UNIT 1

Introduction

1. Business and Its Environment
2. Economic Environment of Business : National
4. Non-Economic Environment of Business
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PART — I

Economic Environment of Business : Theoretical Analysis

"Companies and their suppliers, marketing intermediaries, customers, competitors and publics operate in macro-environment, of forces and trends that shape opportunities and pose threats. These forces represent 'non-controllables', which the company must monitor and respond to. In the economic area, companies and consumers are increasingly affected by global forces."

— Philip Kotler

CHAPTER

1 BUSINESS AND ITS ENVIRONMENT

Meaning of Business
Nature of Modern Business
• Large Size • Oligopolistic Character • Diversification • Global Reach • Technology Orientation • Change • Government Control
Environment of Business
• Internal Environment • External Environment • A. Micro Environment; B. Macro Environment

In a simple economy, where most people produced commodities for self consumption, markets were non-existent and hardly any worthwhile business transactions were conducted. However, with the industrial revolution radical changes occurred in the western economies and business became central to human activity. Now production is carried out mostly by corporate enterprises for global markets. Under the circumstances it is difficult to conceive of a society in which business does not hold an important position. In fact, modern business is only next to the State in importance. The State now ensures stability in the political organisation which is so necessary for business activity. Business contributes to economic growth, creates employment opportunities and provides all kinds of goods and services which we need for our consumption. In substance, ***present day humans cannot manage their lives at the existing level of economic comforts without buoyant business activity.*** In an attempt to explain how environment influences business, we address the following questions :

- What is the meaning of business and how one understands the nature of modern business ?
- How is internal environment of business different from its extenal environment ?
- How can one distinguish between micro and macro environment of business ? From the point of view of present day business which is more relevant ?

MEANING OF BUSINESS

In common parlance business refers to buying and selling of goods. For our purpose this concept of business is too general and thus cannot be of great help in analysing the role of environment in present day business activity. We shall, therefore, attempt to define business in more concrete terms. ***Modern business covers a complex field of industry and commerce which involve activities related to both production and distribution. These activities on the one hand satisfy society's needs and desires and on the other hand bring profits to business firms.***

Let us now spell out the numerous activities involved in organising production and delivering the end product to the ultimate users, as they all constitute business. A careful analysis of all these activities will reveal that the scope of business is vast. Consider that any product that we now use, is to be produced by some business firm. The producer first obtains various inputs to manufacture it. Its production also involves raising of financial resources without which the firm cannot have inputs needed for production purposes. Business firms raise funds from the capital market by issuing shares and debentures and borrow from both banks and non-bank financial institutions. Once the finished product is ready, it has to be transported to the market. Usually there is a chain of distributing agencies through which the product has to pass before it reaches the ultimate users. Advertising plays an important role in creating awareness about the product. Since production and distribution of a product involve heavy investment, business firms cover various risks by securing services of insurance companies. ***Business, in brief, includes activities connected with production, trade, transport, finance, banking, insurance, advertising and certain other activities related to industry and commerce.***

All the business activities are motivated by profits. In case, any of these activities is carried out by some organisation for purposes other than profit seeking, it cannot be justifiably considered as business. Therefore, if during war some industrial units produce certain goods for the army and do not receive any price for these products, their activities would not be regarded as business.

NATURE OF MODERN BUSINESS

Over the years business has undergone radical changes and thus modern business in its nature is significantly different from what it was a few decades ago. In the following discussion we shall attempt to spell out characteristics of modern business which are as follows :

- Large size
- Oligopolistic character
- Diversification
- Global reach
- Technology orientation
- Change
- Government control

Large Size

Business that matters today is large in size. Indian companies in terms of sales revenues, profits, assets and stockholders' equity are relatively small as compared to the companies in developed countries. Only four companies figure in the *Fortune* list for 2003. These are Indian Oil, Bharat Petroleum, Hindustan Petroleum and Reliance Industries. Out of these first three are public sector undertakings. Indian Oil ranked 189 in the top 500 with a revenue of $ 25.3 billion. Reliance Industries, a private sector undertaking ranked 482 with a revenue of $11.3 billion.

Wall-Mart Stores of the United States was the world's largest company in 2003. Its total revenue was $ 263.0 billion or equivalent of Rs. 11,83,500 crore. This was around 50 per cent of India's GDP. Presently there are numerous corporates which are bigger in economic terms than most of the nation economies. Today no one feels surprised to know that Ford Motor and Toyota are economically larger than the fourth most populous country in the world, namely, Indonesia. Wal-Mart Stores and automobile giants like General Motors and Ford Motor have resources substantially larger than those of Norway, Denmark, Greece and Portugal. All these countries are developed countries, yet resources at their command are far less than the resources of some of the global giants. Interestingly, Malaysia which is considered to be a miracle economy had lower GNP in 2003 than the revenues of each of the top 20 *Fortune* corporations.

There were 13 companies in the top 500 in 2003 with revenue exceeding $ 100 billion (Rs. 4,50,000 crore). Apart from ***Wal-Mart Stores these included Exxon Mobil, General Motors, Ford Motor, General Electric, Citi Group, Daimlerchrysler of Germany, BP of Britain, Mitsubishi, Toyota Motor, Mitsui, Itochu, and Nippon Telegraph and Telephone of Japan, Total Fina Elf of France and Royal Dutch/Shell Group of Britain/Netherlands.*** The total revenues of the smallest corporation among the *Fortune* 500 companies were $ 10.8 billion (Rs. 43,200 crore). The world's 500 largest companies earned a total revenue of $ 14,873.0 billion which was more than 30 times India's GDP.

Most of these Fortune 500 companies are located in the USA, Japan and Europe. The USA is the biggest capitalist economy. 189 of the world's largest companies belong to this country. Japan, the second largest economy, is far behind. It had 82 of the *Fortune* 500 companies in 2003. European economies are relatively small. But if we consider Western Europe as a unit, then we find that, it is the house for 138 of the world's largest companies. The companies in Europe are however specialised, largely family owned and smaller in size. Nonetheless all these companies have tremendous international presence.

Most of the companies established in developing countries are smaller in size and thus only a few companies from these countries figure in the list of *Fortune* 500 companies. In 2006, only the companies from

China, South Korea, Brazil, India, Malaysia, Mexico, Thailand and Venezuela could find a place in the *Fortune* 500 list. Most of the Chinese companies are, however, State owned. In contrast, the largest companies located in South Korea are in the private sector.

Indian private sector companies in terms of sales and assets may not look as impressive as the companies in developed countries, yet they are quite large by the standards of developing countries and compare favourably even with a large number of middle size corporate enterprises in western countries and Japan. In 2006, Reliance Industries was ranked first in India. Its assets were as large as Rs. 96,871 crore. Its sales at Rs. 80,055 crore were also fairly large. In all, there were ten companies including private sector giants Larsen and Toubro, Tata Motors, Tata Steel, Maruti Udyog, Sterlite Industries, Hindalco and Bharti Airtel with sales exceeding Rs. 11,000 crore. Each of these companies had assets worth Rs. 8,400 crore or more. For more on size of business refer to Table 1.1 based on *Fortune-2004 Global 5 Hundred.*

Oligopolistic Character

Present day business is mostly oligopolistic in its nature. Oligopolistic business is characterised by a small number of firms selling a homogeneous or a differentiated product. Each firm in an oligopolistic market believes that any change in its price and sales, or in the quality of its product, advertising expenditure or any other variable whose value is under its control is likely to evoke retaliation from other firms in the same line of business. ***The key feature of an oligopolistic business is recognised interdependence among the sellers.***

Oligopolistic business usually emerges from a number of factors which either alone or in some combination may operate. *First,* in certain situations some firms come to enjoy absolute cost advantages over other firms, as a result of which they operate at a price that is too low from the point of view of other firms. *Secondly,* economies of large scale production often allow some firms to corner the entire supply of a product. *Thirdly*, financial capital requirements of modern business are quite large and these forestall entry of too many firms in the business. *Fourthly,* mergers and acquisitions induced by profit possibilities undermine competition and thereby lead to growth of oligopolistic business. *Finally,* product differentiation provides an important advantage to certain firms which manage to control a large proportion of total sales.

In modern oligopolistic business, ***collusion*** is very common. There are two broad categories of collusion: ***cartel*** and ***price leadership***.

A cartel is a combination of business firms constituted with the objective of limiting competition in the market so as to maximise the profits. Cartel may take the form of open or secret collusion. In open collusion, firms enter into an enforceable contract pertaining to price and/or sharing of market. Open collusions are now illegal in a number of countries and even in those countries where these have not been declared unlawful, firms avoid entering into open collusion for fear of inviting State intervention. Secret collusions are quite common even in countries where their formation is not permissible under law. Broadly there are two typical forms of cartels: (*i*) cartels aiming at joint profit maximisation, and (*ii*) cartels aiming at the sharing of the market.

Another way to eliminate uncertainty in oligopolistic markets is to have ***tacit agreements amongst the various firms giving rise to price leadership. Price leadership is subject to much lesser form of collusion as compared to cartels.*** In this arrangement, there is no organisation like cartel to control sales or output. Therefore, this tacit collusion in terms of price leadership is more acceptable to members.

All oligopolistic businesses are, however, not collusive. The number of oligopolistic businesses in which firms pursue ***co-optition***[1] or act independently of others is not small. In some cases independent action leads to price wars and in other cases it results in non-price competition. When some firm not recognising the implications of interdependence of sellers lowers the price of its product with the expectation of increasing its sales, it often compels the rival firms to retaliate. In case the rivals retaliate with vengeance, it may prove to be disastrous for some firms. When price war spreads throughout the industry and each individual firm tries to undercut others, the possibility of price falling to the perfectly competitive price level cannot be ruled out. In a relatively new industry, sellers are not certain about the reactions of rival firms and thus they often inadvertently start price war. Maturity on the part of the firms in an old industry reduces the likelihood of price wars. In India, the typical case of price war relates to colour television market.

Under oligopolistic market conditions, firms are often reluctant to lower the price of their products in order to expand their market, because it can lead to price war. However, they attempt to accomplish same results by using ***product differentiation*** which is more subtle and a much safer method to realise the same objectives.

TABLE 1.1. The World's Largest Corporations

Rank 2003	Rank 2002	Company Name	Home Country	Revenues $ billion	Assets $ billion
		Developed Countries			
1	1	Wal Mart Stores	US	263.0	104.2
2	5	BP	UK	232.6	177.6
3	3	Exxon Mobil	US	222.9	174.3
4	4	Royal Dutch/Shell Group	UK/Netherlands	201.7	168.1
5	2	General Motors	US	195.3	448.5
6	6	Ford Motor	US	164.5	304.6
7	7	Daimlerchrysler	Germany	153.6	224.9
8	8	Toyota Motor	Japan	153.1	211.9
9	9	General Electric	US	134.2	647.5
10	14	Total	France	118.4	100.9
11	12	Allianz	Germany	114.9	1180.5
12	15	Chevron texco	US	112.9	81.5
13	31	Axa	France	111.9	566.6
14	36	Conocophillips	US	99.5	82.5
15	20	Volkswagan	Germany	98.6	150.3
16	16	Nippon Telegraph & Telephone	Japan	98.2	186.8
17	17	ING Group	Netherlands	95.9	982.3
18	13	City Group	US	94.7	1264.0
19	19	Intl. Business Machines	US	89.1	104.5
20	25	American Intl. Group	US	81.3	678.3
		Developing Countries			
46	—	State Grid	China	58.3	127.1
53	70	Sinopec	China	55.1	67.6
54	59	Samsung Electronics	South Korea	54.4	57.4
65	95	Pemex	Mexico	49.2	74.1
73	69	China National Petroleum	China	47.0	97.7
76	—	Povsa	Venezuela	46.0	58.0
98	94	Huyndai Motor	South Korea	39.1	45.5
119	108	SK	South Korea	33.8	34.8
144	189	Petrobras	Brazil	30.8	93.6
147	261	LG Electronics	South Korea	29.9	20.2
167	235	Gazfram	Russia	27.5	90.9
186	204	Petronas	Malaysia	25.7	53.5
189	191	Indian Oil	India	25.3	14.0
241	290	China Life Insurance	China	20.8	55.1
242	230	Mobile Communications	China	20.8	49.7
243	237	Industrial and Commercial Bank of China	China	20.8	637.8
275	254	China Telecommunications	China	17.1	61.7
259	377	Lukoil	Russia	19.3	26.6
263	236	Samsung Life Insurance	South Korea	19.2	72.7
265	279	Korea Electric Power	South Korea	19.1	60.2

Source: *Fortune*, No. 13, August 2, 2004.

Non-price competition occurs in two major forms: (1) advertising, and (2) variation in quality and design of product. Advertising generally raises the demand for the product of the firm which undertakes it on a fairly large scale. The firm thus manages to sell a larger quantity of its product at the same or even at a higher price without risking a price war. It is this reason why in an oligopolistic market a firm attempts to encroach on the markets of rival firms through advertising. Since rival firms will take some time to launch similar advertising programmes, the firm taking lead in advertising campaign makes profits during the time lag period.

In many cases, advertising campaigns by the rival firms only increase the costs and price and there is little gain in terms of profits. Competitive advertising has not been beneficial even to the consumers because they have been made to pay more for the product without any improvement in its intrinsic worth.

Variations in quality and design are often used by firms to differentiate their products from the products of rival firms. When a firm combines product variation with advertising, the demand for the product of the firm concerned shows a tendency to increase and becomes less elastic. In most cases, however, rival firms do not sit idle when they find that their markets are shrinking. They retaliate with their improved brands. Therefore, individual firms are likely to succeed in expanding their markets only temporarily, but if they wish to secure larger market shares permanently, they will have to keep themselves ahead of their rivals. In oligopolistic markets, usually the same firm produces different product qualities to sell them to different groups of buyers at different prices.

Diversification

Modern business in its attempt to grow overtime has taken recourse to diversification. Today not many corporate enterprises confine their activities to production of a single commodity. However, diversification of production by modern corporate enterprises is not always along a uniform pattern. Some business firms prefer to add new related products to their existing production. This is called concentric diversification. Adding new unrelated products or services for existing customers is known as horizontal diversification. Big business houses usually expand their activity by establishing new companies which undertake production of unrelated new products or services. This is ***conglomerate diversification.*** Indian business has undertaken diversification along all these lines. Philips India, a subsidiary of the Dutch multinational giant, Royal Philips Electronics N.V. has operated in India for more than six decades with mainly lighting and audio products. Lately Philips has introduced several colour televisions and audio products. Its new range of products has targeted different consumer segments. This diversification induced by marginalisation of Philips in the Indian market is essentially horizontal diversification. Maruti Udyog Limited, in contrast, is a good example of ***concentric diversification.*** In automobile manufacturing, it now has diversified products such as Maruti 800, Zen, Esteem, Omni, Baleno, Alto, Estilo, Wagon R and Swift. Business houses in India have invariably preferred conglomerate diversification. The Tata group is one of the largest business houses in India. The range of its business is quite extensive. It covers iron and steel, engineering, commercial vehicles, passenger cars, chemicals, fertilisers, tea, textiles, electronics, computers, oil and power among others. Likewise the business of the Birla group is already diversified into areas as diverse as cement, aluminium, copper, fertilisers, chemicals, viscose staple fibre (VSF), telecom, power, oil refining and financial services. The Ambani group is well entrenched in textiles, fibres, plastics and petro-chemicals, the J.K. group has interest in textiles, engineering, computers, chemicals, tyres and tubes, sugar, paints, shipping and finance, and the Modi group has rubber, computers, telecom equipment, xerox machines, cellular telephony and paper products in its portfolio. Larsen and Tourbo is a highly diversified company. It has businesses spanning not only cement and construction but also electrical, electronics, earth-moving equipment and even glass bottles.

However, diversification may not always contribute to growth of a business enterprise. In the recessionary phase, it is quite risky to aspire for growth by going for unplanned diversification. In India, some big companies, including DCM, Britannia, ITC and Nelco did not benefit from diversification. Hence, companies lacking resources and managerial expertise do not foray into new businesses. In some of the developed countries, even business giants show reluctance to diversify. These companies are usually more interested in expanding their business through mergers and acquisitions of companies operating in their own lines of production. Even in the Indian markets some of the business giants have preferred takeover of companies in their own areas. Coca Cola, for example, has taken over Parle Soft Drinks and Whirlpool has taken over Kelvinator Refrigerators.

Global Reach

Till recently even big companies in the world had confined their business to domestic markets. However, liberalisation, technological change and falling trade barriers have rapidly changed the business landscape. Now ***companies that matter have expanded their revenue and assets base across countries and engage in cross-border flows of capital, goods and know-how.*** There are multinational corporations like Nestle, Unilever, Philips Electronics and Electrolux with over two-thirds of their activities outside their home country. ***The 'index*** *of transnationality' is a simple mean of the ratio of foreign to total activities for three indices: assets, sales and employees.*

The most globalised companies are generally from smaller developed countries such as Switzerland, Belgium or Sweden. These companies need foreign sales to achieve global status. For example, Switzerland provides a small market to its companies and thus Nestle, a Swiss company, has to make most of its sales abroad. Even the global companies belonging to the European Union (EU), are from countries like the UK and Netherlands whose home markets are small relative to the EU as a whole.

Alan Rugman is of the view that despite present day interdependence, most of global companies "remain firmly rooted in their native regions, particularly in the 'triad' blocs of North America, the European Union and Japan — 443 of the world's 500 MNEs come from these areas."[2] At present automobile, steel, chemical and petro-chemical industries are not truly global as much more than 50 per cent of their production and sales take place in each of the three separate regional markets. Thus triad based companies are in a privileged position. Companies from non-triad economies do not have an easy access to these regional markets. Nevertheless, multinational companies from countries like South Korea, Taiwan, Singapore, Hong Kong and Mexico have succeeded in finding global markets for their products. Lately even some of the Indian companies have made it to the elite list of 50 most global Asian companies. The study by Hong Kong based Asia Inc. and Arthur D. Little, the global consultancy firms have placed Reliance Industries, Ranbaxy Laboratories, Sundaram Fasteners, Arvind Mills and Bajaj Auto in that order in the top 20 bracket of the list of competitiveness, and this has naturally brought international recognition to corporate India's globalisation efforts.

Technology Orientation

Modern business is technology oriented. This feature of present day business emanates from the expectations of the consumers from the business. People always wish to consume more and more of new goods and more of the same goods. They expect that the quality of products should improve overtime and the real cost fall. Obviously all this can be accomplished by the business if it pays attention to ***sophistication of technology.*** Recently Japanese and Korean companies have launched a large number of consumer goods, including air-conditioners, washing machines, refrigerators, televisions, video cameras, dishwashers and rice cookers with buzzy control systems. These systems change their fuzzy rules as the environment changes or as the machine undergoes wear and tear. Hence, the acceptability of these Japanese and Korean products has rapidly increased world over. In this situation, if rival firms from other countries producing all these goods ignore these technological changes for whatever reasons, they may lose in competitiveness and be pushed out of the market.

Since the advent of modern technology roughly three centuries ago, there has been an accelerated increase in the intensity and speed of exploitation, transfer and diffusion of technical know-how and innovations. Technology itself, particularly electronic media, now contributes to accelerating the flow of technology around the world. On account of increased liberalisation, there is now acute competition at global level between companies. In this state of business, rapid technological change has become a pre-condition for the survival of a company.

Because modern companies regard technological research strategic to their future, they carry out their R&D activities very close to their headquarters. These activities are usually centralised in the country of the company's origin. For example, Novartis has more than two-thirds of its R&D activity in Switzerland while it accounts for a mere 2 per cent of the company's overall sales. Japanese companies now invest, in absolute terms, as much in R&D as does US manufacturing industry. However, as little as 3 per cent of their R&D is carried outside the country. Among Asian countries South Korea has registered most spectacular industrial growth in recent times. The secret of its rapid growth has been its enhanced investments in R&D activity. In 1995, South Korea invested 2.5 per cent of its GNP in R&D compared to 1.3 per cent in 1985. Samsung, an electronic company of South Korea doubled its R&D investment every year between 1990 and 1994. The gains of this technology orientation of the Korean giant are now there for everyone to see. Samsung Electronics is now the biggest corporation in South Korea. It was ranked 54th in 2003 by Fortune (August 2, 2004).

Change

Sustainability of business in the existing economic system depends largely on effective demand. In the absence of effective demand all kinds of business manoeuvring, including aggressive advertising fail. Therefore, for a long time business has been attempting to find ways and means whereby there is no lack of effective demand, particularly on account of declining consumption propensity. Like all of us, the business knows that physical life of almost all consumer durables is such that most people may not feel the need to buy them several times in their lifetime. The business has thus invented the strategy of making changes in product quality, design or packaging speedily. ***This strategy of offering differentiated products periodically has been found quite effective*** as it invariably induces lots of consumers to discard the goods which have not lost their entire utility. Consumers who get influenced by the improved quality or new design of goods develop strong urge to replace old goods by the new ones. This consumer behaviour vividly explains why colour televisions have replaced black and white televisions, frost free refrigerators have replaced direct cooling refrigerators, motor cycles have replaced scooters and so on.

Today a business firm clearly needs to move faster if the fear of irrelevance is not to become a reality. ***A modern firm must be vigilant all the time and be ready for change.*** In case, an improvement in quality, packaging or product design is not sufficient to retain customers, the firm should promptly introduce new products and create demand for them. Ours is no longer an age of physical wants. ***The business through its innovative moves can always create synthetic wants and thus find space to produce new goods to satisfy them.*** These goods, however, may become obsolete overtime and people may not like to buy them. In India, a few decades ago nylon clothes had become very popular at the cost of cotton textiles. But only in a few years time terrycot clothes replaced nylon clothes. Such examples can be easily multiplied. They all clearly suggest that the present day business is bound to doom if it cannot change at an incredible speed in response to emerging consumer behaviour.

Government Control

Since the late 1980s role of the government in both developed and underdeveloped economies has diminished with the dismantling of regulatory controls. It is now widely advocated that the interference of the government in business diminishes allocative efficiency and thus hampers economic growth. Nonetheless even the western capitalist economies still retain various laws whereby business is regulated. In other words, these economies in spite of dilution of economic controls in their system are not truly laissez-faire economies.

Even now in serious discussions relevance of government regulation of business is acknowledged on account of two reasons. First, the government interference in business is required to correct market failures manifested in the form of monopoly and pollution. In these cases, government action improves efficiency rather than lowering it. Second, governments through monetary and fiscal regulation attempt to create stable business conditions.

Market failures are most notable in the cases of imperfect competition, externalities and public goods. It is generally agreed that economic efficiency is maximised in the case of perfect competition. However, modern business has increasingly deviated from perfect competition. Presence of giant firms in oligopolistic markets leads to prices that rise above cost and as a result, consumer purchases are reduced below efficient levels. The pattern of high price and reduced output is hall-mark of the inefficiencies associated with monopoly power. The governments thus take steps to curb monopoly power of the present day business.

Externalities occur when firms or people impose costs or benefits on others outside the market place. In recent times, with the increase in industrial production, business firms have imposed negative spill over effects on people in general. These externalities are no longer perceived by governments as small nuisances. Since air and water pollution, hazardous wastes, unsafe drugs and foods, and radioactive materials are major health hazards, the governments now attempt to regulate activities of the business to contain the worst externalities.

Production of public goods cannot efficiently be left to private enterprise. Building of a highway network, education and public health do not interest profit maximising business firms. The governments can do nothing to induce business to produce public goods. Therefore, whatever be the economic system, production of these socially necessary public goods in any case has to be undertaken by the government.

In addition to promoting efficiency, governments undertake macroeconomic functions to create stable business conditions. Since its origin capitalism has suffered from periodic bouts of depression and inflation. At times, until the 1930s, hardships persisted for many years because governments did not know how to clear the mess in the economy that unregulated behaviour of business often created. Today we all know how to control worst excesses of the business cycles by careful use of fiscal and monetary policies. The government's reliance on these policy measures to stabilise economic conditions nonetheless restricts freedom of the business.

ENVIRONMENT OF BUSINESS

Environment by definition is something external to an individual or an organisation. Therefore, in

strict sense, business environment refers to all external factors which have a direct or indirect bearing on the activities of business. However, some experts have used the term business environment in a broad sense. These experts talk of both ***internal*** and ***external environment*** of business. In their opinion, external environment of business can be sub-divided into ***micro environment*** and ***macro environment.*** In the following discussion we shall follow this approach. At the outset we may also point out that while certain aspects of both internal and external environment pose a threat to business, other aspects provide opportunities for business growth.

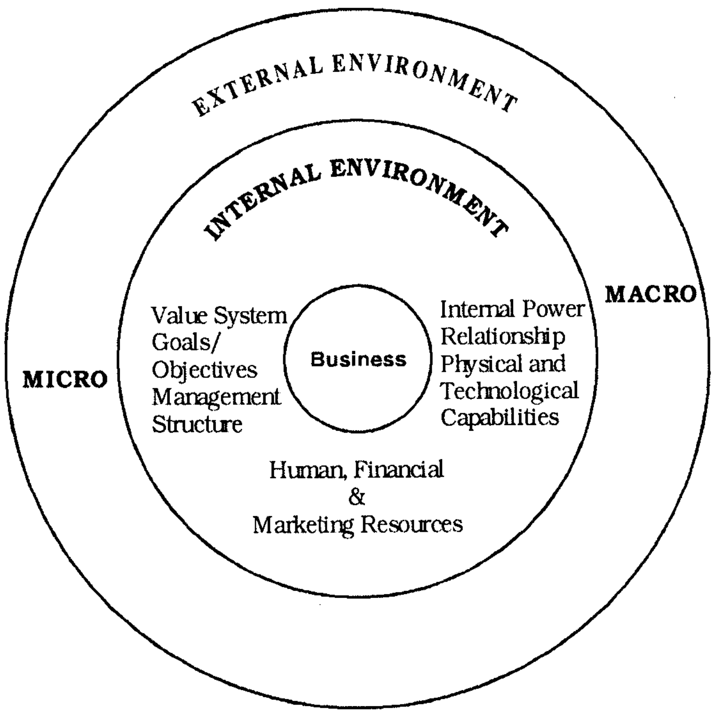

FIG. 1.1. Environment of Business

Internal Environment

Value system, goals and objectives, management structure, relationship among the various constituents, physical assets, technological capabilities and human, financial and marketing resources make the internal environment of business.

Value system. Business is normally undertaken for profit maximisation. It is now generally agreed that no business firm is established for philanthropic purposes. Nonetheless, ***persons holding top positions in certain modern corporate enterprises have some values which influence their policies, practices and overall internal environment.*** JRD Tata, the doyen of Indian business, for example, had voluntarily acknowledged that as an employer he had certain responsibilities towards his employees and thus companies of the Tata group did some commendable work in the field of labour welfare. Now these values are not shared by those who are at the helm of affairs in the companies of the Tata group and thus they have scant regard for the well-being of even physically disabled. The attitude of the Tata companies' bosses is unambiguously clear as these companies employ just 8 disabled persons out of their total workforce of more than sixty thousand. ***The value system of a company need not always be positive. It can be totally negative.*** In such a case, the company does not expect from its executives to care much for the consumers, employees and people in general. Cases of pharmaceutical companies selling banned drugs world over are now too well known. A giant transnational corporation with negative values can even target a democratically elected government if the latter is seen as an obstacle to the realisation of the company's objectives. The shameful track record of the International Telephones and Telegraphs (ITT) of the US in this regard confirms this contention. The ITT successfully manoeuvred through General Pinochet to overthrow the democratically elected government of President Allende of Chile in 1973.

Goals and objectives. In the traditional theory of business firm, profit maximisation has been assumed to be the sole objective of the firm. Since short run profit maximisation does not necessarily result in profit maximisation in the long-run, some experts assert that rational firms attempt to maximise long-run profit. Managerial theories of firm, however, state that ***sales maximisation*** and ***the balanced rate of growth maximisation*** rather than profit maximisation are the real goals of modern business firms. In the behavioural theory of the firm, it is asserted that ***a firm seeks to satisfice, that is, to attain a satisfactory***

overall performance in terms of set aspiration goals, rather than maximise profits, sales, production or some other magnitude.

These divergent approaches with regard to goals of a modern firm are based on empirical evidences. From them one thing that clearly emerges is that in modern times all firms do not pursue a single goal. There are often major differences in the goals and objectives of the various firms which, in turn, lead to differences in their overall internal environment and also in priorities, policies and direction of development.

Management structure. ***A corporate enterprise may be professionally managed or family controlled.*** On its Board of Directors there may be dynamic entrepreneurs capable of taking quick decisions or the Board of Directors may be dominated by persons with conservative or bureaucratic outlook. Nominees of financial institutions having large holdings in companies may or may not have decisive say in decision making. All these factors are of critical importance from the point of view of the company's internal environment.

Internal power relationship. Today the strength of management depends largely on the relationship between the company's shareholders, Board of Directors and the senior executive officers. Conflicts between certain members of the Board of Directors, erosion of shareholders' confidence in the Board of Directors and serious differences among senior executive officers on critical matters often vitiate the company's internal working conditions.

Physical resources and the technology. Both functioning of a company and its competitiveness are very much influenced by its physical resources, production technology, R&D work and distribution logistics. Bengt Holmstrum of the Sloan School of Management is of the view that rapid technological progress is destroying the relative importance of tangible assets *vis-a-vis* human assets. Thus the dependence of intellectual capital on the ownership of physical assets and financial resources is decreasing. In their recent book *Driving Change,* Jerry Yoram Wind and Jeremy Main of the Wharton School's SEI Centre for Advanced Studies in Management regard technology as the most potent force in business. It may thus be argued that R&D activity of the company and the speed at which technological changes occur in it determine company's internal environment which in turn influence business decisions in a decisive manner.

Human resources. ***The quality of human resources of a company depends largely on skill, commitment, attitude and morale of the employees.*** Whether these employees work in the company or for the company makes all the difference in the work culture of the company and its internal environment. When employees work for the company their involvement is far greater in the growth of the company. The company in return is also required to pay due attention to concerns of the employees sympathetically. Over the years due to rapid urban growth people have been pushed to suburbs and, as a result, commuting time has increased. Disintegration of joint family system has reduced the level of domestic infrastructural support. Also the work-hours in modern companies have increased. All these factors have jointly created tremendous pressure on present day company employees, in turn leading to unnecessary tensions in the internal environment of the company. Some companies in recent years have begun responding to these challenges by moving towards ***flexible working arrangements.***

External Environment

External environment of business consists of institutions, organisations and forces operating outside the company. All these individually as well as collectively exercise their influence on the latter. Broadly external environment of business may be classified into **(A)** ***micro environment*** and **(B)** ***macro environment.***

The micro environment refers to such players whose decisions and actions have a direct bearing on the company. Since modern business broadly has two aspects, viz., production and selling of goods, the micro environment of business can be divided accordingly.

The most prominent performers in the micro environment are the following :

- Suppliers of inputs
- Workers and their unions
- Customers
- Market intermediaries
- Competitors
- Publics

Input suppliers and workers together with their unions exercise influence on production. Customers, market intermediaries and competitors affect sales operations of the business firm. The public may influence both production and sales. ***Macro environment, in contrast, comprises large societal and physical forces which affect the company and also the players in the company's micro-environment.***

A. Micro Environment

From the point of view of a company's business operations micro environment has great relevance. Usually the players in micro environment do not affect all the companies in an industry in the same way. Their decisions and actions *vis-a-vis* individual company often differ in accordance with the size, capability and strategies of each company. For example, suppliers of inputs are normally more accommodating if the company is large. However, they may not give the same concessions to relatively small companies.

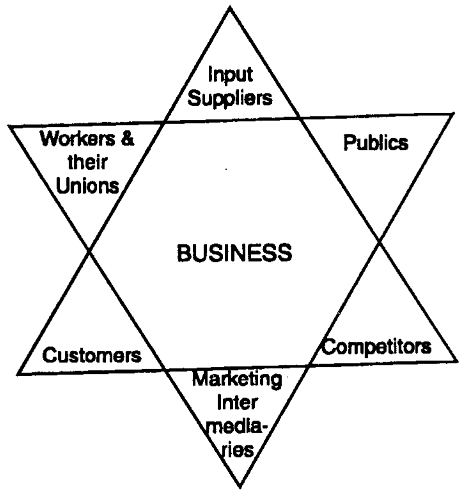

FIG. 1.2. Micro Environment of Business

Likewise, a competitor does not mind starting price war if the rival company is small but he will be reluctant to do so if the rival firm is large and capable of retaliating. Sometimes micro environment of the various firms in an industry is almost the same. In such a case, responses of these firms to their micro environment may differ as each firm will attempt to achieve a higher success level.

1. Suppliers of inputs. An important factor in a company's success is low cost production of goods. This requires that all the time there has to be an ensured and uninterrupted supply of inputs, particularly raw materials. In case the supply of raw materials is uncertain, the producer company has no choice but to maintain stocks of raw materials sufficient for several months' production. This naturally puts financial burden on the company and lowers its profit margins. It has been observed that whenever some supplier manages to secure monopoly control over the supply of some strategic raw material, such as iron ore or copper, it starts regulating its supply to generate maximum possible monopoly profits. The user firms under the circumstances are compelled to buy these raw materials as and when their supplies are released by the monopolist supplier and stock them, failing which production may get disrupted inflicting heavy losses on the company.

Moreover, it is not a sound policy to depend on a single supplier. The supplier firm can always withhold supply if it finds alternative markets for its product. It is also possible that on account of certain happenings production gets disrupted in the supplier's unit. In any case, the company indiscreetly depending on a single suppler may find itself anytime in real difficulties. Therefore, no company should depend for the supply of some input on a single source. Multiple sources of input suppliers obviously reduce these easily avoidable risks. In the periods of input shortages supply management should be high on the agenda of the company.

2. Workers and their unions. Labour is an important input in production. Its nature, however, is very much different from the other major input in production, *i.e.*, raw materials. Labour is provided by workers who may or may not be organised. When workers are unorganised, the bargaining position of the company *vis-a-vis* labour is quite strong and it may force workers to accept just a subsistence wage rate. But nowadays most companies do not find themselves in such a privileged position. Workers now prefer to join their labour union which invariably resorts to collective bargaining and thereby makes them less vulnerable to employer's exploitation. Labour unions organised at the company level are not equally strong. Moreover, while some unions adopt confrontationist attitude towards the company management, others avoid conflict with the management. ***From the point of view of the company, policy of hire and fire may turn out to be counter productive.*** These days any policy that disturbs labour peace at the company level may adversely affect its competitiveness. Also, constant conflict between labour and management will not allow the company to grow and overtime may transform it into a sick unit.

3. Customers. Since nowadays production is done for the market, a business firm to be successful must find customers for its products. ***Customers*** thus ***constitute the most important element in the micro environment of the business.*** Their loyalty to product depends mainly on the degree of their satisfaction. It is, in fact, this reason why customer satisfaction surveys have received so much attention in the 1990s. The world's biggest businesses have now set-up systems for regularly tracking customer attitude or customer satisfaction because today it is universally accepted that the satisfaction of customers is the ultimate bench mark of the company's success.

Usually customers do not constitute a homogeneous group. Demand for the product of a company may come from individuals, business enterprises, institutions and the government. Moreover, customers may or may not be confined to some geographical area. From the company's point of view it is always better to have customers from various groups and regions for that easily sustains demand for the company's product. In the present day business, probability of customers drifting away from the company remains quite high. Therefore, companies like Hindustan Lever always keep on targeting new customers. They also attempt to launch products which are relatively "recession-proof basic necessities". The choice of such products reduces the risk of losing customers during economic recession.

4. Marketing intermediaries. In a company's micro environment, marketing intermediaries such as wholesalers, retailers, distribution firms, agents etc. constitute an important element. Most companies find it too difficult to reach the consumers as they do not have a network to market their products. Distribution firms and agents in such cases render useful service in popularising a product. In case some product of a company is already popular the marketing intermediaries other than wholesalers and retailers are not required. Usually a company lacking its own distribution channels cannot afford to have conflict or strained business relations with the wholesalers or the retailers.

In recent years certain companies have stopped relying on agents and distribution firms to popularise their new products. For this purpose they adopt direct mail or data base marketing. These methods of marketing, however, do not undermine the role of wholesalers and retailers. Dick Shaver, architect of marketing successes like Marion Merrell, DOW, MCI, Amex and AT & T is of the view that the consumer-guided marketing opens the way for a meaningful one-on-one dialogue between the marketer and prospective consumers. These models of marketing undoubtedly reduce the dependence of the company on certain marketing intermediaries but even they fail to make wholesalers and retailers totally redundant.

In mid-nineties Nestle faced a slump in demand for its baby food products in France. The company could have responded to this situation by lowering the production and laying-off workers. But it decided otherwise. During summer time when most people in France take-off on large vacations, Nestle provided stop structures along the highways where parents could feed their babies. Hostesses in these rest shops offered free food samples and disposable diapers to children. These baby rest stops recorded about 1,00,000 visits each summer. This innovative strategy of Nestle to reach the consumers directly proved to be successful. It arrested the fall in demand for the company's baby-food products. The dependence of Nestle on the wholesalers and retailers for the actual sale of its products nevertheless continued.

5. Competitors. No company, howsoever large it may be, enjoys monopoly. In the real business world a company encounters various forms of competition. The most common competition which a company's product now faces is from differentiated products of other companies. For example, in the air-conditioner market Voltas airconditioner faces competition from other branded airconditioners such as Carrier, L.G., Videocon, Amtrex Shizuka, Hitachi and National. This type of competition is called ***'the brand competition'*** and may be found in almost all durable goods markets. A company sometimes encounters what is characterised as ***'the product form competition'.*** A refrigerator manufacturing company, for example, specialises in producing only frost free refrigerators but the competition it is likely to face may not remain confined to manufacturers of other frost free refrigerators. It is just possible that directly cooling refrigerators also turn out to be serious challengers.

A company sometimes enjoys a high degree of monopoly power as it has control over a substantial amount of the supply of the product. But even this company at times may not be comfortably placed because producers of other goods competing for the disposable income of the consumers may succeed in wiping out much of the demand for its product. Often producers of refrigerators in India find that their product faces competition from washing machines, scooters, televisions, music systems and so on. This form of competition has been described as ***'the desire competition'.*** One thing that is quite interesting about this form of competition is that it often remains invisible and thus business enterprises at times fail to devise an appropriate strategy to deal with the situation.

Competition from other firms which a modern corporate enterprise faces is usually *'non-price competition'*. Since modern business is characterised by ***product variation***, it has now become necessary for all the competing firms, irrespective of the nature of competition to advertise their products, failing which their very existence may be in danger. ***Advertising*** is perhaps the most important form of non-price competition. Firms generally incur advertising expenditure on account of their belief that by resorting to advertising their revenues will increase more than the costs and thus profits will be larger. Competitors of the company usually avoid price competition, as it has a tendency to cut down monopoly profits of the competing firms. Modern business enterprises often develop tacit understanding with the competing firms that no one will violate rules of the game and under no circumstance start a price war.

6. Public. In common parlance, the word public refers to people in general. However, Philip Kotler, an expert in marketing management has used the term public in a specific sense. According to him, ***"A public is any group that has an actual or potential interest in or impact on a company's ability to achieve its objectives."***[3] In this sense, one can think of several publics which exist in micro environment of business. Environmentalists, consumer protection groups, media persons and local lobbyists are some of the well known examples of publics. These groups by their actions pose a threat to certain companies. It is now well established that the manufacturing units generally pollute the environment and are thus serious health hazards. However, till recently, no action was taken against these factories though they imposed heavy social costs on the people residing in neighbouring areas.

Now environmentalists have taken up this matter with the government and some such groups have gone to the courts with public interest litigations. These actions on the part of certain groups of environmentalists have now compelled some air and water polluting industrial units to shift to locations away from the residential colonies of the cities. Local lobbyists sometimes start campaigns against consumption of alcohol which adversely affects the business of liquor producing companies. In Delhi, certain publics have recently prevailed upon the government to ban sale of a certain brand of beer because the company had advertised this product on a TV channel violating the government orders. Consumer protection groups and media publics have often succeeded in persuading the government to regulate the prices of essential drugs by highlighting increases in their prices by the pharmaceutical companies. These government interventions obviously have gone against the interests of business.

In democratic socieities publics have assumed important role and their presence in the micro environment of business is often a threat to the interests of the latter. In certain cases, policies of publics have, however, proved to be beneficial to the business. For example, media publics by popularising the merits of consumerism have provided new opportunities to the business.

B. Macro Environment

Macro environment of a company refers to all those economic and non-economic factors which exercise their influence on the business activity in general and thus determine opportunities that a company may have to promote its business.

The role of macro environment from the point of view of the business may be both positive and negative. This implies that the larger forces in the company's environment do not always provide wider space for business operations. They often put restraints on the business activities of the firm. In Chapters 2, 3 and 4 we shall extensively discuss the macro environment of business in the present day world. In this section we shall thus provide only a brief discussion of forces which constitute macro environment of modern business.

Macro environment of business can be broadly classified into ***economic environment*** and ***non-economic environment.*** Since business is basically an economic activity, economic environment of business—both ***national*** and ***global***—is of strategic importance. In the national economic environment of the country, country's economic system, macroeconomic scenario, phase of business cycle through which the economy is passing, organisation of the financial system and economic policies of the government are the most important elements.

Economic system of the country determines the parameters of the business activity. Macroeconomic scenario refers to price situation, levels of saving and investment, fiscal, monetary and balance of payments situations and overall growth activity. These factors broadly determine the prospects of business activity. In a recessionary situation business firms encounter steep fall in effective demand which inevitably leads to business slow down. Developed financial system is now a precondition for the efficient mobilisation of financial resources for the business. Economic policies of the government, particularly the industrial, trade, fiscal and monetary policies shape the opportunities for business. However, at times, these policies are used by the governments to regulate the operations of business firms.

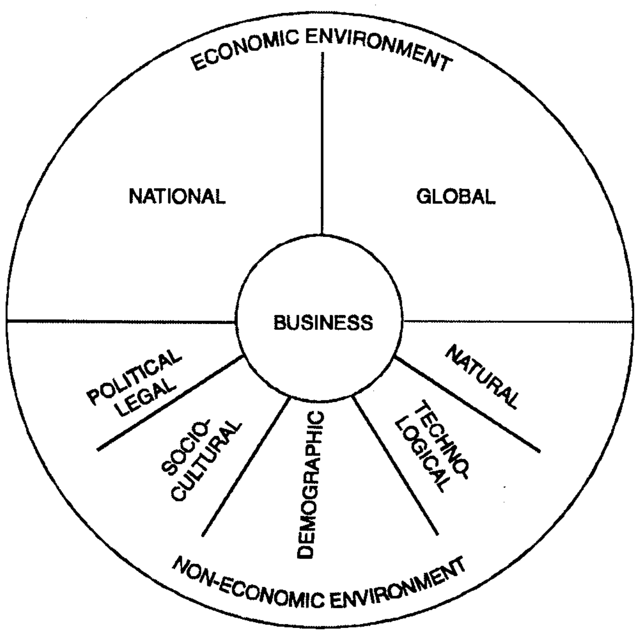

FIG. 1.3. Macro Environment of Business

Now because of liberalisation, from the point of view of the company's business, global economic environment has become as much important as the national economic environment. The notable features of present day global environment are globalisation, underdevelopment of Russia and Eastern Europe, recession in Japanese economy, slow recovery in the USA and the twin deficits, China's emergence as an economic power, India and China overstretching their growth cycles and thus becoming vulnerable to global slowdown, BRIC (Brazil, Russia, India and China) nations to head growth in future, Regional Economic Groupings, protectionism, global slowdown and dominance of the multinational corporations, setting up of the WTO in the mid-1990s and regional trade agreements. We shall discuss national and global environment of business in Chapters 2 and 3 respectively.

Business, despite the fact that it is an economic activity, is also influenced by its non-economic environment. Political system, ideology of the government, legal framework, social system, cultural values, demographic factors, level of technological development and natural and physical environment of the country broadly constitute non-economic environment of business. In fact, all these non-economic elements are of great relevance to present day business. These factors not only determine opportunities for business but also, at times, have serious constraining effects.

NOTES

1. Adam Brandenburger and Barry Nalebuff, professors at Harvard and Yale respectively in their book *Co-optition* explain that firms in oligopolistic markets do not always engage in a zero-sum game. Instead, through a combination of cooperation and competition business rivals benefit by working together, even as they clearly retain their individual identities.
2. Alan Rugman, "Multinationals as Regional Flagships" in *Business Standard—Financial Times* "Mastering GlobalBusiness-Part One", January 1999.
3. Philip Kotler, *Marketing Management* (New Delhi, 1998), p. 671.

CHAPTER

2 ECONOMIC ENVIRONMENT OF BUSINESS : NATIONAL

Economic System
• Capitalism • Socialism
Macro-economic Scenario
• Rates of Growth • Inflation • Rates of Saving and Investment • Fiscal Imbalance • Balances of Payments • Deficits
Prosperity, Recession, Depression and Stagflation
Prosperity • Recession • Depression • Stagflation
Financial System
• The Money Market • The Capital Market
Economic Policies
• Industrial Policy • Trade Policy • Monetary Policy • Fiscal Policy
Neo-Liberal Profile of the Economy
• Liberalisation • Privatisation • Globalisation

In Chapter 1 we have referred to different classifications of business environment. From the point of view of analysis it is generally agreed that the most relevant distinction is between economic and non-economic environment. Moreover, economic environment of business is usually divided into : ***(1) National economic environment of business, and (2) Global economic environment of business.*** We shall also follow this classification, and discuss the national and global environments of business seperately in two different chapters. In this chapter we propose to analyse national economic environment of business.

Business enterprise is essentially an economic institution. It conducts its activities in the market system with the objective of profit maximisation.

The behaviour of an enterprise is economic in nature. It is guided by the economic decisions of the manager of the firm. The manager usually considers the demand and supply conditions which are determined by both micro-economic environment and macro-economic environment. However, in a study of economic environment of business our emphasis is primarily on macro-economic environment.

The existing economic environment of business is highly complex and it is not always easy to comprehend it. It is this reason why different persons interpret it differently and the firms operating in the same economic environment often take different decisions.

In a modern economy, there are broadly five sectors, *viz.*, the business sector, the household sector, the capital market, the government and the external sector. All the sectors together condition the structure of the economy. The activities which keep on going in these sectors create both jointly and separately the economic environment in which the business firms operate.

Individually, business firms can do little to change their economic environment. Collectively in a capitalist economy business firms can do a lot to make economic environment conducive to their activities. Business firms now organise their associations through which they attempt to influence policies of the government. In India, the Confederation of Indian Industry (CII), the Federation of Indian Chamber of Commerce and Industry

(FICCI) and the Associated Chambers of Commerce and Industry of India (ASSOCHAM) are powerful organisations of the business. They exercise considerable influence on the government and thereby attempt to mould economic environment in their favour. These associations of business and industry extract tax concessions and subsidies from the government, influence fiscal, monetary and trade policies and get economic laws enacted in the favour of business and industry. While explaining the structure of economic evironment of business we analyse the following issues :

- What is the nature of the economic system and how does it provide opportunities to business ?
- How does macro-economic scenario determine prospects of business ?
- How do various phases of business cycles offer scope for business activity ?
- What is the role of the financial system in business ?
- Do economic policies of the government play any role in determining economic environment of business ?

ECONOMIC SYSTEM

Each country operates under some economic system. ***Economists define an economic system "as the sum total of the devices by which the preference among alternative purposes of economic activity is determined and by which individual activities are coordinated for the achievement of these purposes. The central problem of an economic system is the allocation of resources."***[1] These economic devices differ according to the customs and institutions of society and need not always be the same in any two countries. However, without denying the existence of national differences we can classify the economic systems of the USA, Japan, Germany, France and the UK as capitalistic. Likewise, despite differences between the economic systems of the former Soviet Union and China, they can both be called socialist. ***Capitalism,*** in the broad sense, ***is a system of private property in both producer and consumer goods, freedom of contract and competition, with limited government intervention in economic affairs. Socialism is a system of collectivisation of means of production; there are no private profits, but incomes may differ according to individual skills and amount of work done; also personal property for consumption purposes is allowed.***

From these definitions of capitalism and socialism it is clear that to a great extent economic system of a country determines its economic environment. ***For business the economic system is a parameter and the former can do little about it. In fact, business has no choice but to adjust itself within the framework of the given economic system.***

The three central problems of an economy, viz., what to produce, how to produce and for whom to produce are solved by the business in a capitalist economy freely in the framework of market mechanism. As against this, the role of business is much less important in a socialist economy because economic planning occupies the central stage under it.

Capitalism

Economists differ widely in their characterization of the existing organisation of a capitalist economy. Today, even when it is very clear that the giant monopoly corporations have become extremely powerful, many people still analyse the situation within the framework of perfect competition. Not only this, there are some people who regard capitalism as a *laissez faire* economic system. This approach implies that to ascribe any kind of economic role to the government in the functioning of the economy is totally uncalled for. However, when we look at the way these economies function in reality, we find that even ***in the United States of America, which is a leading capitalist economy, production takes place in the private and the public sectors side by side.*** Besides this, the government through its fiscal policy and various restrictive policies tries to control the activities of the private sector. There are a number of giant monopoly corporations in the private sector which have distinctly curtailed the importance attached to competition within the market structure. India, which is an underdeveloped country, does not differ significantly from the United States of America in the organisation of its economy. Now mergers and acquisitions are quite common in both developed and developing countries. The recent acquisition of Corus an Anglo-Dutch Steel Company by the Tata Steel Company has now made the Indian giant company the fifth largest producer of steel in the world. ***Now Tatas have become a major global player in the steel production.*** This is clear from the facts provided in Box 2.1.

In India, both private and public sectors co-exist. In the private sector the big business houses, like those of Birlas, Reliance and Tata and MNCs like Hindustan Lever and Nestle India have such a powerful grip over

BOX 2.1. Tata Steel becomes a Major Global Player

- At over $ 12 billion, Tata effected the biggest global merger.
- Tata paid 608 pence a share for Corus.
- Tata Steel has now become the fifth largest steel maker in the world.
- Tata's deal has added 19 million tpa to its installed capacity.
- Tata Steel now hopes to extract synergies worth $ 300-315 million a year.
- Tata Steel now has access to European Union and Corus's world-wide distribution network.
- Tata's deal with Corus network has strengthened this group's negotiations with suppliers on the selling side.
- The group acquires a dominant position in value-added products.

the market that competition is relegated to an unimportant place in the background. Thus, keeping in mind these objective conditions we cannot today at the dawn of the 21st century accept capitalism to be a fully competitive economic system.

Capitalism of today is a mixed economic system in which the private as well as the public sectors co-exist side by side. Due to the emergence of big corporations in the private sector it could no longer retain its competitive character and has, therefore, transformed itself into a monopolistic set-up. The government, in order to ensure a certain level of social welfare for its people, intervenes in various ways in the functioning of the economy.

Socialism

In a socialist economy the responsibility of taking all decisions related to production and economic development lies with the State. In order to understand better the mechanism by which the socialist system solves its central problems it is necessary to take account of the following four considerations:

1. In a socialist economy apart from labour, all the other means of production are owned by the State and not by individuals in their private capacity. Very often immediately after the socialist revolution some land is left in the personal possession of farmers which with the adoption of State farming comes under the ownership of the State.

2. Production in a socialist economy is guided by the objective of social welfare rather than private profit. Since a socialist society is not a class society, there does not arise the problem of conflict of interests among the different people. Therefore, it is an easy proposition to determine what exactly constitutes social welfare.

3. Just as under capitalism, in a socialist economy too there are markets dealing in commodities where people have complete freedom to spend their disposable income on goods and services of their choice. However, the prices ruling in such markets are not assigned the role of solving the economy's central problems.

4. The decisions pertaining to the production pattern, the quantities in which various commodities are to be produced, the choice of technique and the distribution pattern are all taken by the government. The central planning authority renders assistance to the government in these matters. Though in most socialist countries the ultimate say in solving the central problems is that of the government, yet it is the Planning Commission which is entrusted with the task of laying down the production targets and decision-making in respect of technological matters.

MACRO-ECONOMIC SCENARIO

Macro-economic scenario determines the prospects of business in a country. ***In an environment of rapid growth, stable prices, high rates of saving and investment, fiscal stability and favourable balance of payments, prospects of business growth are bright.***

Rates of Growth

Steadily rising incomes in a period of high rates of growth increase demand for various goods, but the rise in the demand for consumer durables is most notable. This naturally induces business activity in this sector. It has been observed that in a period of high growth, demand for automobiles, motorbikes, air-conditioners, music systems, televisions, refrigerators, and such other articles increases rapidly and industries producing these commodities register high rates of growth. In a period of slow growth, this sector is most adversely affected. For example, economic growth in India slowed down over the period 1997-98 to 2002-03. The GDP rose in 2000-01 by 4.4 per cent only. Even in 2002-03 GDP growth remained appallingly low at 4.0 per cent. The overall industrial growth in 2001-02 stood at 2.7 per cent which rose only to 5.7 per cent in 2002-03. As a result, there was a fall in the demand for consumer durables so much so that this sector registered a negative growth rate of –6.3 per cent in 2002-03. However, there was a recovery in 2003-04 with GDP rising by 8.5 per cent and industrial production by 7.0 per cent. This pushed up the demand for consumer durables with the result that their production rose by as much as 11.6 per cent in 2003-04. During the last three years overall economic growth in India was around 8 per cent per annum. In this period industrial growth was equally impressive. In India, ***when overall economic growth remains quite high, the economic environment is conducive to business development. In contrast, when economic growth slows down, the overall economic environment becomes unfavourable to business.*** In a period of slow growth, the aggregate demand is very much reduced and the business has no choice but to curtail its operations.

Inflation

Inflation is commonly defined as a persistent and appreciable rise in general level of prices. For an economy producing below its potential, many economists have long maintained that inflation of creeping variety will have a positive effect on output and employment. This implies that inflation of a mild sort increases aggregate demand which, in turn, opens up fresh opportunities for business growth. In such an environment not only the demand for existing goods increases but the business can also introduce new items for which demand may be created through dynamic marketing.

In India and many other developing economies inflation measured by consumer price indices (CPI) is generally higher than the one measured by wholesale price index (WPI). Since food articles account for much larger share in the CPI than in the WPI, higher rate of inflation measured by the CPI may not always adversely effect the business environment. But in India and many other developing countries where substantial demand has been created in poorer sections of the society by offering industrial products in smaller packs, a higher rate of inflation measured by the CPI than measured by the WPI may create demand constraints which is not a conducive situation to business expansion.

During inflation, prices of various commodities do not rise at a uniform rate. This sometimes causes misallocation of resources and, in turn, a decline in output and income. Obviously, under these circumstances business is adversely affected. When inflation rate is high, there is a drastic redistribution of income, which, in turn, reduces the aggregate demand. It is this reason why during inflation there is involuntary build-up of inventories. Business firms find that the consumers defer their purchases of durable goods with the expectation that eventually inflation will be brought under control and prices will get stabilised. Hence, ***from the business point of view, inflation does not provide a congenial economic environment.*** The government should therefore attempt to stabilise prices not only in the interest of consumers but in the interest of overall business as well.

Rates of Saving and Investment

Savings and investment in a country determine its business potential. Investment can be undertaken in directly productive activities or in infrastructure. Industries and agriculture are directly productive activities. Their growth requires massive investment in them. In less developed countries like India, a substantial part of agricultural output is consumed by farmers themselves and thus only part of it is available for business. Industrial output, before reaching the final users, passes through various business operations. Hence, as investment in industries increases, the scope for business activity grows. Growth of agricultural incomes as a result of larger investment in the farm sector results in increased demand for industrial goods and thereby contributes to growth and business. Investment in transport, power and communication system facilitates business activity. In fact, shortage of power or poor transport and communication system due to inadequate investment in them can prove to be a major obstacle to business growth. ***During the 1980s and mid-1990s China, Republic of Korea and some South-East Asian countries, notably Malaysia, Thailand, and Indonesia had gross rate of investment as high as 30 per cent or more. This enabled them to register rapid economic growth as a result of which there was spectacular expansion in their business activity.*** Low investment results in slower economic growth and lower business potential.

Generally, a high investment rate is sustained by an equally high domestic savings rate. In some cases foreign capital is obtained in large amounts to boost up investment rate and it is hoped that it would accelerate both economic growth and business activity. This attempt is all right so long the borrowing country uses foreign capital in a productive manner and thus avoids the risk of falling in a debt trap. However, a little indiscretion on the part of the government of the borrowing country can prove to be disastrous. In economies where rates of gross domestic saving are as high as 30 per cent or more, conditions exist for self-sustained growth and expansion of business. According to Ashima Goyal, India has now reached this level of saving and investment and thus economic growth of the existing high level is robust and sustainable.[2]

Fiscal Imbalance

Governments in less developed countries now attempt to achieve a high rate of investment by resorting to deficit financing which, in course of time, results in a large fiscal deficit. In ***various developed and developing countries, fiscal deficit is considered to have reached a stage, where it has become unsustainable*** and according to neo-classical economists, unless the governments in these countries take prompt corrective measures it can have serious implications for business activity. It is now well established that the fiscal deficit has to be financed by borrowing and the government borrowing pushes up interest rates. This draws in foreign portfolio investment and gives an overvalued exchange rate which in turn adversely affects exports.

The classical economists had favoured balanced budgets which implied that the governments like individuals, should live 'within their means' and their expenditures should not exceed their resources. This philosophy of balanced budget grew out of the conviction that the State should play a minimum role in economic activity. However, during the period of the Great Depression in the 1930s, it was recognised that the State could push up the productive activity and usher the economy into a phase of recovery if it extended its expenditures much beyond its revenues. It was argued that such an expansion would generate additional demand and this, in turn, would boost up production and business activity. Therefore, deliberate 'unbalancing' of the budget in such a way that government expenditure exceeded government revenue was advocated as a measure to overcome depression and to set the economy on the path of economic recovery.

In less developed countries, deficit financing leads to an immediate increase in the purchasing power in the hands of the people while production does not increase simultaneously. In fact, it is likely that there is a considerable time-lag in the generation of extra purchasing power and the availability of additional consumer goods. In the meantime, an inflationary situation may develop. Many economists have argued that inflationary conditions are conducive to investment since they provide the much needed incentives to private entrepreneurs to invest. However, this is true upto a point only. When inflation persists for a long period, investment in speculative activities is encouraged at the cost of productive activity. This is on account of the fact that the rate of return on the former shoots up at a much higher rate than on the latter. These trends are very much evident in the present day India.

Balance of Payments Deficits

Excessive current account deficit in a country's balance of payments is not desirable for business activity. Such a situation leads to a shortage of foreign exchange which, in turn, forces restrictions on imports. This may have serious implications for the efficiency in production. Restrictions on imports of consumer goods in less developed countries have given protection to domestic industries. These industries thus have felt no compulsion to improve their efficiency. The costs in these industries have been high and quality of products inferior. International competitiveness of these industries is low and therefore once they are exposed to global competition their survival chances are dismal. Certain industries need imported raw materials and intermediate goods to make their products internationally competitive. However, scarcity of foreign exchange due to a large current account deficit has not allowed them the freedom they need to import the necessary raw materials and intermediate components.

In the interest of business the current account position has to be comfortable. In addition, the net inflows from external assistance and direct foreign investment should be fairly large, but this should not be allowed to result in an overvalued exchange rate. In case the situation is otherwise, the country's exports will fall and the business firms will feel seriously constrained on account of it.

PROSPERITY, RECESSION, DEPRESSION AND STAGFLATION

A capitalist economy passes through periods of prosperity and recession. The 1920s were years of great prosperity for Americans. After World War I the economic machine operated at a frantic pace. The production of cars, telephones and aeroplanes increased rapidly. Houses and apartments were built on a large scale. Then, almost without warning in October 1929, came an unprecedented stock market crash. In the four succeeding years, there was worst contraction in recorded history. By 1933 real GNP had fallen by 30 per cent, prices were down 25 per cent and unemployment rate was as high as 30 per cent. In West European economies the situation was not very much different. ***Over the past two and a half decades Americans have experienced two severe*** *recessions. The worst of these occurred in 1982. The so-called 'miracle' economies of Asia viz., South Korea, Thailand, Indonesia and Malaysia were in the grip of recession during the latter half of the 1990s. There is deep economic crisis in Japan. It seems that USA and Western Europe are finding it difficult to recover from economic melt-down.*

Prosperity

From the point of view of business, the prosperity phase of business cycle is ideal. In this phase the economy expands in response to growing aggregate demand and business firms have many options. Expectations of rising profits induce firms to expand the scope of their activities. New products are introduced in this period and markets are created for these products. In the prosperity phase, rapidly rising incomes of the people allow them to increase their consumption substantially and whichever firm can take advantage of this situation by taking appropriate policy decisions will register rapid growth. The wave of optimistic sentiment which prevails in this period sometimes misleads overzealous business executives and they attempt to overexpand their business activities. Lack of caution in this regard during the prosperity phase may lead to losses when the economy takes a downturn. In the period of economic meltdown no strategic management can save an overexpanded firm from its doom.

During the prosperity phase itself certain forces are activated which ultimately lead to recession. The most important of these factors is narrowing down of the profit margin due to a gradual increase in costs relative to prices. Business executives of modern firms often attempt to tackle this situation through aggressive marketing. They expect that extensive advertising will allow them to raise prices of their products while costs are rising. This may happen for some time, but ultimately at high prices demand will fall and the recession will set in.

Recession

Forces of contraction get strengthened during recession. The recession usually gets reflected in the form of stock market crash and some fall in prices. The aggregate demand gradually declines and thus incentive for investment is killed. Shrewd entrepreneurs observing ensuing recession abandon new projects, resulting in a sharp reduction in demand for capital equipment. The demand for consumption goods falls with a lag because people try to stick to their consumption which they had achieved in the expansion phase. Intelligent managers of the corporate enterprises like Nestle India, Hindustan Lever and Colgate-Palmolive India have greater chances of survival during the recessionary periods. These firms produce a variety of consumer goods for which there is substantial demand in India. During the recession when demand diminishes these firms can easily modify their products to suit the shrinking budget of the people. Other firms which cannot show a similar dynamism may suffer losses.

Depression

Following recent recessions some economies have moved into a period of sustained recovery. In cases when recessions persisted over a long period, economies got pushed into depression. Depression is characterised by low economic activity, a notable fall in production and employment, decline in general price level, deterioration in business prospects and continuous erosion in the profits of producers and traders. During the depression phase, there is an atmosphere of pessimism. These are the conditions in which certain firms suffer heavy losses and finding uncertain situation, these firms are not very hopeful of earning profits. These firms are thus reluctant to make investment. Deteriorating business prospects and abandoning the investment activity further deepens the crisis. However, sooner or later there is recovery in aggregate demand and with it depression comes to an end.

Stagflation

Stagflation is a relatively new phenomenon. ***It is characterised by inadequate growth, inflation and unemployment.*** Stagflation has been a common phenomenon in many Latin American countries but did not exist in the developed countries before the 1970s. In India, there have been just two periods when inflation was accompanied by little growth. In these periods unemployment was also quite large. Stagflation results from wrong policies of the government. When some government attempts to achieve a high rate of economic growth by resorting to inflationary policy, the results may be encouraging in the short-period but in the long-run such an economy plunges into stagflation. During stagflation individual firms can do little to expand the market for their products as most buyers attempt to defer purchases of all the goods other than necessities. Stagflation can, however, be corrected by implementing certain effective measures. The Keynesians recommend wage control to moderate price rise. They also suggest use of expansionary fiscal policy to increase income and employment. By pursuing these policies stagflation may be controlled which in turn can improve business prospects. Disagreeing with the Keynesians, the structuralists argue that stagflation results from the structural rigidities in the economy. Therefore, they recommend that the government should attempt to correct structural rigidities and imbalances in the economy to control stagflation.

FINANCIAL SYSTEM

While households are net savers, business firms are net investors. Therefore, ***there is a continuous flow of funds between the household sector and the business sector.*** When business enterprises raise funds through issue of shares and bonds which are subscribed by individuals the mobilisation of funds is direct from the household sector to the business. But a large number of savers do not evince much interest in the stock and bond markets. They even avoid operating in the new issue market. These savers are basically risk averters and they look for such investment opportunities that are entirely safe. Such people deposit their savings with banks and make investment in non-bank financial institutions such as mutual funds and insurance companies. These financial institutions are an important source of funds for the corporate sector. Mutual funds, insurance companies and development banks make heavy investments in stocks and bonds of private business enterprises. Banks, on the other hand, prefer to give loans to the business units.

Since finance is a basic requirement of business, the level of development of the financial system is of crucial importance for business. In India, for example, the financial system is broadly divided into two segments, *viz.*, ***the money market and the capital market.***

The Money Market

The money market refers to a mechanism whereby transactions in short-term claims on banks, financial institutions and corporate sector are effected. Thus it is a market for short-term monetary assets. It is not an integrated unit. The Indian money market is broadly divided into two parts, *viz.*, the unorganised and the organised. In the unorganised sector of the Indian money market, indigenous bankers, unregulated non-bank financial intermediaries and moneylenders operate. Corporate sector of business does not seek funds from the institutions in the unorganised segment of the money market. The organised sector of the Indian money market comprises Indian commercial banks, foreign banks, cooperative banks, finance corporations and Discount and Finance House of India Limited. Though the organised sector of the Indian money market is fairly organised, it is still far less developed than the London or New York money market. ***The main constituents of the Indian money market are: (i) The Call Money Market, (ii) The Commercial Bill Market, (iii) The Treasury Bill Market, (iv) The Repo Market, (v) The Certificates of Deposits Market, (vi) The Commercial Paper Market, and (vii) Money Market Mutual Funds.***

The Capital Market

The capital market is concerned with long-term funds. Broadly speaking it can be divided into two constituents: (1) the financial institutions, and (2) the securities market. The Industrial Finance Corporation of India Ltd. (IFCI), The Industrial Development Bank of India (IDBI), Industrial Investment Bank of India (IIBI), State Financial Corporations (SFCs), State Industrial Development Corporations (SIDCs), the Life Insurance Corporation of India (LIC) and The General Insurance Corporation of India (GIC) and its subsidiaries are the principal financial institutions. In India, since at the time of Independence there were no institutions of long-term corporate finance, the government took initiative to set up development banks as gap fillers.

The securities market has two constituents: (*i*) ***the new issue market*** (the primary market), and (*ii*) ***the stock exchange*** (the secondary market). Every where in the world, capital markets have originated as the new issue markets. Once corporate enterprises are set up in a large number, secondary market for outstanding issues develops. The stock exchange provides a channel through which savings of the people who wish to part with them for only short periods, become available to companies for long-term utilisation. In fact, while business enterprises retain the capital permanently, the shares keep on changing hands.

From the brief description of India's financial system, it is possible to follow the basic functions of the financial system. However, in order to understand the role of financial system in business, it is necessary to explain elaborately mobilisation of savings in both developed and underdeveloped countries.

The basic function of financial markets — both money market and capital market — is the collection

of savings and their transfer to business enterprises for investment purposes and thereby stimulating capital formation which in turn accelerates the process of business growth. The effective channelisation of domestic savings and obtaining finance from abroad are the important activities in the transfer process. In the transfer process the principal activity is allocation of funds from the savings-surplus to the savings-deficit units. Financial markets, if they are well developed, allocate financial resources efficiently among the various business enterprises.

ECONOMIC POLICIES

Economic policies of a government play a significant role in determining the economic environment of business in a country. Broadly these policies are classified under four heads: (1) ***Industrial policy,*** (2) ***Trade policy,*** (3) ***Monetary policy,*** and (4) ***Fiscal policy.***

Industrial Policy

Among various economic activities, industrial activity is more directly related to business. In fact, the present day corporate business has grown as an extension of industrial activity. Therefore, for analysing economic environment of business, industrial policy of the government has to be carefully examined.

In the last few decades, ***various economists have favoured increased involvement of the government in the allocation of capital to industries. This practice is known as industrial policy in the United States.*** This policy has already been practiced in Japan where Ministry of Trade and Industry picked the automobile industry very early on and decided to expand its role in world markets. The strategy has worked well and the Japanese automobile industry has been remarkably successful. Those who believe that the US should also adopt a similar policy argue that adoption of this strategy has become necessary to avoid losing out in international competitiveness.

Critics of this approach however argue that having the government involved in the allocation of capital is inappropriate. In their opinion, investment always involves risk and the best people to judge the extent of risk are those who make the investment and are actually involved in the industrial activity.

In India since 1956 for about two decades the industrial policy had recognised the importance of both private and public sectors. Seventeen industries listed in Schedule A of the Industrial Policy Resolution of 1956 were made the exclusive responsibility of the State. However, the public and private sectors were not totally independent of one another. In 1973 considerable concessions were given to private sector units and foreign multinationals. The actual liberalisation process began during the 1980s. In this period, the limit of exemption from licensing was continuously raised. In order to encourage production, the government delicensed 28 broad categories of industries and 82 bulk drugs and their formulations, and gave various concessions to companies falling under Monopolies and Restrictive Trade Practices Act (MRTP Act) and Foreign Exchange Regulation Act (FERA). With a view to improving capacity utilisation in industries, government allowed capacity re-endorsement. The scheme of broad banding of industries was introduced in 1984. Besides these liberalisation measures the government also announced various concessions in its industrial policy to promote the expansion of exports.

The New Industrial Policy of 1991 has de-regulated the industrial economy in a substantial manner. It has abolished all industrial licensing except for 5 industries related to strategic and social concerns. The number of industries reserved for the public sector has been reduced to 3 which implies that the public sector's role in future would be very much diminished. On the recommendations of the Raghavan Committee the government has decided to replace the MRTP Act by a new competition law. The new industrial policy has also liberalised import of foreign capital and technology. In the case of high investment priority industries, approval of foreign investment is automatic. Guidelines have also been announced for the expeditious approval of foreign direct investment in other industries.

Trade Policy

Trade policy is an important factor in the economic environment of business. For analytical convenience, trade policies are classified into two categories—outward-oriented and inward-oriented. An outward-oriented trade policy does not discriminate between production for domestic market and exports. It is also non-discriminatory between purchases of domestic goods and foreign goods. Hence, outward-oriented trade policy provides a somewhat liberalised economic environment to business. In this environment domestic firms have the freedom to decide whether they wish to produce for exports or they will confine their activities only to the domestic market. But in both cases they have to be efficient and internationally competitive. An inward-oriented trade policy is biased in favour of domestic market. This approach is also known as the import substitution strategy. Protection is the principal instrument of inward-oriented trade policy. Business firms operating under protective umbrella do not feel any compulsion to raise their efficiency level. These firms not only survive over a long period without being internationally competitive but also make big profits.

India's trade policy was inward-oriented for about four decades since 1951. As a result, its share was less than half a per cent in the world trade. This policy neither made India less dependent on the external world nor allowed it to prosper industrially. The growth of Indian business was quite poor by international standards in this period. Beginning in 1992, the government has effected some major changes in import and export policies. These policy changes have reduced export pessimism. The openness in trade has created compulsions for the Indian business to improve its competitiveness internationally. It if fails on this front, it will definitely suffer a severe setback.

Monetary Policy

"Monetary policy", according to C. Rangarajan, ***"is an arm of macro-economic policy and, as such, its role and importance are determined in any economy by the overall policy framework and the various instruments available for implementing policy."***[3] Monetary policy influences cost and availability of credit and money and is thus of great relevance to business. The increasing openness of the Indian economy in recent years, the need to service external debt and the necessity to improve country's exports in world trade in a highly competitive external environment require stability in the domestic price level and monetary policy is often used to realise this objective. Price stability, however, in this context does not imply absence of any increase in prices. Paul Krugman has argued that absolute price stability or zero inflation is not a good thing. The costs of getting zero inflation are large. In contrast, an inflation rate of 3-4 per cent creates a good environment for business. Since the mid-1990s inflation rate has been as high as 5.5 per cent. The Reserve Bank of India in the existing recessionary climate cannot adopt a policy of credit squeeze to control inflation as it can have a serious repercussion on economic growth. However, the inflation in this country must be kept under control to improve the environment for business activity. For this purpose the government must adopt a prudent fiscal policy.

Fiscal Policy

Fiscal policy refers to the process of shaping taxation and public expenditure in order to dampen the swings of the business cycle and to contribute to rapid economic growth with high employment and stable prices. This policy when mismanaged leads to fiscal imbalances which at times become unsustainable. This has actually happened in India during the last two decades. At present India's fiscal situation is most unsatisfactory. On account of continuously increasing non-development expenditure throughout the 1980s the fiscal situation deteriorated so much that the Central Government's fiscal deficit was as high as 6.6 per cent of GDP in 1990-91. Fiscal deficit at this level is unsustainable. The government had announced its commitment to reduce the fiscal deficit to 3 to 4 per cent of GDP by the mid-nineties. However, over the last ten years there has been very little improvement in the fiscal situation. Since fiscal deficit has to be financed by public borrowing which has a tendency to push up interest rates, credit has not been cheap in this country in recent years. The high cost of finance thus puts Indian business at a great disadvantage in international markets *vis-a-vis* other countries where interest rates are relatively low. High rates of interest also attract foreign portfolio investment which, in turn, gives us an overvalued exchange rate. In today's highly competitive international markets an overvalued exchange rate undermines the competitiveness of our exports. Therefore, fiscal corrections are necessary for providing a stable background for the economy and offsetting major disturbances in the economic system arising from different sources.

NEO-LIBERAL PROFILE OF THE ECONOMY

Presently most of the developed and developing economies have shaped their economies in accordance with the neo-liberal economic policies. ***According to the lobbyists of the Washington Consensus, the new profile of the economies world over has made business scenario far more encouraging than what it was a few years ago.***

Policy makers' approach in a country towards liberalisation, privatisation and globalisation now decides

the character of neo-liberal profile of an economy. In India, the environment of business is largely influenced by the neo-liberal profile of the country's economy. At present, in India, there is not much dispute between the leading political parties on liberalisation. Even smaller parties are often seen supporting liberalisation measures. The Left on whose support the existing UPA government survives in the Centre is opposed to privatisation. Regarding globalisation these is some scepticism but from the present indication the country would continue to tread the globalisation path, of course a little cantiously . However, so far the country has remained immune to global melt-down.

Liberalisation

Prior to 1991, the Indian economy like some other economies was a highly regulated economy. In order to induce business growth several economies adopted the policy of liberalisation. In India, this process started in 1991. For want of space, ***we shall briefly discuss liberalisation measures in relation to (i) the industrial sector, (ii) trade reforms, (iii) foreign investment and technology, (iv) the public sector and (v) the financial sector.***

In the industrial sector, barriers to entry for new firms and limits on growth in the size of existing firms have been removed. ***Industrial licensing has been abolished for most of the industries irrespective of the level of investment.*** The MRTP Act has ben amended to remove the threshold limit of one billion rupees on the assets of large business houses. The prior approval from the government is no longer required for capacity creation, amalgamation, mergers or acquisitions on the part of such companies.

The abolition of controls in the sphere of investment decisions was necessary and desirable. However, deregulation by itself does not reduce the degree of monopoly. It may also fail to increase the degree of competition among the firms. Some recent developments in India suggest that mergers, acquisitions or takeovers by firms in the industrial sector have enabled the large corporate enterprises to capture larger market share. There are so many examples which one can cite, but some cases are worth noting: the merger of Brooke Bond Lipton with Hindustan Lever, acquisition of Goa Electricals by Crompton Greaves, the merger of Parle with Coca Cola, and the merger of Ponds India with Hindustan Lever. In these cases either the established competition has been eliminated or potential competition has been pre-empted.

The trade policy reforms have eliminated quantitative restrictions on imports and exports. Further, there has been a substantial reduction in tariffs on imports alongwith abolition of subsidies on exports. The exchange rate changes have led to a sizeable depreciation of the rupee. It is hoped that the exposure of domestic firms to international competition in this manner will compel them to become more efficient. In this relatively open environment domestic firms will have to upgrade technology, reduce cost and improve the quality of products. The assumption of the trade policy reforms introduced in the country is that internationally competitive good products can always be exported. In practice, this may not always be true because in the period of recession there is the problem of insufficient demand. Moreover, all countries cannot generate export surplus. Some countries in any case must have matching import surplus. This implies that it is not easy for Indian firms to raise exports unless certain countries choose to cooperate with them.

The policy regime for foreign investment and foreign technology has been liberalised at a rapid pace. The government now wants to enlarge non-debt creating inflows. Hence, prior approval for foreing investment is generally not required now. The liberal access to imports of technology aims at facilitating technology upgradation which is a necessary condition for increasing international competitiveness in industry.

As a result of liberalisation the activities of the public sector have been reduced. Now the focus of public sector is only on those sectors which are strategic or constitute an integral part of the infrastructure. Chronically sick public enterprises are being referred to the Board of Industrial and Financial Reconstruction which decides whether these units are to be revitalised or simply closed down. Further, ***disinvestment of government equity in government enterprises is creating greater space for the private sector in industries.***

Till recently the commercial banking system and the domestic capital market were over-regulated. Over the past few years an attempt has been made to improve the health of the financial sector through deregulation. With the reductions in the statutory liquidity ratio and the cash reserve ratio, resources received by the banks in the form of deposits are not pre-empted by the government but are made available to the private sector. Interest rates in the domestic capital market have been deregulated. Now prior government approval regarding the size and price of equity issues in the primary capital market is not required. Market forces are now expected to discipline the capital market. The Securities and Exchange Board of India (SEBI), however, establishes rules and regulations to govern the stock market.

Privatisation

In India, there is a lack of enthusiasm for outright privatisation, which seems to many experts to be justified. Privatisation often fails to yield allocative efficiency because output is sub-optimal in the absence of an effective anti-trust law. Further, as Bimal Jalan points out, the sale of public enterprises would be of little help unless macroeconomic environment is improved and it is quite probable that if macroeconomic stabilisation is successful, disinvestment of equity in public sector enterprises may not be necessary.[4] But this viewpoint is not shared by many. It is often argued that there are strong reasons for disinvestment in public sector undertakings. R.K. Mishra *et al* point out that disinvestment of shareholdings enables public sector undertakings in acquiring their corporate identity whereby they can "keep pace with the market dynamism flowing from quick business reflexes resulting from their being distanced away from the government."[5] Further, disinvestment permits public enterprises to develop their own financing plans reducing thereby their dependence on the government. In any case, these have never been the considerations behind disinvestment deals. There is now considerable evidence to believe that disinvestment exercise has become a device to transfer public assets to private corporates at throwaway prices. In February/March 2001 Bharat Aluminium Company (BALCO)—a profit making PSU estimated to be worth more than Rs. 5,000—crore was squandered away for one-tenth of its value in a sleazy deal. Another well known controversial deal relates to Hotel Airport Centaur, Mumbai. A.L. Batra bought Airport Centaur for Rs. 83 crore and sold it for Rs. 115 crore making a cool profit of Rs. 32 crore within four months. How could such a thing happen but for the involvement of the government in the sleazy deals ? There is also evidence to believe that shares of public sector undertakings are usually undersold creating suspicion against the highest and the mightiest.

The new industrial policy enunciated in 1991 abolished industrial licensing and created considerable scope for the growth of the private sector. Hence, during the post liberalisation phase, private sector registered a fast growth. Opening up the economy to foreign MNCs forced restructuring of the private sector in India via consolidation, mergers and acquisitions. This also paved the way for growth of monopoly corporates in the private sector. Presently the largest industrial house is of Ambani (Reliance Industries) followed by Tata's. According to net sales, the largest private sector company in 2006 was Reliance Industries. Its net sales were as large as Rs. 80,055 crore. Reliance Industries was also the largest company in terms of operating and net profits and aggregate assets. In terms of net sales, the second ranked private sector company was Tata Motors. However, as compared to Reliance Industries, Tata Motors was too small as its assets were hardly one-sixth of the former.

Globalisation

During the post-reform period, efforts have been made to integrate the Indian economy into the global economy. The three policy measures initiated to realise the objectives of globalisation are : (1) Exchange rate adjustment and rupee convertibility; (2) Import liberalisation; and (3) Opening up to foreign capital.

Since July 1991 rupee has been allowed to depreciate more or less freely. It is argued that the depreciation of the rupee increases international competitiveness of Indian products. However, the fact remains that over the years India's exports have not increased significantly in spite of a steady fall in the external value of the rupee. The value of external debt in rupee terms has nonetheless increased substaintally. ***In 1992-93 the rupee was made partially convertible. The 1993-94 Budget introduced full convertibility of the rupee on the trade account. Full convertibility of the rupee on current account was achieved on August 19, 1994. India has adopted a cautious approach about the capital account convertibility,*** and most experts are now convinced that this country managed to avoid South-East Asian melt-down contagion precisely on account of this reason.

There are two aspects of import liberalisation. First, ***the quantitative controls on imports have been dismantled and second, import duties have been cut drastically.*** Import liberalisation is expected to make Indian industry efficient and internationally competitive. Over the years Indian industries had become rent earners and did not consider it necessary to become efficient. With import liberalisation either they will have to become competitive or else perish.

The Indian Government now sees merit in foreign capital. It is now widely believed that foreign direct investment (FDI) accelerates the industrial growth. Therefore, in a bid to attract foreign capital, the government has offered various incentives and facilities to foreign investors. Now foreign institutional investors also have access to the Indian capital market. In 2004-05 foreign direct investment (FDI) inflow in India amounted to \$ 5.6 billion. In contrast, FDI inflow in China in this year amounted to \$ 60.6 billion. In 2005-06, the FDI inflow in India rose to $ 7.75 billion. Even at this level, the FDI inflow in India remained meagre as compared to that in China.

Now globalisation is a reality. It definitely offers opportunities to Indian business. But in the existing global situation it is doubtful that Indian firms will manage to penetrate foreign markets in a big way. The Indian firms are presently small as compared to major players in the global market. In the domestic market itself Indian firms are now uneasy at the threat that foreign capital poses. At the apex, corporate sector in this country is represented by three separate business associations. The Federation of Commerce and Industry (FICCI) is the oldest. The Confederation of Indian Industry (CII) is the most powerful because of its large resources. The Associated Chambers of Commerce and Industry (Assocham) was founded as the Association of Indian Engineering Industry and later changed to Confederation of Engineering Industry. Now all the three associations of the corporate business are disenchanted with the abrupt globalisation. In fact, FICCI's president K.K. Birla had criticised the red carpet treatment acorded to foreign companies as early as August 1991.[6] K.K. Modi, a former President of FICCI, is of the view that unipolar world of MNCs is worse than a politically unipolar world. According to him, the whole formula of globalisation is in serious doubt and a high-level international debate is called for.[7] Even the CII now feels uneasy at the threat that foreign capital poses to Indian industry. In March 1996 Director General of the CII, Tarun Das, sharply criticised the behaviour of foreign MNCs towards their local partners.[8] Addressing a CII national conference, EID Parry's managing director M.V. Subbiah remarked, "The multinationals have strong financial power. They are buying Indian brands and gradually killing them. There should be some sort of regulatory mechanism to prevent this. The idea of inviting multinationals into India is to provide competition and not to build up monopolies by killing the Indian brands."[9] Another important industrialist stated, "Multinationals should not be allowed unfettered freedom in India. If the multinationals are allowed to hold a majority stake in the Indian joint ventures in an unfettered way, Indians would be second class citizens in their own country."[10] Assocham President H. Somany affirmed, "We would like to caution (against) the predatory nature of foreign capital, sometimes manifesting in the form of hostile takeovers."[11] Hence, the Indian corporate business does not consider the presence of foreign companies in India beneficial to them. In fact, many Indian companies now find that they are the target rather than the beneficiaries of the increased acitivity of foreign MNCs.

C.K. Prahalad, however, argues that under the circumstances one need not become defeatist about foreign MNCs. The correct approach is to create our own MNCs.[12] This is easier said than done. Prahalad, it seems, has overlooked the fact that the less developed countries have failed to create major players in the global economy. Indian business at the most can hope to survive only in those industries in which major global players have little stakes.

NOTES

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CHAPTER

3 GLOBAL ECONOMIC ENVIRONMENT OF BUSINESS

Unipolar World
• US Hegemony over the Global Economy
The Global Economic Performance
• The US Slowdown • The Recession in the Japanese Economy • The Collapse of the Economies of Eastern Europe and the Former Soviet Union
The Global Economic Prospects
• Global Recession • Emergence of China as an Economic Power
Global Trade Structure
• Role of the WTO in Global Economic Environment • Regional Trade Agreements • Protectionism • Dominance of MNCs in the Global Trading System

The global environment of business has witnessed drastic changes during the last two decades. The fast growing economy of Japan has been caught repeatedly in recession and has not recovered as yet. The collapse of the East European socialist economies in 1989 and the Soviet Union in 1991 led to demise of socialism in these countries. The transformation of these economies from socialism to capitalism has not been smooth. Moreover, the package of structural reforms imposed by the IMF and the World Bank on these countries has resulted in their underdevelopment. Meanwhile, the Chinese economy has been registering a growth rate of around 10 per cent per annum. However, the USA remains the only super power in the world. This unipolar world has conferred immense power on the USA to bully other countries to tow its line. ***In 1995 the World Trade Organization (WTO) was set up to serve as a watchdog in the spheres of trade in goods and services, foreign investment, intellectual property rights, etc.*** However, as expected, all WTO agreements are heavily loaded in favour of the rich countries. Alongwith the spread of multilateralism and opening up of global trade under the aegis of WTO, another opposite tendency of regionalism and bilateralism has been gaining ground in recent years and a number of RTAs (Regional Trade Agreements) are being signed by different countries.

In the present chapter we propose to address the following issues :

- Emergence of the unipolar world.
- Global economic performance with focus on global macro-economic imbalance.
- The twin US deficits and the slow down of the US economy.
- The collapse of the socialist economies of the Eastern Europe and the Soviet Union.
- Recession in the Japanese economy.
- Emergence of the Chinese economy as a strong economy.
- Global economic prospects.
- Existing world trade structure.

- Setting up of the WTO and opening up of the global trade.
- Regional trade and preferential trade groupings.
- Dominating role of the MNCs in the global trading system.

UNIPOLAR WORLD

US Hegomony over the Global Economy

The collapse of Eastern Europe in 1989 and the USSR in 1991 marked the end of a bi-polar world. With the demise of socialism in these countries, the USA established its hegemony over the world economy. No doubt Japan had emerged by the end of the 1980s as the second largest economy but it was in no position to challenge the political and economic moves of the USA. The West European countries such as Germany, France, Italy and the UK could match the USA collectively but individually none of these countries had political and economic resources to question the hegemony of the USA over the capitalist world—developed and underdeveloped. The USA now behaves like a big brother, makes policy prescriptions for all and sundry and threatens to punish all those countries which dare to take independent policy decisions. In the late 1990s India was made to pay a price for acting contrary to the dictates of the USA. The nuclear tests by India in May 1998 invited the wrath of the USA and its slapped sanctions on this country. Even South Korea has not been spared. The USA had threatened South Korea of a trade war in 1998 unless it agreed to import more American cars. In this existing unipolar world the overall economic environment for the business firms of the countries other than that of the USA is not congenial. According to William Blum, the USA has now emerged as a rogue state. Criticising the USA Nalsen Mandela stated in 1987, ***"they have the arrogance to dictate to us, where we should go and which countries should be our friends."***[1]

On January 1, 1999 the ***European Economic and Monetary Union launched a signle European currency, 'euro'.*** This process was initiated by the Maastricht Treaty in 1991. ***The euro's launch is seen as a major step towards the economic and political integration of the biggest economic zone.*** The major players in the European and Monetary Union (EMU) believe that it will ultimately lead to the emergence of a powerful and integrated bloc of European capital capable of challenging the political and economic hegemony of the USA. Alan Callinicos, however, has an entirely different perception about euro's launch. He argues, "Both the original project of European integration and EMU itself have been an expression of the conflicts between the major European national capitalism. If anything, the euro's launch is likely to intensify rather than to mollify these antagonisms."[2]

With the euro's launch coinciding with the weakening of major Asian currencies including the Japanese yen and Chinese yuan, the dollar and euro are likely to dominate world economy as reserve and key currencies. This trend may spell doom for developing economies including India by triggering off competitive devaluation and increasing debt burden. ***IMF Managing Director,*** however, ***believes that the world is moving towards a multipolar world in monetary field.*** Apart from the euro and dollar the yen will also play an important role when the Japanese financial system is strengthened. However, in the immediate future this does not seem to be the possibility. Therefore, at the most we should expect a bipolar world to emerge in a few years time, but how strong the second pole of the EMU will be cannot be said at this juncture.

Arvind Virmani, Director and Chief Executive, ICRIER, is of the view that ***within 10 years global economy will be transformed from a unipolar to a bi-polar one.*** According to his projections, ***by 2015, China is to become the largest economy, accounting for 19.5 per cent of GDP at purchasing power parity.*** Virmani measures the incremental import of an economy on the rest of the world through trade and financial flows by change in GDP at the current exchange rate. ***By 2015 China will become a larger driver of globel growth than the US and the European Union's six largest economies.***[3] China's economy is projected to become 50 per cent larger than the US economy by 2025 and almost double that of the US economy by 2035.

THE GLOBAL ECONOMIC PERFORMANCE

The world economy registered at best a modest rate of growth in terms of GDP per capita during the three year period from 2002 to 2004. The growth rate rose from 0.5 per cent per annum in 2002 to 2.9 per cent per annum in 2004. In 2005, the world growth rate declined to 2.4 per cent per annum. It continued to fall in the subsequent period despite impressive growth rates registered in China, India and Russia. The high rates of growth registered by these developing countries powered developing countries as a group to an anticipitated 5.0 per cent growth rate in 2004 — an expansion without precedence over past 30 years.[4]

One of the important reasons for this extraordinary global economic performance has been an exceptional 10.2 per cent increase in world trade in 2004 which was largely due to massive increase in import demand in China (particularly for oil, steel and minerals in manufacturing and construction sector) and the continued tendency for demand to exceed production in the USA.

In this section we propose to address the following issues :

- The US slowdown
- The twin US deficits usually referred to as macroeconomic imbalances.
- The recession in Japan.
- Collapse of the East European socialist economies and the disintegration of the Soviet Union.

The US Slowdown

The economic slowdown in the USA that started some years back still continues. Economic growth in 2001 was a tepid 1.2 per cent. Even as late as 2005-06 the growth rate in the USA was as low as 2.4 per cent. The year 2007-08 has been particularly bad for the US economy with Macroeconomic Advisers, a St. Louis Forecaster, predicting that the US would grow at a 1.6 per cent annual rate in the fourth quarter. This shows that there is considerable showdown in the US economy. Many economists opine that a recession in increasingly likely. This fear has exacerbated by a rise in unemployment rate to 5 per cent in December 2007 from 4.7 per cent, its highest level since November 2005. A report of US Labour Department suggests that "the US economy either stalled or came close to stalling in December." ***The main reasons for a likely recession in US economy are basically three: housing prices are falling, oil prices are rising and both lenders and borrowers have grown more cautious after five years of incaution.*** According to David Wessel, housing starts in September 2007 were 26 per cent below year-earlier levels. That is a direct hit on economic growth. Falling housing prices are a second hit. The price of the median existing home sold in September 2007 was down 4.2 per cent from a year earlier. That is reducing household wealth, shaking confidence and increasing foreclosures. This is significant because today's recessions are triggered more by collapsing asset prices – the bursting tech-stock bubble in 2001, for instance – than by the old cycle of retailers and factories reacting to rising inventories of unsold goods by curtailing orders and production. According to Edward Learner of the University of California Los Angeles (UCLA) the US economy faced this kind of housing collapse without a recession only twice earlier, in 1951 and 1967, and both times, the department of defence came to the rescue, because of the Korean War and the Vietnam War. However, Learner and his UCLA forecasting team say this time things will be different. They predict "a near–recession" experience.

The energy story is less clear. Oil and gasoline prices are up and look likely to keep rising. That has hurt, but not crippled, consumer spending on other things. However, says David Wessel, if oil prices keep climbing, the effects are unlikely to be as benign. The next $ 10 per barrel increase in oil prices would hurt consumers more than the last $ 10 a barrel increase.

The third factor is the prospect of a credit crunch, the consequence of lenders and investors being burnt by mortgages and other loans that turned out to be much riskier than anticipated. Commercial banks, investment banks and the market itself are tightening lending terms. Coming on top of housing and energy crisis, the understandable desire of lenders to be a little more tight-fisted is likely to turn what might have been painfully slow growth into a recession.[6]

At present the US economy occupies a strategic position in the global economy as far as its share in world's GDP is concerned. It also occupies commanding heights on international capital, financial markets and inter-national trade. The ongoing slowdown in the US will exercise devastating tremors in the world economy. (in this context, see Box 3.2).

The Recession in the Japanese Economy

Performance of the Japanese economy was simply spectacular during the 1960s and 1970s. However, it considerably slowed down during the 1980s and its GDP growth rate was as low as 1.2 per cent per annum during 1995-2001. Never since the Great Depression of the 1930s a developed country has been caught in an economic crisis of the dimension Japan faces presently.

A cursory overview of certain select indicators clearly shows that ***crisis of Japanese economy seems to be deep rooted.*** The economic stagnation, a characteristic of the 1990s, is being observed even now. *Financial Times* reported on 26 February, 2005 that Japan's economy slipped into recession for the fourth time in 10 years. Data released in February 2005 showed that the GDP contracted by 0.1 per cent in the fourth quarter of 2004. GDP in real terms for the quarter ended 3 December, 2004 dropped from the previous quarter on weak consumer spending and a surge in imports. On an annualised basis, GDP declined 0.5 per cent.[7] Economists were, however, divided in their judgement on whether such a small contraction meant that the world's second largest economy missed the opportunity to grow rapidly in future. The data highlight that Japanese economy's emergence from the legacy of its bubble economy, namely, fragile consumer sentiment, anaemic growth, chronic deflation is fraught with risk. Some economists, however, saw a beginning of the recovery in investment activity in Japan since the country's property bubble burst in the 1990s. At this juncture it is, however, difficult to say that Japan's economy has finally begun treading the recovery path. Only the sustained growth if it materialises in the economy in the coming years will mark the end of the recessionary process in Japan. At present, symptoms of economic implosion are present every where. The stock market moves in spirals, banking system lacks money to write off bad loans, yen is overvalued, commercial and industrial companies are becoming bankrupt, exports are not increasing, unemployment is continously increasing and consumer spending remains sluggish. In addition to these problems, the Japanese government is facing a serious fiscal crisis. Over the years public debt has been increasing and is presently as large as 120 per cent of Japan's GDP. Japan's fiscal imbalance has also exploded during 1991-2006. It rose from a surplus of 3 per cent of GDP in 1991 to a deficit of 14 per cent in 2006. The corporate sector has also been caught in a debt trap as its debt has grown as large as 100 per cent of GDP. Banks are in bad shape. In Japan, recession that has persisted for more than a decade is now deep rooted. There are no buoyancy factors in the economy that could induce the corporates to boost investment, generating employment opportunities and income. In this situation capitalists are using reduced capital flows to repay their debts. This has undermined both consumers' and investors' confidence. As a result, GDP has declined in money terms and the economic crisis has become self-reinforcing. In this context, see Box 3.1

BOX 3.1. Japan's Economic Slump Feared

Concern that Japan's economy could be heading for another dull or worse has sharpened with the availability of results of economic growth for the third quarter of 2007–08. ***Growth for this quarter was sharply revised down to an annualised 1.5 per cent from the original estimate of 2.6 per cent in the results published on December 9, 2007.***

Japan's economic output data are notoriously volatile, but the downward revision matches an emerging consensus that the economy is faltering and that things could get worse before they get better.

Together with the June quarter, when the economy contracted, ***Japanese GDP grew by just 0.1 per cent in the first half of the fiscal year, or at an annualised 0.3 per cent.***

The Japanese downturn heightened worries over the release this week of the Bank of Japan's widely followed Tankan survey of corporate sentiment.

Goldman Sachs said that it expected this to show deteriorating business confidence and a widening disparity between big business and small enterprises less able to cope with rising cost of raw materials, including oil.

Mamoru Yamazaki, economist at Royal Bank of Scotland said, "Profits have been worse than we thought and many companies, especially smaller ones, will become more cautious about increasing wages and capital spending."

In recent months, economists have been revising down growth estimates for the year to March 2008.

In the latest revision, output grew at 0.4 per cent quarter on quarter in the third quarter. Net exports pushed GDP up 0.5 points, with the domestic economy making a negative contribution of 0.1 point. That underlined Japan's continued reliance on exports leaving it vulnerable to an external downturn.

***Source : Business Standard,* December 10, 2007, p.8**

The Collapse of the Economies of Eastern Europe and the Former Soviet Union and their Underdevelopment

The collapse of the socialist economies of the Eastern Europe and the former Soviet Union is now considered to be an important event in the world history. However, during the 1990s things looked less clear. The collapse of the old economic system did not unleash a new dynamism as anticipated. In fact, the region got trapped in chaos,depression and gloom.

A World Bank study states,

"The social costs of transition are higher than expected. Predictions did indicate that some unemployment would emerge. But nobody expected massive decline (ranging 10 to 40 per cent between 1987-1993) of measured GDP in transition economies, which dwarfed in its proportion, the output and income loss of the United States and Germany during the Great Depression."[8]

The inept policies recommended by the lobbyists of the Washington Consensus when adopted by the economies of Eastern Europe and former Soviet Union led to their underdevelopment. Table 3.1 provides data on growth of GDP in these economies during 1989 to 1994. Over the period, the industrial output also substantially declined. In fact, it was a case of output collapse. Hence, environment for business deteriorated in these countries.

TABLE 3.1. GDP Growth in Transition Economies (1989-94)

Economies	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*
Transition Economies	3.1	−6.2	−8.8	−15.2	−8.6	−6.0
Eastern Europe	0.0	−11.6	−11.2	−5.2	−0.8	−2.0
Soviet Union and Successive States	3.0	−4.0	−8.0	−18.3	−10.0	−9.5

***Source** :U.N. World Economic and Social Survey, 1994.* (United Nations, Yew York, 1994) p. 15.

Agriculture in Eastern Europe also suffered a severe setback in this period. Agriculture is important in Eastern Europe where some 20 per cent of the world's farmland is found. Since 1989 agricultural output declined in all the Eastern European countries though usually less than industrial output.

Moreover, the collapse of output in East European economies was accompanied by a dramatic decline in investment. Another important aspect of power restructuring has been weakening of human capital and related R&D base in Eastern Europe. In this period, Eastern Europe has witnessed brain drain on a considerable scale. Thus for positive restructuring most of these economies have been facing shortages of skilled labour. Obviously the perverse restructuring in the East European economies does not offer conducive environment to the development of business.

THE GLOBAL ECONOMIC PROSPECTS

The global economy slowed down in 2005 and 2006 expanding by less than 3.0 per cent in each year mainly due to the following factors :

1. The investment cycle in the USA had peaked, causing a slowdown in growth there.
2. World demand had outstripped supply resulting in substantial increases in oil and other commodity prices that have cut into incomes, moderating demand in many countries.
3. Higher interest rates slowed investment growth as central banks continued shifting monetary policy from a loose to a more neutral stance.
4. The large fiscal impulse that has propelled the U.S. economy weakened although the deficit remained high.
5. In Europe, budgetary policy tightened as countries sought to regain control over deficits.
6. Efforts in China to bring growth down to a more sustainable pace should also contribute to weaker, but still strong, demand over the medium term.

Given this global environment and especially the slow expansion of trade, growth in most low and middle income countries also moderated the demand. However, according to the World Bank their performance could deteriorate considerably, if one or more of the following events happens :

1. There is an additional rise in oil prices. Such a rise would have important negative effects on all oil-importing countries, particularly those low and middle income countries that face current account constraints. These countries will have to accommodate increases in oil prices by cutting down other imports, consumption and investment volumes — implying a significant real-side adjustment. For the most vulnerable of such countries, an additional $ 10 a barrel increase in oil prices could reduce domestic income by as much as 4 per cent.
2. Financing requirements of the U.S. current account and government deficits (known together as 'twin deficits'), and renewed pressure on the dollar, caused long-term interest rates to rise more than forecasted. As this happened, one economy after another slowed down. More particularly, the hardships of heavily indebted countries increased. Increased financial market turbulence also ensued especially for those developing countries most exposed to the U.S. dollar.
3. If efforts to slow the unsustainable pace of growth in China failed, major disruptions could result. Currently, investment levels are unsustainably high and food-price increases are likely to push up production costs adversely affecting the competitiveness. If this happens, a much more abrupt slowdown might be provoked than is presently envisaged. Given China's growing importance as a driver of world trade

growth, such a sharp slowdown could have a significant adverse effect on global economic activity, particularly among China's major trading partners.

Global Recession

Free marketers and the IMF-World Bank experts did not think till recently that their policies would inevitably push the world economy into recession. But what was not suspected actually happened. The world is now in the grip of recession.

In contrast, the decade of 1990s registered spectacular growth. Everybody seemed to be benefiting from this situation. The six fold flows of finance capital from the developed countries to the developing countries in six years and increase of 90 per cent in the world trade over the decade of the 1990s resulted in an unprecedented growth. It was believed that the trade and financial flows would create jobs and growth.

Making his observations on the evolving situation Joseph Stiglitz has remarked in his *The Roaring Nineties*, ***"In the roaring nineties, growth soared to levels not seen in a generation."*** Newspaper articles and experts proclaimed that there was a New Economy, that recessions were a thing of the past and that globalisation was going to bring prosperity to the whole world. ***But toward the end of the decade, what seemed to be the dawn of a new era began to look more and more like the one of those short bursts of economic activity, or hyperactivity, inevitably followed by a bust, which marked capitalism for two hundred years. Except this time, the bubble — the boom in both the economy and the stock market — was greater, and so were its consequences.*** The new era was a new era for the United States and the whole world. Thus, ***the bust that followed was a downturn not only for the United States but for much of the whole world."***[9]

The Economist in its June 23-29 issue of 2001 presented a pessimistic picture of the global economy. It wrote, "The world economy is starting to look remarkably, even dangerously, vulnerable. America's growth seems to have fallen close to zero in the current quarter. Japan has almost certainly slipped into another recession. And although the euro area is still growing, its pace has slowed more sharply than expected. Worse, a nasty complication has emerged, just as growth has slumped, average inflation in the big rich countries has gone up to its fastest rate for almost eight years, kindling fears that stagflation, the disease that spread around the globe in the 1970s may return."

The group of seven leading industrialised countries (G7) in a recent statement observed, ***"Financial market conditions have deteriorated in many parts of the world, leading to a further weakening of growth prospects, especially in most emerging market economies."*** For this global melt-down the free marketers, international finance capital and the IMF-World Bank must share the responsibility. Jeffery D. Sachs, Director, Harvard Institute of International Development, has blamed the IMF for its faulty prescriptions and adding to the already existing problems of the South Asian economies.

With the disintegration of the Soviet Union, and Russia alongwith other East European countries embracing market economy, de-industrialisation began in these countries. This was a matter of great rejoining for the USA and other western countries. After all, capitalism had triumphed over socialism. However, overtime, as a result of rapid negative growth in these countries, purchasing power of the people fell and demand for imports was drastically reduced. Financial support which these countries got from the IMF, the World Bank and the Western industrially developed countries failed to sustain demand in these countries.

In 1997-98 swift flows of highly volatile international finance capital and patently wrong policies of East and South-East Asian countries plunged these economies into deep crisis. The crash of Japan has given a severe jolt to Western Europe and the USA. The economy of USA is also facing recession now. The American economy is a giant economy, generating about one-third of the world income. Due to globalisation there are many countries in its shadow and their economies would be jolted severely by its problems. The crash of 2007-08 has not remained confined to US economy. It has impacted the global economy. Blaming the "securitisation of credit" for the latest financial crisis, Avinash D. Persaud argues, "What makes the on going crisis in world financial markets more complicated than the previous ones is the very thing that Alan Greenspan and others argued that made financial systems safer : *"the securitisation of credit."*[10] Avinash D. Persaud, adds to his earlier observations, "The crash of 2007-08 could have been avoided. It was the result of poor investment decisions supported by a mistaken monetary and regulatory policy background. Investors will need to ensure that their fund managers are agile enough for fast markets."[11] It is too late for the policy makers to do much to tackle the problems arising from the ongoing crisis. They should now be careful to ensure that their wrong policies do not lay the foundations for the next crash.

BOX 3.2 US Subprime Crisis Makes Its Presence Felt Around the Globe

Few people knew at the start of 2007 the meaning of "subprime" real estate loans or how they might affect the US and global economies.

Today, worries are growing that the crisis that began with mortgage failures and spread to banks and brokerages may push the US economy into a downturn and put the entire global economy at risk.

Subprime loans flourished at the end of the US housing boom as lenders offered mortgages to people with shaky credit in an effort to cash in on surging prices.

These loans were packaged into securities that were sold to investors around the world, with little regard to what would happen when low "teaser" rates were reset to increase payments from homeowners.

When a wave of defaults began to hit, US and global banks began to see billions of dollars in losses on their balance sheets. The lenders had to tighten credit, crimping consumer and business spending and threatening the overall economy.

Goldman Sachs Group Inc. economist Jan Hatzius said his "back–of–the–envelope calculation" now suggests "losses of around $ 400 billion (about Rs.15.8 trillion)" for global banks and investors.

Although this may not seem large in the overall economy, Hatzius said the effect is magnified because banks need to scale back their lending to keep capital ratios intact after accounting for the losses. As a result he said ***lending could be cut by $ 2 trillion.***

"Even if this occurs gradually and even if there are some offsets from reduced credit demand and increased lending by other sectors, the drag on economic activity could be substantial", said Hatzius in a note to clients.

Adding to the woes from housing are near–record energy prices and a weak dollar that could fuel inflation and hurt business confidence. Some say a recession is a possible scenario.

While debate is raging on whether the US economy will avert recession, another question is how much a US slowdown will affect the global economy.

Some experts say there has been a "decoupling", meaning the rest of the world is less dependent on the US. But any slump in the US is still likely to have a global impact.

"We think 2008 will be the 'year of recoupling'," said Peter Besezin, a Goldman Sachs global economist. "The mortgage meltdown in the US has clearly affected global financial markets", he noted, adding that "the weakness in the US housing market is starting to raise concerns that the global housing market may suffer a similar fate". Paul Sheard, economist at Lehman Brothers Inc., is guarded, saying: ***"2008 is shaping up to be more challenging for the global economy than 2007 was. We expect growth to be slower."***

The global economy will feel an impact of a US slowdown, even if the world's largest economy averts recession, Sheard said.

"If the US slows and other developed economies follow on, these economies will not be able to escape knock-on effects via the trade channel in particular but also via financial and confidence channels", Sheard said.

Source: **Rob Lever, "Growing Worries: US Subprime Crisis Makes Its Presence Felt Around the Globe,"** ***mint,*** **December 27, 2007, p.15**

Emergence of China as an Economic Power

It is now generally agreed that China's growth performance in recent decades is no less than a miracle. China's GDP growth has averaged nearly 10 per cent over the two and a half decades period beginning from 1980. According to Alok Ray, ***"China's economic performance is even a bigger miracle than the Eastern Asian countries, involving Singapore, Hong Kong and South Korea."***[12] Analysing the sources of the Chinese growth, Deepak Lal has attributed the miracle growth rate of China to ***higher savings, the growth of labour intensive small scale export industries operating in towns and villages, a massive increase in infrastructure, a large unilateral liberalisation of foreign trade, and the market determination of nearly all domestic commodity prices.***[13] This labour intensive growth allowed the transfer of a vast amount of labour from both the rural sector and the declining State owned enterprise (SOE) sector." Thus Chinese growth has been possible at a spectacular rate. ***The output growth has also been accompanied by growth of employment.*** However, this may not be sustained in future. Deepak Lal argues that there is inefficiency in the deployment of savings and thus in the future, China may find it difficult to maintain even the existing level of savings. Moreover, the low rate of return on household savings from the State owned Banks will deter people to raise their savings level. As a consequence, China may face shortage of savings for maintaining existing rate of growth. According to Deepak Lal, China's commitment to social responsibility may prove to be an obstacle to economic growth due to the possibility of social burdens' eating up resources which the country may need for further growth. He asserts, ***"The policy and social burdens carried by State enterprises need to be eliminated"***[14] ***for sustaining the present level of growth rate.*** If these measures are not undertaken by the Chinese government, it is most likely that growth rate will fall and the Chinese economic miracle will be over.

The importance of China for the global economy is reflected in various spheres. At present China's exports plus imports are 75 per cent of its GDP while for Japan the ratio of total exports and imports falls in the range of 25-30 per cent of its GDP. According to latest estimates, China currently accounts for 15.7 per cent of the global income while the US has 26.4 per cent of the global GDP. In another few decades China is expected to surpass even the United States in terms of aggregate output. According to Batuk Galhani, ***"some 80 Chinese companies are on a global move and could make inroads into key Western markets. With over***

10 per cent economic growth per annum, Chinese companies will not be restricted to trading and manufacturing in the Far East."[15]

Now India's imports from China exceed India's imports from the USA. China is already importing from India far more than most of the countries. It is estimated that very soon it will emerge as the leading importer of Indian products. Thus ***China is replacing the USA as the engine of global growth.*** In this situation the importance of China becomes obvious for Indian business.

GLOBAL TRADE STRUCTURE

An important aspect of global business environment is global trade structure. At present the following institutions and policy measures broadly constitute the global trade structure :

- The World Trade Organisation (WTO)
- Regional Trade Agreements
- Protectionism
- Multinational Corporations (MNCs).

Role of the WTO in Global Economic Environment

The most important development in global environment during the period of last one and a half decade has been the setting up of WTO (World Trade Organisation) in 1995. The main focus of the WTO is on cutting down trade barriers among countries with the objective of encouraging multilateralism. This is expected to bring about substantial growth in world trade and increased income from liberalisation, improved market access and greater export opportunities, besides greater predictability of the trading environment. The WTO also provides for protection of intellectual property rights of the innovators (patents, copyrights etc.). For the purpose of negotiations on trade and various other issues, a provision has been made for a meeting of the Ministerial Conference (consisting of representatives of all the member countries) at least once in two years.

Developing countries' unity at Cancun: Formation of G-20 and G-16. The debate at Cancun Ministerial Conference (held in Cancun, Mexico, from September 10 to 14, 2003) was focused basically on two issues: (1) ***liberalisation of agriculture,*** and (2) ***developing new multilateral disciplines on the Singapore issues.*** As far as the first issue is concerned, the main focus was on reducing the level of agricultural subsidies. The main providers of these subsidies have been the USA and EU and, therefore, it was their responsibility to announce drastic reductions in agricultural subsidies. However, they conspired together to put pressure on developing countries without making any reduction commitments on their own behalf. For example in mid-August 2003, USA and EU entered into a mutual agreement to accommodate each other's concerns by drawing up a framework on further negotiations envisaging marginal reduction in domestic support and elimination of export subsidies in some products only. The formula for tariff reductions developed by them required minimal market access commitments in their sensitive products, but projected them as demanders of substantial improvements in market access in developing countries particularly large and relatively more advanced among them. To counter and stall these designs of USA and EU, India and some other developing countries came together to form a group (known as G-20) whose chief spokesman is Brazil. G-20 sought elimination of distortions in world agriculture created through high level of subsidies in the developed countries. Therefore, G-20 member countries called upon the developed countries to cut down the subsidies provided by the latter to their farm sector. Urgent need to bring down the high tariffs and non-tariff barriers on products of export interest to developing countries was also underlined, to secure for these countries sufficient gains from globalisation.

Let us now turn to the second subject—***the Singapore issues.*** These include four issues — ***investment, competition policy, government procurement and trade facilitation.*** The Singapore issues were included in the Doha Agenda (as agreed upon in Doha, Qatar, in November 2001) in a two step procedure. Preparatory work commenced at the beginning of the round and actual negotiations were to start after the Cancun ministerial meeting, "on the basis of a decision to be taken, by explicit consensus, at that session on the modalities of the negotiation." India, while continuing with the clarification process, has been reiterating its stand that many of these issues desired to be treated outside the framework of WTO. The lack of explicit consensus on modalities was also emphasized by India. A core group of 16 countries (G-16) including India (and led by Malaysia) took a strong and effective stand at the Cancun ministerial, highlighting the problems and lack of explicit consensus on modalities. Nevertheless, the draft ministerial text of September 13, 2003 ignored the position taken by over 90 countries (including India), and suggested commencement of negotiations on three of the four Singapore issues, *viz*, Investment, Transparency in government procurement, and Trade facilitation. As this position was unacceptable to these and least developed countries, the ministerial conference ended in a deadlock over Singapore issues.

What Cancun failure brought to the fore was the strong negotiating capabilities acquired over time by the developing countries. These countries have come together in the past as well, but only to break up and forsake common goals in the face of rich country pressure and selective inducements. At Cancun, developing countries not only held together, but also became more professional in their approach to negotiations, offering alternative legal text to counter the official draft text presented by the WTO Secretariat. Such developing country sophistication has caused considerable uneasiness in the developed world and trade representatives of the latter are now asking for a change in the way decisions are arrived at in WTO. ***Cancun failure is being used by the developed countries, particularly USA and EU to push forward regional trade agreements (RTAs) and bilateral agreements with a vengeance.***

In fact, in hindsight it can be said that the ***developed countries were only waiting for an opportunity to move away from the multilateral to the regional and bilateral track. This suits the interest of these countries as in bilateral and regional trade agreements it is the strong which dictate both the policies as well as how they will be implemented.***

Regional Trade Agreements

WTO rules say a trading nation must offer equal access to every other (exporting) nation, in every distinct product line. That is the essence of the famous ***Most Favoured Nation*** (MFN) rules which means that importing economies must extend the best terms that they offer any exporting economy to every other WTO-contracting party. Such ***non-discrimination has been the cornerstone of all post -Second World War multilateral trade negotiations*** — first under GATT and now under WTO.

As against this, ***members of RTAs (Regional Trade Agreements) trade freely (without tariffs or other barriers) only amongst themselves***; ***they can, and often do, confront outsiders with a 'common' tariff wall.*** RTAs are generally of the following types:

Preferential Trade Agreement: When a group of countries agrees to reduce tariffs on a few products which they trade between themselves.

Free Trade Agreement: When all tariffs between the member countries are removed on some items, but each country has its own tariff structure for the rest of the world.

Customs Union: When there is free trade with member countries and common tariffs are applied on goods, which come in from the rest of the world.

Common Market: When there is a truly open market among all member countries — not only goods and services but also capital and labour can move freely across the member countries.

As is clear, ***RTAs go against the spirit of multilateralism as embodied in the spirit of WTO as they encourage bilateralism and regionalism.*** However, WTO (and earlier on GATT) has been allowing RTAs as an exception to the fundamental principle of non-discrimination set out in the MFN clause of GATT's Article 1 — the rationale being that such agreements *eventually* lead to more world trade as different sectors of different member countries acquire competitive strength over a period of time. However, as stated earlier, it is the powerful countries in an RTA that call the shots and therefore, post-Cancun, USA and EU have been trying to push forward RTAs. Many developing countries (including India) are also actively engaging themselves in forming new RTAs or joining existing ones to protect their interests. Many observers argue that the slow pace of multilateral negotiations of the WTO has been responsible for increase in RTAs around the world in recent years. ***From the global economic environment point of view, the emergence and extension of RTAs in recent years has been the most important development*** and the next couple of years are bound to see a further increase in their influence.

According to World Bank's report *Global Economic Prospects 2005*, the number of RTAs has more than quadrupled since 1990 (from 50 to nearly 230 by late 2004).[16] Trade between RTA partners now makes up approximately 40 per cent of total global trade, and new agreements increasingly address issues beyond trade. WTO estimates that another 60 agreements are in various stages of negotiation. According to World Bank, nearly all countries belong to at least one RTA, and some are party to numerous agreements. On an average, each country belongs to 6 RTAs, though there is considerable variation across regions and levels of development. Northern countries (*i.e.*, developed countries) have participated to the greatest extent, each signing, on an average, 13 agreements. The main RTAs and their members are listed in Box 3.3.

BOX 3.3. Frequently Cited RTAs and their Members

- **ASEAN Free Trade Area:** Brunei, Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
- **APEC** (Asia Pacific Economic Cooperation): Australia, Brunei, Canada, Chile, China, Hong Kong (China), Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, United States, Vietnam
- **CACM** (Central American Common Market): Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua
- **CAFTA** (Central America Free Trade Area): United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Dominican Republic
- **CARICOM** (Caribbean Community and Common Market): Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Monserrat, Trinidad and Tobago, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname
- **CEFTA** (Central European Free Trade Agreement): Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia
- **CIS** (Commonwealth of Independent States): Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, Russian Federation, Ukraine, Uzbekistan, Tajikstan, Kyrgyz Republic
- **ECOWAS** (Economic Community of West African States): Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Cote d'Ivoire, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo
- **EFTA** (European Free Trade Association): Iceland, Leichtenstein, Norway, Switzerland
- **EU** (European Union)*: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK
- **EEA** (European Economic Area): EU, Iceland, Leichtenstein, Norway
- **EMFTA** (Euro-Mediterranean Free Trade Area): EU, Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syrian Arab Republic, Tunisia, Turkey, Palestenian Territory
- **GAFTA** (Greater Arab Free Trade Area): Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qator, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, Yemen
- **GCC** (Gulf Cooperation Council): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
- **MERCOSUR** (Southern Common Market): Argentina, Brazil, Paraguay, Uruguay
- **NAFTA** (North American Free Trade Agreement): Canada, Mexico, United States
- **SACU** (Southern African Customs Union): South Africa, Botswana, Lesotho, Swaziland, Namibia
- **SAFTA** (South Asian Free Trade Area): Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
- **SAPTA** (South Asian Preferential Trade Arrangement): Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka

*In addition to 15 countries listed here, 10 new "accession countries" joined on May 1, 2004 bringing up the membership to 25 countries. The new members include two countries from the Mediterranean, Cyprus and Malta, seven from former Soviet Block, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia, and one of the successor States of former Yugoslavia, Slovenia.

Source: World Bank, *Global Economic Prospects 2005* (Washington, 2005), pp. xxiii-xxv

Since 2000, several major new trends have been emerging in the pattern of RTAs. One unifying characteristic is that these take RTAs well beyond agreements between adjacent countries. World Bank's report *Global Economic Prospects 2005* discusses three such trends[17]:

1. The EU's move toward bilateral market access FTAs (Free Trade Agreements) and EPAs (Economic Partnership Agreements) with the ACP (African Caribbean and Pacific) countries;
2. The shift in the US position toward bilateral preferential agreements; and
3. The effort of a handful of developing countries to open up markets through RTAs.

EU's Preferential Trade Arrangements. During the 1990s, the EU was an active sponsor of bilateral arrangements with individual countries and group of countries and was the major player in the RTA game. Prior to the accession of 10 new members on May 1, 2004, the EU had bilateral or regional agreements with 111 countries. These agreements fell into the following three categories:

• **Europe Agreements** were intended to prepare bordering East European countries (*i.e.* the former socialist countries of East Europe) for eventual accession to the EU. They involved bilateral agreements between each other and with EU to reduce tariffs, develop uniform rules of origin, EU-consistent regulatory approaches to services, and common treatment of standards as well as transition rules in sectors such as agriculture. These efforts culminated with the full admission of 10 new countries in the EU in 2004.

• **Euro-Mediterranean Agreements** were intended to build bilateral trade relations between neighbours, with the objective of forming a NAFTA - like free trade area by 2010. Launched in 1995, the EU and 12 countries have been involved in talks on "association agreements" that would subsume some existing bilateral agreements. So far, bilateral agreements have been signed with Tunisia (1995), Israel (1995), Morocco (1996), Jordan (1997), the Palestinian Authority (1997), Algeria (2001), Egypt (2001), and Lebanon (2002).

• **Partnership and Cooperation Agreements (PCAs)** with the western Balkans, Russia, and the CIS were designed to help promote stability on the border of the EU, and in the case of Russia, to expand trade.

In addition to the above three agreements, two new agreements have been added to the list since 2000:

• **Economic Partnership Agreements (EPAs)** are designed to promote trade and development in the ACP (African Caribbean and Pacific) 77 countries in a WTO-consistent fashion by establishing agreements between large groups of countries forming customs unions.

After a one-year clarification phase by the ACP countries, the first negotiations were launched in October 2003. Reciprocal trade liberalisation would be the centre piece under the terms of the EPA programme. In addition, EU is pressing for inclusion of services liberalisation, investment, competition, government procurement, and trade facilitation in the agreements.

• **Free Trade Agreements** with South Africa (which entered into force in 2000), Mexico (2000), and Chile (2003) are designed to open markets and secure trade. Agreements with the Gulf Cooperation Council (GCC) and the Common Market for the South (MERCOSUR) are under active consideration. These embody free trade provisions for a range of products as well as provision to liberalise some services.

The US Turns Towards Bilateralism. USA has been turning towards more and more bilateralism and RTAs in recent years. Since 2002, USA has signed bilateral accords with Australia, Bahrain, Central America plus the Dominican Republic, Chile, Morocco, and Singapore. After the failure of Cancun WTO Ministerial in September 2003, the USA has intensified its pursuit of RTAs and negotiations are officially under way with Colombia, Ecuador, Panama, Peru, SACU, and Thailand. Other economies deemed to be in queue are Bolivia, Egypt, New Zealand, Pakistan, the Philippines, South Korea, Sri Lanka, Taiwan and Urnguay.

The main features of the RTAs being formalised by USA are as follows :

1. Tariff rates on most non-agricultural products are bound at zero; for example, the US-Chile FTA will bind duties at zero for 85 per cent of trade.
2. Exclusion or delayed liberalisation of sensitive products, commonly including agricultural products such as 'dairy products, cotton, ethyl alcohol, peanuts and peanut butter, sugar and tobacco for the United States. Some exclusions are due to be phased out according to lengthy timetables.
3. Intellectual property rights are conventionally accorded stronger protections than under the WTO's TRIPs agreements with investor-State suits permitted in the event of disputes.
4. Investment protections, with provisions for national treatment and non discrimination in pre-establishment provisions for companies based in each other's markets.
5. Services trade are to be open except for those excluded in a negative list; notably excluded are labour service providers, except for the provisional visas held by professionals associated with investing firms.
6. Labour and environment issues are included in recent agreements, with signatory countries undertaking commitments to enforce their own environmental and labour laws.

Developing Countries Actively Pursue RTAs. Many developing countries have evinced keen interest in establishing new RTAs or joining existing ones with a view to increasing their access to more markets. Mexico and Chile have been at the forefront of these efforts. After joining NAFTA, Mexico turned its attention to Central America and Latin America. It established arrangements with Costa Rica (1995), Bolivia (1995), Nicaragua (1998), the EU (2000), EFTA (2001), and Japan (2004). Chile established agreements with MERCOSUR (1996), Canada (1997), Peru (1998), Mexico (1999), Central America (2002), the USA and EU (2003), and EFTA (2004). By 2004, Chile had signed free trade agreements that provided over 60 per cent of its exports with duty free access to markets around the world. Countries of Africa also pushed RTAs during 1990s to intensify preferential trade liberalisation. The treaty establishing COMESA (Common Market for

Eastern and Southern Africa) was signed in 1993. It included Kenya, Tanzania and Uganda. The SADC (Southern African Development Community) Trade Cooperation Protocol was signed in 1996 as part of an effort to reintegrate South Africa into the regional economy after the end of apartheid.

Since 2001, Asian countries have launched similar negotiations. These include China, India, Thailand, Singapore, Pakistan, Bangladesh, Sri Lanka and so on. In the following section, we discuss the efforts being made by the Government of India in this regard.

India's Tryst with FTAs. The Government of India has also launched FTAs negotiations with a number of regions/countries in recent years. The main reason for the negotiations is that India now wants to play more role in global trade. In addition, with China's relationship with ASEAN growing stronger, it has become imperative for India also to foster stronger relationship with East Asia. For example, by not having an FTA with Singapore, efficient producers in India will appear to be high-cost to customers in that country for the simple reason that we have to pay tariffs on imports into Singapore whereas more inefficient producers in, say, Thailand do not, because they are a part of a free trade agreement. Let us now critically examine India's FTA negotiations.

1. Some critics have pointed out that all FTAs that are presently being negotiated by India constitute only a small part of India's trade. Even ASEAN (despite our much hyped 'East Asia' policy) accounts for only around 9 per cent of our trade. Thus, the benefits from these FTAs are bound to be limited.

2. The second problem is that India, with its high tariff barriers, is negotiating with countries and blocks such as ASEAN, whose trade barriers are already low. Therefore, on opening up, other members will gain more than India. For example, it has been estimated that for every $ 1 increase in exports from India because of an FTA with ASEAN, there will be a $ 4 increase in exports from ASEAN to India.[18]

3. India's high tariff barriers could pose other problems too. For example, we could start importing goods made by inefficient producers within the FTA rather than from more efficient producers outside the FTA simply because the former do not have to pay customs duty and can thus sell cheaply — a phenomenon known as ***trade diversion***. Trade diversion is especially strong in countries having high tariff barriers. In addition, the government loses valuable revenue because the inefficient producer does not pay customs duty.

4. Another problem is that producers in countries outside the FTA could start trying to route their goods to India through a third country with which we have an agreement. Again, this problem gets worse if we have high tariffs. To control this problem, countries have what are called ***rules of origin***, which try and stipulate the amount of value that a member country has to add to goods before it can qualify for a duty free status with its FTA partner. Rules of origin range from as low as 15 per cent to as high as 60 per cent of the value added. India's FTA with Nepal has a rule of origin of 40 per cent while with Sri Lanka our rule of origin is around 35 per cent. However, as correctly pointed out by Avinash Celestine, rules of origin are extremely hard to negotiate and complex. Moreover, enforcing these rules requires a huge bureaucracy. They also allow the custom authorities — and individual custom officers — a good deal of discretion which could be abused.[19]

Protectionism

Since the mid 1970s the industrialised countries of the West have been increasingly resorting to protection. The success of Japanese exports and then of exports from the newly industrialising countries created pressure on the USA and the West European countries for pursuing the protectionist policy. The older industrialised countries want to avoid competition from newly industrialising countries in their domestic markets and thus create non-tariff barriers (NTBs). During the past few decades trade in textiles, leather goods, footwear, steel, ship-building, cars and consumer electronics has been subjected to blatant protectionism by the western countries.

Tariffs are now low and thus not used for protection. ***The main instrument of protection during the past two decades has been the non-tariff barrier (NTB).*** It violates widely accepted principles of non-discrimination and transparency in trade. According to *World Development Report 1987,* "NTBs are unfair because they do not treat exporters equally. Often it is the exporters with the least bargaining power whose exports are most reduced."[20] Recently European Union imposed anti-dumping duties on Indian exports of stainless steel products while the EU countries continue to heavily subsidise their steel industry. ***This is obviously a case of blatant protectionism. It amply clarifies that it is not easy for the business firms of the developing countries like India and Pakistan to penetrate the markets in developed countries.*** A detailed analysis of the extent of NTBs has been carried out by the staff of the World Bank. It shows that around one-fifth of industrial countries, imports are subject to hardcore NTBs. Trefler has pointed out that NTBs in US manufacturing in 1983 reduced manufacturing imports by as much as 24 per cent.[21] Even now protectionist sentiments in the USA are quite strong. Countervailing duties and anti-dumping provisions as laid down under GATT are used with impunity by the USA and the EU countries. Messerlin wrote, "First, the EC (anti dumping) procedure is now far from being marginal : it involves hundreds of cases, concerns all the important trade partners of the community and shows increasingly restrictive outcomes. Second, there is a clear tendency for this GATT honoured procedure to generate outcomes embarrassing to GATT principles : harassment, discrimination between trade partners, non-tariff barriers are intrinsic to this procedure."[22]

Dominance of MNCs in the Global Trading System

At present the global economy is dominated by 40,000 corporations. The activities of these enterprises cross national boundaries. These firms operate in overseas markets through some 2,50,000 foreign affiliates. According to an estimate of the Washington based Institute for Policy Studies (IPS) the top 100 of these global firms account for a growing share of the world's economic activity. Illustrating the growing economic clout of the global giants the IPS report states that out of the 100 largest economies in the world, 51 are corporations; only 49 are countries. Wal-Mart the number 12 corporation is bigger than 161 countries including Greece, Poland and Israel, Mitsubishi is larger than the fourth most populous nation on earth. Indonesia, Toyota is bigger than Norway, General Motors is bigger than Denmark and Ford is bigger than Portugal.

In their capital structures, size and strategies, top 200 mega corporations are neither homogeneous nor are the individual rankings immutable. Over the last two decades there has been a sharp differentiation within the top 200 and, therefore, their respective rankings have shifted; several have been pushed to the wall, gobbled through mergers and acquisitions. Over the last decade the number of US firms in top 200 slipped drastically from 80 to 60 whereas those of Japan rose from 35 to 54. A parallel movement was the fall in the number of UK corporations and rise in the number of French and German firms. Switzerland, a relatively small country, accounts for eight of the top 200 corporations. Among Third World countries only South Korea, Venezuela and Brazil have penetrated the ranks of the top 200. In this environment there is not much hope for corporate enterprises from other Third World countries.

At present one-third of the world trade is simply in the form of transactions among various units of the same corporation. These corporations are net job-destroyers. The total employment provided by these 200 mega corporations is only 18.8 million which is just 0.75 per cent of the world work force. The world's largest 500 firms have shed over 4,00,000 workers yearly notwithstanding the upsurge in their revenue. This strategy of revenue maximisation with cost reduction looks wonderful at the firm level. However, when all firms pursue this policy, it leads to a drastic reduction in aggregate demand which eventually causes recession. The corporate managers ignoring this basic principle of macroeconomics have actually pushed the global economy into a recessionary situation. The giant corporations with massive resources at their command, in the face of falling demand, are engaged in ruthless competition with relatively smaller companies. Peter F. Drucker has rightly pointed out that medium and small businesses also operate in the world economy and they are not always visible.[23] These firms in the prosperity phase of the business cycle grow and generate substantial revenues. However, with the onslaught of global recession their existence is threatened. In this period no goal setting, no vision and no strategy will help these small corporate enterprises in their growth pursuit.

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CHAPTER

4 NON-ECONOMIC ENVIRONMENT OF BUSINESS

Business is an economic activity. It is nonetheless influenced by its non-economic environment as much as by its economic environment. The non-economic environment of business can be broadly classified as follows:

- Political and legal environment
- Socio-cultural environment
- Demographic environment
- Technological environment
- Natural environment.

While analysing the impact of various aspects of non-economic environment on business, we shall address the following issues:

- What constitutes the political environment in a country ?
- How a country's class structure, ideology of the ruling class and global superpowers shape the political environment ?
- How has existing legal environment of business developed in response to activities of business enterprises themselves ?
- How do social organisation and cultural values in a country constitute the socio-cultural environment and how do they impact business ?
- Whether globalisation of culture creates larger scope for MNCs to invade cultural pattern and consumer goods markets ?
- How do caste, race, gender, ethnicity and demographic environment impact business ?
- What is the significance of available technology for business, and why rapid development of technology contributes to growth of business ?

- How much impact the choice of techniques makes on technological environment ?
- How is natural environment relevant for the business activity and does business activity result in deterioration of natural environment causing various problems for the society ?

POLITICAL AND LEGAL ENVIRONMENT

Political Environment

What constitutes political environment ? In a capitalist economic system corporate firms are very powerful. In this system, ***the capitalists who own or manage most of the business have control over the State power.*** Hence ***the policies of the government serve the interests of the capitalist class. This kind of political environment is conducive to business activity.*** Besides, the factor of political stability is important. In countries like Afganistan and Iraq, business activity has suffered a lot due to political instability. Political system in India is far more stable than in these countries. But over the past twelve years there has been considerable political uncertainty in this country on account of coalition governments at the Centre. These governments have been very much unstable and lacked a clear cut policy direction. This is not an ideal situation for the growth of business.

Ideology of the government. The ideology of a government determined by the ruling classes also shapes political environment in a country. For example, the British government under Margaret Thatcher and the US government under Ronald Reagan had deregulated the British and the American economies respectively. Under these governments the working class had suffered a major setback while the business got larger space for its activity.

Under the influence of great classical economist Adam Smith who wrote *An Enquiry into the Nature and Causes of Wealth of Nations* in the late eighteenth century, it was generally agreed that the market was the most appropriate instrument for accomplishing business growth and improving human welfare. The State's role was thus to be restricted to certain core functions — providing public goods such as defence and highways, maintaining law and order to ensure security of persons and property, enforcing contracts and providing primary education to the people. However, State intervention was effectively used in Germany, Japan and even in the USA to support market development. In fact, there was no prejudice against State intervention and often business firms welcomed it because it served their interests. In the nineteenth century the State's role in redistributing income was limited and tax systems were used entirely for revenue raising. States thus remained small by modern standards until World War 1.

Between the two world wars certain dramatic events led to significant expansion of the State. The first was the Bolshevik Revolution of 1917 in Russia which changed the class character of the State. The new State introduced central planning replacing the market. In the socialist system that was adopted in the Soviet Union the government became the planner and promoter of business development. Replacing private enterprise by the public enterprise the government also assumed the role of the producer. The *second* event was the Great Depression of the 1930s which caused unprecedented economic turmoil in industrially developed capitalistic countries. The widespread economic devastation and rampant unemployment completely shattered the faith in the market system and the business community saw hope only in the government's counter-cyclical economic policies to revive industrial activity. Impressed by J.M. Keynes's classic work *The General Theory of Employment, Interest and Money*, governments in the developed countries assigned a significant role to the fiscal policy as a stabilisation measure. The *third event was endorsement of the Welfare State in the industrialised countries* in the afternath of World War I. The second and third events made radical changes in the political environment in the developed countries. The governments world over expanded since 1960 for about three decades.

In the developed economies of the West, the policy makers by and large agreed on three principles. *First* there was agreement on the limitations of the private sector and thus a mixed public-private economy was regarded as desirable. This implied nationalising a wide range of strategic industries. *Secondly,* need for a coordinated macroeconomic policy was recognised because market alone failed to ensure macroeconomic stability that is needed for sustained growth of business. *Finally,* reliance entirely on market for the welfare of the people was a questionable proposition. Hence, it was generally agreed that the State should provide social security and welfare benefits to those who suffer from transitory loss of income or other deprivation.

In the three decades between 1960 and 1980, governments in developed western economies assumed new roles and expanded existing ones. By the end of 1980s the range of tasks performed by the government and its agencies included not only maintenance and development of infrastructure and utilities but also much more support for education, health care and social security. In India, in the 35 year period from 1960 onwards the Central government expenditure rose from less than 20 per cent of GDP to over 35 per cent. In this period transfers and subsidies led to a dramatic increase in government expenditure. However, the increase in government expenditure was not at the same rate in the various industrial countries. From "a point of rough equivalence in 1960, the Swedish State grew to nearly twice the size of that in the United States by 1995, in terms of both spending as a share of income and public employment as a share of population."[1]

Governments in developing countries also expanded their existing activities and reached new areas in the 1960s and 1970s. After the collapse of colonialism most developing countries in Asia, Africa and the Middle East attempted to initiate industrial growth. These countries had a strong belief in State-dominated industrial development. ***The government assumed the role of the programmer, promoter and energiser of development. In some of the countries, the public sector was seen as an engine of growth***. State control of the economy was central to this strategy. How India followed this strategy is described in Box 1.3 of *World Development Report 1997*. The Report points out that in the Nehru era, a powerful State with a planned economy was regarded essential for transforming India's agrarian economy into an industrialised economy. The strategy of growth did not assign an important role to foreign trade. Under Indira Gandhi as the Prime Minister, there were two major shifts in the role of the State. First, the State became active in the agricultural sector, as it subsidised fertilisers and new seeds, expanded institutional credit and provided electricity for farm operations. This strategy led to green revolution. The second shift was tightening of State control over industrial finance, foreign investment, trade and industry.

Between 1977 and 1991 political environment changed significantly and the process of relaxing controls started. However, both open and hidden subsidies went on increasing. In this period fiscal deficit became unsustainable and the country was in deep economic crisis in 1990-91. In response to this crisis the reform process mandated by the IMF and the World Bank began in this country. Most of the controls were dismantled and the State's role changed from that of principal investor to that of facilitator of entrepreneurship.[2]

State activism. State activism was extremely popular throughout the world during the 1960s and 1970s. ***The Great Depression of the 1930s had discredited market based capitalism. In contrast, the Keynesian demand management with an effective State intervention seemed to be quite successful. In developing countries also market failures were emphasised and the State was assigned central role to correct them.*** Following the Soviet Union many Latin American, African and Middle Eastern countries adopted a State dominated, import-substituting strategy for industrialisation. ***Comprehensive centralised planning, regulated resource allocation and a public sector led industrial development constituted the core of this strategy.*** By the 1960s in many developing countries the State had become involved in important aspects of the economy as a regulator, promoter, planner and producer. The confidence in this strategy was shaken in the 1970s and ***the collapse of the Soviet Union exposed the limitations of the government dominated economies.***

With the disintegration of the Soviet Union and other socialist economies, position of the working class weakened world over and the class of big capitalists acquired a dominant position. Hence, political environment induced growth of private corporate enterprise. At this juncture, the USA and the IMF-World Bank operating under the US influence dictated policies which served the interests of the developed countries and the global finance capital. Thus there was a radical shift in the perspective. ***Market friendly strategies became popular in the 1980s and everywhere in the developing world, State's role was drastically curtailed. This caused fiasco in a number of countries because in an attempt to correct fiscal imbalances important infrastructural development programmes were abandoned and expenditures on health and education programmes were reduced. This naturally eroded foundations of market oriented industrial development and threatened well-being of the people.***

Global super power and the IMF-World Bank. The overzealous rejection of government imposed by the USA and the international financial institutions, particularly the IMF and the World Bank on the developing countries proved to be disastrous in these countries. It was not realised by the USA that ***like the State dominated industrialisation, Stateless business activity was destined to fail. This implies that growth of business without effective State is almost impossible.***

In India, till recently the ideology of the party in power at the Centre for a long time *i.e.* the Indian National Congress was not entirely partisan with pro-business bias. Therefore, the country had legislations like the Monopolies and Restrictive Trade Practices Act (MRTP Act) and the Foreign Exchnage Regulation Act (FERA). Moreover, because of the experiences of the colonial era, the foreign capital and the multinational corporations were suspects. Since 1990-91 the political environment in the country has changed. Those who now matter in major political parties are no longer sensitive to the problems of the common people. They are solely committed to the cause of business. This explains why irrespective of party in power at the Centre, the Indian economy is increasingly being liberalised and the business is getting larger and larger space for its activity.

Legal Environment

The governments set the legal framework within which business firms operate. From the point of view of business, not all legislations are relevant. ***Legislations defining property and business organisations, laws of contracts and bankruptcy, mutual obligations of labour and management and a multitude of laws and regulations constraining the way business activities are carried out constitute legal environment of business.*** Economic legislations, as these are often called, have a direct bearing on the business. Broadly economic legislations can be classified into two categories: ***(1) Legislations which have a facilitatory role in business, and (2) Legislations which are restrictive in their nature.***

Production in a market economy takes place in a wide variety of business organisations. However, the bulk of economic activity in the industrial sector takes place in corporations which are set up under the provisions of the Company Law. The Contract Act provides the rules for systematic exchange transactions. These legislations thus have a facilitatory role in business.

It is now widely accepted that violations of competitive norms by business firms undermine the economic welfare and thus there must be a legislation to prevent growth of monopolies and cartel formation. The government in the USA had passed the Sherman Anti-Trust Act in 1890, the Clayton Anti-Trust Act in 1914 and Federal Trade Commission Act in 1914 to prevent unfair monopolistic practices. Some other western countries also have anti-monopoly legislations. In our own country the MRTP Act was adopted in 1969 and the MRTP Commission was set up in 1970. However, over the years the MRTP Act was diluted. In November 2002, it was replaced by the Competition Act on recommendations of the Raghavan Committee.

The Foreign Exchange Regulation Act (FERA) was passed in 1973 and came into force on January 1, 1974. It directly regulated the foreign exchange related transactions of the Indian business. Section 29 of the Act related to the operations of multinational corporations in India. The business in India has been highly critical of FERA provisions. The government has thus replaced it by the Foreign Exchange Management Act (FEMA) which does not contain the stringent provisions of FERA. Both MRTP Act and FERA were restrictive in nature.

The Industries (Development and Regulation) Act passed in 1951 aimed at both — the development and regulation of industries in the private sector. However, in practice it concentrated more on the regulation aspect. Prior to the setting up of the Securities and Exchange Board of India (SEBI), capital issues in India were regulated by the Capital Issues (Control) Act, 1947. The main objective of this Act was to promote private corporate sector on sound lines. This Act was repealed in 1992. The SEBI Act now empowers SEBI to regulate the securities market. ***Thus even in a market economy like ours the modern corporate business is not entirely free. Its activities are governed by various legislations which may be either facilitatory or restrictive in their nature.***

SOCIO-CULTURAL ENVIRONMENT

Business firms operate in a socio-cultural environment and their strategies are formulated keeping this factor in view. Western societies are modern and liberal. Muslim societies are generally conservative. The Japanese society despite a very high level of economic development still retains certain tenets of orthodoxy. A business firm aiming at capturing markets for its products in these diversified societies has to be careful about the cultural sensitivities of these societies. Each society has its own culture which consists of the customs, habits, beliefs, values, attitudes, language and other forms of interaction between the members of the society. Culture of a society changes only gradually and a business firm can afford to ignore this reality at the risk of cold response from the targeted users of the products.

Since Western societies are modern and liberal, people belonging to these societies are more receptive to new products. They have no prejudices against any kind of advertising. However, people in the Western countries are health conscious and therefore, a product injurious to the health of the people cannot be successfully introduced in these markets. In the Muslim countries since a vast majority of women still observe purdah, demand for cosmetics and Western clothes is rather limited. In these societies, modelling by women is not generally allowed and the business firms advertising their products cannot ignore this fact. Indian society is definitely liberal and this explains why we are receptive to new products. Recently certain multinational companies have successfully introduced new products in the Indian market. Indian people who are not very rigid in their consumption habits do not resist use of these products. Today among the teenager boys and girls, blue jeans are more popular than traditional pants. Since women in Indian middle class families enjoy greater freedom than their counterparts in the Muslim world, the business firms easily target them for their consumption products. Because of liberal outlook, modelling by young women for advertising fashionable products, commodities of household consumption, wine and beer is acceptable in the Indian society.

Having explained role of socio-cultural environment in business we shall now discuss elaborately as to what constitutes social environment of a country and do cultural differences make differences in business. However, with the globalisation of culture a new situation has been developing in which transnationalisation of production, capital flow and consumerism is engulfing the whole world.

Meaning of Social Environment

"The social environment is made up of the attitudes, desires, expectations, degrees, of intelligence and education, beliefs and customs of people in a group or society."[3] Ethical environment is generally considered to be an element in social environment. However, the narrow concept of social environment excludes sets of generally accepted and practised standards of personal conduct. This implies that ***in narrow sense the term 'social environment' does not include ethical environment.*** The ethical standards are usually not codified by law. However, for any social group to which they are meant to apply, they sometimes have virtually the force of law.

Since socio-cultural environment is interwoven with other environmental elements, it is not easy to understand it. To forecast changes in it is still more difficult. Hence, a manager in the corporate sector can prepare his business plans to meet changing social environment only with extraordinary vision. Social beliefs, desires, expectations and pressures impact determination of standards of ethics and enactment of laws. Social forces including ethical codes normally arise before laws are passed. ***Normally machinery of the State which is responsible for making laws responds to socio-cultural demands. It passes laws anticipating changes in socio-cultural environment.***

Cultural Differences and Business

In most discussions culture is confused with 'civilization' and 'civilization' with 'religion'. This is a totally unscientific approach. Against looking at culture as spiritual or religious heritage we need to have "a materialist conception of culture which considers culture as a set of material practices through which people live and produce the meanings of their lives."[4] ***Culture in an anthropological and historical sense, is the heart of a particular group or society — what is distinctive about the way members interact with one another and with outsiders — and how they achieve what they do."***[5] These definitions of culture enable us to follow the concept of corporate culture which is very much relevant to understand the behaviour of all those who are associated in one capacity or the other with present day business enterprises. According to Eliott Jacques, an ***organisational culture is "the customary or traditional ways on thinking and doing things, which are shared to a greater or lesser extent by all members of the organisation (and) which now members must learn and at least partially accept in order to be accepted into the service of the firm."***[6] Eliot Jacques's definition of culture refers to organisational culture which is of little help in understanding socio-cultural environment of business. Socio-cultural environment is made up of attitudes, desires, expectations, beliefs, faiths, customs of people besides their set of material practices through which people produce goods and services that they need for satisfying their wants.

A producer in present day world is usually a corporate enterprise. Since it produces goods or services for diversified markets, it has to keep the diversities in socio-cultural environments in view if it wishes to be successful in its business pursuits. As pointed out earlier, socio-cultural environment of the USA is different from that of Japan and China. Likewise, socio-cultural environment in the middle-east is not the same as in India and South-east Asia. A firm wanting to market its products in various regions with diversified cultures will have to carefully study the existing consumption pattern and scope for creating demand for new products. Marketing methods and advertising techniques should also conform to the sensibilities of the people. If a society is multi-cultural, then the firm cannot meet demands of different groups with a uniform product. To be successful in a multi-cultural society, the firm with have to carefully study the consumption behaviour of different groups. Moreover, retailing practices may not be the same in all societies and a firm can afford to ignore this reality only at the risk of losing customers even for products which are otherwise acceptable to them.

Globalisation of Culture

Capitalist globalisation has now become a reality. Whether one likes it or not, ***globalisation has assumed a new dimension of transnationalisation of production. The implication of this social reality is that economic globalisation is invading cultural patterns. Worldwide proliferation of internationally traded consumer brands, the global ascendency of popular cultural icons and artefacts, and the simultaneous communication of events by satellite broadcasts to millions of people at a time on all continents are visible marks of economic globalisation which is invading the cultural arena.*** People generally feel that the most common symbols of globalisation are Coca Cola, Pop music and the news of BBC.

The present day global reach and volume of cultural traffic through telecommunication, TV network, and transport system has led to both economic and cultural globalisation. However, culture does not predominate in globalisation. The present day world is a world of complex community. We now have a global market place, international fashion codes, an international division of labour and a common eco-system. Hence every day actions of millions of people, their attitudes, beliefs, and outlooks have a common link. This is an ideal situation for allowing global reach to business firms. Business firms have thus acquired transnational character. ***Under the globalisation dispensation, the world is reduced to the status of economic territories which are being exploited by the transnational capital which has virtually no accountability to the nation State.***

Multiculturalism — Caste, Race, Gender and Ethnic Issues

An important issue in any society is that people with different cultural backgrounds coexist and flourish within the society and thus business firms have to deal with different people considering their social and cultural backgrounds. While in India people are divided on the basis of caste, religion, gender and language, in the US, race, gender and ethnicity are more important. In a democratic system theoretically business firms should ignore the caste, linguistic, ethnic, racial on gender differences that may exist in the society. However, in practice, employers' behaviour is influenced by their prejudices. Somehow the company managers have convinced themselves in India that workers from the dalit category are not suitable for sophisticated jobs. Therefore, there is discrimination in practice and it is generally found that in the private sector very few persons with dalit background are selected to perform jobs which require some special skill or expertise.

For about three decades, India remained a secular State despite Pakistan being a theocratic State. In secular India, there has been no discrimination on the basis of religion. However, lately, religious sentimentalism has started raising its head. This has obviously influenced the attitude of employers towards workers. Lately, in practice, personal biases of employers have got reflected in the choice of workers. Interestingly, linguistic differences do not matter much. India being a patriarchal society, women are not treated at par with men. In private sector they are often denied wages/salaries equal to male workers, though they may be as much efficient as male workers and their productivity may not be lower than of their male counterparts.

US is a pluralistic society as white people and blacks, Japanese, Chinese and Indians have made America their home country. But despite democratic political system and multiculturalism in the US society, there is both racial and ethnic discrimination. Also, statistics reveal *earning gaps* between white workers, African Americans, Hispanic Americans, American Indians and Asians. There is also age bias in US society. Since 1990 age bias has increased. Hence, wherever possible, older workers are replaced by the younger ones. Although US claims to be the leader of the civilised world yet it tolerates gender discrimination. Moreover, women often face sexual harassment in the workplace. But sexual harassment is not a problem limited to the US. Studies show that it exists all over the world. The ILO surveys have revealed that from 15 to 30 per cent women have experienced sexual harassment by co-workers or superiors in private enterprises. These findings and also personal information about individual cases of sexual harassment often discourage women to look for work in corporate enterprises. Moreover, private enterprises in the USA violate the principle of equal pay for equal work with impunity in cases of women workers.

DEMOGRAPHIC ENVIRONMENT

Humans are both consumers and producers. Therefore, ***demographic factors like the size and growth rate of population, life expectancy, age and sex composition of population, work participation rate, employment status, rural-urban distribution of population, educational levels, religion, caste, ethnicity and language are***

all relevant to business. Normally the absolute size of the population in a country is an important factor determining the size of the domestic market. Even at a relatively lower level of economic development markets are quite large in countries with large populations. It is this reason why multinationals are interested in penetrating the markets of these countries. Growth rate of population and life expectancy determine the age-composition of population which in turn affects the demand for goods. In a country when population growth rate is high, children constitute a large section of the population. Thus, in such a country, demand for baby products is large. In contrast, there are countries where size of population is stable and life expectancy high. In these countries elderly people constitute a large section of the population. Obviously their demand pattern is very much different from that of the younger people. Women in younger age-group have preference for certain consumer goods. Business firms have to keep these demographic factors in view while deciding about the product mix and marketing strategy. Quite often ethnicity and the religion of the people exercise great influence on the demand pattern of the people.

Large labour force and the rapid growth in it affect the choice of techniques. In western developed economies, growth rate of population and labour force is low and thus labour is the relatively scarce factor. The technology in these countries is therefore capital intensive. On the other hand, in large labour-surplus developing economies, labour intensive techniques are generally preferred.

Size and Growth Rate of Population

As the 21st century began, the estimated world population was almost 6.1 billion. The UN projections place the figure for 2050 at 9.3 billion. Presently 90 per cent of the world's population inhabits the developing world.

The role of population growth and its large size is a complex phenomonon from the point of view of the business. Thus conflicting positions have been taken by both demographers and business management experts. Broadly speaking, these experts can be divided into two categories: (1) those who argue that population growth decreases the scope for business activity, and (2) those who argue that population growth opens up new vistas of business activity.

The contention of the former group of people is that rapid population growth squeezes the scope for business activity on account of the following reasons:

1. Rapid population growth usually has an adverse impact on per capita income and standard of living. It thus may lead to a reduction in demand for industrial goods.
2. As rapid population growth is likely to affect savings adversely, its impact on capital formation *i.e.* investment may be unfavorable.
3. Larger population growing rapidly will adversely impact employment situation and heavily cut down demand for industrial goods.
4. Rapid growth of population will force many more people to join agricultural sector which implies that more and more people will join subsistence economy and as a result space for business activity will shrink.

Those who think that rapidly growing population does not adversely affect business activity refer to history. Their contention is that despite rapid growth of population, productive forces have grown continuously and thus new space has been created for business activity. Many economists, including Kuznets, Houthakker, and Spengler have reposed confidence in the capability of mankind to meet the challenging situation arising from rapid growth of population. Their argument is that rapid growth of population in any case offers bigger market for industrial products. Management guru C.K. Prahlad is of the view that the people who constitute the bottom of the pyramid (BOP) make significant demand for good things of life. If they are approached by business firms differently than the traditional market, the profits of private sector companies may not diminish. In fact, he asserts ***"The future profitability of MNCs and Indian private sector ventures entirely depends on this market. This is not an option, but a necessity. Many companies look at BOP as problem, but they have keys that can open new opportunities."***[7] This implies that rapidly growing population will enlarge size of BOP and thereby larger opportunities will be created for business.

Age Structure of Population

Age structure of population in a country determines the productivity level and demand pattern which are very much relevant to a business activity in a country. Usually in countries like Japan, Britain, France and