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9th Revised Edition

Economic Environment of Business

(With Case Studies)

V.K. Puri
S.K. Misra

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ECONOMIC ENVIRONMENT OF BUSINESS

(With Case Studies)

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PREFACE TO THE NINTH REVISED EDITION

Despite the good economic performance registered by the Indian economy during the period of economic reforms (the post-1991 period) with rate of growth of GDP rising from 5.2 per cent per annum in the pre-reform decade (1980-81 to 1990-91) to as high as 7.5 per cent per annum during the first decade of the present century (2000-01 to 2010-11) and the rate of growth of per capita GDP doubling itself over this period (from 3.0 per cent per annum to 6.0 per cent), levels of poverty, hunger, malnutrition and undernutrition continue to remain at unacceptably high levels, income inequalities are increasing, high inflationary pressures persist, there is widespread unemployment, environmental degradation and destruction continues unabated, and rampant corruption continues to plague the economy. As far as domestic environment for business is concerned, India continues to remain one of the most difficult places to do business in the world. This would be clear from the fact that in the latest *Doing Business* report (for the year 2014) published by the International Finance Corporation, India is ranked a lowly 134 in terms of doing business out of the 189 countries considered. Thus, the challenges facing the Indian economy are immense. As far as the global economic environment is concerned, it seems to be improving with some major economies of the world coming out of recession, but recovery is slow and uneven.

In the present ninth edition of our book, we attempt to examine all issues relating to the economic environment of business in general and India in particular. The discussion in the book is divided into two parts — Part I on ' An Overview of Business Environment' and Part II on 'Environment of Business in India'. Part I consists of three units and Part II consists of five units. The organisation, structure and contents of these units are as follows:

Unit 1 on 'Economic Environment: An Introduction' consists of six chapters in which we discuss the domestic and global environment of business, economic roles of the State and Government and the issues pertaining to economic growth and development, economic fluctuations, economic planning and controls.

Unit 2 on 'Non-Economic Environment of Business' has five chapters. This unit takes up for discussion the political and legal environment, demographic and socio-cultural environment, natural environment and technological environment of business. The last chapter of this unit focuses on the social responsibility of business.

Unit 3 on 'Anatomy and Functioning of the Economy' discusses the basics of the macroeconomic framework and the determination of national income in an economy, the theory of multiplier, *IS/LM* model, the issue of inflation and stagflation, economic stabilisation, and the role of monetary and fiscal policies.

Unit 4 on 'Indian Economic Environment' is devoted to a discussion of the broad profile of the Indian economy, the macroeconomic scenario (particularly as it has emerged after the initiation of economic reforms in India), the impact of globalisation and international institutions on the Indian economy, role and importance of infrastructure, and agriculture and business, etc.

Unit 5 on 'Business and Government — Indian Perspective' discusses the process of economic planning in India, India's monetary and fiscal policies, industrial policy, foreign trade policy, policy regarding SEZs, FERA and FEMA, and consumer protection.

Unit 6 on 'Indian Industrial and Trade Environment' is naturally the largest unit of the book consisting of thirteen chapters and spread over almost 150 pages. It takes up a detailed discussion of all issues pertaining to the industrial development of India like the processes of industrial growth and diversification over the planning period, the Industries (Development and Regulation) Act, role and performance of small-scale industries in India, the role and performance of public sector in India and the process of privatisation and disinvestment, the role and importance of private sector in India, modern corporations and the company law (with particular focus on Companies Act, 2013), the fast emerging trends of mergers and acquisitions in India, MRTP Act and Competition Act, industrial sickness in India, trends in foreign trade and balance of payments, and the government policy towards foreign investment and multinational corporations.

Unit 7 on 'Labour Environment in India' includes a discussion on the characteristics of Indian labour market, trade unions and industrial labour, workers' participation in management, etc. It also discusses how the process of economic reforms has impacted the employment scenario and labour welfare in India.

Unit 8 on 'Financial Environment of Business' describes the features of the Indian money market, the capital market and the stock market, how these markets have evolved over the years, and the government policy for the development of these markets. It also discusses the role and progress of commercial banking and financial institutions in India.

As is clear from the above listing of the issues discussed in this edition, we have undertaken a comprehensive examination and review of all issues pertaining to the economic environment of business in general and India in particular. In this elaborate exercise, we have received considerable help and support from Dr. Divya Misra, Associate Professor in Economics, Lady Shri Ram College, Delhi University, and Mrs. Kiran Puri. We express our deep sense of gratitude to them. We are also deeply indebted to our publishers M/s Himalaya Publishing House Pvt. Ltd. for their wholehearted cooperation in the preparation of this edition.

Suggestions for further improvement of the book are welcome from all quarters.

V. K. Puri

PREFACE TO THE FIRST EDITION

We are living in a fast changing world. With new emerging technologies and rapid expansion of internet, E-mail, E-commerce, etc., access to global information and knowledge and to commodity markets worldwide is now much easier than before. In a bid to meet commitments to international institutions like the World Trade Organisation (WTO), International Monetary Fund (IMF) and World Bank, country after country is pulling down barriers to foreign trade and investment. The Government of India has also followed suit with the result that quantitative restrictions on foreign trade are being dismantled speedily, tariff barriers are on the decline, and new opportunities to foreign investors and entrepreneurs are being provided to operate in the country. On the domestic front also, there are clear signals of privatisation and liberalisation as licensing is being given up, controls are being dismantled, restrictive laws are either being removed from the statute books or are being rendered toothless, disinvestment programmes in public sector are being taken up, and takeover code is being modified to make mergers and acquisitions easier. Taking advantage of the 'liberal' atmosphere, the transnational corporations are also expanding their operations in the economy at an aggressive speed and are adapting their marketing strategies to local conditions (with new terms like 'glocalisation' being coined to explain this phenomenon). Thus, the entire economic environment of business (both micro and macro) is going through a drastic change. The coming years might well witness the extinction of many businesses and considerable realignments in many others (through the process of consolidation, restructuring, mergers and acquisitions, etc.).

On account of the above changes sweeping the entire business sector in recent times, we feel that the time is now ripe for undertaking a serious and in-depth study of the economic environment of business in general and for our own country, in particular. Unfortunately, the books that are currently available do not address all the issues satisfactorily. In fact, either they do not raise a number of economic issues at all or the treatment is highly superficial. We are of the firm opinion that our present book fills an important gap in the area and would be viewed by the rapidly expanding field of management experts, worthy of adoption and recommendation to the students of management courses spread across the various universities and institutions in the country.

The plan of our book is as follows: Part One of the book deals with the general economic environment of business while Part Two is devoted to a discussion on economic environment of business in India. Part One consists of three units — Introduction, Theoretical Framework, and Anatomy and Functioning of the Economy. Unit I on 'Introduction' deals with the issues of internal and external, economic and non-economic, and global and national environment of business. In Unit II 'Theoretical Framework', we discuss the economic systems, issues pertaining to market economy, planning and controls, economic fluctuations, and economic growth and development. Unit III on 'Anatomy and Functioning of the Economy' is devoted to a discussion on the macroeconomic framework, determination of national income and the two market (money market and product market) equilibrium, consumption and investment, inflation and stagflation, importance of monetary and fiscal policies and issues in economic stabilisation. Part Two consists of four units — Indian Economic Environment, Business and Government — Indian Perspective, Indian Industrial Environment and Financial Environment of Business. Unit IV on 'Indian Economic Environment' presents a broad profile of the Indian economy and examines the macroeconomic scenario of the country, contemporary economic reforms, importance of infrastructure for business, relationship between agriculture and business, and trends in global and international economic environment as they are now emerging under the aegies of the World Trade Organisation and the changing role of international institutions. Unit V on 'Business and Government — Indian Perspective' examines the economic roles of the State and Government, economic planning, the policies of the Government of India in the field of industry and trade, and consumer protection. It also highlights the fiscal and monetary policies of the Government of India. Unit VI on 'Indian Industrial Environment' is naturally the largest unit of the book consisting of 12 chapters and running into more than 160 pages. It discusses the growth and performance of the industrial sector in India, role and performance of public and private sectors and the issue of privatisation, mergers and acquisitions, role and performance of small-scale industries, IDR and MRTP Acts, issues relating to industrial labour, industrial sickness and exit policy, workers' participation in management, and the role, importance and effects of foreign investment and technology (including MNCs). The last unit of the book Unit VII examines the 'Financial Environment of Business' in the Indian context and consists of four chapters on the Indian money market, capital market, stock market, and financial institutions.

We take this opportunity to thank our publishers M/s Himalaya Publishing House Pvt. Ltd. for their unstinted and wholehearted support in the preparation of the present book. Dr. Divya Misra, Reader in Economics, Lady Shri Ram College, Delhi University and Mrs. Kiran Puri also helped us in a number of ways in preparing the manuscript of the book. We also thank them. Since the book is addressed primarily to the students and teachers of management courses in various universities and institutions, we invite suggestions from them for the further improvement of the book.

V.K. Puri and S.K. Misra

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ECONOMIC ENVIRONMENT: AN INTRODUCTION

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"Companies and their suppliers, marketing intermediaries, customers, competitors and publics operate in macroenvironment, 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

In a simple economy of ancient times, 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. In the present day world, 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 external environment?
- How can one distinguish between micro and macro-environment of business? From the point of view of present day business, which of the two 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 involves 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 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 the 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. Table 1.1 presents information on the massive resources and revenues of the world's largest companies. As is clear from the Table, the world's largest company in 2013 in terms of revenue was USA based Wal-Mart Stores, with its revenues placed at $ 476.3 billion. The second largest company in terms of revenue in 2013 was Netherlands/U.K. based Royal Dutch Shell with its revenues placed at $ 459.6 billion. This was followed by Sinopec Group of China with revenues placed at $ 457.2 billion. In fact, there were thirteen companies in 2013 with revenues exceeding $ 200 billion. Even the last company in the Table (twenty-fifth in overall rank) Industrial and Commercial Bank of China, had revenues touching almost $ 150 billion. The massive size of the large companies would be clear from the fact that the revenues of Wal-Mart Stores were larger than the GDP of as many as 102 countries of the world (out of the 125 countries for which data are provided in *World Development Report,* 2014).

Most of the Fortune 500 companies are located in the USA, China, Japan and Europe. The USA is the biggest capitalist economy. 128 of the world's largest 500 companies (in terms of revenue) belong to this country. China, which has recently replaced Japan as the second largest economy of the world, had 95 of the *Fortune* 500 companies in 2013, while Japan had 57 companies in the list. European economies are relatively small, but they house a large number 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 the developing countries are smaller in size and thus only a few companies from these countries figure in the list of *Fortune* 500 companies. In 2013, only companies from China, South Korea, Brazil, Mexico, Venezuela, Colombia, Taiwan, Malaysia, Thailand, India, Poland, Singapore, Saudi Arabia and UAE 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.

Table 1.1. The World's Largest Corporations by Revenue, 2013

Rank	*Company Name*	*Home Country*	*Revenues $ billion*	*Assets $ billion*	*Profits $ billion*
1	Wal-Mart Stores	USA	476.3	204.7	16.0
2	Royal Dutch Shell	Netherlands/UK	459.6	357.5	16.4
3	Sinopec Group	China	457.2	353.0	8.9
4	China National Petroleum	China	432.0	620.6	18.5
5	Exxon Mobil	USA	407.7	346.8	32.6
6	BP	UK	396.2	305.7	23.4
7	State Grid	China	333.4	424.5	8.0
8	Volkswagen	Germany	261.5	446.9	12.1
9	Toyota Motor	Japan	256.4	402.4	18.2
10	Glencore International	Switzerland	232.7	154.9	–7.4
11	Total	France	227.8	239.0	11.2
12	Chevron	USA	220.4	253.7	21.4
13	Samsung Electronics	South Korea	208.9	202.9	27.2
14	Berkshire Hathaway	USA	182.1	484.9	19.5
15	Apple	USA	170.9	207.0	37.0
16	AXA	France	165.9	1,043.2	6.0
17	Gazprom	Russia	165.0	409.2	35.8
18	E. ON	Germany	162.6	180.1	2.8
19	Phillips 66	USA	161.2	49.8	3.7
20	Daimler	Germany	156.6	232.2	9.1
21	General Motors	USA	155.4	166.3	5.3
22	ENI	Italy	154.1	190.6	6.8
23	Japan Post Holdings	Japan	152.1	2,838.2	4.8
24	EXOR Group	Italy	151.0	182.8	2.8
25	Industrial and Commercial Bank of China	China	148.8	3,124.9	42.7

***Source*: *Fortune,* July 7, 2014 issue.

As far as India is concerned, only eight companies figure in the *Fortune* list for 2013. These are Indian Oil, Reliance Industries, Bharat Petroleum, Hindustan Petroleum, State Bank of India, Tata Motors, Oil and Natural Gas Corporation and Tata Steel. Out of these, Indian Oil, State Bank of India, Bharat Petroleum, Hindustan Petroleum, and Oil and Natural Gas Corporation are public sector undertakings. Indian Oil ranked 96th in the top 500 companies with a revenue of $ 81 billion in 2013.

It may be pointed out here that while the Indian private sector companies do not look as impressive as the companies in the developed countries in terms of sales and assets, yet they are quite large by the standards of the developing countries and compare favourably even with a large number of middle size enterprises in Western countries and Japan. In 2012-13, Reliance Industries was the largest private sector company in India with a total income of ₹ 4,04,986 crore. Its assets in that year were as large as ₹ 3,62,357 crore. In all, there were ten companies in the private sector in 2012-13 with total income exceeding ₹ 64,000 crore each. These included Reliance Industries, Tata Motors, Tata Steel, Bharti Airtel, Larsen & Toubro, Hindalco Industries, Adani Enterprises, Mahindra and Mahindra, Essar Oil, and Tata Consultancy Services. Each of these companies had assets worth ₹ 47,000 crore or more.

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, automobile manufacturers, mobile handset manufacturers, telecom service providers, etc.

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.

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 sometime 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 is often not beneficial even to the consumers because they are 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 over time, has taken recourse to diversification. Today, not many corporate enterprises confine their activities to the 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 Alto, Estilo, Wagon R, Swift, Swift Dzire, Ciaz, A Star, Ritz and Ertiga. 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 petrochemicals, 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 & Toubro 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 the 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 market, 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".[2] At present automobile, steel, chemical and petrochemical 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. 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 over time and the real cost fall. Obviously, all this can be accomplished by the business only 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 precondition 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. Over the period 2000-08, South Korea invested 3.21 per cent of its GDP in R&D compared to 1.3 per cent in 1985. South Korea now has 17 companies in the *Fortune* 500 companies. 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 13th in 2013 by *Fortune* (July 7, 2014).

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, smartphones have replaced ordinary mobile phones, 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 over time 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 hallmark 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 marketplace. In recent times, with the increase in industrial production, business firms have imposed negative spillover 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 subdivided 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.

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

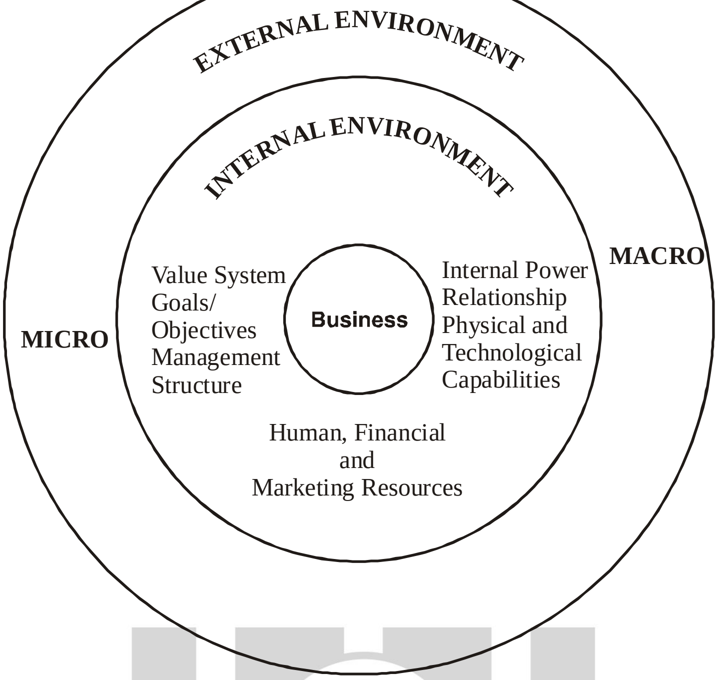

Fig. 1.1. Environment of Business

towards his employees and thus companies of the Tata group did some commendable work in the field of labour welfare. ***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. The 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.

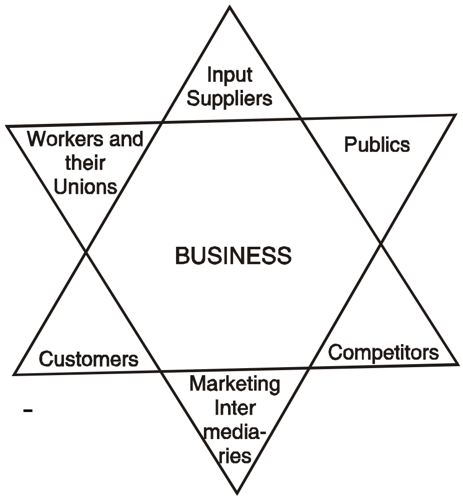

Fig. 1.2. Micro-environment of Business

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 an uninterrupted supply of inputs, particularly raw materials, has to be ensured all the time. 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 supplier may find itself in real difficulties at any time. Therefore, no company should depend for the supply of some input on a single source. Multiple sources of input supplies 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 over time 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 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 recent times. 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 benchmark 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 Unilever 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 database 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-1990s 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 air-conditioner faces competition from other branded air-conditioners such as Carrier, LG, 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'.*** To illustrate, consider a refrigerator manufacturing company that specialises in producing only frost-free refrigerators. The competition that this company 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. Through their actions, these groups 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. Consumer protection groups and media publics have often succeeded in persuading the governments 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.

Publics have assumed an important role in the democratic societies 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 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 and 3, 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 ***domestic (national)*** and ***global*** — is of strategic importance. In the national economic environment of the country, country's economic system, macro economic 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 slowdown. 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.

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 USA, Japan and many European economies, China's emergence as an economic power, BRIC (Brazil, Russia, India and China) nations to head growth in future, Regional Economic Groupings, protectionism, dominance of the multinational corporations, setting up of the WTO in the mid-1990s and regional trade agreements. We shall discuss domestic and global environment of business in Chapters 2 and 3 respectively.

Fig. 1.3. Macro-environment of Business

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. We shall discuss the non-economic environment of business in Unit 2 of the present book.

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 Global Business-Part One", January 1999.
3. Philip Kotler, *Marketing Management* (New Delhi, 1998), p. 671.

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