Part 1

AN OVERVIEW OF BUSINESS ENVIRONMENT

Business decisions in general and strategies in particular are moulded by the business environment – those external factors like the economic, political/regulatory, social/demographic, technological and natural factors which make up the opportunities for and threats to business and internal factors like the resources, capabilities and goodwill of the organisation, internal power relationships etc. which decide the strengths and weaknesses of the firm. A thorough understanding of the business environment, therefore, is a prerequisite for making any strategic decision. Indeed, formulation of strategy is some times defined as establishing a proper firm-environment fit.

This *Part* starts with a general introduction to the broad nature of business environment, and environmental analysis and forecasting. It also presents a broad picture of the Economic Environment, Political and Government Environment, Natural and Technological Environment, and Demographic Environment.

1 A GLIMPSE OF BUSINESS ENVIRONMENT

Business Environment consists of all those factors that have a bearing on the business.

Just as the survival and success of any individual depend on his innate capability – such as the physiological and physiological factors - to cope with the environment and the extent to which the environment is conducive to the development of the individual, the survival and success of a business firm depend on its innate strength — resources at its command, including physical resources, financial resources, human resources, skill and organisation — and its adaptability to the environment and the extent to which the environment is favourable to the development of the organisation. The survival and success of a firm, thus, depend on two sets of factors, viz, the internal factors – the internal environment – and external factors – the external environment. However, the term business environment often refers to the external factors.

Any meaningful organisation has certain mission, objective(s) and goal(s) and a strategy to achieve them. Formulation of strategy is sometimes defined as establishing a proper *firm-environment fit.* Indeed, the mission/objectives/goals themselves should be based on an assessment of the external environment and the organisational factors (*i.e.*, the internal environment).

The external environment has, broadly, two components, viz, business opportunities and threats to business. Similarly, the organisational environment has two components: strengths and weaknesses of the organisation. Thus, strategy formulation is properly pitting the organisational factors (the internal environment) against the opportunities and threats in the external environment. In other words, business decisions are conditioned by two broad sets of factors, *viz.*, the internal environment and the external environment.

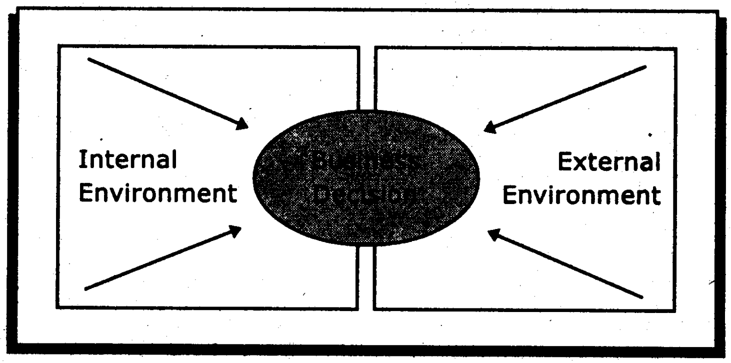

Fig. 1.1 : Factors Influencing Business Decision

A SWOT analysis (analysis of the strengths and weaknesses of the organisation and opportunities and threats in the environment), therefore is one of the first steps in the strategic management process. Business dynamics, to a large extent, is a dependent factor — it depends on, *inter alia,* the environmental dynamics. Hence, the importance of environmental analysis.

TYPES OF ENVIRONMENT

On the basis of the extent of intimacy with the firm, the environmental factors may be classified in to different types or levels. As indicated above, there are, broadly, two types of environment, the internal environment, *i.e.,* factors internal to the firm and external environment, *i.e.,* factors external to the firm which have relevance to it.

The internal factors are generally regarded as *controllable factors* because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organisation and functional means, such as marketing mix, to suit the environment.

The external factors, on the other hand, are, by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc., are, therefore, generally regarded as uncontrollable factors.

It may, however, be noted that a firm may not sometimes have complete control over all the internal factors. Also, it is some times possible to change certain external factors.

Some of the external factors have a direct and intimate impact on the firm (like the suppliers and distributors of the firm). These factors are classified as micro environment, also known as task environment and operating environment. There are other external factors which affect an industry very generally (such as industrial policy, demographic factors etc.). They constitute what is called macro environment, general environment or remote environment.

We may, therefore consider the business environment at three levels.

- Internal environment
- Micro environment / task environment / operating environment.
- Macro environment / general environment / remote environment.

Although business environment consists of both the internal and external environments, many people often confine the term to the external environment of business. In this book too, in the subsequent chapters, the term refers mostly to external environment of business.

INTERNAL ENVIRONMENT

The important internal factors which have a bearing on the strategy and other decisions are outlined below.

Value System

The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organisation, business policies and practices. It is a widely acknowledged fact that the extent to which the value system is shared by all in the organization is an important factor contributing to success.

The value system of JRD Tata and the acceptance of it by others who matter were responsible for the voluntary incorporation in the Articles of Association of TISCO its social and moral responsibilities to consumers, employees, shareholders, society and the people.

After the EID Parry group was taken over by the Murugappa group, one of the most profitable businesses (liquor) of the ailing Parry group was sold off as the liquor business did not fit into the value system of the Murugappa group.

The value system and ethical standards are also among the factors evaluated by many companies in the selection of suppliers, distributors, collaborators etc.

BOX 1.1 : VALUES, GOVERNANCE AND EXCELLENCE

Infosys Technologies Limited is a publicly held company based in India that provides information technology consulting and software services to Fortune 1000 companies and employs more than 3,000 people worldwide. Infosys has based its growth on several key principles of corporate governance: best practices, financial markets, and human capital. Its core value: *To achieve our objectives in an environment of fairness, honesty, transparency, and courtesy towards our customers, employees, vendors, and society at large.*

All Infosys activities are continually benchmarked with global best practices. The Firm's quality control and project management have helped it achieve total quality management accreditation. Feedback from process audits enable the reengineering of internal processes when required. International accounting practices are also followed. Infosys publishes all financial reports according to both U.S. and Indian Generally Accepted Accounting Practices. Best practices at Infosys are captured through a knowledge management systems that makes experience gained from various client assignments freely available in an intranet repository.

The first Indian-registered direct listing on a U.S. market, Infosys began trading on Nasdaq in March 1999. Infosys viewed the listing as a way to achieve a more liquid currency (through stock options) for attracting the best employees and future acquisitions. It anticipates that its presence on Nasdaq will give potential customers greater comfort and confidence in the company.

Infosys views its employees as its key resource. With "wealth creation for employees" as one of its stated objectives, Infosys provides innovative compensation and benefit packages. Infosys pioneered the concept of the employee stock ownership plan in India. Infosys also offers such benefits as training, asset acquisition, loans, housing, and personal assistance services. This combination of stock options and benefits allows Infosys to attract top talent to contribute to its growth.

Infosys won the first National Corporate Governance Award (1999), instituted by the Ministry of Finance and sponsored by the UTI.

Source : Financial Times, reproduced in M.R. Iskander and N. Chamlou, *Corporate Governance: A Framework for Implementation.*

Mission and Objectives

The business domain of the company, priorities, direction of development, business philosophy, business policy etc., are guided by the mission and objectives of the company. Ranbaxy's thrust in to the foreign markets and development have been driven by its mission "to become a research based international pharmaceutical company". Arvind Mills' mission – "To achieve global dominance in select businesses built around our core competencies through continuous product and technical innovation, customer orientation and focus on cost effectiveness", – has driven its future development strategy including the portfolio strategy, and indicated the thrusts required in the functional areas to help achieve the mission.

Management Structure and Nature

The organisational structure, the composition of the Board of Directors, extent of professionalisation of management etc., are important factors influencing business decisions. Some management structures and styles delay decision making while some others facilitate quick decision making.

The Board of Directors being the highest decision making body which sets the direction for the development of the organisation and which overseas the performance of the organisation, the quality of the Board is a very critical factor for the development and performance of company. The private sector in India presents extreme cases in this respect. At one end there are companies with highly qualified and responsible Board and at the other end there are companies which do not possess these qualities.

The share-holding pattern could have important managerial implications. There are very large companies where majority of the share is held by the promoters (like Wipro) and there are large firms where the promoters' position is very vulnerable (like the Tata group of companies).

Financial institutions have large share holding in many Indian companies. The stand of nominees of financial institutions could be very decisive in several critical instances.

Internal Power Relationship

Factors like the amount of support the top management enjoys from different levels of employees, shareholders and Board of Directors have important influence on the decisions and their implementation.

The relationship between the members of Board of Directors and between the chief executive and the Board are also a critical factors.

Human Resources

The characteristics of the human resources like skill, quality, morale, commitment, attitude etc., could contribute to the strength and weakness of an organisation. Some organisations find it difficult to carry out restructuring or modernisation because of resistance by employees whereas they are smoothly done in some others.

The involvement, initiative etc., of people at different levels may vary from organisation to organisation. The organisational culture and overall environment have bearing on them. John Towers, M.D., Rover Group, observes that a Japanese company of 30,000 employees is 30,000 process improvers. In a Western company, it is 2,000 process improvers and 28,000 workers.[1] And in an Indian company?

Company Image and Brand Equity

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

Miscellaneous Factors

There are a number of other internal factors which contribute to the business success/failures or influence the decision-making. They include the following.

1. *Physical Assets and Facilities* like the production capacity, technology and efficiency of the productive apparatus, distribution logistics etc., are among the factors which influence the competitiveness of a firm. *For example*, as quality is very important in the pharmaceutical industry, particularly for a global player, in the case of Core Healthcare not only there is no compromise on quality but also the company made the quality norms stricter than international or other relevant standards and the quality mantra has been well imbibed throughout the organisation.
2. *R & D and Technological Capabilities,* among other things, determine a company's ability to innovate and compete.
3. *Marketing Resources* like the organisation for marketing, quality of the marketing men, brand equity and distribution network have direct bearing on marketing efficiency. They are important also for brand extension, new product introduction etc.
4. *Financial Factors* like financial policies, financial position and capital structure are also important internal environment affecting business performances, strategies and decisions.

EXTERNAL ENVIRONMENT

As stated earlier, the external business environment consists of a micro environment and a macro environment.

MICRO ENVIRONMENT

As indicated earlier, the micro environment is also known as the Task Environment and Operating Environment because the micro environmental forces have a direct bearing on the operations of the firm.

"The micro environment consists of the actors in the company's immediate environment that affect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the publics."[2] The macro environment consists larger societal forces that affect all the actors in the company's micro environment — namely, the demographic, economic, natural, technical, political and cultural forces."[3]

It is quite obvious that the micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. *For example,* a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When competing firms in an industry have the same micro elements, the relative success of the firms depends, *inter alia,* on their relative effectiveness in dealing with these elements.

Suppliers

An important force in the micro environment of a company is the suppliers, *i.e.,* those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious. Uncertainty regarding trouble. Hindustan Lever too faced major challenge when it faced a collective boycott in Kerala on the issue of trade margin.

Financiers

Another important micro environmental factor is the financiers of the company. Besides the financing capabilities, their policies and strategies, attitudes (including attitude towards risk), ability to provide non-financial assistance etc. are very important.

Publics

A company may encounter certain publics in its environment. "A public is any group that has an actual or potential interest in or impact on an organisation's ability to achieve its interests."[10] Media publics, citizens action publics and local publics are some examples.

Some companies are seriously affected by such publics. *For example,* one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily which was allegedly bent on bringing down the share prices of the company by tarnishing its image. Such exposures or campaigns by the media might even influence the government decisions affecting the company. Many companies are also affected by local publics. Environmental pollution is an issue often taken up by a number of local publics. Actions by local publics on this issue have caused some companies to suspend operations and/or take pollution abatement measures. Non-government organisations (NGOs), particularly in developed countries, have been mounting up protests against child labour, sweat labour, cruelty against animals, environmental problems, deindustrialisation resulting from imports and so on. Exports of developing countries, particularly, are affected by such developments.

Growth of consumer publics is an important development affecting business.

It is wrong to think that all publics are threats to business. Some of the actions of the publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, *for example,* regard consumerism as an opportunity for the business. The media public may be used to disseminate useful information. Similarly, fruitful co-operation between a company and the local publics may be established for the mutual benefit of the company and the local community.

MACRO ENVIRONMENT

A company and the forces in its micro environment operate in a larger macro environment of forces that shape opportunities and pose threats to the company. As stated earlier, the macro environment is also known as General Environment and Remote Environment.

The macro forces are, generally, more uncontrollable than the micro forces. When the macro environment is uncontrollable, the success of a company depends on its adaptability to the environment. *For example,* if the cost of the imported components increases substantially because of the depreciation of the domestic currency, a solution may be their domestic manufacture.

Important macro environment factors include economic environment, political and regulatory environment, social/cultural environment, demographic environment, technological environment, natural environment, and global environment. Several of these are dealt with in some detail in subsequent chapters.

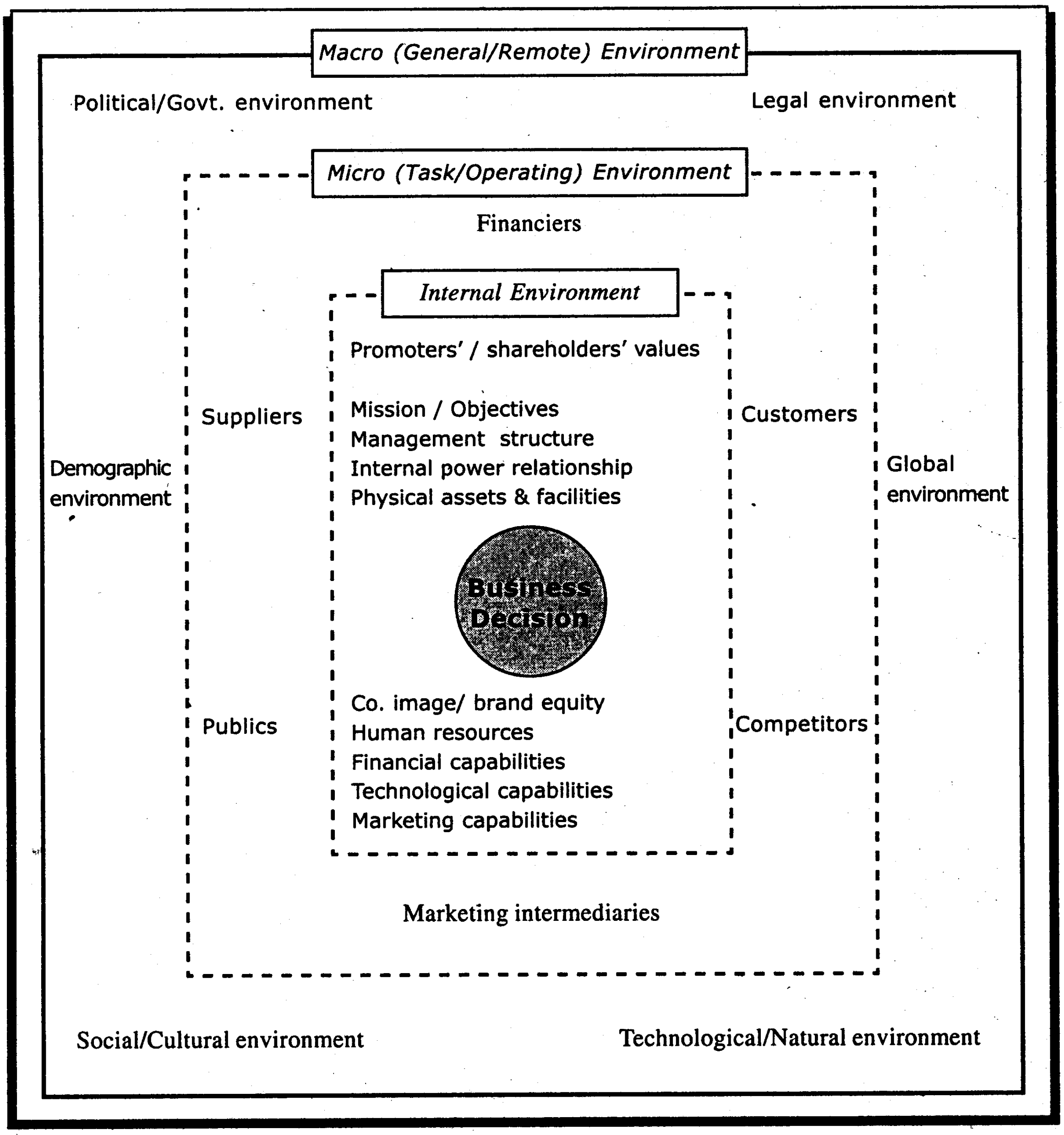

Fig. 1.2 : Business Environment

Global Environment

Even domestic business is affected by certain global factors.

The global environment refers to those global factors which are relevant to business, such as the WTO principles and agreements; other international conventions / treaties / agreements / declarations / protocols etc.; economic and business conditions / sentiments in other countries etc. Similarly, there are certain developments, like a hike in the crude oil price, which have global impact.

COMPETITIVE STRUCTURE OF INDUSTRIES

The competitive structure of industries is a very important business environment. Identification of forces affecting the competitive dynamics of an industry will be very useful in formulating strategies.

According to Michael Porter's well known model of structural analysis of industries, the state of competition in an industry depends on five basic competitive forces, *viz.*,

1. Rivalry among existing firms
2. Threat of new entrants
3. Threat of substitutes
4. Bargaining power of suppliers
5. Bargaining power of buyers.

Fig. 1.3 depicts the five forces competitive structure of industry. The diagram is a slightly modified presentation of the one provided by Porter. The arrows in the diverse directions indicate opposing forces. *For example,* just as the buyers and suppliers may have bargaining power over the firm, the firm may also have some bargaining power over the buyers and suppliers.

Threat of Entry

A growing industry often faces threat of new entrants that can alter the competitive environment. There may, however, be a number of barriers to entry. Potential competition tends to be high if the industry is profitable or critical, entry barriers are low and expected retaliation from the existing firms is not serious.

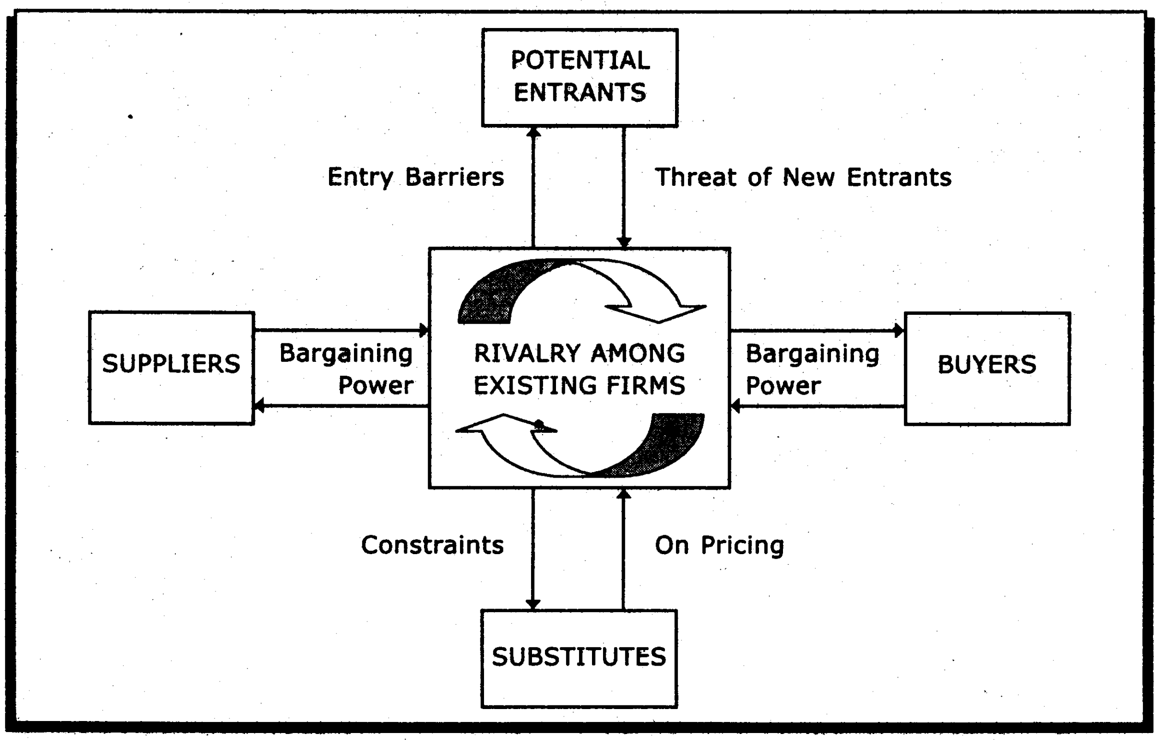

Fig. 1.3 : Forces Driving Industry Competition

The following are some of the important common entry barriers

1. ***Government Policy:*** In many cases government policy and regulation are important entry barriers. *For example,* prior to the economic liberalisation in India, government-dictated entry barriers were rampant, like reservation of industries / products for public sector and small scale sector, industrial licensing, regulations under MRTP Act, import restrictions, restrictions on foreign capital and technology etc.
2. ***Economies of Scale:*** Economies of scale can deter entry in two ways: it keeps out small players and discourages even potentially large players because of the risk of large stakes.
3. ***Cost Disadvantages Independent of Scale:*** Entry barrier may also arise from the cost advantages, besides that of economies of scale, enjoyed by the established firms which cannot be replicated by new firms, such as proprietary product technology, learning or experience curve, favourable access to raw materials, favourable location, government subsides etc.
4. ***Product Differentiation:*** Product differentiation characterised by brand image, customer loyalty, product attributes etc. may form an entry barrier forcing new entrants to spend heavily to overcome this barrier.
5. ***Monopoly Elements:*** Proprietary product / technology, monopolisation / effective control over raw material supplies, distribution channels etc. are entry barriers which are insurmountable or difficult to overcome.
6. ***Capital Requirements:*** High capital intensive nature of the industry is an entry barrier to small firms. Further, the risk of huge investment could be a discouraging factor even for other firms.

Rivalry Among Existing Competitors

Rivalry among existing competitors is often the most conspicuous of the competitions. Firms in an industry are "mutually dependent" – competitive moves of a firm usually affects others and may be retaliated. Common competitive actions include price changes, promotional measures, customer service, warranties, product improvements, new product introductions, channel promotion etc.

There are a number of factors, which influence the intensity of rivalry. These include:

1. ***Number of Firms and their Relative Market Share, Strengths etc:*** Rivalry is likely to be affected by the number firms, their relative market shares, competitive strengths, etc.
2. ***State of Growth of Industry:*** In stagnant, declining and, to some extent, slow growth industries a firm is able to increase its sales only by increasing its market share, *i.e.,* at the expense of others.
3. ***Fixed or Storage Costs:*** When the fixed or storage costs are very high, firms are provoked to take measures to increase sales for improving capacity utilisation or reducing storage costs.
4. ***Indivisibility of Capacity Augmentation:*** Where there are economies of scale, capacity increases would be in large blocks necessitating, in many cases, efforts to increase sales to achieve capacity utilisation norms.

normally national or at least regional players whereas the unorganised sector firms, by and large, are local or at best regional player. The direct and major competitors and market/target customers of these groups would be different and, therefore, the marketing strategies would be different. In the furniture industry, *for example,* Godrej and Allwyn are national players and their important customers are corporates and other quality conscious customers – organisations and individuals – who are not very price sensitive. The numerous firms in the unorganised sector in this industry are largely local players and they cater mostly to price sensitive customers. In the hotel and restaurant industry, the competitors of a five star hotel is mostly other five star hotels and they have many common strategic dimensions. The five star hotels, therefore, form one strategic group. Similarly, three star hotels constitute another strategic group.

There may be barriers to shifting strategic position from one strategic group to another. Such barriers are referred to as mobility barrier. *For example,* an assembler of personal computers may encounter several barriers to shift to the position of a fully integrated computer manufacturer, such as barriers of technology, capital investment human resources and organisation, brand image and market standing of established firms etc. Similarly, there are several barriers to entering the proprietary group by generic drug firms, such as capital investment, research facilities, human resources, high risks of investment on R&D etc. In contrast, it is easier for a proprietary drug firm to enter the generic group.

Implications of Strategic Groups

The concept of strategic groups has implications for industry analysis and identification of opportunities and threats. A company's immediate competitors are firms within the same strategic group.

Second, the nature and intensity of competition and business prospects vary from strategic group to strategic group. The choice of strategic group is, therefore, very important.

Third, high mobility barriers normally help insulate the group from new entrants and facilitate high profitability. "The firms in strategic groups with high mobility barriers will have greater profit potential than those in groups with lower mobility barriers. These barriers also provide a rationale for why firms continue to compete with different strategies despite the fact that all strategies are not quickly successful".[18]

Fourth, "just like entry barriers, mobility barriers can change; and as they do (such as if the manufacturing process becomes more capital intensive) firms often abandon some strategic groups and jump into new ones, changing the pattern of strategic group. Mobility barriers can also be influenced by firm's choices of strategy. A company in an undifferentiated product industry, *for example,* can attempt to create a new strategic group (with higher mobility barriers) by investing heavily in advertising to develop brand identification...Or it can try to introduce a new manufacturing process with greater economies of scale".[19]

Fifth, the competitive standing of the different strategic groups would be different with respect to each of the five competitive forces. *For example,* the threat of new entrants is less in respect of the proprietary group compared to the generic drug group. The bargaining power of the buyers is also weak for patented drugs because of no or limited alternative. Such is the case with competition from substitutes. Players in the strategic group of fully integrated firms may not be subject to as much supplier power as other firms because of their lesser dependence on the outside suppliers. (It is, of course, true that in a number of cases outsourcing firms have advantages over integrated ones.)

Limitations of Porterian Models

The five forces and strategic group models provide very useful frameworks for analysing the nature of competition in an industry. These models, however, suffer from some important shortcomings mentioned below.

In many industries competition is a process driven by innovation and industry structures are very significantly changed by innovation. In a later work, Porter has recognized the role of innovation in revolutionising industry structure. Innovations, according to him, can unfreeze and reshape industry structure. He holds that after a period of turbulence triggered by innovation, the structure of an industry once more settles down to a stable pattern. Once the industry stabilises in its new configuration, the five forces and strategic group concepts can once more be applied. This view of the evolution of industry structure is often referred to as punctuated equilibrium. The punctuated equilibrium view holds that long periods of equilibrium, when industry's structure is stable, are punctuated by periods of rapid changes when industry structure is revolutionized by innovation. Thus, there is an unfreezing and refreezing process.

COMPETITOR ANALYSIS

Competitor analysis is necessary for formulating right strategies and determining the right positioning for the firm in the industry.

Competitor analysis seeks to find answers to certain basic questions such as:

1. Who are the competitors of the firm?
2. What are the current strategies of the competitors?
3. What are their future goals and likely strategies?
4. What drives the competitor?
5. Where is the competitor vulnerable?
6. How are the competitors likely to respond to the strategies of others?

Porter has suggested a framework for competitor analysis, consisting of four diagnostic components, *viz.*, future *goals*, *current strategy*, *assumptions* and *capabilities*.

As Porter observes, "its goals, assumptions, and current strategy will influence the *likelihood, timing, nature*, and *intensity* of competitor's reactions. Its strengths and weaknesses will determine its *ability* to initiate or react to strategic moves and to deal with environmental or industry events that occur".[20]

Competitor Response Profile

An analysis of these components will help to formulate what Porter calls competitor's response profile, *i.e.*, answers to critical questions such as: What moves or developments will provoke the competitor and how is the competitor likely to respond or retaliate?

The competitor response profile seeks to predict the competitor's offensive moves and defensive capabilities.

Future Goals

Analysis of future goals would be helpful to identify the attitude and behaviour of the competitor and likely strategies. As Porter observes, "a knowledge of goals will allow predictions about whether

Chandler describes strategic management as "the determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to carry out these goals".[26] According to Paine and Naumes, "Strategic management involves the decision-making and the activities in an organisation which (1) have wider ramifications, (2) have a long time perspective, and (3) use critical resources towards perceived opportunities or threats in a changing environment".[27]

Strategic management or business policy is, thus, the means to achieve the organisational purpose. Strategic management process involves determining the mission and objectives, analysis of the environmental opportunities and threats and evaluating the strengths and weaknesses of the firm to tap the opportunities or to combat the threats, formulating strategies to achieve the objectives on the basis of the SWOT analysis, choosing the most appropriate strategy, implementation of the strategy and reformulation of the objectives or strategy, if needed.

The strategic management process is schematically presented in Fig. 1.4. A very brief account of the steps in the strategic management process is given below. A detailed discussion of strategic management is, obviously, beyond the scope of this book; what is given below is only a sketch. As the objective of this chapter is to the highlight the importance of the environmental analysis to managerial decision-making, more space is devoted to the description of this step than the other steps.

Formulation of Mission and Objectives

Determining the mission and objectives of the company is the first step in the strategic management process. A strategy is, in fact, a means to achieve the ends or objectives. It should, however, be noted that objectives should not be static, they should be dynamic. That is changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to the objectives. A company should, therefore, appraise how well its objectives tap the firm's opportunities and resources. Dynamic companies conduct audit of their objectives and reformulate or reorient the objectives, if desirable, to ensure that the company's objectives are the most appropriate, given the environment and the company's resources. It is such appraisal and the resultant reorientation of the business which have enabled many companies to achieve remarkable successes.

To formulate clear objectives, it is essential to get definite answers to certain questions, *viz.*, "what business the company is in?" "What should the company's business be?" "What will the company's business be?" As Gluek aptly remarks, "objectives help define the organisation in its environment."[28] Environmental analysis will help find answer to the question what should the company's business be? If 'what should be the business' is different from 'what is the business', there is certainly a need for redefining the business, matching the company resources to the environment. The question 'what will the company's business be?' exposes another dimension of business objectives, namely, the long term perspective. As Drucker succinctly puts it, 'what will the business' is related to 'what changes in the environment are already discernible that are likely to have high impact on the characteristics, mission, and purpose of our business? and how do we now build these anticipations into our theory of business, into its objectives, strategies and work assignments?"[29]

SWOT Analysis

Identification of the threats and opportunities in the environment and the strengths and weaknesses of the firm is the cornerstone of business policy formulation; it is these factors which determine the course/courses of action to ensure the survival and/or growth of the firm.

BOX 1.4 : WHERE RAYMOND WANTS TO BE?

Raymond has been a well known fabric brand in India. The Raymond Ltd (estimated 2000-01 turnover: Rs 1,374 crore) over time had made significant investments in process oriented businesses such as cement, steel and polyester fibre, besides textiles.

Gautam Hari Singhania, 36, who took over from Vijaypat Singhania as chairman and managing director in 1998, sought to put Raymond on a strong footing, restructuring its business portfolio based on a SWOT analysis. So, in early 1999, says Singhania, "we started looking at our business portfolio, and decided where we wanted to be as compared to where we are today. We decided there were three areas that the company did not want to be in, in our long-term strategy. One was filament yarn, the second was cement, and the third, steel." These businesses were either not giving adequate returns or were making losses. The company also did not have the expertise to run these units. Raymond, therefore, pulled out of these businesses and decided to focus on the core business of dressing (textiles and readymade apparel).

The divestment of these three businesses brought in about Rs. 1100 crore. Out of this, Rs. 291 crore was used to repay outstanding debt and this helped to substantially reduce the interest burden. The company also spent around Rs 158 crores for buying back shares through the open market route and this increased the Singhanias' share in the Raymond from 27 to 31 percent. The company has been left with a large amount for investment – for developing the existing core business or entering new businesses (including acquisition).

In Singhania's vision, Raymond must turn itself into a lean and efficient company, before striking out to conquer new territory overseas. While Raymond claims to be among the top three fabric brands in the world in integrated worsted (wool-blended) fabrics, it certainly isn't a household name anywhere except South Asia. "The endeavour is to make it a truly global brand," says the chairman.

Courtesy : Roshun Povaiah, "Everybody Loves Raymond", *A&M*, 31 March, 2001.

The environment might present many opportunities, but a company might not have the strengths to exploit all the opportunities. Similarly, sometimes a firm will not have the strength to meet the environmental threats. If a company, thus, finds that it will not have the competence to survive in a particular line of business, it will be prudent to give it up and concentrate on such business/ businesses for which the firm is most competent. The economic liberalisation is ushered in India in 1991 drastically changed the business environment. Many companies have exited several of their businesses and have been concentrating on their core businesses. *For example,* the Ceat exited four non-tyre businesses (glass fibre, electronics, photocopiers and nylon code) and decided to concentrate on its core business – tyre. Funds obtained by the divestment have been used, in many cases, to consolidate or further develop the businesses they have decided to focus on.

Indeed, *strategic management* has come to assume great importance as a result of the liberalisation. The liberalisation, by substantially expanding the scope of private enterprise and removing the entry and growth restrictions, has given a substantial leeway to private enterprise to decide the portfolio strategy. A number of companies have changed their business portfolios (*i.e.,* the businesses they are in). Many have entered new businesses (Reliance, for example) and exited some of their businesses, while many have done both (like the Tata group and RPG group). A number of companies have been growing organically as well as by acquisitions (*e.g.,* Gujarat Ambuja).

CHAPTER 2 PART 1

ENVIRONMENTAL ANALYSIS AND FORECASTING

The previous and the following chapters provide a broad description of the important environmental forces and give an indication, either implicit or explicit, of their many implications for business.

Business decisions, particularly strategic ones, need a clear identification of the relevant variables and a detailed and in-depth analysis of them.

A good amount of information is available about the past, recent, current, ensuing and future events and developments in respect of many matters. However, there are a number of things about which information is scantly or not readily available at all. To generate adequate information in such areas, research, discussion and forecasting, including scenario building, may be necessary.

There are many pieces of vital information available in respect of a number of matters. Such information should be analysed to understand the impact on and implications for the organistion. *For example,* what is the impact of the different aspects of liberalisation on a company? What are the implications of the liberalisations for the company? In other words, what are the threats posed by the liberalisation and what are the opportunities unfolded by the liberalisation? A thorough analysis of the environment is necessary for finding answers to these.

Anticipating the future is essential for identifying the future threats and opportunities and for formulating strategic plans.

TECHNIQUES FOR ENVIRONMENTAL ANALYSIS

Techniques for environmental analysis refer to the methods of gathering the relevant information for appraising the environment.

William Glueck mentions four techniques for environmental analysis: Verbal and Written Information; Search and Scanning; Spying; and Forecasting and formal studies.[1]

Verbal and Written Information

A lot of documented information, published or unpublished, is available on many matters. However, people may not like to put on record certain types of information which they may be prepared to divulge orally, some times on condition of anonymity or confidentiality. Tact and proper approach are required to obtain such information. Verbal information is significant in several other situations. The situation might have changed after the documentation of the information, necessitating personally contacting knowledgeable people to get the latest information. Personal contacts will be helpful in getting more details of the written information. Personal contacts will also be useful in obtaining diverse views of different people.

There are indeed many matters on which written information is non-existent or scanty. All these highlight the importance of verbal information in environmental analysis.

While using written information, several factors such as the purpose for which it was prepared, the methodology used for collection of the information, reliability of the sources of information, the ideology/orientation of the individual/organisation that prepared the information etc. need to be evaluated. Such cautions should also be exercised while going in for verbal information.

Sources of verbal information also include electronic media, seminars, workshops etc.

Search and Scanning

Even when the required information exists somewhere, it may not become readily available. Search and scanning are, therefore, needed, many a time, to identify the sources of information and to manage the timely availability of the required information.

A number of organisations have *clipping service* which constantly scan newspapers, periodicals etc. and prepare clippings containing information required by different departments/executives of the organisation.

Many organisations have Management Information System for systematic gathering, processing, storing and disseminating information. An MIS is generally regarded as very useful.

Spying

Spying, albeit regarded unethical by many, is not very uncommon in business. This has been used to a considerable extent to obtain secret information regarding defence and space research. There are many instances of industrial espionage also. This is used mostly to gather competitive information.

The fourth approach to environmental analysis is formal forecasting. This is described in the following section.

STEPS IN/APPROACHES TO ENVIRONMENTAL FORECASTING

The steps in environmental forecasting are similar to the steps in formulating and executing a research project. The important steps in environmental forecasting are the following.

Identification of Relevant Environmental Variables

The first most important step in environmental forecasting is identification of the environmental variables critical to the firm. All environmental variables do not have the same relevance to all the industries or firms. A variable that is relevant to one industry may not be relevant for another. Again, important developments in some market may not have any implications for some other markets. *For example,* the high level of penetration of microwave ovens in some of the developed countries like USA is a critical variable as far as food processing industry in that market is concerned; but it is not relevant in markets where the microwave ovens have not penetrated – if micro-waveable packaging increases the cost of the product it could be a negative factor in such markets. Similarly, a factor relevant in one technological environment may not be relevant in a different environment. Diesel price is a critical factor for railways which use that energy source but not for those which depend on electricity (assuming that there is no competition between those depending on these two different energy sources).

Some demographic trends have implications for certain business. A falling birth rate is a threat to several businesses (*for example,* for companies like Johnson & Johnson, which depends heavily on the baby segment of the market). The increase in the longevity and the resultant increase in the number of aged generates good demand for several goods and services.

To envision the future environment it is essential to identify the critical environmental variables and to predict their future trends. Omission of any critical variable will affect the assessment of the future environment and strategies based on that premise. Similarly, inclusion of variables which are not adequately relevant could have misleading effects.

Pearce and Robinson point out that the list of key variables that will have make or break consequences for the firm can be kept to manageable size by limiting key variables in the following ways.[2]

1. Include all variables that would have a significant impact although their probability of occurrence is low. Delete others with little impact and low probability.
2. Disregard major disasters, such as nuclear war.
3. Aggregate when possible into gross variables (*e.g.,* a bank loan is based more on the dependability of a company's cash flow than on the flow's component sources).
4. If the value of one variable is based on the value of the other, separate the dependent variable for future planning.[3]

Collection of Information

The key environmental variables having been determined, the next important step is the collection of the needed information. This involves identification of the sources of information, determination of the types of information to be collected, selection of methods of data collection and collection of the information.

Selection of Forecasting Technique

The dependability and usefulness of the forecast depend a lot on the appropriateness of the forecasting technique used.

The choice of forecasting technique depends on such considerations as the nature of the forecast decision, the amount and accuracy of available information, the accuracy required, the time available, the importance of the forecast, the cost, and the competence and interpersonal relationships of the managers and forecaster involved.[4]

One issue often debated is the *quantitative techniques versus qualitative techniques*. The fact is that each has its own merits and limitations. Some people have a mistaken notion that quantitative techniques are highly dependable and qualitative techniques are often too subjective that they are not reliable. The dependability of the quantitative techniques is affected by the accuracy / reliability of the data used. It is pointed out that the difference in the predictions using each type of approach is often minimal. Additionally, subjective or judgement approaches may often be the only practical method of forecasting political, legal, social, and technological trends in the remote external environment. The same is true of several trends in the task environment, especially customer and competitive considerations.[5]

Monitoring

The characteristics of the variables or their trends may undergo changes. Further, new variables may emerge as critical or the relevance of certain variables may decline. It is, therefore, necessary to monitor such changes. Sometimes the changes may be very significant so as to call for a re-forecasting.

TYPES OF FORECASTING

Forecasts of the important business environments, viz; economic environment, social environment, political environment etc. would be useful in formulating plans and strategies.

Economic Forecast

The fact that economic environment is a very critical determinant of business prospects underscores the importance of economic forecasts.

Important economic factors often considered include general economic conditions, GDP growth rate, per capita income, distribution of income, structural changes in GDP, investment and output trends in different sectors and subsectors / industries, price trends, trade and BOP trends etc.

The macro economic forecasts serve as a base for deriving industry and company forecasts.

There are indeed a number of sources of short, medium and long-term forecasts. International organisations like World Bank, IMF, UNCTAD, UN, WTO etc. and regional organistions like Asian Development Bank have periodic and occasional publications which provide, inter alia, economic forecasts.

The Planning Commission and several other bodies like, *for example,* National Council of Applied Economic Research (NCAER) and Confederation of Indian Industry (CII) make macro economic estimates and forecasts of the Indian economy. Sector specific organisations do such things for the concerned sectors.

Planning Commission's estimates of some vital variables for the Ninth Plan 1997 – 2002 and the Perspective Plan (1997-2012) are given in Tables 2.1 and 2.2.

TABLE 2.1 : ALTERNATIVE GROWTH PERSPECTIVES

(per cent)

	Eighth Plan	15 year Perspective Plan	
		Scenario I	Scenario II
1. Growth rate of GDP	6.8	6.5	7.4
2. Investment rate	24.9	27.4	29.8
(a) Private	16.6	18.5	21.2
(b) Public	8.3	8.9	8.6
3. Saving rate	23.8	25.3	27.2
(a) Private	22.4	23.6	25.1
(b) Public	1.4	1.7	2.1
4. CAD to GDP ratio	1.1	2.1	2.6
5. ICOR (absolute)	3.7	4.2	4.0
6. Unemployment rate (Terminal year)	1.5	2.5	3.5

Notes : 1. Growth Rates of GDP is at Factor Cost.
2. Investment and Saving rates are expressed as ratios to GDP at market prices.
3. Unemployment is on Usual Status basis.

It may be noted that one of the eight components of the world competitiveness index used in the *World Competitiveness Report* is technology which measures computer usage, the spread of new technologies, the ability of the country to absorb new technologies and the level and quality of Research and Development.

The Technology Information, Forecasting and Assessment Council (TIFAC) established in 1988 has done considerable work to draw up a Technology Vision 2020 for India. It is among the tasks of TIFAC to look ahead at the technologies emerging worldwide and pick those technology trajectories which are relevant for India and should be promoted.

Brainstorming and Delphi methods are popular in technology forecasting.

TECHNIQUES FOR ENVIRONMENTAL FORECASTING

As mentioned earlier, there are a number of quantitative and qualitative techniques used in environmental forecasting. Some important techniques are mentioned below.

Econometric Techniques

Economic techniques involve casual models to predict major economic indicators.

When there is a well established relationship between two or more variables, that casual relationship can be used to forecast the future. *For example,* if demand is a function of consumer income, the impact of an increase in consumer income on demand can be predicted using the equation representing the relationship between these two key variables.

The econometric models may "utilise complex simultaneous regression equations to relate economic occurrences to areas of corporate activity. They are especially useful when information is available on casual relationships and when large changes are anticipated."[6]

The most commonly used econometric environmental forecasting techniques are multiple regression analysis and time series regression models.

Trend Extrapolation

Time series models assume that the past is a prologue to the future and extrapolate the historical data to the future. The technique may use simple linear relationship or more complex non-linear relationships to forecast trends.

Scenario Development

A very popular and useful forecasting method is development of alternative scenarios.

When it is not possible to accurately forecast the future, the alternative scenarios help managers to formulate strategies to cope with different possible future situations. As hinted earlier (under political forecasts), Royal Dutch Shell's anticipation of a possibility of a substantial crash in oil prices in future prompted it cut exploration costs by pioneering advanced exploration technologies, massive investments in cost efficient refining facilities etc so that by 1989 its exploration costs at $2 per barrel were less than half the industry average.

"Scenario analysis is a technique used to forecast the occurrence of complex environmental events. It is particularly useful for forecasting events in which many variables play a role. Scenarios allow the integrated consideration of these multiple variables in explaining the emergence of future conditions. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organisation."[7]

Shrivastava suggests the following steps to develop scenarios.[8]

1. Identify strategic environmental issues that are likely to affect the industry/firm. Prioritize these issues in order of their importance to the firm.
2. Select the most important issues as the focus for scenario development. List the organizational assumptions with respect to these issues and identify the possible variations in these assumptions.
3. Prepare a preliminary description of these issues and how they evolved. Include the key economic, social, political, and cultural influences that affect them. Do this with help of outside industry experts.
4. Draw out the implications of the issue for organizational performance. What has the organization done and what can it do to cope with the issues? Identify those variables shaping the issue that the management can control and partially control. Also, identify those variables over which management has no control.
5. Develop detailed descriptions of the future in the form of scenarios. Scenarios are constructed under a worst case, best case, and most likely case set of assumptions. Draw out the implications of these scenarios for future performance of the company.
6. Discuss the scenarios with top management and refine them.
7. Develop contingency action plans for each scenario.

Developing alternative scenarios is common in economic planning too. The Planning Commission of India, *for example,* have drawn up alternative scenarios regarding growth rates of different sectors, poverty ratios etc. under different assumption.

Many forecasts which use the scenario method draw up three alternative scenario – a most likely scenario, a pessimistic scenario and an optimistic scenario. However, forecasts having more than three scenarios are not uncommon.

Tables 2.2, 2.4 and 2.5 provide some examples of alternative scenarios drawn up by the Planning Commission of India.

TABLE 2.3 : SECTORAL GROWTH RATES IN PERSPECTIVE PLANS

(per cent per annum)

Sectors	***Scenario I***	***Scenario II***
Agriculture and Allied	3.9	4.8
Manufacturing	8.0	9.6
Infrastructure :		
Group 1	6.3	6.6
Group 2	9.6	10.4
Services	6.8	7.5
GDP at factor cost	6.5	7.4

Notes : 1. Infrastructure Group 1 contains Construction, Rail and Other Transport.
2. Infrastructure Group 2 contains Electricity, Gas and Water supply and Communications.

TABLE 2.4 : PROJECTION OF NATIONAL POVERTY RATIOS : SENSITIVITY ANALYSIS

(per cent)

Scenario	*1996-97*	*2001-02*	*2006-07*	*2011-12*
1. Scenario I	27.17	16.00	8.01	3.51
2. Scenario II	28.99	17.84	9.45	4.35
3. Scenario III	26.98	15.86	7.93	3.48
4. Scenario IV	25.08	14.02	6.60	2.79
5. Scenario V	28.81	17.71	9.37	4.32
6. Scenario VI	24.69	13.76	6.48	2.75
Base Case	29.18	17.98	9.53	4.37

Notes : 1. Scenario I is based on a reduction of Lorenz ratio by 5%, *i.e.,* from 0.2816 to 0.2875 in rural areas and from 0.34 to 0.323 in urban areas.

2. Scenario II is based on a reduction of per capita urban-rural consumption differential by 5%, *i.e.,* from 62.78% to 59.64%.

3. Scenario III is based on the impact of both Scenario I and Scenario II.

4. Scenario IV is based on a reduction of Lorenz ratio by 10%, *i.e.,* from 0.2816 to 0.2534 in rural areas and from 0.34 to 0.306 in urban areas.

5. Scenario V is based on a reduction of per capita urban-rural consumption differential by 10%, *i.e.,* from 62.78% to 56.50%.

6. Scenario VI is based on the impact of both Scenario IV and Scenario V.

Methods of Scenario Building

Premising Method: In this method, a series of premises is drawn up from which projection of the future scenarios is made. The premises might consist of basic assumptions about certain important variables, current trends etc. Sometimes extreme projections may also be made focusing on a few tendencies and exaggerating their evolution. *For example,* the extreme possible outcome of some ethnic issues in a country.

Systems Diagram Method: The systems diagram method seeks to explore policy and strategic options based on the present system of the organisation's activities. *For example,* a newspaper firm may think of entering other media, extending the publication business, starting information service business etc. using and developing its existing capabilities.

Critical Site Method: This method which bases the scenario projection on the policy making structure of an organisation identifies the key decision making points and dynamics of the system focuses on the critical site where the key decisions are taken, such as the meeting of the Board of a company, the national convention or the meeting of the policy decision making body of the relevant political party, critical meetings of organisations like OPEC or WTO etc. Scenarios are drawn up based on the anticipation of the possible critical decisions made at such sites and their future implications.

The Newspaper Headline Method: In this method the scenario writer posits one or more hypothetical headlines for some future date such as: New Delhi, January 20, 2010: "The three surviving car manufactures in India intensify the battle for market share." The scenario writer then tries to map out the possible developments in the industry during the course and chart out a strategy for the company to successfully navigate through.

Logical Possibilities Method: This method which generates alternative scenarios based on those already developed is used as a supplement to other methods.

Judgement Models

Judgement models involve the use of opinion of people who have intimate knowledge of relevant factors. *For example, sales force's opinion* of the sales potential, competitive challenges, customer behaviour etc. Another method is *juries executive opinion* which "combine estimates made by executives from marketing, production, finance and purchasing and then average their views"[9].

The Delphi method described below is a refined judgement model.

Brain Storming

Brain storming is a creative method of generating ideas and forecasts. Under this method, a group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. With a view to encouraging throwing up new ideas without any reservation, the discussion and evaluation of the ideas generated is often done only after the idea generation process is over.

Brain storming is a popular technique of technological forecasting.

Delphi Method

The Delphi method, which is also a common technique of technological forecasting, is a more systematic technique than brain storming.

This method uses a panel of experts on the subject from whom opinions are gathered, may be by using a semi-structured questionnaire and/or interview. The opinions of the experts are documented and consolidated and circulated among the panel members, preferably anonymously, for their evaluation and comments. The experts are requested to review their opinion in the light of the feedback. This process may be continued until a consensus view is arrived at.

The RAND Corporation which pioneered the use of this technique used it to predict the impact of the formation of the OPEC on oil supplies and oil prices. Other applications of this technique included assessing trends in terrorist activities and their influence on international businesses and prioritising domestic social programmes.

Strategic Issues Analysis

Strategic issue analysis is a qualitative technique that can be used for assessing emerging strategic environmental issues. It consists of systematically monitoring of social, regulatory and political changes that can affect corporate performance and identifying their impact on the company. *For example,* companies which were doing business in South Africa used this technique to assess the impact of racial tensions there on their worldwide business. Similarly, chemical companies, such as Du Pont, Monsanto, and Stauffer Chemicals have used this techniques for assessing the impact of environmental movement on the cost of doing business.[10]

BENEFITS/IMPORTANCE OF ENVIRONMENTAL ANALYSIS

Environmental analysis has several benefits like those mentioned below.

1. The very idea of environmental analysis makes one aware of the environment-organisation linkage.
2. A corollary of the above is that (environmental analysis helps) an organisation to identify the present and future threats and opportunities.
3. Environmental analysis will provide a necessary and very useful picture of the important factors which influence the business.
4. Environmental analysis helps to understand the transformation of the industry environment.
5. Technological forecasting will indicate some of the future opportunities and challenges.
6. A very important benefit of environmental analysis is its contribution to identification of risks.
7. Environmental analysis is a prerequisite for formulation of right strategies – corporate, business and functional.
8. Environmental monitoring helps suitable modifications of the strategies as and when required.
9. Environmental analysis keeps the managers informed, alert, and often dynamic.

LIMITATIONS OF ENVIRONMENTAL FORECASTING

Environmental forecasting has several limitations. Some of the limitations arise from the forecasting techniques used.

Further there are also chances of certain errors affecting the reliability of the forecasts. Errors may occur.[1]

1. The selection of the variables included in the predictive model.
2. The selection of the functional form for linking these predictor variables to the variable(s) being predicted and
3. The estimation of the 'correct' values for the predictor variables.

Several techniques use opinions of people and they may be affected by subjectivity.

SUMMARY

Adequate and reliable information is a prerequisite for managerial decision making. That strategic management is establishing the right 'firm-environment' fit and further that strategic decisions involve committing resources today for tomorrow make clear the importance of environmental analysis, including environmental forecasting, to strategic management.

Figure 2.1 provides a summary view of the salient aspects of environmental analysis and forecasting.

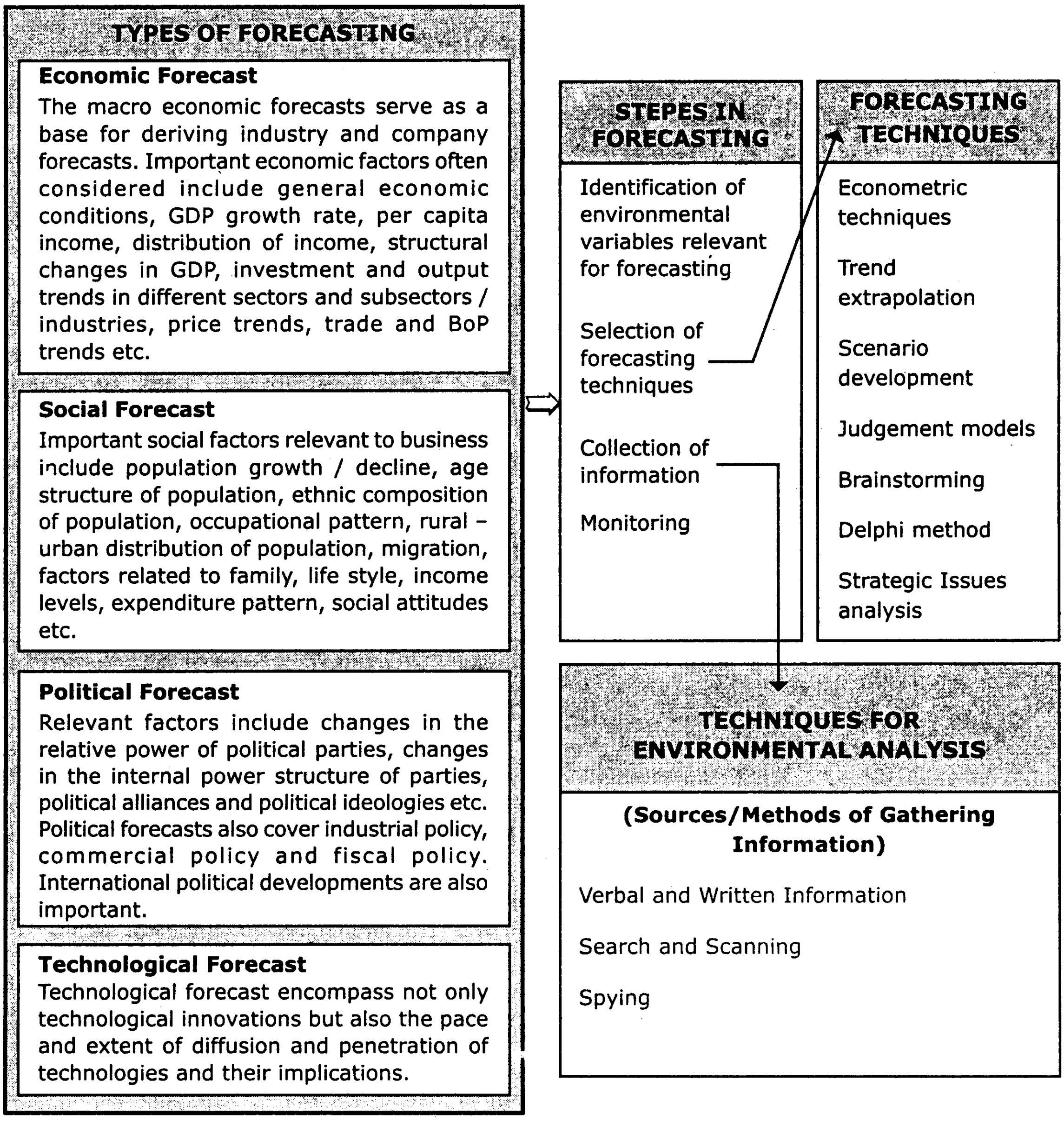

Fig. 2.1 : Epitome of Environmental Forecasting

Differences in the income levels between countries is not a true reflection of the purchasing powers or living standards of people. *For example,* international comparisons of GNP and per capita income in a nominal currency unit (say US dollar) do not reflect a realistic picture because the purchasing power of the national currencies vary. Further, exchange rate changes would give a misleading picture of the economic position of the country when the income is converted into dollars from the national currency. For instance, if the national currency has depreciated against the dollars at a rate higher than the GNP growth rate, when the GNP is converted into dollar, it will show a decline even though the GNP has actually increased in terms of the national currency. To overcome such problems, it has become common to estimate the GNP and per capita income at purchasing power parity (PPP) too. *For example,* in 2000 the per capita income of India was estimated at $ 598; in PPP terms it was estimated at $ 2840. What it means is that a bundle of goods which costs $ 598 in India will cost $ 2840 in USA. In other words, having $ 598 in India is equivalent to having $ 2840 in USA.

TABLE 3.1 : SOME ECONOMIC COMPARISONS, 2000

Country/Region	*GNP*		*GNP (PPP)*		*GNP Per capita*	*GNP (PPP) Per capita*
	$ billion	*Rank*	*$ billion*	*Rank*	*(Dollars)*	*(Dollars)*
U S A	9,646	1	9,646	1	34,260	34,260
Japan	4,337	2	3,354	3	34,210	26,460
Germany	2,058	3	2,054	5	25,050	25,010
U K	1,464	5	1,407	7	24,500	23,550
France	1,429	4	1,440	6	23,670	24,470
Italy	1,154	6	1,348	8	20,010	23,370
China	1,065	7	4,966	2	840	3,940
Canada	647	8	840	11	21,050	27,330
Brazil	607	9	1,245	9	3,570	7,320
Spain	590	10	757	1	14,960	19,180
Mexico	498	11	864	10	5,080	8,810
India	***471***	***12***	***2,432***	***4***	***460***	***2,390***
World	**31,171**	**–**	**44,506**	**–**	**5,150**	**7,350**
High Income Countries	*24,829*	–	*24,781*	–	*27,510*	*27,450*
Middle Income Countries	*5,308*	–	*15,229*	–	*1,970*	*5,650*
Low Income Countries	*1,030*	–	*4,892*	–	*420*	*1,990*

Source : World Bank, *World Development Report 2002*

Developing and Developed Economies / Countries is an often used classification of countries.

Low income and middle income economies are developing economies. The developed economies as a group are sometimes referred to as the *North* as they, with some exceptions like Australia and New Zealand, are in the northern hemisphere and the developing economies are referred to as the *South* as most of them are in the southern hemisphere.

The use of the terms developed and developing, though convenient, is not, however, intended to imply that all economies in the group of developing are experiencing similar; development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status. In the group of the high income economies, the industrial economies are developed economies; all the oil exporters are not developed economies (*For example,* Kuwait and UAE, though high income economies, are regarded as developing economies). Besides income, some other criteria such as the sectoral distribution of the income and employment generation, social development indicators etc., are applied to consider whether an economy is a developed or developing one. Besides the income and social dimensions, there are a number of common characteristics of developed economies. They are characterised by widespread use of modern and sophisticated technology; continuous innovations; fast diffusion of new ideas and technologies; low share of the primary sector (mainly agriculture) and dominance of the tertiary (service) sector and secondary (mostly manufacturing) sector in the income and employment generation; market friendly economic policies; comparatively open trade and investment policies; democratic rights; competition and consumer choice etc.

Some times the terms *less developed* countries (LDC) and *more developed* countries (MDC) are used to refer to the developing and developed countries. The use of the term *underdeveloped* to refer to the developing countries is also common.

Low income is just an indication of deprivation people in developing countries. Low income prevents access to even basic necessities, not only better and modern amenities.

Further, in the developing economies the inequality in the distribution of income is very high and as a result a large proportion of the population lives in object poverty. Although many countries have achieved considerable reduction in poverty, the incidence of poverty is very high in many countries. They are generally characterised by high birth and population growth rates. Death rates are also higher than in developed countries.

Developing countries are generally characterised by the prevalence of rudimentary and traditional methods and obsolete technology.

The group of developed as well as the developing countries is a heterogeneous mixture. Because of the large number, the developing countries exhibit a very diverse spectrum.

Within the category of low income economies, *for example,* sometimes a special category by name *least developed economies* is identified. Most of the least developed economies suffer from one or more of the following constraints: a very low GNP per capita, land locked remote insularity, desertification and exposure to natural disasters. According to the *Human Development Report 2000*, there were more than 40 least developed countries in 1999, including Bangladesh, Bhutan, Nepal, Maldives, Mali, Uganda, Myanmar, Sudan, Zambia, Zimbabwe, and Yemen.

There are, on the other hand, developing economies which have been experiencing rapid industrialisation such as Hong Kong, South Korea, Singapore and Taiwan (*i.e.,* Taipei, China) – the Asian Tigers. They are sometimes referred to as *newly industrialising economies*. Some publications use the term newly industrialised (instead of industrialising) to refer to them. Now Peoples Republic of China is regarded as a newly industrialising economy. The newly industrialising economies show

ECONOMIC POLICIES

There are several economic policies which can have a very great impact on business. Important economic policies are industrial policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology policy.

Some types or categories of business are favourably affected by government policy, some adversely affected, while it is neutral in respect of others.

Similarly, an industry that falls within the priority sector in terms of the government policy may get a number of incentives and other positive support from the government, whereas those industries which are regarded as inessential may have the odds against them.

Industrial Policy: Industrial policy can even define the scope and role of different sectors like private, public, joint and cooperative, or large, medium, small and tiny. It may influence the location of industrial undertakings, choice of technology, scale of operation, product mix and so on.

In India, until the liberalisation ushered in 1991, the scope of private sector, particularly of large enterprises, was very limited. The development of 17 of the most important industries was reserved for the state. In the development of another 12 major industries, the state was to play a dominant role. In the remaining industries, co-operative enterprises, joint sector enterprises and small-scale units were to get preferential treatment over large entrepreneurs in the private sector. Further, the production of a large number of items was reserved for the exclusive manufacture of the small scale sector. Even in respect of industries which were open to the private sector, entry and growth were regulated by licensing and also by, in the case of certain categories of large firms, the MRTP Act. The government policy, thus limited the scope of private business. However, the new policy ushered in July 1991 has wide opened all but a few industries for the private sector, dramatically changing the business environment. In the pre-liberalisation era, the government policy was a severe constraint on the portfolio and growth strategies of companies.

The liberalisation has enormously expanded the business opportunities. It has at the same time tremendously increased the competition tending to make survival of the fittest the order. While many companies entered new businesses, many exited from some of their old businesses, unable to be competitive in the new environment. A number of companies have done both.

Trade Policy: The trade policy can significantly affect the fortunes of firms. *For example,* a restrictive import policy, or a policy of protecting the home industries, may greatly help the import competing industries, while a liberalisation of the import policy may create difficulties for such industries.

Trade policy is, often, integrated with the industrial policy. As part of the economic liberalisation and WTO compliance, India has very substantially liberalised imports. Domestic firms now face increasing competition from imports. In other words, they face a growing international competition in the domestic turf. This implies that in many cases Indian firms which do not come up to the international standards – in quality, cost, marketing, after sales service etc. – will not be able to survive. And a firm which effectively fights foreign competition in the home market may be provoked to think 'why not compete with foreign firms in the foreign markets.'

Liberalisation of imports facilitate global sourcing and this could help many Indian firms to become more competitive.

Foreign Exchange Policy: Exchange rate policy and the policy in respect of cross-border movement of capital are important for business. The abolition/liberalisation of exchange controls all around the world since the late 1970s has encouraged cross-border movement of capital, for example.

TABLE 3.3 : INDIAN ECONOMIC REFORMS AND ENVIRONMENTAL CHANGE

Pre-1991 situation	*Post-1991 situation*	*Consequence/implication of the change*
Private sector excluded from many important industries. In a number of other important industries public sector had priority to establish new undertakings.	All but a few industries are open to the private sector.	Enormous scope for private investment. Considerable freedom to decide the portfolio strategy. Competition increases substantially and public sector loses its monopoly/ dominant positions.
Entry, involving investment above specified exemption limit, was restricted by licensing.	All but a few industries are free from licensing.	Reinforces the above factors.
Entry of large firms was subject to MRTP Act restrictions, besides licensing.	No MRTP Act restrictions on entry.	Reinforces the above factors.
Licensing and MRTP Act restrictions on growth of existing undertakings.	All but a few industries are free from licensing restrictions on growth. No MRTP Act restrictions on growth.	Companies can grow organically and by acquisitions. Firms will grow in size and several industries will witness consolidation of firms. A small number of firms would eventually dominate the industry in several cases.
Limited scope for foreign capital and technology.	Foreign capital and technology policies have been substantially liberalised.	Entry of many foreign firms by green-field projects and acquisitions. Opportunity for Indian firms for acquiring technology and establishing joint ventures. Substantial increase in competition.
Highly restrictive import policy.	Imports substantially liberalised.	User industries can benefit by global sourcing. Import competing firms face stiff competition. Global competition emerges in the Indian market. Indian firms will have to improve their competitiveness and become more innovative to face the global competition.

Foreign Investment and Technology Policy: Until the late 1980s, when the world wide trend towards liberalisation set in, foreign capital and technology were under severe restrictions in many developing and socialist/communist countries.

Restrictions on foreign capital and technology constrain not only the foreign firms but also the domestic firms because it may come in their way of acquiring the technology of their choice from the best source. Restrictions on foreign capital may affect the growth plans of firms, including establishment of joint ventures. India has restrictions on foreign investment by Indian companies.

Huge investments in infrastructural and other vital sectors can significantly improve the environment for industrial development, as in the case of China.

A liberal foreign investment and technology policy will increase domestic competition and would put many domestic firms, which were shielded from foreign competition, in to problems. At the same time it would benefit many domestic firms – by permitting global sourcing of capital and technology, by increasing the quantity and quality of domestic supply of many goods and services etc.

Fiscal Policy: Government's strategy in respect of public expenditure and revenue can have significant impact on the business. The pattern of public expenditure may affect the development of various regions, sectors and/or industries differently. Such is the case with the taxation policy. Governments often use tax incentives or disincentives to encourage or discourage certain activities. *For example,* when an industry suffers from recession, a reduction of taxes like excise duty or sales tax may help improve the demand. A reduction of rates of direct taxes like personal income tax and corporate tax may help increase, because of the resultant increase in the disposable income, the spending in the economy leading to an increase in demand. Governments, central as well as provincial, of many countries offer different fiscal incentives to woo industries.

BOX 3.1 : PUSHING INDICA

Ratan Tata wants the government of Maharashtra to push the Indica, whose sales are sputtering. The second quarter (of 2000 – 01) has reported a 22.2 per cent slump from the first quarter's figure, and the third quarter is unlikely to see a major acceleration. So, Mr Tata is lobbying chief minister Vilasrao Deshmukh for tax cuts. He seems to believe that sales will spurt if the Indica is exempt from sales taxes in Maharashtra. This is a dubious assumption. Premier Automobiles Ltd (PAL) was fattened on tax breaks in Maharashtra, one reason why Mumbai still has a large population of aged Padminis. The sops could not keep PAL afloat. Ineptitude — the inability or unwillingness to invest and compete against rivals like Maruti and later, other rivals — drove it to the wall. Car sales can't be fuelled by tax breaks alone. Remember, market leader Maruti get no sales tax breaks, but outsells all rivals combined by comfortable margin.

Mr Tata can, correctly, say that Hyundai and Ford enjoy sales tax breaks in Tamil Nadu, while Daewoo buyers pay no sales taxes in UP. Maharashtra lost the Ford and Hyundai investments, because Ms Jayalalitha was ready to forgo revenues which it was not. Arguments like these should not sway Mr Deshmukh. Globally, decentralised states compete to give tax breaks to attract investments. This kicks off a race to the bottom. The quality of administration and public investment fall as revenues dry up. Rather than following other chief ministers in their headlong rush toward fiscal anarchy, Mr Deshmukh should take a longer view of competitiveness. He should use revenues to improve the quality of governance, build roads and infrastructure.

These will cut costs and boost productivity of manufacturers based in Maharashtra. That is better than tax freebees on several counts. One, better infrastructure and administration will attract new investors; two, existing play will become more competitive as major costs decline; third, the fiscal position will be sound. The biggest gain could political: voters like governments that work for them, *i.e.,* those that go bust handing sops to industry.

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