up in sick units gives no returns and effects the availability of resources to other viable units. The continued operations of chronic loss-making firms snatches markets from more efficient producers and acts as a drain on the financial system. Besides, the huge amount of capital, running into many thousands of crores, which is invested in sick units is being wasted which a capital scarce country like ours can ill-afford.

Check Your Progress-1

What do you mean by industrial sickness?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

4.2 CAUSES OF SICKNESS

Industrial units may become sick at different stages and due to different reasons. Indeed, some industries are born sick, some achieve sickness and some have sickness thrust upon them.

Born Sick:

Industries born sick are those which arc destined for disaster right from their conception due to various causes. A study conducted by the Institute of Economics, Hyderabad, found that 50 per cent of the dead units closed within three years of opening. This proves that these industries never had any reasonable survival prospect right from birth.

Anyone or more of the following factors may cause the birth of sick, units:

1. Lack of experience of the promoters, wrong selection of the project, faulty project planning, etc., may give birth to sick units. The mushroom growth of the so-called consultancy firms has been regarded as a factor contributing to these sorts of problems because the primary interest of such consultancy firms is to make money by selling some ideas or project reports to the aspirants who may thus be misguided or made overenthusiastic. We must also think that the rosy hopes generated by the high-sounding promises and schemes including these of employment schemes of the financial institutions and other promotional agencies of the Governments also contribute to this on fortunate situation.
2. Paucity of funds and faulty financial management may also cause the birth of sick units. Many new units have been found to be under utilized and the strains of under capitalization become evident when the unit becomes operational. In case of some companies, the heavy investment in non-

productive capital assets like staff housing projects even before they commence production distorts tire liquidity and causes a lot of problems. Problems also crop up due to inadequate provisions for contingencies, faulty fund flow and cash flow estimate, etc.

3. Time and cost over-runs sometimes prove to be, very disastrous. Particularly in case of large projects, delays in project commissioning due to delay in supply equipment, both indigenous and imported, slippage in the schedule of civil works, creation of equipment, etc, are not uncommon. Such delays cause cost escalations leading to capital shortage, liquidity problems, hike in the production costs and break-even point etc.
4. Sickness may arise from locational problems also: It has been observed that high-technology based unit is established in areas without skilled labour or supporting infrastructure industries based on imported raw materials and founded in regions without adequate transport and communication system.
5. Technological factors like selection of obsolete or improper technology- or the technology becoming outdated due to innovations while the project is being executed, sub-standard machinery, wrong collaboration etc., also cause sickness.

   According to the Tiwari Committee, 14 per cent of the large sick units suffered from technical factors and faulty initial planning.
6. Wrong assessment of thee market potential or faulty demand forecasting, change in the market conditions, including the change in the consumer tastes and preferences and competitive situation, etc. can also cause birth of sick units.

Achieved Sickness:

Industries which achieve sickness are those which fail after becoming operational due to internal causes. Such internal causes which are common are the following.

(i) Internal Causes

(i) Bad management, which covers a wide range from inexperience, inefficiency, lack of professional expertise, neglect and internal squabbles to delinquency and dishonesty is an important cause of industrial sickness. According to the Tiwari Committee Report, 1984,- the factor most often responsible for industrial sickness can be identified as management; This may take the form of poor production management, poor labour management, poor resources management, lack of professionalism, dissensions within the management, or even dishonest management". The Committee found that 65, per cent of the large sick units were affected by this problem.

(ii) Unwarranted expansion and diversion of resources may also result in sickness. Some concerns tend to expand beyond the resources including managerial capability. Diversion of resources to start new units or to acquire interest in other concerns without due regards to the capability of the unit to provide such, funds sometimes lands the unit in trouble.

(iii) Personal extravagances and acquisition of unproductive fixed assets like company guest houses or corporate luxuries like air-conditioned cars, etc., also may contribute to sickness.

(iv) Poor inventory management in respect of finished goods as well as inputs may land a unit in trouble.

(v) Failure to modernize, the productive apparatus, changes the product mix and other elements of the marketing mix to suit the changing environment are a very important cause of industrial sickness.

(vi) Poor labour-management relationship and the associated poor worker morale and low productivity, strikes, lockouts, etc., also may ruin the, health of a unit to survive.

(ii) External Causes:

Sickness may be caused also due to factors beyond the control of an industrial unit. Some of these common external factors are the following:

(i) Energy crisis arising out of power cuts or shortage of coal, and oil have almost become a constant problem for many industrial units in India.

(ii) In a number of cases the units are not able to achieve optimum capacity due to shortage of raw materials due to production set-backs in the supply industries, poor agricultural output due to natural reasons, changes in the-import conditions etc.

(iii) Infrastructural problems like transport bottlenecks also sometimes cause serious problems.

(iv) It is a general complaint of the, industrial circles that the credit squeeze very adversely affects the industrial sector. According to the Tiwari Committee, 24 per cent of the large sick units were affected by shortage of working capital/liquidity constraints.

(v) Artificial economic constraints also make their contribution to the growing industrial sickness. Government controls on the product mix and prices are said to be causing serious problems for certain industries. Some times, it is not possible to automate or rationalize due to unfavourable government policy or labour attitude.

Check Your Progress-2

Explain the reasons for industrial sickness

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-17

4.3 GOVERNMENT POLICY

There has been strong demand for take-over of sick units by the Government, particularly to protect the employment. However, a relevant question to be considered here is the opportunity cost of the government decision. Should the government utilize the scarce resources to create new productive employment or should they be spent on maintaining some jobs at heavy social costs? Further, it is also necessary to guard against the managements, looking forward to the government take-over of an undertaking after fleecing and mismanaging it to the point of making it permanently sick.

However, in an economy where the government has assumed strong, regulatory and promotional roles, it should take necessary steps to prevent sickness and to help cure incipient sickness.

The Companies Act, 1956, empowers the government to collect information from the companies which would enable it to assess the state of affairs of the companies and to take certain measures to prevent mismanagement. The Industries (Development and Regulation) Act, 1951 (IDRA), empowers the government to regulate the management of industrial undertakings, including the take-over of the management or the undertaking. The Sick Industrial Companies (Special Provisions) Act, 1985, is a very important law to deal with industrial sickness.

In 1981, the government announced certain policy guidelines to deal with industrial sickness. These guidelines require the ministries administratively concerned with various industries to take responsibility for rehabilitation of sick units. Banks and financial institutions are required to strengthen the monitoring arrangement for prevention of sickness.

Indeed, both Government and financial institutions have been concerned at the problem of growing sickness, and attempts have been made to devise suitable measures to tackle it. The approach fol1owed has been to nurse sick units which are potentially viable back to health through a managed programme of financial assistance for modernization and recovery. The Reserve Bank took the initiative in the matter of identifying sick industrial units, and coordinating the lending operations of the term lending institutions and commercial banks.

An important limitation on the ability to tackle sickness arises from the fact that commercial banks may legitimately consider sick units as poor security risks.

Government policy towards the, Prevention and treatment of industrial sickness is guided by the following considerations:

On the preventive side, it is considered that closer and more vigilant involvement of the financial institutions in the units with management of doubtful competence or integrity is essential. Financial institutions have jointly set up a group of professional directors who are full-time employees of the institutions and who could be nominated on the Board of Directors of companies with doubtful management and in which the institutions have a substantial stake. These directors report to the institutions on the measures that should be taken to prevent sickness. If any such director comes across features of a company's operation which give cause td suspect malpractice or gross incompetence, he would report to the financial institutions for further investigation. The concerned institution will then report the matter to an interinstitutional group under the Chairmanship of Industrial Development Bank of India. If this group comes to the conclusion that the management has acted in a patently incompetent manner or has indulged in malpractice, all the institutions and the commercial banks should take a decision that this unit or any other unit under the same management will not be extended financial assistance until the management is changed.

The rehabilitation scheme for a sick unit will depend on the extent of sickness pf the unit, its future prospects and the Management. Financial institutions have realized that the usual methods of rehabilitation are not quite adequate for acute cases of sickness. Such cases may require extraordinary efforts and measures including leasing out an undertaking, merger and amalgamation restructure of capital and liabilities, selling a unit on block oasis, etc. In such cases, the cooperation of all concerned agencies is of utmost importance and invariably workers are called upon to extent greater cooperation. It has been agreed that the lead financial institution and the lead bank will jointly ensure that a scheme is prepared within a time limit of 90 days as fixed under the Sick Industrial Companies (Special Provisions) Act. Some of the State Governments have also started taking preventive measures by announcing certain relief's and-concessions in advance even for units which do not attract the definition of industrial sickness.

The Government has recently specified the economic size of units in many industries: This measure is expected to help check sickness arising out of uneconomic size of industrial units.

The RBI has been closely monitoring certain specific industries where the incidence of sickness is high. Standing Committees have been set up in the R8I for the jute and sugar industries to consider the specific problems of these sectors.

Another significant policy initiative has been- the introduction of liberalized margin money scheme for supplementing the efforts of the State Governments in reducing sickness in the small-scale sector in June 1987. Under this scheme, the State Governments are to make a matching contribution on a 50:50 basis in providing assistance to sick small-scale units in their rehabilitation. In the revised scheme, the maximum quantum of assistance has been enhanced from Rs.20,000 to Rs.50,000 per unit.

IDRA

The Industries (Development and Regulation) Act, 1951, empowers the Central Government to take over an undertaking or its management in certain cases.

In the case of industrial units that are already sick the following options will first be explored before the question of the take-over of management under the Industries (Development and Regulation) Act is considered:

(i) Rehabilitation through State Governments and financial institutions that would provide both financial and managerial support with suitable restructuring of management wherever necessary. In cases where coordinated action is necessary for the revival of the unit outside the framework of the Industries (Development and Regulations) Act, the concerned Administrative Ministry will take the initiative to co-ordinate the arrangements.

(ii) Proposals, if any, for the merger of the sick unit with a healthy unit in the private sector will be examined by the Specified Authority under the Income-Tax Act, 1961, with reference to the guidelines on the subject.

It is only where neither of the above alternative course of action is feasible or desirable that action under the, Industries (Development and Regulation) Act would be considered.

In the past, the Government took: over, se1ectiveIy the management of a number of sick industrial undertakings under the IDRA. For example, a large number of sick textile mills were taken over and brought under the National Textiles Corporation (NTC). The objective was to revive these units by providing management support and financial assistance through banks and other financial institutions: While some units were nursed back to health, a number. of others continued to suffer huge losses.

The Government do not now favour take over of sick units.

Now the approach of the government towards rehabilitation of a sick unit is very selective because the government is convinced that there is no point in throwing away further resources in support of the units which are irretrievably sick. Only such units which are found to be potentially viable need to be taken up for formulation of rehabilitation packages to restore them to health. The package consists of concessions from banks, financial institutions, government (Central/State), government agencies, shareholders, labour, suppliers of goods as viable it if would be in a position, after implementing a package of concessions spread over a period not exceeding seven years from the commencement of the package, to continue to service its repayment obligations, as agreed upon, including those forming part of the package, without the help of any further concessions after the aforesaid period. The repayment period for restructured debts should not exceed 10 years from the date of implementation of the package.

Check Your Progress-3

What are the steps taken by the government to prevent sickness?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-18

4.4 SICK INDUSTRIAL COMPANIES ACT

The most important piece of legislation dealing with industrial sickness is the Sick Industrial Companies (Special Provisions) Act, 1985.

4.4.1 OBJECTIVES

The objectives of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), are:

(i) The timely detection of sick and potentially sick companies owning industrial undertaking;

(ii) The speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies; and

(iii) The expedition's enforcement of the measures so determined and for matters connected therewith or incidental thereto.

4.4.2 APPLICATION OF THE ACT

This Act which extends to the whole of India applies to all the scheduled industries (i.e., industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951) other than the scheduled industry relating to ships and other vessels drawn by power. However the Central Government may, in consultation with the RBI, apply this Act to the scheduled industry relating to ships and other vessels drawn by power.

Ancillary and small scale undertakings F excluded from the application of this Act.

Sick and Potentially Sick Companies

According to the SICA, a sick industrial company means an industrial company (being a company registered/or not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

An industrial company is regarded as potentially sick, if the accumulated losses of an industrial company as at the end of any financial year have resulted in the erosion of fifty per cent or more of its peak netwonh9 during the immediately preceding four financial years.

4.4.3 BIFR AND AAIFR

The SICA provides for the establishment by the Central Government of a Board for Industrial and Financial Reconstruction (BIFR) to exercise the jurisdiction and powers and discharge the functions and duties conferred or imposed on the Board by the Act.

The Board shall consist of a Chairman and not less than two and not more than fourteen other members (having the qualifications specified under this Act) appointed by the Central Government.

The Act also provides for the establishment of an appellate authority called the Appellate Authority for Industrial and Financial Reconstruction consisting of a Chairman and not more than three other members (having the qualifications prescribed in the Act) for hearing appeals against the orders of the BIFR.

The jurisdiction, powers and authority of the Board or the Appellate Authority may be exercised by Benches there of constituted by the chairman. Each Bench shall consist of not less two members.

The Board and the Appellate Authority have the tame powers as are vested in a civil court under the Code of Civil Procedures.

Check Your Progress-4

Explain the purpose of sick industrial companies act

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-19

4.5 FINANCIAL INSTITUTIONS AND INDUSTRIAL SICKNESS

Financial institutions have to playa very important role in the prevention of sickness and rehabilitation of potentially viable sick units.

In view of the fact that large amount of bank, credit was blocked up in the sick unit, the Reserve Bank had issued, in 1976, guidelines to- the commercial banks so as to identify incipient sickness. The RBI had also set up a sick unit’s cell. The cell serves as a reference point and tries, to bring about co-ordination in the efforts of banks, financial, institutions and Government in solving the, prob1ems of sick units and issues suitable instructions and guidelines to banks as and when necessary.

The steps initiated by the commercial banks and other financial institutions and the, Government under the Sick, Industrial Companies (Special Provisions) Act are, helping in timely detection of sickness From time to time, industrial studies have been conducted by the financial institutions where, it has, been found, that sickness is afflicting the industrial growth and climate. Inter-Institutional Rehabilitation Meetings (IIRMs) are periodically held under the auspices of Industrial Reconstruction Bank of India (IRBI) were sick, cases are discussed in detail and detail rehabilitation packages drawn up, in addition to various policy issues relatingtd1'ehabilitation.of sick industrial units.

As modernisation is one of the important measures to prevent sickness financial institutions are extending soft loans for modernisation of industrial units in 1986 the IDBI established the Textile Modernisation Fund and the IFCI established the Jute Modernisation Fund. Further in the same year, the IDBI created the Small Industries Development Fund (SIDF).

In 1971, the Central Government established the Industrial Reconstruction Corporation of India (IRCI) with the specific objective of dealing with the problem of industrial sickness. The IRCI ceased to exist when the Industrial Reconstruction Bank of India (IRBI) was established in 1985. The assets and liabilities of the IRCI were taken over by the IRBI. This has been given statutory status so as to effectively, discharge its function.

It is reported that as a result of the efforts taken by the IRBI towards prevention of industrial sickness industrial undertakings are now approaching the IRBI for their cases at the incipient stage of sickness and that they have become aware of the need to correct the imbalances of long-term and short, term funds, replacement of balancing equipment and Modernisation of obsolete and old plant and machinery at an early stage so that the cases of rehabilitation visa vis their financial involvement to set right their industrial activities become less. In addition, the companies are also approaching IRBI for financial assistance for expansion, diversification, Modernisation etc. for further information on IRBI see chapter 29.

4.5.1 SICK SMALL-SCALE UNITS

The number of, sick units in the small-scale sector has increased substantially- According to the RBI data, the number has increased from 23,149 involving a bank credit of Rs- 305.77 crores at the end of December 1980 to 2.45 lakhs involving a bank credit of Rs. 3100.67 crores at the end of March 1992. Nearly 8 per cent of the total numbers of small-scale units, enjoying bank credit were found to be sick. The sick small-scale units accounted for more than 16 per cent of the bank credit to the small-scale units.

Reflecting the serious concern over the growing sickness-in-the small scale sector in February 1987 the Reserve Bank (issued to all scheduled commercial banks guidelines for rehabilitation of small scale units. The separate guidelines regarding sick small-scale units have been issued because, although sickness in large, medium and small industrial units exhibit many common features, any approach to sickness in SSI sector has to reckon with the relative weakness of such units to withstand difficulties as also the distinction between the small-scale units and tiny sector units and units in the decentralized Sector comprising artisans village and cottage industries units. It has, therefore, been felt that the emphasis of the rehabilitation effort in the case of SSI units should be on adequate and intensive relief measures and their speedy application rather than giving a long span of time to the units for rehabilitation.

According to the definition adopted by the guidelines: a SSI unit should be considered sick if it has (a) incurred cash loss in the previous accounting year and is likely to continue to incur cash loss in the current accounting year and had an erosion on account of cumulative cash losses to the extent of 50 per cent DT more of its net worth and/or (b) continuously defaulted in meeting four consecutive quarterly installments of interest or two half-yearly installments of principal of term loans and there are persistent irregularities in the operations of its credit limits with bank. While both the conditions (a) and (b) should be satisfied in the case of large SSI units, it would suffice if either alternative (a) or (b) is satisfied in case of the tiny and decentralized.

The guidelines point out that it is of utmost importance to take measures to ensure that sickness is arrested at the incipient stage itself and the management of the units financed should be advised about theft primary responsibility to inform the banks if they face problems which could lead to sickness and to restore the units to normal health. The bank branch officials, who are in constant contact with them, should develop mutual confidence between the bank and the borrowers. The organisational arrangements at the branch level should also be fully geared for early detection of sickness and prompt remedial action. Bank Financial institutions will have to identify the units showing symptoms of sickness by effective monitoring. The Guidelines give an illustrative list of warning signals of incipient sickness related to periodical financial data, stock statements, reports on inspection of factory premises and godowns etc. which serve as a useful guide to the operating personnel. The branch officials who are familiar with the day-to-day operations in the borrowal accounts should be under obligation to identify the early warning signals and initiate corrective steps promptly. Such steps may include providing timely financial assistance depending on established need, if it is within the power of the branch manager, and an early reference to the controlling office where the relief required are beyond his delegated powers. The branch manager should also help the unit in sorting out difficulties which are non-financial in nature and require assistance from outside agencies like Government departments/ undertaking, Electricity Board etc. He should also keep the term lending institutions informed about the position of the units wherever they are also involved.

The Guidelines emphasize that only those units which arc considered as potentially viable be taken up for rehabilitation. According to the Guidelines, a unit may be regarded as potentially viable if it would be in a position, after implementing a relief package spread over a period not exceeding 5 years from the commencement of the package from the banks, financial institutions, Government (Central/State) and other concerned agencies, as may be necessary to continue to service its repayment obligations as agreed upon including those forming part of the package. In the case of tiny/decentralized sector units, the period of relief/concessions and repayment period of restructured debts will be 2 years and 3 years respectively.

The norms, prescribed by the Guidelines, for grant of relief and concessions by banks/financial institutions to potentially viable sick SSI units for rehabilitation are reproduced.

LOC

The Industrial Reconstruction Bank of India (IRBI) introduced a Line of Credit (LOC) Scheme for the small-scale sector. Under this Scheme funds are given to State level institutions designated by the State Governments at a lower rate of interest.

In May 1986, the IDBI created a Small Industries Development Fund to provide assistance for development expansion, diversification, modernisation and rehabilitation of small-scale, cottage and village industries and village industries tiny sector units.

4.5.2 NATIONAL EQUITY FUND

Another important step was the establishment of the National Equity, Fund in 1986-87, with a contribution of Rs. 5 crores each by the Central Government and the IDBI. Under this scheme, administered by the IDBI and operated, through nationalized banks, assistance will be provided by way of seed capital, in the form of soft loans to eligible small and only units with the project cost not exceeding 5 lakhs and located in villages or towns with the project cost not exceeding 5 lakhs.

New units, as also the potentially viable sick units in the small-scale sector, eligible for assistance under the Refinance Scheme of IDBI, will get support out of the Fund. Assistance under-the scheme is available up to a maximum of Rs. 75,000 per project at a nominal -service charge of 1 per cent per annum. The units, availing this assistance are required to mobilize cash contribution of 10 per cent of the project cost.

LESSON-20

4.6 MRTP ACT

The Monopolies and Restrictive Trade Practices Act, 1969, brought into force from 1st June 1970, was a very controversial piece of legislation.

The principal objectives of the MRTP Act which extends to the whole of India except to the State of Jammu and Kashmir were:

1. Prevention of concentration of economic power to the common detriment, and
2. Control of monopolistic, restrictive and unfair trade practices which are prejudicial to public interest.

4.6.1 AMENDMENTS

The MRTP Act was significantly amended in 1982, 1984, 1985 and 1991. One of the amendments of 1982 was the redefinition of dominant undertaking. Before this amendment, a dominant undertaking was one which either by itself or with interconnected undertakings controlled not less than one-third of the total production, supply or distribution of any goods or the provision of any service in India of any substantial part thereof. With the 1982 amendment, this market share for consideration of dominance became one-fourth instead of one-third. Since the amendments of 1982, the share of installed capacity of ail undertaking in the total installed capacity for the production of a commodity in India also became a factor for consideration of dominance.

Before the amendment of 1982, the MRTP Act had distinguished another category of undertaking, namely, monopolistic undertaking which meant an undertaking which either by itself or together with inter-connected undertakings controlled not less than half of the market share.

With the amendment of 1982, goods exported out of India are excluded from the calculations for the purpose of determining market dominance.

The MRTP Act was amended in 1984; to bring unfair trade practices under the control of the Act. Further in 1984, certain provision of the Companies Act related to imposing restrictions on the acquisition and transfer of shares were transferred to the MRTP Act. The amendment of 1984 also .empowered the central government to direct severance of inter connection between undertakings in certain cases.

The amendment of 1985 was to raise the asset threshold of undertaking (s) from Rs: 20 crores to Rs. 100 crores for applying the provisions of the MRTP Act relating to prevention of concentration of economic power.

The Industrial Policy Statement of July 24, 1991, announced very drastic changes in the MRTP Act, viz., repeal of the provisions of Act; pertaining to concentration of economic power, except the provisions empowering the government to defuse concentration of economic power to the common detriment. In other words, the main thrust of the MRTP Act hereafter will be to the achievement of prevention of monopolistic, restrictive and unfair trade practices. Thus, the M has almost been knocked out of the MRTP Act.

The provisions of the MRTP Act pertaining to the concentration of economic power were much criticized because of their negative impact on growth and competition.

The MRTP Act sought to prevent the concentration of economic power to the common detriment by preventing those developments which might result in the concentration of economic power such as substantial expansion of existing undertakings; mergers and amalgamations; takeovers; and, interconnection of undertakings. Accordingly, the MRTP companies (i.e., dominant uooerta1dngs with assets of Rs. one crore or more and other undertakings having assets, including that of interconnected undertakings, of Rs.100 crores or more) had to obtain prior approval of the central government for any of the developments mentioned above.

As the new industrial policy Statement confesses, with the growth complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international market, the interference of the government through the MRTP Act in investment decisions of large companies became deleterious in its effects on Indian industrial growth.

It has therefore, been decided to repeal the provisions of the MRTP Act requiring prior governmental approval for expansion of existing under takings; establishment of new undertakings; merger, amalgamation and takeover and appointment of certain directors.

The thrust of the MRTP Act in future will be on the control of restrictive and unfair trade practices.

The Government however retains the power to defuse or breakup concentration of economic power to the common detriment. If the central government is of the opinion that the working of an undertaking, is prejudicial to the public interest, or has, led or is leading, of is likely to lead, to the adoption of any monopolistic or restrictive trade practice the government is empowered by the MRTP Act to direct:

(i) The division of any trade of the undertaking by the sale of any part of the undertaking or assets thereof; or

(ii) The division of any undertaking or interconnected undertakings into such number of undertakings as the circumstances of the case may justify.

4.6.2 MRTP COMMISSION

In accordance with, the provisions of the Act the Government of India has set up a Commission known as the Monopolies and Restrictive Trade, Practices Commission. The Act provides that the Commission still consist of a, chairman, and not less than two and not more than eight other members, to be appointed by the Central Government. The chairman shall be a person who has the qualification to be a judge of the Supreme Court or of a High court and the members thereof shall be persons of ability integrity and standing, who have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or, administration.

The Act empowers the Central Government to appoint a Director General of investigation and Registration, and as many Additional, Joint, Deputy or Assistant Directors-General of Investigation and Registration; as it may think fit, to conduct investigations for the purposes of this Act, and for maintaining a register of agreements subject to registration under this Act and for performing such other functions as are; or may be, provided by, or under this Act. The Director-General may authorize a one of the Additional, Joint, Deputy or Assistant Directors General to Junction as the Registrar of Agreement subject to registration under this Act.

Jurisdiction and Powers of the Commission

The MRTP Commission is vested with powers to inquire into restrictive, monopolistic and unfair trade practices.

The Commission, may inquire into any restrictive trade practice either on the application of the Director-General of Investigation or upon a reference made to it by the Central or State Government or on receiving complaint from any trade or consumer association having a membership of not-less than 25 persons, or 25 or more consumers, or upon, its own knowledge or information.

The Commission may inquire into any monopolistic trade practice upon a reference made to it by the Central Government or upon its own knowledge or information.

Where a complaint about any restrictive trade practice, is received by the Commission from a trade or consumers association or consumers as stated above the Commission may, before issuing any process requiring the attendance of the person complained against, require the Director-General to make, or cause to be made, a preliminary investigation in such a manner as it may direct and submit a report to the Commission to enable it to satisfy itself as to whether or not the complaint requires to be inquired into. Such a preliminary investigation maybe made by the Director-General also upon his awn knowledge or information, or a complaint made to him.

For the purpose of an inquiry under this Act, the Commission has the same powers as are vested in a Civil Court under the Civil Procedure Code, 1908, in respect of:

(i) Summoning a witness and his examination an oath;
(ii) Discovery and production of evidence;
(iii) Reception of evidence an affidavits;
(iv) Requisitioning public records from a court or an office; and
(v) Issuing a commission for the examination of a witness.

The proceedings before the Commission are judicial proceedings and the Commission is deemed to be a Civil Court.

The Commission is empowered to require any, person:

(i) To produce before, and allow to be examined and kept by an officer of the Commission specified by it in this behalf, such books, accounts or other documents in the custody or under the central of the person required as may be specified or described in the requisition, being documents relating to any trade practice; the examination of which may be required for the purposes of this Act; and

(ii) To furnish to an officer so specified such information as respects the trade practice as may be required for the purpose of this Act or such other information as maybe in his possession in relation to the trade carried an by any other person.

During an inquiry before the commission in to any monopolistic, restrictive or unfair trade practice, the commission empowered to grant temporary injunction restrictive the undertaking or person concerned from carrying en any monopolistic, or restrictive, or unfair trade practice.

There was no provision in the MRTP Act an award compensation for the lass or damage caused by monopolistic, restrictive or unfair trade practices. The Sachar committee observed. It is a well established principle of jurisprudence that for every wrong there must be a remedy. It is approved that prohibited practices, if indulged in, are likely to cause grave loss or damage to many consumers. But in the Act there is no provision for awarding the damages. This is a highly unsatisfactory state of affairs. The Committee pointed out that the corresponding Acts in the USA, Switzerland, Japan, Australia, Canada, etc., provide for such compensation, and recommended that the MRTP Act should be modified by incorporating provisions in it for - the payment of compensation to the affected party. Accordingly, a new Section, 12-B, was inserted by the Amendment Act of 1984 to empower the MRTP Commission to award compensation for the loss or damage caused by monopolistic, restrictive or unfair trade practices.

Check Your Progress-5

Enumerate the functions of MRTP commission

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

Monopolistic, Restrictive and Unfair Trade Practice

As mentioned earlier, the MRTP Act is now concerned mostly with the control of monopolistic, restrictive and unfair trade practices which are prejudicial to the public interest.

4.6.3 CONTROL OF MONOPOLISTIC TRADE PRACTICE

A monopolistic trade practice is a trade practice which is, or is likely to have the effect to unreasonably preventing or lessening competition in the production, supply or distribution of any goods or services limiting technical development- and capital investment to the common detriment; or allowing the quality of goods or services to deteriorate.

Chapter IV - of the Act empowers the Central. Government to control and prohibit those monopolistic trade practices that are, or are likely to be, prejudicial to the public interest.

A monopolistic trade practice shall be deemed to be prejudicial to the public interest, if having regard to the economic conditions prevailing in the country, and to all other matters which are relevant in the particular circumstances, the effect of the trade, practice is or would be:

(i) To increase- unreasonably the cost relating to the production, supply or distribution of goods or the performance of any service.

(ii) To increase unreasonably

(iii) the price at which goods are sold or

(iv) the profits derived from the production supply or distribution of goods or from the performance of any service

(v) To reduce or limit or unreasonably competition in the production, supply or distribution of any goods (including their sale or purchase) or the provision of any service;

(vi) To limit or prevent unreasonably the supply of goods to consumers or the provision of any Service

(vii) To result in a deterioration in the quality of any goods or in the Performance of any service.

Section 31 provides that where it appear to the Central Government that the owners of one or more monopolistic undertakings ate Indulging in any monopolistic trade practice, or that monopolistic trade practices prevail in respect of any goods or services, the government-may refer the matter to the MRTP Commission for an inquiry and the Commission shall, after such hearing as it thinks fit, report to the Central Government its, findings thereon. The Commission may make such an inquiry also OD its own motion. If such an inquiry finds that any monopolistic trade practice-operates or is likely to operate against the public interest, the Central Government may pass such ail inquiry also on its own motion. If such an-inquiry finds that any monopolistic trade Practice operates or is likely to operate against the public interest the Central Government may pass such orders as it may think fit to remedy or prevent any mischief which result or may result from such trade practice. Any order made by the Central Government in this regard may include an order.

a) Regulating the production storage, supply distribution or control of any goods by the undertaking or the control or supply of any service by it and fixing the terms of sale (including prices) or supply thereof

b) Prohibiting the undertaking from resorting to any act or practice or from pursuing any commercial policy ,which prevents or lessens, or is likely to prevent or lessen competition in the production supply or distribution of any goods or provision of any services;

c) Fixing standards for the goods used or produced by the undertaking

d) Declaring unlawful, except to such extent and in such circumstances as may be provided by or under the order the making or carrying out of any such agreement as ma be specified of described in the order

e) Requiring any party to any such agreement as may be so specified or described to terminate the agreement within such time as may be so specified, either wholly or to such an extent as may be so specified.

Exemptions

A monopolistic trade practice is deemed lobe prejudicial to the public, Interest except when it is:

(i) Authorized by the Central Government; or

(ii) Found necessary by the Central Government to (a) meet the defence requirements; (b) ensure the maintenance of essential services; or (c) give effect to the terms of an agreement to which the Central Government is a party.

4.6.4 CONTROL OF RESTRICTIVE TRADE PRACTICE

A restrictive trade practice is a trade practice which has the effect, actual or probable of restricting, lessening or destroying competition. Such trade practices may tend to obstruct the flow of production or to bring about manipulation of prices or conditions of delivery etc. to the common detriment.

Indeed, every monopolistic trade practice is also a restrictive trade practice. The distinction between the two is based, perhaps, on the Monopolies Inquiry Commission, which confined the word restrictive trade practices to mean restrictive trade practices other than those pursued by monopolists. In the words of the Commission, every monopolistic practice is, on the face of it, a restrictive trade practice. Indeed, sometimes the two words are used indiscriminately. We shall confine the words restrictive trade practice to mean practices other than those pursued by monopolies which obstruct the free play of competitive forces or impede the free flow of capital resources into the stream of production or of finished goods in the stream of distribution or of any point before they reach the hands of the ultimate consumer.

Possible restrictive Trade Practices

The following are· some common types of restrictive trade practices:

(i) **Concert or Collusion/Cartels:** That is, collusive action on the part of manufacturers or suppliers infixing prices or terms of sale to lessen competition; or concert against manufacturers suppliers to divide markets to eliminate competition.

(ii) **Price Discrimination:** This refers to the practice of selling goods or services where there are no or nominal cost differences at different effective prices to distinct and separate groups of Customers.

(iii) **Predatory Pricing:** This is a practice of temporarily selling at prices below cost with the intention of driving out existing competitors or warding off competitors about to enter the market so that the/market power of the person resorting to such a trade practice-is either enhanced-or maintained.

(iv) **Tie-Up sales:** Manufacturers or suppliers of fast-moving products may tie up sales of such products with the sales of slow-moving products resulting in distortion in competition in the field of slow, moving products.

(v) **Full-line Forcing:** This is the practice that requires a buyer to purchase quantities of each item in a product range in order to be able to buy one of them. This is a more drastic variation of tie up sales.

(vi) **Exclusive Dealing:** This is a trade practice in which the supplier or the manufacturer insists that the dealer will exclusively deal in the products of the manufacturer / suppliers that is to say, be will not deal in the products of the competitor / competitors.

(vii) **Area Restriction:** This is a trade practice whereby a restriction is placed by the manufacturer on the dealer to make supplies only within a fixed area or designated territory and not to sell outside that area.

(viii) **Resale Price Maintenance:** This is a trade practice under which a manufacturer fixes a price at which a retail shop, which he does not own, must re-sell his product to the public or at which a wholesale business, which he does not own, must re-sell that product to a retailer.

Under the MRTP Act, restrictive trade practices are not prohibited except in so far as re-sale price maintenance is concerned; but here, too, there is a provision for getting exemption for any class of goods.

However, barring those exempted under the Act (mentioned under the title Exemptions), the agreements which relate to a restrictive trade practice or practices (wide enough to cover arrangements and understanding - the MRTP Act covers restrictive trade practices through agreements as also otherwise) are required to be registered with the Registrar of Agreements, authorized by the Director-General of Investigation and Registration, so that he can get them evaluated by the MRTP Commission to whether the restrictive practice is or is not against the public interest. Registration, however, is not a necessary prerequisite for starting an enquiry, for it can be started without the formality of registration. The initial burden is on the Registrar to show that a trade practice is restrictive, and thereafter it shifts on the party proceeded against to show that the practice, though anticompetitive, is not against the public interest in the facts and circumstances of the case.

There is no punishment for indulging in a restrictive trade practice (with the exception of re-sale price maintenance) put there is punishment if there is a violation of a cease and desist order of the Commission.

Once the MRTP Commission finds that the impugned restrictive trade practice is prejudicial to the public interest, it has powers to pass an order directing:

(a) That the practice shall be discontinued or not repeated (these are called Cease and Desist Orders)

(b) That the agreement relating to .the said practice shall be void (becomes unenforceable by any Court)

(c) That the agreement relating to the aforesaid practice be modified in a specified manner.

Instead of passing an order, the Commission may, on an application by a person, party to a restrictive trade practice, permit him to take steps within such specified as maybe necessary to ensure that the trade practice is no longer prejudicial to the public interest. The Commission has wide powers to

(a) Make provisions necessary or desirable for the proper execution of its order; and

(b) Amend on revoke its order.

An order made by the Commission may be general in application or limited to a particular class of traders, trade practice, and locality or to a particular trade practice.

An appeal against an order of the Commission lies only to the Supreme Court.

Unfair Trade Practices (UTPs)

It is said that the consumer needs no special protection and everything can be left to the market forces. The perfectly competitive market is an economist's dream and consumer sovereignty is a myth. In real life, products are of great variety, many of them being complex and the consumer has imperfect product-knowledge. Moreover, the supplier often has a dominant position against the buyer who has less bargaining power in the market. There has been a growing realisation for not depending on the old doctrine of caveat emptor - let the buyer beware. The consumer, therefore, needs legal protection against certain trade practices and business methods.

It is not the consumer alone who needs protection. Even an honest businessman needs legal protection from unscrupulous and dishonest competitors.

Several countries across the globe have adopted statutory measures for the control of unfair trade practices to protect the consumers. Names which come to one's memory in this context are UK, Australia, Canada and the USA.

In our country, the need for the protection of consumers is all the more great because the large majority of consumers are illiterate, ill-informed and possessing limited purchasing power, where there is a perennial shortage of many goods and where growth with social justice is the guiding principle. MRTP Act seeks to provide protection in this case.

Before the 1984 amendment, the MRTP Act contained no provisions for the protection of consumers from unfair trade practices, such as deceptive and misleading advertising, hoarding of goods and the supply of unsafe and hazardous products. The Act was directed against restrictive and monopolistic trade practices and the consumers interest was sought to be protected by promoting competition and curbing of anti-competitive activities of manufacturers and dealers. However, the consumer needs protection not only from restrictive and monopolistic trade practices but also from unfair and unethical practices which are adopted by unscrupulous businessmen to maximise their profit and sales at the expense of the consumer.

The major provisions are contained in Sections 36A, 36B, 36C, 36D and 36E which have been inserted in the MRTP Act by the 1984 amendment, which became effective from August 1, 1984. Other provisions relevant to the regulation of unfair trade practices are contained in certain other sections of the Act, which include Sections 12A, 12B, 12C, 14 and 61.

Concept of unfair Trade Practice

Broadly speaking, any trade practice which is considered unfair and harmful to the consumer is an unfair trade practice.

The genesis of unfair trade practice is human greed which leads to the exploitation of the consumer by the trader. Mahatma Gandhi said that the rich must act as the trustee of the poor for their wealth and that all must have bread before some have cake. It is breach of this dictum that initiates unfair trade practices.

As defined under the MRTP Act, unfair trade practice refers to any of the five trade practices specified under clauses (1) to (5) of Section 36A, which are adopted for the purpose of any services, and which cause loss or injury to the consumer. Briefly stated, these trade practices are:

- Misleading advertisement and false representation;
- Advertising of bargain price (or bait advertising) and switch selling;
- Offering of pseudo gifts or prizes and conducting of promotional contests, lottery and games of chance or skill;
- Supplying of unsafe or hazardous products and
- Hoarding or destroying of goods, or refusal to sell goods, resulting in a Price increase.

The loss or injury to the consumer may arise by eliminating or restricting competition or otherwise.

Thus, the definition of unfair trade practice is not a general definition but is confined to the above mentioned five trade practices. While the definitions or a monopolistic trade practice and a restrictive trade practice, as given in the Act, are general in nature and any trade practice falling within the respective criterion may amount to the monopolistic trade practices, is a specific one in the sense that no practice other than the five practices specified for the purpose can be taken to be an unfair trade practice. Neither the MRTP Commission ~or any other authority is empowered to include any other trade practice within the definition of an unfair trade practice.

Any trade practice would, therefore, amount to an unfair trade practice under the following conditions:

- The practice falls within one or more of the five trade practices mentioned above.
- The practice is adopted for any of the following purpose:
  - promoting the sale, use or supply of any goods or
  - provision of any services.
- The practice causes loss or injury to the consumers of the relevant goods or service.

- The loss or injury to the consumers may be caused .by eliminating or restricting competition or otherwise.

To be specific, the following are the UTPs:

➢ The practice of making any statement, whether orally or in writing or by visible representation which:

  - Falsely represents that the goods are of a particular standard, quality, grade, composition style or model.
  - Falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods.
  - Falsely represents that the services are of a particular standard, quality or grade.
  - Represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have.
  - Represents that the seller or the supplier has sponsorship, approval or affiliation which, such a seller or supplier does not have.
  - Makes a false or misleading representation concerning the need for or the usefulness of any goods or services.
  - Gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof.
  - Makes to the public representation in a form that purports to warranty or guarantee of a product or of any goods or service or a promise to replace, maintain or repair an article or any part there of or to repeat or continue a service until it has achieved a specified result. If such purported warranty, guarantee or promise is materially misleading or if there is no responsible prospect that such warranty, guarantee or promise will be carried out.
  - Materially misleads the public concerning the price at which a product or like products or goods or services have been or are ordinarily sold or provided and for this purpose, a representation as to the price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by the supplier generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made.
  - Gives false or misleading facts disparaging the goods, services or trade of another per son. .

- Permits the publication of any advertisement, whether in any newspaper or otherwise, for the sale or supply at a bargain price of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is and in quantities that are reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business and the nature of the advertisement.
- Permits: (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole, (b) the conduct of any contest lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest.
- Permits the sale or supply of goods intended to be used or are of a kind likely to be used by consumers, knowing or having reasons to believe that the goods do not comply with the standards, prescribed by a competent authority relating to performance, composition, contents, design, construction, finishing or packing as are necessary to prevent or reduce the risk of injury to the person using the goods.
- Permits the hoarding or destruction of goods or refusal to sell the goods or make them available for sale, or to provide any service, if such hoarding, destruction or refusal raises or tends to raise or is intended to raise the cost of these or other similar goods or services.

Regulation of UTPs

The MRTP Commission may enquire into any UTP:

- Upon receive a complaint from any trade or consumers association with a membership of 25 or more;
- Upon a reference made to it by the Central or State Government.
- Upon Government an application made to it by the Director-General
- Upon its own knowledge or information and
- With the latest amendment to the MRTP Act, upon a application from any member of public.

If the enquiry proves that the UTP does exist and it is prejudicial to the public interest the Commission may direct that:

- the practice shall be discontinued or shall not be repeated and
- any agreement relating to such an UTP shall be stand modified m such a manner as may be directed by the Commission.

	MTPs		RTPs
1.	Market is sought to be misused. Stress is on abusing market power.	1.	Competition is sought to be curbed. Stress is on preventing competition from its free play.
2.	Commission can conduct enquiry on either (i) reference from the Central Government, or (ii) on its own knowledge or information.	2.	Commission can conduct enquiry on any of five bases: (i) a complaint from 25 or more consumers or dealers, (ii).Reference from Central Government, (iii) Reference from the State Government, (iv)The application of the Director General or (v) on its own knowledge of information.
3.	Commission submits report about the findings to the Central government. The power of making final order rests with the Central Government.	3.	Commission itself can pass final order after enquiry.
4.	Commission's role advisory. It can only conduct enquiry.	4.	Commission has the power of passing final order which is subject to appeal only to Supreme Court.
5.	Consequences of indulging in an MTP are more serious. Apart from the order to prohibit the person concerned from indulging in an MTP, the Central Government is empowered to pass orders to remedy or prevent any mischief resulting from the practice.	5.	Consequences of indulging in an RTP are not very serious. A cease and desist order is passed and the relevant clauses of the RTP agreement are declared void.
6.	With regard to the compliance of the final order, the Director General is required to report compliance of the cease-order within 90 days of the government order. The owner of the undertaking is also required to report compliance of the cease-order within 90 days of the government order.	6.	No such requirement in the case of RTPs unless a specific obligation has been imposed on the party concerned as part of the Commission's final order.
7.	Agreements relating to MTPs need not be registered.	7.	All agreements relating to specified restrictive trade practices are required to be furnished for registration to the Director-General.

	MTPs		RTPs
1.	Concerned with the protection of consumer	1.	Concerned with the promotion of competition in the market
2.	No such deeming provision in the case of an UTP	2.	While RTP deemed is to be prejuidical to the public interest unlease the commission is satisfied of any one or more of the circumstance or gateways of public interest.
3.	No such bar in the case of an UTP.	3.	A cease and desist order cannot be passed in respect of an agreement between buyers of goods meant for ultimate consumption (and for resale).
4.	Cease and desist order can be passed if the commission is of the opinion that the practice is prejudicial to the interest of any consumer or consumers in general or public interest.	4.	Cease and desist order can be issued when the commission is of the opinion that the practice is prejudicial to public interest.
5.	No need fro registering of agreements	5.	Agreements must be registered.
6.	Penalty for contravention of final order is uniform whether the offence is for the time of repeated one.	6.	Additional penalty has been provided for the second of subsequent offence in relation to the same goods or service. Additional penalty is more stringent than the one provided for the first one.
7.	Arise of vertical relationship between the firm and the consumer	7.	Arise out of vertical agreement 9i.e exclusive dealing set - up sales and territorial restriction) and horizontal price agreement.
8.	The control is intended to provide for the physical protection, besides economic interest of consumers. The provision that the supply of an unsafe or hazardous product would amount to an UTP is a case in point	8.	The control is intended to protect economic interests of consumers and the general public.

Check Your Progress-6

a. What do you mean by monopolies trade practices?

b. What do you mean by restrictive trade practices?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

4.7 LET US SUM UP

Sickness is found being understood, interpreted and measured differently be individuals and even by institutions. Common symptoms of industrial sickness include failure to pay statutory liabilities like provident fund and E.S.I. contributions, failure to pay timely installment of capital and interest on loans taken from financial institutions and through public deposits, increase in inventories with a large number of slow or non-moving items, high rate of rejection of goods manufactured, low capacity utilization and frequent industrial disputes. Data for the recent years show that in the large-scale sector, the incidence of sickness was high in industries like engineering, cotton textiles, jute textiles and sugar. Industrial units may become sick at different stages and due to different reasons.

Government policy towards the, Prevention and treatment of industrial sickness is guided by the following considerations-On the preventive side, involvement of the financial institutions in the units with management of doubtful competence. The rehabilitation scheme for a sick unit will depend on the extent of sickness pf the unit, its future prospects and the Management. The most important piece of legislation dealing with industrial sickness is the Sick Industrial Companies (Special Provisions) Act, 1985.

The principal objectives of the MRTP Act is to Control of monopolistic, restrictive and unfair trade practices which are prejudicial to public interest. In accordance with, the provisions of the Act the Government of India has set up a Commission known as the Monopolies and Restrictive Trade, Practices Commission. The MRTP Commission is vested with powers to inquire into restrictive, monopolistic and unfair trade practices. The MRTP Act is now concerned mostly with the control of monopolistic, restrictive and unfair trade practices which are prejudicial to the public interest.

4.8 MODEL ANSWERS FOR CHECK YOUR PROGRESS

1. The Sick Industrial Companies (Special Provisions) Act, 1985, as amended in 1993 defines a sick industrial company as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

2. Industrial units may become sick at different stages and due to different reasons. Indeed, some industries are born sick, some achieve sickness and some have sickness thrust upon them. Industries also achieve sickness due to internal and external causes.

3. The steps taken by the government are categorized into preventive and curative measures. The Industries (Development and Regulation) Act, 1951, empowers the Central Government to take over an undertaking or its management in certain cases.

4. The objectives of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), are: The timely detection of sick and potentially sick companies owning industrial undertaking; The speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies; and The expedition's enforcement of the measures so determined and for matters connected therewith or incidental thereto

5. For the purpose of an inquiry under MRTP Act, the Commission has the same powers as are vested in a Civil Court. The Commission is empowered to require any, person: To produce before, and allow to be examined and kept by an officer of the Commission specified by it in this behalf, such books, accounts or other documents in the custody or under the central of the person required as may be specified or described in the requisition, being documents relating to any trade practice; the examination of which may be required for the purposes of this Act; and To furnish to an officer so specified such information as respects the trade practice as may be required for the purpose of this Act or such other information as maybe in his possession in relation to the trade carried an by any other person.

6. a. A monopolistic trade practice is a trade practice which is, or is likely to have the effect to unreasonably preventing or lessening competition in the production, supply or distribution of any goods or services limiting technical development-and capital investment to the common detriment; or allowing the quality of goods or services to deteriorate.

b. A restrictive trade practice is a trade practice which has the effect, actual or probable of restricting, lessening or destroying competition. Such trade practices may tend to obstruct the flow of production or to bring about manipulation of prices or conditions of delivery etc. to the common detriment.

Suggested Readings

1. Francis Cherunilam-Business Environment
2. C.B.Gupta- Business Environment
3. K. Aswathappa- Essential Of Business Environment

UNIT – V

UNIT - V

CONTENT

AIM AND OBJECTIVES

In this unit, we discuss the significance of Business Environment. After going through this lesson, you will be able to understand:

I. Significance of financial institution
II. Objectives and functioning of various financial institutions
III. Role of foreign capital
IV. Types of foreign capital
V. Government policy regarding foreign capital

LESSON-21

5.0 INTRODUCTION

Finance is the life-blood of an organization. There are different type of financial institutions that finance the production activities of business. There are many financial institutions like IDBI, ICICI, IRBI, UTI, LIC etc. which contribute to development of business apart from commercial banks. Apart from these financial institutions, foreign investments are also encouraged. Foreign policy of the government facilitates foreign investment in the country.

In response to the varied and growing demands of industry, several specialize of financial institutions have been set up in India both at all India level and at the State level. Today there are 60 financial institutions each performing a specific, task. These financial institutions perform tasks which are far beyond the conventional function of providing term finance to eligible entrepreneurs and mobilizing resources for their lending operations.

5.1 INDUSTRIAL FINANCIAL INSTITUTIONS

Finance is a pre requisite to mobilize real resources for organising production. In a developing economy, however, lack of finance is not the only deterrent to economic development. Even when finance is available, other important factors like imperfections in the information flow and dearth of entrepreneurship may come in the way of industrial and economic development. Hence, it is necessary to make finance and other development assistances in a package to take the dormant and developing economies to the take offstage. The present trend, therefore, is to set up Development Banks rather than institutions which merely provide finance.

5.1.1 MEANING OF DEVELOPMENT BANKS

Specialized financial institutions are not merely lending agencies. They assess market potential, provide technical and managerial advice, identify and encourage new entrepreneurs, give preference to the development of backward areas and provide underwriting facilities. Therefore, these institutions are called Development Banks.

A development bank may be defined as a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth.

The concept of development banking is based on the assumption that mere provision of finance will not bring about entrepreneurial development.

Development banks provide a package of financial and non-financial assistance. Their activities include discovery of new projects, preparation of project report, provision of funds, technical assistance and managerial advice. These institutions do not compete with the conventional institutions but supplement them. Therefore, development banks are called gap fillers. They serve as motive engines of industrial development. As catalysts of economic growth they provide injections of capital, enterprise and management.

The distinctive features of a development bank are as follows:

i. It provides medium and long-term finance.
ii. It is project oriented rather than security oriented.
iii. It acts as a partner in progress by guiding, supervising and advising the entrepreneurs.
iv. It provides both equity capital and debt capital.

In a developing country like India, need for special financial institutions was felt due to shyness of capital, low rate of capital formation, ill-organised capital market, requirements of five year planning, etc.

A development Bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth. The concept of development banking is based on the assumption that mere provision of finance will not help to bring about entrepreneurial development. Successful entrepreneurial banking should include the discovery of investment projects, undertaking the preparation of project reports, provision of technical advice and management services and finally assisting the management of industrial units.

After Independence starting with the establishment of the Industrial Finance Corporation of India in 1948, a number of development banks have been set up at all- India and State levels for assisting the development of large, medium and small industries by providing financial and various other promotional assistances.

There are three all-India Development Financial Institutions (DFIs), viz., Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI) and Industrial Credit and Investment Corporation of India (ICICI). The Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units was converted into the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers.

Besides the four institutions referred to above, the all-India financial institutions (AIFIs) providing industrial finance are some investment institutions~ namely the Unit Trust of India' (UTI), Life Insurance Corporation of India (LIC), and the General Insurance Corporation of India (GIC) and its subsidiaries.

Development banks have been established at the State level too. In 1987, there were 18 State Financial Corporations (SFCs) and 26 State Industrial Investment/Development Corporation (SIDCs).

Financial assistance is provided, directly or indirectly, also by National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs) and Khadi and Village Industries Commission (KVIC), although, financing is only an ancillary function of these organizations.

The IDBI is the apex institution which co-ordinates the activities of various institutions.

A very important source of industrial finance is commercial banks.

Provision of rupee and foreign currency loans, subscription to shares and debentures, underwriting of shares and debentures, guaranteeing-of deferred payments and loans are the important types of financial assistance provided by these institutions (some of the institutions do not provide some of these assistances).

Development activities of the DFIs include identifying industrial potentials of different areas; development of entrepreneurship through training and motivation; assistance in project identification, feasibility studies and preparation of project reports; technical and managerial consultancy; seed/risk capital assistance, etc.

Direct assistance from the all-India development banks is normally confined to projects costing over Rs.3 crores various state level institutions and certain special institutions like the National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs), Khadi and Village Industries Commission (KVIC) and banks assist small-scale (including khadi and village) units and medium-scale units involving investment of less than Rs.3 crores. However, these institutions, particularly the IDBI, assist the small-scale sector indirectly, through schemes of refinancing, rediscounting of bills, resource support to institutions assisting small-scale sector, etc.

The limit of direct subscription by the all-India DFIs to equity of companies has recently been raised from Rs.50 lakhs to Rs.l crore.

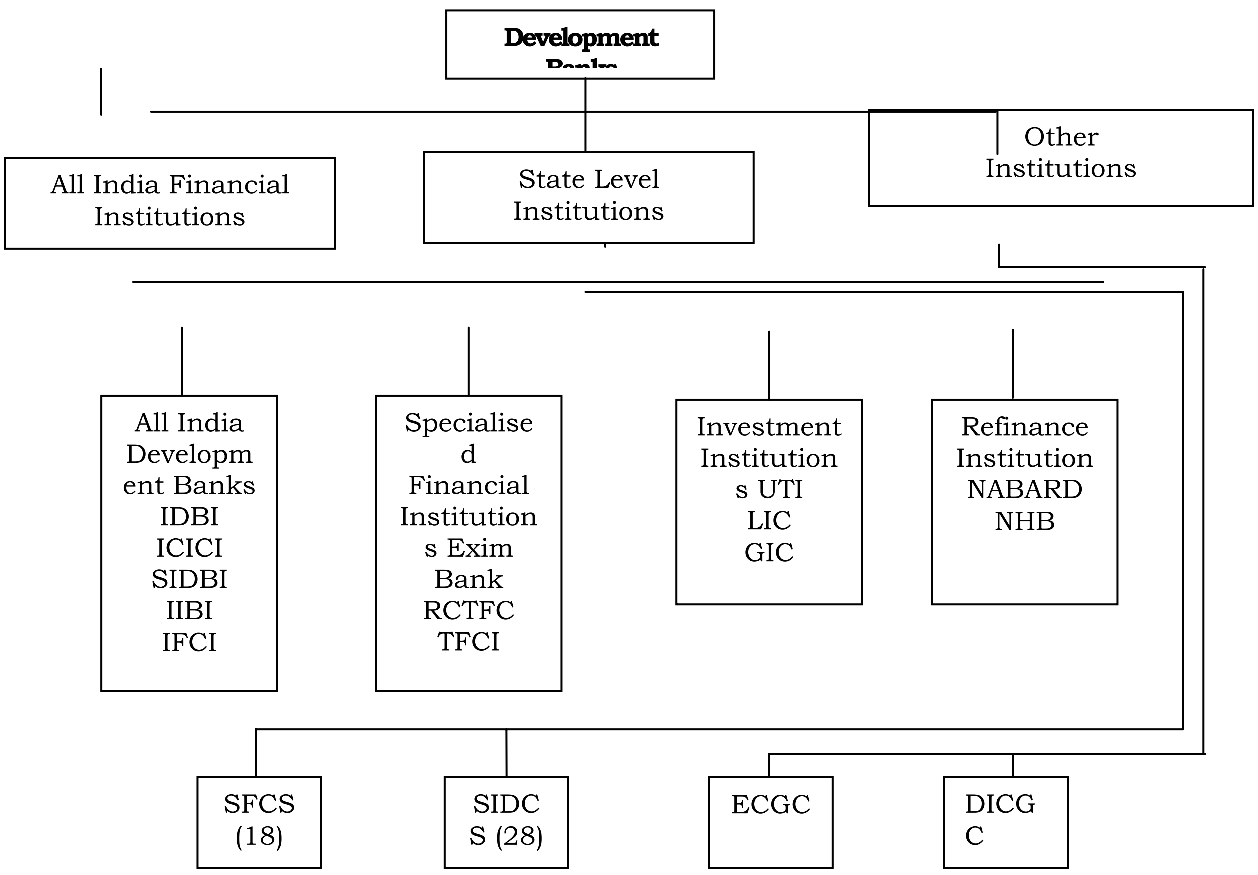
Projects involving very large investment are assisted by the all-India financial institutions through consortium financing (i.e., the project is jointly financed by a group of financial institutions). In consortium financing, one of the institutions plays the lead role. The AIFls have been trying to make the single window concept more effective and to expedite the process of sanction and disbursement of assistance.

The DFIs have sponsored a number of technical consultancy organizations (TCOs) and some institutes for entrepreneurial/management development.

The assistance sanctioned by all financial institutions (AFIs) increased very substantially from Rs. 118.1 crores in 1964-65 to Rs. 54,212 crores in 1994-95.

The share of the AIFls in the total sanctions is more than 90 per cent and of the state level development banks is one tenth. IDBI, the premier institution, alone accounts for more than 27 per cent about of the total assistance by the AFIs.

About three-fourths of the cumulative assistance sanctioned by the AFls has gone to the private sector, about 15 per cent has gone to the public sector, 77 per cent to the joint-sector and the cooperative sector received 33 percent.



5.1.2 NEED FOR FINANCIAL INSTITUTIONS

After the Second World War several countries felt the need for setting up specialized financial institutions to reconstruct their war-shattered economies. After independence, the Government of India adopted the policy of planned economic growth through rapid industrialization. Rapid industrial development required long term and medium-term funds which were beyond the traditional sources of finance. Commercial banks catered to the short-term working capital requirements of trade and industry. It became necessary to develop the investment habit among people and to develop the capital market. In order to develop the capital market and to meet the financial problems of industrialization several specialized financial institutions were established in the country. These institutions have been set up at both national and regional levels. Specialized financial institutions provide financial assistance to industrial enterprises for investment in expansion and modernisation of plants and for setting up new plants.

Special financial institutions or development banks have been set up in order to achieve the following objectives:

i. To promote and develop new industries so as to fill up gaps in the industrial structure of the country;

ii. To meet the growing needs of industries for long-term finance;

iii. To help in the promotion of new enterprises by: (a) identifying and formulating projects, (b) training and developing entrepreneurs, and , (c) streamlining the management of assisted industrial units;

iv. To provide merchant banking facilities like issue houses and underwriting to assist industrial concerns in raising long-term finance from, the capital market;

v. To mobilize public savings and accelerate the rate of capital formation in the country;

vi. To ensure balanced regional development by encouraging industrialization in backward regions;

vii. To develop a healthy and strong capital market;

viii. To assist in the modernisation, expansion and diversification of existing industries;

ix. To encourage the growth of small scale industries and new and technical entrepreneurs;

x. To optimize the use of scarce resources.

Check Your Progress-1

What do you mean by a development bank?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-22

5.2 INDUSTRIAL DEVELOPMENT BANK OF INDIA

The IDBI was established on July 1, 1964 under the Industrial Development Bank of India Act, 1964, as a wholly owned subsidiary of the Reserve Bank of India. In terms of the Public Financial Institutions Laws (Amendment) Act, 1975, the ownership of IDBI has been transferred to the Central Government with effect from February 16, 1976.

The most distinguishing feature of the IDBI statute is that it has been assigned the role of the principal financial institutions for coordinating, in conformity with the national priorities, the activities of the institutions engaged in financing, promoting or developing industry. IDBI has been assigned a special role to play in the matter of:

(i) planning, promoting and developing industries to fill vital gaps in industrial structure;

(ii) providing technical and administrative assistance for promotion, management or expansion of industry; and

(iii) Undertaking market and investment research and surveys as also techno-economic studies in connection with development of industry.

IDBI is also expected to co-ordinate, guide and monitor the entire range of credit facilities offered by the other institutions for the small and cottage sector.

IDBI is empowered to finance all types of industrial concerns engaged or to be engaged in the manufacture, processing or preservation of goods, or in mining, shipping, transport, hotel industry, generation or distribution on power, fishing or providing shore facilities for fishing or in the maintenance, repairs, fishing or servicing of machinery or vehicles, vessels, etc. or for the setting up of industrial estates. The Bank can also assist industrial concerns engaged in the research and development of any, process or product or in providing special or technical knowledge or other services for the promotion of industrial growth.

The IDBI Amendment Act, 1986, has enlarged the definition of industrial concerns eligible for assistance from IDBI to cover diverse range of industrial activities including the activities of services sector of industries like informatics, health care, storage and distributing of energy and other services contributing to value addition. The Act has also widened the scope of business of the Bank so as to cover consultancy, merchant banking and trustee ship activities. The range of financing instruments has been further enlarged to include lines of credit and letters of credit and IDBI has been permitted to grant loan and advances to individuals for investment in industrial concerns.

Object:

i. Co-ordinate, regulate and supervise the activities of all financial institutions providing term finance to industry;
ii. Enlarge the usefulness of these institutions by supplementing their resources and by widening the scope of their assistance;
iii. Provide direct finance to industry to bridge the gap between demand and . supply of long-term and medium-term finance to industrial concerns in both public and private sectors;
iv. Locate and fill up gaps in the industrial structure of the country;
v. Adopt and enforce a system of priorities so as to diversify and speed up the process of industrial growth. The Bank has been conceived of as a development agency that will ultimately be concerned with all questions or problems relating to industrial finance in the country.

Functions:

The main functions of the IDBI are as follows:

i. Subscribing to the shares and bonds of financial institutions and guaranteeing their underwriting obligations;
ii. Refinancing term loans and export credits extended by other financial institutions;
iii. Granting loans and advances directly to industrial concerns;
iv. Guaranteeing deferred payments due from and loans raised by industrial concerns;
v. Subscribing to and underwriting shares and debentures of industrial concerns;
vi. Accepting, discounting and rediscounting bonafide commercial bills or promissory notes of industrial concerns including bills arising out of sale of indigenous machinery on deferred payment basis;
vii. Financing turnkey projects by Indians outside India and providing credit to foreigners for buying capital goods from India;
viii. Planning, promoting and developing industries to fill gaps in the, industrial, structure of the country. The Bank may undertake promotional activities like marketing and investment research, techno-economic surveys, etc.
ix. Providing technical and managerial assistance for promotion and expansion of industrial undertakings;
x. Coordinating and regulating the activities of other financial institutions.

Besides providing assistance to industry directly, IDBI also provides assistance to industries through other financial institutions and banks. IDBI provides project finance for new projects and for expansion, diversification and modernisation of existing projects. IDBI also, provides equipment finance, asset credit, corporate loans, working capital loans, refinance, rediscounting, and fee based services (e.g., merchant banking, mortgage, trusteeship, forex services).

Thus, the Bank performs financial, promotional and coordinating functions. As an apex institution in the field of development banking, the IDBI supplements and coordinates the activities of various national and State level financial institutions in the country.

The IDBI has been given wide powers and it enjoys full operational autonomy. The Bank can provide financial assistance directly as well as through other institutions to all types of industrial concerns irrespective of their size or form of ownership. There are no maximum or minimum limits on the amount of assistance or security. The Bank has the freedom to deal with any problem relating to industrial development in general and industrial finance in particular.

The IDBI has created a special fund known as Development Assistance Fund to assist industrial concerns which are not able to get assistance from normal sources. It makes available foreign funds to industrial concerns.

Management:

IDBI is managed by a Board of Directors consisting of 22 directors including the chairman. The directors are elected by the shareholders of the IDBI. The IDBI has four regional offices at Mumbai, Kolkata, Chennai and Delhi in addition to the held office.

Working:

In the sixties, the IDBI directed its financial assistance at capital intensive industries. During seventies and eighties the focus was on technology up gradation, import substitution and export promotion and venture capital funding. During nineties the IDBI responded to the liberalized environment by offering new services like asset credit, equipment leasing and bridge loans for pollution control and energy conservation. A sharp focus has also been given to non-fund based activities like merchant banking, debenture trusteeship, and foreign exchange services. IDBI has been assisting backward areas, small scale sector and sick units.

The IDBI has sponsored/co-sponsored the following institutions

i. Credit Analysis and Research (CARE) Ltd.
ii. Investor Services of India Ltd. (ISIL)
iii. National Stock Exchange (NSE)
iv. A merchant banking outfit in collaboration with Asian Capital Partners, Hong Kong
v. IDBI Capital Market Services Ltd. (ICMS)
vi. Small Industries Development Bank of India (SIDBI) IDBI Intech Ltd.
vii. IDBI Trusteeship Services Ltd. (ITSL)

viii. National Securities Depository Ltd.
ix. Entrepreneurship Development Institute of India (EDII)
x. IDBI Bank Ltd.

Restructuring of IDBI:

On 30th December 2003, the parliament enacted, The IDBI (Transfer of Undertaking and Repeal) Act, 2003 to convert IDBI into a banking company. On October 1, 2004 IDBI Bank Ltd. was merged into IDBI.

IDBI's strengths lie in:

- Diversified portfolio across different industries, regions and sectors.
- Long-standing business relationships with all major industrial houses.
- Proven core competence in Project financing.
- Large balance sheet and sound financials.
- Capacity to take large single party exposure.
- Capacity to Leverage.
- Sizeable stock of cost-effective, long-term funds.
- Fairly good retail network with a large investor’s base.
- Lean organisation with a sizeable pool of qualified experienced professionals.

Further, the authorized capital of IDBI was raised to Rs. 1,000 crores and it can be raised further up to Rs. 2,000 crores by the Central Government by a notification in the official gazette.

As an apex development bank, the IDBI has been playing a leading role in the field of industrial finance and promotion. Over the last two and a half decades, the bank has evolved new areas of promotional activities to meet the emerging needs for development of industry. It has also strengthened the institutional structure of industrial finance in the country with effective and appropriate linkages among the development financing institutions based on· coordinated policies and practices. It provides resource support to State level institutions by way of refinance facilities and certain special schemes.

Although the direct financing by the IDBI is confined, by and large, to the medium and large-scale units, it has been assisting the small-scale sector through its contribution, to several special schemes and resource support to the State level institutions.

The IDBI provides the following types of financial and promotional assistance:

(i) Term loans (both rupee and foreign currency).

(ii) Underwriting of and subscription to shares and debentures.

(iii) Financial guarantees for deferred credits and loans raised from other sources.

(iv) Soft loan assistance for modernisation.

(v) Under the Technical Development Fund Schemes, matching rupee resources by way of direct loans to industrial units which are recipients of import licenses under T.D.F. Scheme of Government of India.

(vi) Under the Equipment Finance Scheme, loan assistance for import of capital goods or equipments by existing industries against IDBI credit or for imports covered by T.D.F. licenses.

(vii) Under the Technical Assistance Fund Scheme:

(a) Assistance for Entrepreneurship Development Programmes;

(b) Assistance for self-employment of blind and handicapped.

(c) Subsidy for turnkey arrangements entrusted to approve technical consultancy organisation (TCOs).

(viii) Seed capital assistance through SFCs and SIDCs to new entrepreneurs who do not have adequate source of their own for setting up industrial projects.

(ix) Refinance facilities to State level financial institutions and banks for providing assistance to small and medium industrial projects.

(x) 100 per cent refinance in respect of composite term loan up to Rs.25,000 sanctioned to artisans, village and cottage industries and SSI units in tiny sector and projects promoted by SC/ST and physically handicapped.

(xi) Special scheme of concessional refinance assistance to small scale units covered under the credit guarantee scheme.

(xii) Refinance against loans up to Rs.2 lakhs granted to technician entrepreneurs by SFCs without insisting on promoter's contribution and at concessional rate of interest.

(xiii) Concessional finance for industries in the notified backward areas.

(xiv) Under the Textile Modernisation Fund Scheme, assistance for modernisation on concessional terms to spinning and composite textile and woolen mills.

(xv) Under the Venture Capital Fund Scheme, financial assistance for projects involving development and use of indigenous technology as well as for adaptation and use of imported technology.

(xvi) Under the Technology Up gradation Scheme; assistance for selected capital goods industries.

(xvii) Scheme for providing Automatic Stand by Credit for payment of enhanced customs duty on project imports.

IDBI provides financial assistance to cottage, tiny, small and medium enterprises through:

(i) refinance of industrial loans granted by SFCs, SIDs, commercial/co-operative and regional rural banks:

(ii) rediscounting of bills arising out of sale of indigenous machinery;

(iii) seed capital assistance to new entrepreneurs;

(iv) Resource support to SFCs, SSIDCs and NSIC by way of subscription to shares and bonds.

In order to step up the flow of assistance to the small sector and to provide a focal point to coordinate at the apex level the availability of both financial and non-financial inputs required for the orderly and healthy growth of this sector, the IDBI established in May 1986 Small Industries Development Fund (SIDF). In fulfillment of these objectives, the Bank took a variety of measures to increase the flow of assistance to this sector. Besides liberalizing the terms of existing schemes, new schemes were introduced in favour of such special target groups as women entrepreneurs and ex-servicemen. Assistance is also made available for such purposes as financing in-house quality testing facilities, common quality testing centers, setting up of Training-cum - Development Centers in north-eastern states of the country, etc.

5.2.1 SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA (SIDBI)

SIDBI was set up on April 2, 1990 under a special Act of Parliament, as a wholly owned subsidiary of the IDBI. SIDBI took over the outstanding portfolio of IDBI relating to the small scale sector worth over Rs. 4,000 crores. It has taken over the responsibility of administering small Industries Development Fund and National Equity Fund which were earlier administered by IDBI. SIDBI was delinked from the IDBI through the SIDBI (Amendment) Act, 2000 with effect from March 27, 2000. Its management vests with an elected Board of Directors.

Objectives:

SIDBI was envisaged as the principal financial institution for the promotion, financing and development of industry in the small scale sector and to coordinate the functions of other institutions engaged in the promotion, financing and developing industry in the small scale sector and for matters connected therewith or incidental thereto.

Thus, financing, promotion, development, and coordination are the ba~ic objectives of SIDBI.

Functions:

SIDBI's main functions are:

i. Refinancing loans and advances extended by primary lending institutions to small scale industrial units.

ii. Discounting and rediscounting bills arising from sale of machinery to or manufactured by industrial units in the small Stale sector.

iii. Extending need capital/soft loan assistance under National Equity Fund, Mahila Udyam Nidhi, Mahila Vikas Nidhi and through specified agencies.

iv. Granting direct assistance and refinance for financing exports of products manufactured in the small scale sector.

v. Extending support to State Small Industries Development Corporations (SSIDCs) for providing scarce raw materials to and marketing the end products of industrial units in the small scale sector.

vi. Providing financial support to National Small Industries Corporation (NSIO) for providing leasing, hire-purchase and marketing support to industrial units in the small scale sector.

vii. Providing services like leasing, factoring, etc. to industrial concerns in the small scale sector.

Working:

SIDBI provides both term loans and working capital loans as well as equity finance. Assistance is provided for new projects, expansion, diversification and modernisation of existing units, for quality improvement, marketing and rehabilitation of sick units in the small scale sector. SIDBI makes use of the network of banks and state level institutions to enhance the flow of finance to small scale sector.

Besides financing, SJDBI provides development and support services under its Promotional and Developmental (P&D) schemes. Through such assistance it seeks to ensure enterprise promotion, technology upgradation, market promotion, human resource development, information dissemination, and quality management. SIDBI Foundation for Micro credit, Mahila Vikas Nidhi, Rural Industries Programme, Entrepreneurship Development Programmes, Management Development Programmes, and Environment Management are the thrust areas of SIDBI's P&D activities.

Under refinance assistance SIDBI operates special schemes like Single Window Scheme, Composite Loan Scheme and Equipment Refinance Scheme. It also runs Venture Capital Assistance and Scheme for Ex-servicemen. There is a Credit Guarantee Fund Scheme also. SIDE I is promoting employment-oriented industries especially in semi-urban areas to create more employment opportunities so as to check migration of rural population to cities.

Check Your Progress-2

What are the functions of IDBI?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

5.3 INDUSTRIAL FINANCE CORPORATION

The Industrial Finance Corporation o(India was established in 1948 under the IFCI Act, with the object of making medium and long-term credit more readily available to industrial concerns in India. Today, IFCI's role extends to the entire industrial spectrum of toe country. While it continues to be one of the important purveyors of direct financial assistance to eligible industrial concerns, no less important is its promotional role whereby it has been helping and developing the small and medium-scale industrial entrepreneurs by providing them much needed guidance through its specialized agencies in project identification, formulation and implementation, development of ancillary and small-scale industries, encouraging the adoption of indigenous technology, etc.

As in the case of the recent amendments to the IDBI Act, the amendment to the IFCI Act has broadened the scope of business of the Corporation and enlarged the list of industrial activities eligible for assistance by inclusion of informatics, health care etc.

Direct financing is the Corporation's main business, ·the assistance under which can take anyone or more of the following forms:

(i) Rupee loans;

(ii) Sub-loans in foreign currencies out of the foreign exchange lines of credit made available to it;

(iii) Underwriting of and/or direct subscription to the shares and debentures of public limited companies; and

(iv) Guaranteeing of.-

   a) Deferred payments for machinery imported from abroad or purchased within-the country;

   b) Foreign currency loans raised by industrial concerns from foreign institutions~ and

   c) Rupee loans raised by industrial concerns from Scheduled banks or state Co-operative Banks or the market.

Like the other all-India development banks, IFCI also provides concessional finance to industrial units in notified backward areas.

IFCI has been designated as the nodal point to administer the Jute Modernisation Fund set up by the Government of India and which became operative from November, 1986, with a view to revitalizing the jute industry and giving thrust to its modernisation programme.

Further IFCl has been appointed as agent of the Government of India for making disbursement of loans from the Sugar Development Fund for rehabilitation and modernisation of sugar units and monitoring the end use of loans and affecting recoveries.

Being a development bank, the IFCI has been undertaking a number of development activities. These include the following.

(i) Guidance to new, tiny, small- scale and medium-Scale entrepreneurs in project identification, formulation, implementation, operation etc.

(ii) Help to new and small entrepreneurs by subsidizing the cost of Feasibility /Project Reports, market studies, diagnostic studies, revival of sick units, development of technology and in – house R&D efforts.

(iii) The Risk Capital Foundation (RCF) sponsored by the IFCI (established in 1976) provides risk capital assistance on soft terms to the first generation entrepreneurs to make good the shortfall in the requirement of promoters contribution to the equity capital of the medium and medium-large industrial projects promoted by them in the cost-range of Rs.2 crores to Rs.15 crores. No interest is charged on the loans given by RCF, except a nominal service charge. The assistance is normally limited to 50 per cent of the promoter's contribution excluding the contribution from SIDC and/or other similar public sector financial institutions to the equity of a project.

During 1986-87, the Corporation introduced the Scheme of Interest, Subsidy for Encouraging Quality Control Measures in Small-Scale Sector.

Recently, IFCI has set up a Merchant Banking DJ vision (MBD) with its head office at Delhi and bureau in Bombay. The MBD undertakes assignments for capital restructuring, merger and amalgamation, loan syndication with other financial institutions, and. trusteeship assignments. It guides entrepreneurs in project formulation and raising resources for meeting project costs.

The IFCI was established on July 1, 1948 by a special Act of the Parliament. It was jointly owned by the Government of India, the RBI and financial institutions. The IFCI has since been converted into a public limited company with effect from July 1, 1993. This was done to enable the IFCI to reshape its business strategies with greater authority, tap the capital market for funds, expand its equity base and provide better customer services. It is now known as IFCI Ltd.

Objects:

IFCI has been set up for making medium and long-term credits more readily available to industrial concerns in India, particularly in circumstances where normal banking facilities are inappropriate or recourse to capital issue methods is impracticable. The corporation aims at assisting industrial concerns which have carefully considered schemes for manufacture or for modernisation and expansion of a plant for the purpose of increasing their productive efficiency and capacity. Now, public sector undertakings can also avail of assistance from the corporation.

IFCI provides project finance, merchant banking, suppliers credit, equipment leasing, finance to leasing and hire-purchase concerns, etc. and promotional services.

The corporation gives priority to development of backward areas, new entrepreneurs and technocrats, indigenous technology, ancillary industries, cooperative sector, import substitution and export promotion.

The focus of IFCI is on providing financial assistance to public companies and cooperative societies engaged in manufacturing, mining, shipping, hotel business, etc.

Functions, Scope and Forms of Assistance

i. Granting loans and advances to or subscribing to debentures of industrial concerns.
ii. Guaranteeing loans raised by industrial concerns from the capital market, scheduled banks or State cooperative banks.
iii. Providing guarantees in respect of deferred payments for imports of capital goods manufactured in India.
iv. Guaranteeing with the approval of the Central Government, loans raised frdIllor credit arrangements made by industrial concerns with any bank or financial institution outside India.
v. Underwriting the issue of shares and debentures by industrial concerns.
vi. Subscribing directly to the shares and debentures of industrial concerns. (Vii) Acting as an agent of the Central Government and World Bank in respect of loans sanctioned by them to industrial concerns in India.
vii. Participating along with other all India term lending institutions, in the administration of the Soft Loan Scheme for modernisatibn and rehabilitation of sick industries.
viii. Providing financial assistance on concessional terms for setting up industrial projects in backward areas notified by the Central Government.
ix. Providing guidance in project planning and implementation through specialised agencies like Technical Consultancy Organisations.

The financial assistance is available for setting up of new projects as well as for the expansion, diversification, and modernisation of existing units. IFCI Ltd. also provides financial assistance to industrial concerns not tied to any project. The following schemes of assistance have been introduced for this purpose: (i) Equipment learning, (ii) Suppliers credit, and (iii) Buyers credit. Indirect finance is provided as assistance to leasing companies. Now IFCI also provides short-term loans for working capital purposes.

Management:

IFCI is now a joint stock company owned and managed by the Government. Government has been vested with wide powers over the corporation and it is expected to carry out the policy set out by the Government. The day-to-day management of the corporation is vested in a Board of Directors consisting of a whole time chairman and twelve directors. The chairman is appointed by the Central Government in consultation with the Industrial Development Bank of India. Two directors are nominated by the Central Government four by the IDBI and the remaining six directors are elected by the shareholders other than the IDBI. The Board of Directors will act on business principles with due regard to the interests of trade, industry and general public. There is also a Central Committee comprising the chairman and four directors.

Working:

IFCI has completed more than fifty years of operations. During this period, the activities of the corporation have progressively expanded both in scope and magnitude. It has emerged as a leading institution providing financial and other assistance to industry in diverse forms. IFCI also diversified into merchant banking, project counseling, loan syndication, and rehabilitation programmes, etc.

Before sanctioning assistance to any concern, the IFCI evaluates the proposal in terms of the following criteria:

i. The importance of the industry in the national economy, (ii) the feasibility and the cost of the project,
ii. The competence of the management,
iii. The nature of the security offered,
iv. The adequacy of the supply of technical personnel end raw materials, and
v. The country's requirements of the product manufactured and its quality.

Institutions Promoted by IFCI

i. Tourism Finance Corporation of India (TFCI) Ltd.,
ii. Management Development Institute (MDI),
iii. Technical Consultancy Organisations (TCDs),
iv. Investment Information and Credit Rating Agency of India (ICRA) Ltd.,
v. Institute of Labour Development (ILD),
vi. Tourism Advisory and Financial Services Corporation of India Ltd.

Subsidiary Companies of IFCI:

(i) IFCI Financial Services Ltd.,

(ii) IFCI Venture Capital Funds Ltd.

Evaluation:

The IFCI has been criticized due to the following reasons:

i. Assistance sanctioned for new projects has been only about 20 per cent of the total assistance.
ii. Equity finance has been very little as compared to debt finance.
iii. Adequate focus has not been laid on backward regions and small scale sector;
iv. Percentage share of infrastructure projects in the total loans outstanding is just about 13 per cent.
v. There has been a sharp fall in the assistance provided in foreign currency.
vi. The income of the IFCI has fallen sharply.
vii. The non-performing assets of the IFCI are very high (more than 20 per cent) of the total net assets. Its capital adequacy ratio has fallen to less than one per cent.

Inspite of recapitalization and restructuring of liabilities, the financial position of the IFCI deteriorated so much that in January, 2004 Government of India proposed to merge it with the Punjab National Bank. But the employees of the IFCI have questioned the rationale of the proposed merger.

5.4 INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

The Industrial credit and Investment Corporation of India Limited (ICICI) was set up in 1955 to encourage and assist industrial development in India.

Its objectives, inter alia, include:

(i) providing assistance in the creation, expansion and modernisation of industrial enterprises;

(ii) encouraging and promoting the participation of private capital, both internal and external in such enterprises; and

(iii) Encouraging and promoting industrial investment and the expansion of investment markets.

In pursuit of its objective of promoting industrial development, ICICI provides financial assistance in various forms such as

(a) Underwriting of public and private issues and offers of sale of industrial securities-ordinary shares, preference shares, bonds and debenture stock;

(b) Direct subscription to such securities;

(c) Securing loans in rupees, repayable over periods up to 15 years;

(d) Providing similar loans in foreign currencies for payment for imported capital equipment and technical services;

(e) Guaranteeing payments for credits made by others;

(f) Providing credit facilities to manufacturers for promoting sa1e of industrial equipment on deferred payment terms.

ICICI sells securities from its own portfolio to investors whenever it can get a reasonable price for them. It does so for the dual purpose of revolving its resources for new investments and for encouraging the investment habit in others, thereby promoting widespread distribution of private industrial securities. Thus, unlike the normal investor, ICICI does not retain successful investments merely because they are profitable. On the contrary, dissemination of profitable investments is in accord with its broad objectives and the form of ICICI's own investment in a particular enterprise is often influenced by the prospect of selling it eventually.

The primary purpose for which assistance is extended is purchase of capital assets in the form of land, buildings and machinery. Of the alternative types of assistance provided by ICICI, the one best calculated to assure the success of enterprises is chosen in each case.

A significant feature of ICICI's operations is the relatively high share of foreign currency loans in its assistance portfolio compared to other all India development banks.

Towards the national objective of development of backward regions, ICICI has been extending financial assistance on concessional terms to new, projects located in backward areas.

ICICI played an active role in the techno-economic surveys of various ~ States under the initiative of the all India financial institutions. The surveys were carried out to determine the industrial potential of the selected States and to suggest measures for realizing such potential. The effort was to identify specific projects based on local resources, which would be of maximum benefit to the economy.

Functions:

ICICI provides assistance in the following ways:

i. Granting medium and long-term rupee loans to industrial concerns.
ii. Advancing loans in foreign currencies towards the cost of imported capital equipment.
iii. Providing guarantees to the loans raised by companies in the open market.
iv. Sponsoring and underwriting new issues of industrial securities.
v. Subscribing directly to shares and debentures of companies.
vi. Making funds available for reinvestment by revolving investments as rapidly as prudent.

vii. Providing technical and managerial know-how to industries.
viii. Assisting industrial concerns in obtaining technical and administrative services from internal and external sources.
ix. Encouraging the participation of private capital (both internal and external) in industrial concerns.

Management:

Management of the ICICI is vested in a Board of Directors consisting of a full-time chairman cum managing director and eleven directors. One director is nominated by the Central Government; seven directors are elected by the Indian Shareholders and three by the foreign shareholders. There are a few committees to assist the Board of Directors.

The ICICI Bank thus provides both project finance, corporate finance and retail finance. It also undertakes fee based services and capital market operations. In fact the organisational structure of the ICICI Bank consists of five principal groups:

1. Retail Banking.
2. Wholesale Banking.
3. Project Finance and Special Assets Management.
4. International Business.
5. Corporate Centre.

The merger of the ICICI with the ICICI Bank has strengthened the financial position of the combined entity.

Subsidiaries of ICICI Bank Ltd.

i. ICICI Securities Ltd.
ii. ICICI Brokerage Services Ltd.
iii. ICICI Venture Funds Management Co. Ltd.
iv. ICICI Prudential Life Insurance Co. Ltd.
v. ICICI Lombard General Insurance Co. Ltd. ICICI Home Finance Company Ltd.
vi. ICICI Investment Management Company Ltd. ICICI Trusteeship Services Ltd.·
vii. ICICI Securities Holdings Inc.
viii. ICICI Secl1rities Inc.
ix. ICICI International Ltd.

Working:

The ICICI has played a vital role in the development of industries in the private sector and in strengthening the capital market in the country. It has become the largest supplier of foreign currency to private sector industries. It has made significant efforts in promoting investments in information technology, agro based industries, energy conservation, pollution control, export orientation and computerization. For this purpose it has been carrying on leasing operations. The ICICI has established the Housing Development and Finance Corporation (HDFC) Ltd. for financing housing schemes. It has also sponsored the Institute of Financial Management and Research for training and research in the field of financial management.

ICICI has played a leading role in the areas of venture capital. It launched a Programme for Acceleration of Commercial Energy Research (PACER). It promoted Technology Development and Information Company of India (TDICI) Ltd. to widen technology development in the country. ICICI assisted in setting up the Credit Rating and Information Services of India Ltd. (CRISIL). It also administers the Programme for the Advancement of Commercial Technology (PACT).

ICICI has established Indian Investment Centre (IIC) to encourage the participation of foreign capital in Indian industries. It has emerged as the pioneer in the field of underwriting by developing consortium underwriting in cooperation with other institutions. The Corporation has set up a Merchant Banking Division to promote a healthy capital market. It has a Project Promotion Department for developing backward regions. It is also providing soft loans for the modernisation and rehabilitation of sick industries.

ICICI provides financial assistance to private sector enterprises for expansion and modernisation. It offers deferred credit, leasing credit, asset credit and venture capital. It provides technical consultancy and managerial know how to industries in India. It encourages flow of private and foreign investment in the country.

ICICI Bank Ltd. is listed on the New York Stock Exchange and has successfully floated ADRs and GDRs. It launched infinity the first internet banking service in India.

ICICI, in consortium with IDBI and IFCI, operates the Soft Loan Scheme for modernisation of industrial concerns in cement, sugar, cotton textiles, jute and certain engineering industries.

Consistent with its corporate philosophy and its role as an experienced development bank, ICICI provides promotional assistance to worthwhile projects. The Corporation has provided, on a formal basis since 1973, promotional assistance like identification of new projects on the one hand and location of suitable entrepreneurs on the other. In selecting projects for this purpose preference is given to those with a potential to cover immediate and emergent gaps in the economy. Special consideration is also given to new products and processes. It provides comprehensive guidance to entrepreneurs on elected projects for their formulation on sound lines and expeditious maturing to a bankable stage. In suitable cases a small fee is charged for these services. The regional offices of the Corporation also contribute to these activities and serve as convenient contact points for entrepreneurs.

ICICI started a Merchant Banking Division in 1973 for advising clients, on a selective basis, on raising finances in suitable forms and on restructuring of finances in existing companies. It also advises clients on amalgamation proposals. Assistance is provided in preparing proposals for submission to financial institutions and banks for negotiations with them for loam and underwriting. The Division acts as Managers to the Issue of Capital. Assistance is provided for completion of formalities connected with the public issue and of legal formalities for raising loans. ICICI charges a suitable fee for these services.

The Corporation has taken some initiatives in the field of rural development since 1976. It has assisted, on an experimental basis, projects of landscaping, agricultural research and lift irrigation.

The Corporation's interest and initiative in rural development activity was enlarged during 1977 and Rs.25 lakhs were earmarked for projects of rural development to be taken up in association with industrial units and voluntary social service organizations.

ICICI considers financial assistance on liberal terms to suitable rural development schemes initiated either by voluntary organizations or corporate bodies. The scheme should have a demonstration value and be replicable in other rural areas. They should aim at improving living conditions of the rural population and their impact should be measurable. For bankable rural development schemes, ICICI extends financial assistance in the form of seed money/margin money or suitable interest rate subsidy. For other deserving but non-bankable schemes, ICICI extends financial support depending on their merit and requirements.

ICICI has been instrumental in setting up the institute for Financial Management and Research at Madras. The Institute has been conducting specialized courses and carrying on research in the field of financial management.

An important development initiative taken by ICICI resulted in the formation of Housing Development Finance Corporation Limited (HDFC) in 1977. HDFC provides long-term loans on reasonable terms, primarily for lower and middle income group housing.

The ICICI which commenced leasing operations in 1983, provides leasing assistance for computerization, modernisation/replacement schemes, equipment for energy conservation, export orientation, pollution control, balancing and expansion. The industries assisted under leasing include textiles, engineering, chemicals, fertilizers, cement, sugar etc. ICICI has made significant efforts in promoting investments in information technology, service industry like hotels and agro-based sectors like hatchery and poultry.

In 1987, ICICI launched its Venture Capital Scheme under which long term financial assistance is extended to projects involving development and or commercialization of new technologies, for which entrepreneurs, due to inherent high risks, may not be able to raise funds through conventional lending mechanisms. The assistance is provided in the form of participation in share capital, conditional loans and-normal loans.

The Corporation is administering and managing the Programme for the Advancement of Commercial Technology (PACT) which commenced with a grant of US $ 10 million from the United States Agency for International Development (USAID). The primary emphasis of PACT is on market oriented R & D activity from which India and USA would derive economic benefit.

ICICI provides special assistance to technology development projects based on indigenous R&D efforts.

In order to broad-base technology development oriented activities, the Corporation has promoted a new company called Technology Development and Information Company of India-Ltd. (TDICI) The major functions of TDICI would be technology financing and technology information. Technology financing will include financing of commercial R&D schemes through grants and conditional loans, venture capital financing and technology up gradation financing.

The Credit Rating Services of India Limited (CRISIL) promoted by ICICI became operational in 1987. CRISIL, in whose equity banks and financial institutions have participated, is an independent organisation managed professionally.

Check Your Progress-3

What are promotional activities carried out by ICICI?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

5.5 INDUSTRIAL RECONSTRUCTION BANK OF INDIA

In 1971, the Government of India established an institution, namely, Industrial Reconstruction Corporation of India (IRCI), with the main objective of reconstruction and rehabilitation of industrial units which were closed down or were facing the risk of closure but which could be made viable with suitable assistance.

The need for a more powerful institution to deal with the problem of industrial sickness was felt and on March 20, 1985, the Industrial Reconstruction Bank of India (IRBI) was established as per the provisions of the Industrial Reconstruction Bank of India Act, 1984, and the erstwhile Industrial Reconstruction Corporation of India was vested and transferred to the IRBI 011 that date.

The IRBI functions as the principal all-India credit and reconstruction agency for industrial revival, assisting and promoting industrial development and rehabilitating industrial concerns. It has also to co-ordinate similar work of other institutions engaged in this field.

The IRBI gives loans for modernisation, diversification, expansion and renovation as also for meeting supplementary needs such as bridging liquidity gap and for working capital requirements. The other forms of assistance include lines of credit, equipment leasing, hire purchase, etc. The Bank extends assistance to sick small-scale units under its line of credit scheme, which is operated through various State level agencies.

To arrest sickness at its incipient stage or to prevent any unit firm falling to sickness, the IRBI has been emphasizing the need to obtain economic size of operation, modernisation, diversification, technological up gradation etc. of its assisted units, either singly or jointly in consortium with other all-India financial institutions. The IRBI also provides consultancy services to banks and financial institutions on a selective basis and merchant banking services for amalgamation/merger and reconstruction.

5.6 STOCK HOLDING CORPORATION OF INDIA

A new company, namely, the Stock Holding Corporation of India Ltd. (SHCI), was recently established with its registered office in Bombay order to secure efficient post trade processing services for transactions in securities carried out by the all-India financial and investment institutions (IDBI, IFCI, ICICI, lRBI, LIC, UTI and GlC). SHCI is owned at the outset by the seven sponsoring institutions. It would hold custody of securities of the sponsoring institutions and handle transfer of-securities as also collection of dividend/interest in respect of such securities on their behalf. After setting up the infrastructural facilities and gaining experience in the field, SHCI would, extend its services to others such as stock-brokers and individual investors when it would make a public issue of share capital.

5.7 DISCOUNT AND FINANCE HOUSE OF INDIA

The Reserve Bank of India, together with public sector banks and financial institutions, has recently set up a company called the Discount and Finance House of India Limited (DFHI), to deal in short-term assets in order to provide liquidity in the money market.

The SFCs do not normally lend more than Rs.60 lakhs to a single concern. The prohibition is intended to ensure that the SFCs do not deviate from the main objective of their creation, namely, catering to the requirements of the small and medium-scale sectors. The large concerns can approach the all-India financial institutions - IFC, IDBI and ICICI.

Loans or advances are granted primarily -for the establishment of new industries or for expansion and development of existing industrial concerns. Loans to the new industrial concerns will be considered where a feasible scheme has been prepared and the initial capital has been collected by the prospective industrial unit. In case of existing industrial concerns loans are granted for the purpose of expansion or renovation of units. In both the cases, loans are granted for the purpose of acquiring tangible assets in the form of land; building, plant and machinery and other accessories. Foreign currency loans are granted for importing plant and machinery, other accessories and - machine tools and technical know-how in special cases. With the exception of shipping, SFCs' are now empowered to assist all industrial activities including mining, transport by ropeways and development of industrial areas.

Types of Assistance

Financial assistance from State 'Financial Corporations takes the following forms:

(i) Granting of loans or advances and subscribing to the debentures of industrial concerns, repayable within a period of not exceeding twenty years.

(ii) Guaranteeing loans raised by industrial concerns in the capital market or from scheduled banks or state co-operative banks.

(iii) Guaranteeing deferred payments due from any industrial concern in connection with its purchase of capital goods within India.

(iv) Underwriting the issues of stocks, shares, bonds or debentures by industrial concerns.

(v) Subscribing to the stocks, bonds or debentures of an industrial concern out of the funds representing the special class of share capital subscribed by the State Government and the IDBI in accordance with the provisions Of Section 4A of the SFCs Act, 1951.

The main activity of the SFCs is providing loans and some of them also underwrite shares of industrial concerns. The SFCs grant loans mainly for the acquisition of fixed assets like land, buildings and plant and machinery. Sometimes, they also provide loans for working capital margin in combination with loans for acquisition of fixed assets.

SFCs are also providing foreign currency loans to small and medium scale industrial units for import of plant and machinery and/or technical know-how under the IDA - World Bank credits to IDBI.

5.7.1 INDUSTRIAL INVESTMENT BANK OF INDIA (IIBI)

In 1971, Industrial Reconstruction Corporation of India (IRCI) was set up to revive and rehabilitate sick and weak industrial units. Industrial Reconstruction Bank of India (IRBI) was set up on March 26, 1985 as a statutory corporation. It was set up as the principal credit and reconstruction agency for industrial revival in the country. It was primarily entrusted with the task of reviving the sick industrial concerns. The IREI was converted into a government company with effect from March 27, 1997 and was renamed as IIB1. The restructuring was done to provide adequate operational flexibility and functional autonomy. At present the Government owns the entire share capital. But IIBI is permitted to access the capital market for additional equity.

Functions:

As a full fledged development bank, the IIBI now undertakes the following functions:

i. Granting medium and long-term loans.
ii. Providing hire-purchase of equipment, leasing finance and finance for the purpose of buying assets.
iii. Underwriting shares and debentures.
iv. Subscribing directly to shares and debentures. (v) Guaranteeing deferred payments.
v. Granting short-term working capital loans.

The IIBI lays emphasis on up gradation of technology and improving productive capacity which are very essential for the long-term viability of the assisted units. For the sick/weak industrial units, assistance is provided for capital expenditure, acquisition of balancing equipment, etc. For non-sick units or units who are in their incipient stage of sickness, assistance is also provided to prevent sickness. The IIBI also provides assistance for acquiring pollution control equipment. It provides loans to individuals also for housing, professional and personal needs.

IIBI has diversified into ancillary activities such as consultancy services, merchant banking and equipment leasing.

The IIBI is facing a difficult financial position due to mounting non-performing assets and low capital adequacy ratio. The Government feels that the IIBI cannot survive alone and is thinking of merging it with the IDBI.

5.8 STATE FINANCIAL CORPORATIONS

The State Financial Corporations Act, 1951, has enabled the State Governments to set up State Financial Corporations (SFCs) to function as regional development banks, making a significant contribution to the industrial advancement of their respective States.

The SFCs are meant to finance small and medium-scale industries.

Apart from their share capital, the SFCs depend for financial resources, on repayment of loans and income from investments, issue of bonds, refinancing of loans from the IDBI and to a limited extent on borrowings from the RBI, deposits from the public, and occasionally loans from the State Governments.

The IFCI does not provide finance to all types of enterprises. It provides financial assistance to large public companies and cooperative societies. Therefore, need was felt for state level financial institutions to meet the financial needs of local, medium and small sized industries. On September 28, 1951 the Parliament passed the State Financial Corporations Act. It empowered the State Governments to establish financial institutions for their local limits.

Objects:

The main aim of State Financial Corporations (SFCs) is to provide finance to medium and small scale industries and other enterprises which are outside the purview of the IFCI. Proprietary and partnership firms and joint stock companies and cooperative societies are authorized to borrow funds from these corporations. SFCs seek to supplement the operations of the IFCI.

Functions:

The State Financial Corporations are authorized to provide financial assistance in the following forms:

i. Granting loans or advances and subscribing to the debentures of industrial concerns;

ii. Guaranteeing loans raised by industrial Concerns on such terms and conditions as may be mutually agreed upon.

iii. Underwriting shares, debentures and other industrial securities;

iv. Guaranteeing deferred payments for the purchase of capital goods within India;

v. Acting as the agent of Central and State Governments in the matter of disbursing loans to small scale units.

vi. SFCs have also been entrusted with the International Development Association (IDA) credit for assisting small and medium industrial units; and

vii. Rediscounting bills of small scale units.

Management:

Each State Financial Corporation is managed by a Board of Directors consisting of a managing director and nine other directors. Four directors (including the Managing Director) are nominated by the State Government and one each by the IFCI and the Reserve Bank of India. The remaining four directors are elected by the outside shareholders. There is also an Executive Committee selected by the Board of Directors.

Working:

At present eighteen SFCs are working in the country. In most of the States, these corporations are providing concessional finance to small scale industries on behalf of the State Governments. The bulk of the assistance is granted by SFCs to small scale industries including road transport operators. SFCs have granted liberal financial assistance on concessional terms to industrial units in the specified backward areas and to technician entrepreneurs. SFCs sanction and disburse seed capital assistance of IDBI to women and other entrepreneurs.

The State Financial Corporations face several problems and difficulties in practice. It is very difficult to assess correctly the financial position and credit-worthiness of applicants due to lack of systematic, up-to-date and audited accounts. Many applicants are not able to provide adequate security and about 27 per cent of the outstanding loans are overdue. The SFCs must playas purveyor of term credit to small scale sector and unemployed, particularly in backward areas. They must take measures to ensure that loans granted are invested in viable projects. They must monitor the progress of the borrowing concerns.

Criticism:

The functioning of SFCs has been criticized on the following grounds:

i. There is unnecessary delay in sanctioning and disbursement of loans.

ii. The rate of interest charged from borrowers is very high.

iii. There is nepotism and favouritism in granting loans.

iv. SFCs have limited financial resources due to small capital base.

v. Management is bureaucratic and there is lack of professional attitude:

There is an urgent need to augment the financial resources of SFCs. An efficient organisational and managerial structure is required. Assistance granted is inadequate for the growing needs of industry. SFCs should reduce procedural delays and cost involved in providing assistance. Proper arrangements should be made for training and development of executive staff of SFCs. Focus should shift from traditional industries to new industries and backward areas. Efforts are being made to liberalize the terms and conditions on which the SFCs sanction financial assistance to industrial concerns.

Most SFCs are broke. A committee headed by former IDBI chairman G.P. Gupta had estimated in early 2001 that 12 out of 18 SFCs had their net worth wiped out. The committee recommended recapitalization of SFCs, subject to restructuring. Keeping SFCs afloat is necessary to maintain the flow of funds to small and medium enterprises, particularly new ventures. Merger of SFCs into SIDCs (State Industrial Development Corporations) may be considered.

The Government of India amended the State Financial Corporations Act with effect from September 12, 2000. The amendment seeks to equip the SFCs to meet international competition by enlarging the shareholder base and providing operational flexibility and greater functional autonomy to SFCs.

The Working Group on Development Financial Institutions appointed by the RBI submitted its report on May 10, 2004.·The Group concluded that the SFCs have outlived their utility in the present context and should be phased out within a time frame.

5.8.1 STATE INDUSTRIAL DEVELOPMENT/INVESTMENT CORPORATIONS

Since 1960, many States and Union Territories have set up State Industrial Development Corporations (SIDCs)/State Industrial Investment Corporations (SIICs), with the main' object of accelerating the industrial development of the respective States and Union Territories.

The SIDCs/SIICs have been promoted by the State and Union Territories as promotional bodies entrusted with the major task of promoting industries and ensuring balanced regional growth within each State.

For efficiently carrying out the functions of promotion, improvement and development of industries, these Corporations are empowered to plan, formulate and execute industrial undertaking, project or enterprise which is likely to accelerate industrial development. Further, they promote medium/ large industrial ventures as joint sector units in collaboration with private entrepreneurs, or as wholly owned subsidiaries and provide risk capital to new generation entrepreneurs. Various incentive schemes of Central/State Governments are also administered through them.

These Corporations undertake a wide range of functions. The important functions are:

1. Grant of financial assistance to industrial concerns in the form of:
    a. direct investment,
    b. loans,
    c. extension of guarantee for loans and deferred payments, and
    d. underwriting and subscriptions to the issue of shares, bonds and debentures;

2. Promotion and management of industrial concerns;
3. Provision of industrial sheds/plots; and
4. Promotional activities such as identification of project ideas, selection and training of entrepreneurs, provision of technical assistance during project implementation, etc.

The Corporations in States like Karnataka and Bihar are empowered to undertake special activities like establishing and managing industrial estates, development of industrial areas, generation, transmission and sale of electricity etc.

Out of the 26 Corporations in operation in the country in 1986-87, nine were also functioning as SFCs.

SIDCs provide financial assistance to industrial concerns by way of loans, guarantees, underwriting and direction subscription to shares and debentures. In addition SIDCs undertake promotional activities such as techno economic surveys, project identification, feasibility studies, selection and training of entrepreneurs. They also promote joint sector projects in association with private' sector entrepreneurs. SIDCs undertake the development of industrial areas by providing all infrastructural facilities. They administer various incentive schemes of Central and State Governments. They pay special attention to industrial development of backward areas, and small entrepreneurs. Some other institutions are as follows:

1. National Small Industries Corporation (NSIC):

NSIC was set up in 1955 as a fully Government owned company, especially to assist the small scale units through promotional, marketing, financing and other activities. The main functions of NSIC are as follows:

i. Supply of machinery, both indigenous and imported, on hire-purchase basis for setting new units and for modernizing existing units.

ii. Developing prototypes for transfer along with know how to manufacturing units for commercial production.

iii. Providing training in various engineering trades.

iv. Supplying indigenous and imported raw materials on continuing basis.

v. Marketing of products of small scale units both within the country and abroad.

vi. Setting showrooms for regular display of products of small scale units.

vii. Undertaking small industries projects on turnkey basis and providing total services from feasibility studies to installation and commissioning of plant.

2. State Small Industries Development Corporations (SSIDCs):

SSIDCs have been set up to serve the needs of small scale industries in the respective States and Union Territories. They have been established under the Companies Act to undertake a variety of activities for the benefit of small scale industries.

SSIDCs perform the following activities:

i. Procurement and distribution of raw materials;
ii. Supply of machinery on hire-purchase basis;
iii. Operation of seed capital scheme on behalf of the State Governments;
iv. Management assistance to production units;
v. Construction and management of industrial estates;
vi. Undertaking marketing activities; and
vii. Participating with other institutions in setting up of technical consultancy organisations.

In addition, SSIDCs provide infrastructural facilities like sheds, godowns, and common production facilities, technical and consultancy services, particularly to the unemployed, like preparation of feasibility reports, formulation of project reports, planning for modernisation/expansion of product range and implementation of projects. Some SSIDCs have also sponsored industrial potential surveys to identify viable small projects to be based mainly on local raw materials and local demand conditions. SSIDCs also arrange for domestic and export marketing of finished products of small scale units. Many SSIDCs have helped in setting up emporia and showrooms for the products of small scale units. They also organise and participate in exhibitions in various markets.

Khadi and Village Industries Commission (KVIC), Export-Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), Infrastructure Development Finance Company Limited (IDFC), Indian Railway Finance Corporation Ltd., Power Finance Corporation Ltd., Tourism Finance Corporation of India also act as financial and developmental institutions in their respective fields of activities.

LESSON-23

5.9 INVESTMENT INSTITUTIONS

5.9.1 UNIT TRUST OF INDIA

The Unit Trust of India (UTI), a public sector investment institution, was established in 1964 under the Unit Trust of India Act, 1963.

The share capital of the UTI was subscribed by the IOBI, LIC, SBI and its subsidiaries and other scheduled banks and financial institutions. Sale of' units and other savings schemes are the main sources of funds for the Trust

The main objective of the UTI is to mobilize the savings of the community and chanalise them into productive corporate investments so as to provide for growth and diversification of the economy. It is at the same time intended to provide the facility for an equity type of investment to the large and growing number of investors in the small and -medium income groups.

The UTI mobilizes funds from the public through a number of schemes. The savings thus mobilized is channeled into productive activities by the Trust by investing them in the shares and debenture of industrial concerns.

It is one of the main intentions of the UTI to provide opportunity to investors belonging to small and medium income groups to indirectly participate in the ownership of shares and debentures of joint stock companies.

For small investors, the UTI offers the advantages of (i) considerably reduced risk since funds are invested in a balanced and well distribute portfolio (ii) the benefit of expert management; (iii) a steady income; and (iv) liquidity.

The Trust's investment in any one company is restricted to certain specified limits ill the interests of diversification. Its investment is expected to cover a judiciously selected diverse portfolio of securities designed to give to the Unit holder’s security of capital, besides reasonable return and capital appreciation.

Underwriting the public issues of shares and debentures, direct subscription to the shares and debentures and subscription to the privately placed debentures are the usual forms of assistance provided by the UTI to the industries.

The UTI examines the proposals for underwritings from the point of view of financial-liability of projects, prospective earnings from investments to the Trust and prospects of capital appreciation. Consistent with these considerations, the Trust underwrites public issues of equity shares, preference shares and debentures.

The Trust ha5 also joined the Inter- Institutional meeting Forum of all India financial institutions, viz., IDBI, IFCI, ICICI, LIC and GIC under the aegis of the IDBI and the Ul1 indicates its intention to provide financial assistance to the projects in these meetings. For such assistance the Trust follows more or less the norms prescribed by the IOBI.

Particularly in recent years there has been a very substantial increase in the investible funds of the Trust. Several skillfully designed new savings schemes which have enabled the tapping of the savings potentials of various segments have significantly contributed to this growth.

Apart from registering appreciable growth in sales, number of unit holding accounts, investible resources, income and reserves, the UTI has also been one of the significant participants in the share capital of new financial organisations such as Infrastructure Leasing and Financial Services Ltd., Discount and Finance House of India Ltd., Credit Rating Information Services of India Ltd. Stock Holding Corporation of India Ltd. and Can Fin Homes Ltd., which are expected to playa vital role in the improvement and development of the money and capital markets and housing finance in India.

5.9.2 LIFE INSURANCE CORPORATION OF INDIA

Consequent to the decision to nationalize the life insurance business, the Life Insurance Corporation of India was established in 1956 as a wholly owned corporation of government of India in order to carry on the business of life insurance and deploy the savings to the best advantage of the policy holders and the community as a whole.

A large part of the funds of LIC is deployed as loans to assist the development of social overheads like housing, rural electrification, water supply and sewerage schemes.

However, LIC provides substantial assistance to the industrial sector. Besides normal investment operations by way of sale and purchase pf securities in stock markets and investment in government securities, the Corporation has been participating with other all-India institutiol1s in extending direct assistance to industries in the forn1 of loan and direct subscription to shares and debentures of industrial concerns. LIC extends resource support to the term bending institutions by way of subscription to their bonds and thus contributes to industrial financing in an indirect manner. The Corporation also helps small and medium industries by granting loans for setting up of industrial estates.

5.9.3 GENERAL INSURANCE CORPORATION OF INDIA

As a member of the consortium of all-India Financial Institutions, the General Insurance Corporation of India and its four subsidiaries (The United India Insurance Co. Ltd., Oriental Fire and General Insurance Co. Ltd., National Insurance Co. Ltd., and New India Assurance Co. Ltd.) provide assistance to industries in the form of loans, underwriting and direct, subscriptions to, shares and debentures, placement of short-term deposits with companies, etc.

Besides taking right entitlement and underwriting of debenture issues, GIC, along with LIC and UTI buys back debentures tendered by individual holders back to companies for encashment after a stipulated period and thus provide liquidity to such long-term financial assets.

It may be noted that, as per Government guidelines, investment towards socially-oriented purposes (mainly in the form of Central/State, Government securities, bonds of public sector undertakings, etc.) should constitute around 70 per cent of annual investible funds of GIC.

Assessment of the Role of Financial Institutions

The various financial institutions that have been set up after independence have been expected to serve not merely as providers of finance but to act as catalytic agents in the industrialization of the country. These institutions have accomplished their purpose to a large extent.

Positive Impact

i. No project found viable has been denied assistance solely due to paucity of funds.

ii. Long-term finance has been provided at fixed interest rates, thus avoiding uncertainty of cash flows.

iii. A substantial portion of the equity of new projects has been contributed by these institutions.

iv. These institutions have set up special agencies for venture capital funding, leasing, factoring.

Negative Impact

i. Most institutions have laid emphasis on projects promoted by existing entrepreneurs and companies.

ii. They have mostly assisted large and medium projects thereby contributing to concentration of economic power in the country.

iii. The gap between sanctions and disbursements has been increasing indicating delay in mobilization of funds.

iv. Adequate attention has not been paid on reduction of regional disparities in industrial development.

v. These institutions have not been able to deal effectively with growing sickness in Indian industry.

vi. These institutions have been indifferent towards the management of assisted companies.

vii. The non-performing assets (NPA) of most of the financial institutions have increased fast showing poor recovery of loans and advances.

viii. More than one institution caters to identical purposes leading to duplication and wastage. Effective collaboration and coordination between various financial institutions have been lacking.

M. Narasimham Committee (1991 and 1998) and S.H. Khan Working Group examined the working of financial institutions in the country. On the recommendations of these bodies, the Government of India has carried out the following policy reforms in connection with the financial institutions:

i. Dependence on SLR has been reduced.

ii. Prudential norms have been prescribed.

iii. Operations of various institutions have been diversified.

iv. Interest regime has been more liberalized.

v. Major institutions (e.g., ICICI, IDBI) are being converted into universal banks.

Check Your Progress-4

Explain the types of investment institutions

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-24

5.10 FOREIGN CAPITAL AND TECHNOLOGY

Most of the countries have been making use of foreign capital and technology to accelerate the pace of their economic growth. There is hardly any advanced country the development of which was not assisted by foreign capital or technology. It is interesting to note that foreign capital and technology are to play a very important role in economic rejuvenation of Eastern Europe, Russia etc. It is quite sometime since China began to receive foreign capital and technology in a big way.

India being a developing country, the importance of foreign capital and technology needs no emphasis. The domestic savings available for investment being small, foreign capital can help augment the productive, capacity of the nation. While it is true that in the last four decades we have made significant progress in the field of science and technology, we still lag behind in a number of cases. In today's dynamic world, even a developed country can be hardly self sufficient and most up-to-date in all spheres of technology.

5.10.1 TYPES OF FOREIGN INVESTMENT

Broadly there are two types of foreign investment, namely, foreign direct investment (FDI) and portfolio investment.

FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firm concerned normally go together.

If the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad, it is referred to as portfolio investment That is, in the case of portfolio investments, the investor uses his capital in order to get a return on it, but has no much control over the use of the capital.

FDIs are governed by long term considerations because these investments cannot be easily liquidated. Hence, factors like long term political stability, government policy, industrial and economic prospects, influence the FDI decision. However, portfolio investments which can be liquidated fairly easily are influenced by short term gains. Portfolio investments are generally much more sensitive than FDIs. Direct investors have direct responsibility associated with the promotion and management of the enterprise. Portfolio investors do not have such involvement with the promotion and management.

Since the economic liberalization of 1991, there has been a surge in the FDI and portfolio investments in India.

There are mainly two routes of portfolio investments in India, viz., by Foreign Institutional Investors (FIIs) like mutual funds and through global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs).

GDRs and FCCBs are instruments issued by Indian companies in the Euro markets for mobilizing foreign capital by facilitating portfolio investment by foreigners in Indian securities. Since 1992, Indian companies, satisfying certain conditions, are allowed to access foreign capital markets by Euro issues.

With reference to foreign investment in India, foreign investment may be classified as follows:

Foreign Investment

- Foreign Direct Investment
  - Wholly Owned Subsidiary
  - Joint venture
  - Acquisition
- Portfolio Investment
  - Investment by FIIS
  - Investment in GDRs and FCCBs

5.10.2 ROLE OF FOREIGN CAPITAL

As mentioned, above, foreign capital played an important role in the early stages of industrialization of most of the advanced countries of today, like the countries of Europe (including the USSR) and North America. Though the problems development of the developing countries of today are not very much similar to those faced by the advanced countries in the past, there is a general view that foreign capital, if properly directed and utilized, can assist the development of the development countries.

Economic growth is a function of among other things, capital formation. In the developing countries, the per capita income and savings rate being very low, domestic capital formation is inadequate to give a big push to the economy to take it to the take - off stage. Hence the domestic resources may be supplemented with foreign capital to achieve the critical minimum investment, to break the vicious circle of low income-low savings-low investment-low income.

Another way by which, foreign capital helps accelerate the pace of , economic growth is by facilitating essential imports required for carrying out development programmes, like capital goods, know-how, raw materials and other inputs and even consumer goods. The machinery know-how and other inputs needed may not be indigenously available. Further, the demand spurt created by large-scale investments may necessitate import of consumer goods. When the export earnings are insufficient to finance such vital imports, foreign capital should help reduce the foreign exchange gap.

Foreign investments may also help increase a country's export and reduce the import requirements if such investments take place in export-oriented and, import-competing industries.

Following the analysis of Donald MacDougall and Paul Streeten, Gerald Meier observes that, from the standpoint of national economic benefit, the essence of the case for encouraging an inflow of capital is that the increase in real income resulting from the act of investment is greater than the resultant increase in the income of the investor. If the value added to output by the foreign capital is greater than the amount appropriated by the investor, social returns exceed private returns. As long as foreign investment raises productivity, and this increase is not wholly appropriated by the investor, the greater product must be shared with others, and there must be some direct benefits to other income groups as mentioned below:

(i) Domestic Labour:

Domestic labour may get higher real wages because of the increase in productivity. There might also be an expansion of the employment opportunities.

(ii) Consumers:

If foreign investment is cost-reducing in a particular industry, consumers of the product may gain through lower product prices. If the investment is product-improving or product-innovating, consumers benefit from better quality products or new products.

(iii) Government:

The increase in production and foreign trade resulting from foreign capital might, increase the fiscal revenue of the government.

(iv) External Economies:

Foreign capital may bring in a number of indirect gains through the realization of external economies. For instance, if foreign investment is used for the development of infrastructure, this could stimulate domestic investment in industrial and other sectors.

Foreign Capital and Technology

Further advantages of foreign capital are mentioned under Private Foreign Capital.

5.10.3 PRIVATE FOREIGN CAPITAL

Private foreign capital mostly takes the form of direct investment. Hence, we deal herewith the direct foreign investment (private). The important advantages of direct foreign investment are the following:

1. It helps increase the investment level and thereby the income and employment in the host country.
2. Direct foreign investment facilities transfer of technology to the recipient country.
3. It may kindle managerial revolution in the recipient country through professional management and the employment of highly sophisticated management techniques.
4. Foreign capital may enable the country to increase its exports and reduce import requirements.
5. Foreign investments may stimulate domestic enterprise because to support their own operations, the foreign investors may encourage and assist domestic suppliers and consuming industries.
6. Foreign investment may also help increase competition and break domestic monopolies.

5.10.4 LIMITATIONS AND DANGERS OF FOREIGN CAPITAL

Foreign capital, private and official (governmental and institutional), have certain limitations. Certain additional risks are associated with the private foreign capital.

One of the important limitations to utilize the foreign capital is the absorptive capacity of the recipient country, i.e., the capacity of the country to utilize- the foreign capital effectively. Lack of infrastructural facilities, technical know-how, personnel, inputs, market, feasible projects, inefficiency or inadequacy of administrative machinery, etc., are important factors that affect the absorptive capacity.

Sometimes strings are attached to the official assistance - the recipient country may be pressurized to fall in line with the ideology or direction of the donor.

The following criticisms are leveled against private foreign capital:

1. Private foreign capital tends to flow to the high profit area rather than to the priority sectors.
2. The technologies brought in by the foreign investor may not be adapted to the consumption needs, size of the domestic market, resource availabilities, stage of development of the economy, etc.
3. Through their power and flexibility, the multinational corporations can evade or undermine economic autonomy and control, and their activities may be inimical to the national interest' of particular countries.

4. Foreign investments, sometimes, have unfavourable effect on the Balance of Payments of a country because the drain of foreign exchange by way of royalty, dividend, etc., is more than the investment made by the foreign concern.

5. Foreign capital sometimes interferes in the national politics.

6. Foreign investors sometimes engage in unfair and unethical trade practices.

Check Your Progress-5

a) Explain the role of foreign investment

b) What are the types of foreign investment?

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

LESSON-25

5.10.5 GOVERNMENT POLICY

India was following a very restrictive policy towards foreign capital and technology. Foreign collaboration was permitted only in fields, of high priority and in areas where the import of foreign technology was considered necessary. In other areas, import of technology was considered on merits if substantial exports were guaranteed over a period of 5 to 10 years and if there were, reasonable prospects for such exports. The government had issued lists of industries where:

(i) (a) foreign investment may be permitted;

(b) Only foreign technical collaboration (but no foreign investment) may be permitted;

(ii) No foreign collaboration (financial or technical) was considered necessary.

The government policy on foreign equity participation was thus selective.

Such participation had to be justified, having regard to factors such as the priority of industry, the nature of technology involved, whether it would promote exports which might not otherwise take place and the alternative terms available for securing the same or similar technological transfer. Foreign equity participation was limited to 40%, although exceptions were allowed on merit. The foreign share capital was to be by way of cash without being linked to tie imports of machinery and equipment or to payments for know-how, trade marks, brand names etc.

Technical collaborations were to be considered on the basis of annual royalty payments which were linked with the value of actual production. The percentage of royalty was dependent on the nature of technology. Wherever possible, the payment of fixed amount of royalty per unit of production was preferred. Royalty payments were limited to a period of 5 years.

The Foreign Exchange Regulation Act (FERA), 1973, served as a tool for implementing the national policy on foreign private investment in India. The FERA empowered the Reserve Bank of. India to regulate or exercise direct control over the activities of foreign companies and foreign nationals in India.

Foreign company was defined as one (other than banking company) which was not incorporated in India or in which non-resident interest was more than 40% or any branch of such company.

According to the FERA, non-resident (including Indian citizens), foreign citizens resident in India and foreign companies required the permission of the RBI to accept appointment as agents or technical management advisers in India of any person or company, or permit the use of their trade marks.

The trading, commercial and industrial activities in India of person's resident abroad, foreign citizens in India and foreign companies were regulated by the FERA. They had to obtain permission from the RBI for carrying on in India any activity of a trading, commercial or industrial nature; opening branches/offices or other places of business in India; acquiring any business undertaking in India; and purchasing share of Indian companies.

RBI had given general permission for certain matters. For example, general permission was granted to foreign companies to acquire or hold any immovable property in India which was necessary for or incidental to, any activity undertaken by them with the permission of the RBI.

The New Policy

The Industrial policy statement of July 24, 1991, which observes that while freeing the Indian economy from official controls, opportunities for promoting foreign investment in India, should also be fully exploited, has liberalized the Indian policy towards foreign investment and technology. The policy statement regards as follows:

In view of the significant development of the economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy. The relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment.

Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new technologies for promotion of exports.

This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities.

To the extent that expertise of this nature is not well developed so far in India, government will encourage foreign trading companies to assist in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involves interaction with some of the world's largest international manufacturing and marketing firms.

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority.

In the fast changing world technology, the relationship between the suppliers and users of technology must be a continuous one. Such a relationship becomes difficult to achieve where the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty.

The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances of his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

Therefore, with a view to injecting the desired level of technological dynamism in Indian industry, the policy provides for automatic approval for technology agreements related to high priority industries within specified parameters. 51 % foreign equity is also allowed in these industries. 35 industries have been specified in the category. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free foreign exchange.

It may be noted that earlier foreign equity participation was restricted normally to 40% and foreign investment and technology agreements needed prior approval.

The new policy has also made the import of capital goods automatic provided the foreign exchange requirement for such impart is ensured through foreign equity.

The Reserve Bank of India (RBI) has announced changes in the policy towards NRI* investments. Accordingly, non-resident Indian and Overseas Corporate Bodies (OCBs) predominantly owned by NRIs can acquire shares/ debentures of Indian companies, listed on the stock exchange, up to 24% of their paid up capital under the Portfolio Investment Scheme as against the earlier ceiling of 5%, provided the Indian company so resolves through the general body resolution.

In further relaxation of the policy, on 25th October, the Government announced its decision to allow direct foreign investment by non-resident Indians (NRIs) up to 100% of the equity in 34 industries figuring in Annexure III of the new industrial policy. (These are industries where direct foreign investment up to 51 % of the equity is allowed). There will be automatic clearance for such investment proposals from NRIs subject to the condition that the project's capital goods imports would be met from the foreign equity. In other words, the Reserve Bank of India will directly handle such applications and clear them.

Import of components, raw materials and intermediate goods and-payment of know how fees and royalties will- be governed by the general policy applicable to other domestic units.

The government has also' decided to consider applications for direct foreign investment by NRIs up to 100% in areas other than the 34 items mentioned in Annexure III of the industrial policy. However, there will be no automatic clearance for such proposals.

Even in areas still reserved for the Public Sector (telecommunication, hydrocarbons, coal, rail ways and postal services) the Government now has a more liberal approach towards private investment, including foreign investment.

In 1994-95, foreign investment was opened for NRI and persons of Indian origin in a wide range of construction and real estate related activities. Foreign investment was also allowed in constructing and operating highways, express -ways and bridges on a toll tax system, generating electricity on build-operate own (BOO) basis, telephone services and certain operations in railways on build operate lease transfer BOLT basis. Without prior approvals, foreign investors can now own up to 24 per cent equity in any Indian firm and up to 20 per cent in new private banks.

5.10.6 FII INVESTMENTS

The Indian stock market was opened up to FII investment in 1992-93 and since then there has been a significant increase in the portfolio investment by FIIs.

The Regulations on Foreign Institutional Investors, which were notified on November 14, 1995, contains various provisions relating to definition of FIIs, eligibility criteria, investment restrictions, procedures of registration and general obligations and responsibilities of FIIs. According to the Regulations, FIIs may invest only in:

a. Securities in the primary and secondary markets including shares, debentures and warrants of companies listed on a recognized stock exchange in India, and

b. Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognized stock exchange or not.

Joint ventures between a variety of domestic and foreign securities firms have been approved in the stock broking, merchant banking, assets management and other non bank financial services sectors. The overall effect of FII investment/and financial joint ventures has peen the introduction of international practices and systems to the Indian securities industry.

The number of FIIs registered with the SEBI increased from 10 with a cumulative investment of $ 0.2 million in January 1993 to 331 with a cumulative investment of $ 5.5 billion in April 1996).

Check Your Progress-6

Enumerate the salient features of new foreign policy adopted by the government

Notes: a) Write your answer in the space given below

b) Check your answer with the one given at the end of this lesson

----

5.11 LET US SUM UP

A development Bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth. With the establishment of the Industrial Finance Corporation of India in 1948, a number of development banks have been set up at all- India and State levels for assisting the development of large, medium and small industries by providing financial and various other promotional assistances. Development banks have been established at the State level too.

IFCI:

Set up as a statutory corporation on July 1, 1948 to provide term finance to public companies and cooperatives. Now a public company.

ICICI:

Set up on January 5, 1955 as a public company in private sector to promote and develop private sector industries. Now a universal bank.

IDBI:

Set up as a statutory corporation on July 1, 1964, an apex institution in the field of industrial finance. Now a public company.

IIBI:

Set up as an agency for revival of sick units. Now a Government company.

SIDBI:

Set up as a statutory corporation on April 2, 1990 to assist in the development of small scale sector.

SFCs:

State level institutions to assist industries at the state level.

SIDCs:

Government undertakings at state level for industrial development.

Most of the countries have been making use of foreign capital and technology to accelerate the pace of their economic growth. There are two types of foreign investment, namely, foreign direct investment (FDI) and portfolio investment. The domestic resources may be supplemented with foreign capital to achieve the critical minimum investment. There are some direct benefits and indirect benefits from foreign investment. One of the important limitations to utilize the foreign capital is the absorptive capacity of the recipient country, i.e., the capacity of the country to utilize- the foreign capital effectively.

5.12 MODEL ANSWERS FOR CHECK YOUR PROGRESS

1. A development bank may be defined as a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth. A development Bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth.
2. The main functions of the IDBI are as follows: Subscribing to the shares and bonds of financial institutions and guaranteeing their underwriting obligations; Refinancing term loans and export credits extended by other financial institutions; Granting loans and advances directly to industrial concerns; guaranteeing deferred payments due from and loans raised by industrial concerns; Subscribing to and underwriting shares and debentures of industrial concerns; Accepting, discounting and rediscounting bonafide commercial bills or promissory notes of industrial concerns including bills arising out of sale of indigenous machinery on deferred payment basis; Financing turnkey projects by Indians outside India and providing credit to foreigners for buying capital goods from India; Planning, promoting and developing industries to fill gaps in the, industrial, structure of the country. The Bank may undertake promotional activities like marketing and investment research, techno-economic surveys, etc.
3. The promotional activity carried out by ICICI are: Underwriting of public and private issues and offers of sale of industrial securities-ordinary shares, preference shares, bonds and debenture stock; Direct subscription to such securities; Securing loans in rupees, repayable over periods up to 15 years; Providing similar loans in foreign currencies for payment for imported capital equipment and technical services; Guaranteeing payments for credits made by others; Providing credit facilities to manufacturers for promoting sa1e of industrial equipment on deferred payment terms.

4. The three main investment institutions are- Unit Trust of India, Life Insurance Corporation of India and General Insurance Corporation of India.

5. a. The important advantages of direct foreign investment are the following: It helps increase the investment level and thereby the income and employment in the host country. Direct foreign investment facilities transfer of technology to the recipient country. It may kindle managerial revolution in the recipient country through professional management and the employment of highly sophisticated management techniques. Foreign capital may enable the country to increase its exports and reduce import requirements. Foreign investments may stimulate domestic enterprise because to support their own operations, the foreign investors may encourage and assist domestic suppliers and consuming industries. Foreign investment may also help increase competition and break domestic monopolies.

5. b. There are two types of foreign investment, namely, foreign direct investment (FDI) and portfolio investment. It is further subdivided into many categories

6. The government had issued lists of industries where:

   (i) (a) foreign investment may be permitted;

   (b) Only foreign technical collaboration (but no foreign investment) may be permitted;

   (ii) No foreign collaboration (financial or technical) was considered necessary.

Suggested Readings

1. Francis Cherunilam-Business Environment

2. C.B.Gupta- Business Environment

3. K. Aswathappa- Essential Of Business Environment

MODEL QUESTION PAPER

Answer any five. All questions carry equal marks

1) Discuss the significance of understanding the environment of business
2) Discuss the significance of environmental analysis and techniques used for environmental analysis
3) Write a note on business ethics. Explain social responsibilities of business
4) Bring out the differences between capitalism, socialism and mixed economy
5) What are the steps taken by the government to prevent industrial sickness?
6) Enumerate the objectives of MRTP act
7) What are functions performed by ICICI?
8) Enumerate the salient features of new foreign policy adopted by the government