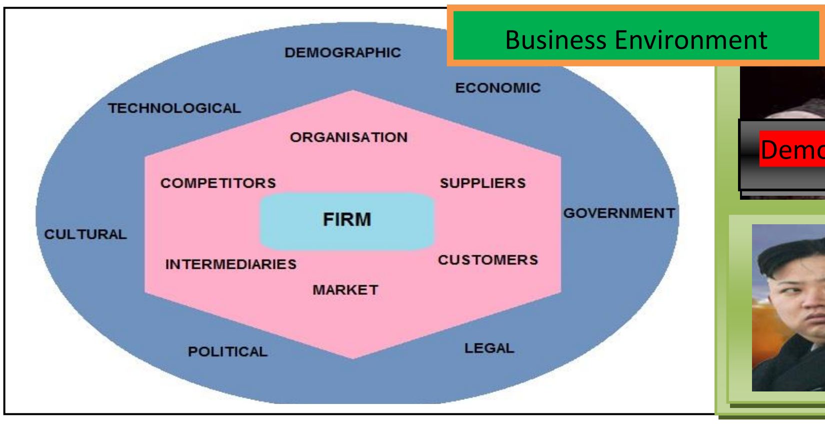
Chapter-3

Business environment

Business environment is the surroundings in which business exists. It is the sum total of all external and internal factors the influences the working and performance of a business. Environment of a business consists of everything it (business) depends upon. Business is a social institution .It has to depend upon society in various ways. Society consists of customers, emolyees, government, natural resources, general public etc.To sale its product, a business has to depend on customers, to produce goods it has to depend upon resources and labour supplied by the society. Business also has to depend upon government on various legal matters; it has to depend upon financial institutions to meet various financial needs.

The changing needs of customers, activities of competitors, new innovations in the market, relation between nations, policies of political parties etc are parts of business environment. Understanding of all these factors, persons and institutions carefully is must for every business man. The complete awareness and understanding of business environment is known as *environment scanning.*



Change in business environment and its effect on performance of business enterprises

Change in business environment	Effect on performance of business enterprises
Increased competition in the market	Reduction in profit
Increasing taxes by government	Value of raw materials increased, leads to increased cost of production
Change in technology	Existing product become obsolete Eg video cassettes become obsolete with introduction of CD.
Change in fashion and taste of customers	Shift in market demand from existing product to new ones
Government policies	It may sometimes leads to closure of business.eg.Kerala Government recently decided to close two star bar.

Features of Business environment

Main features of business environment are:

1. **Internal and External forces**

The environment of business comprises of internal and external factors. Internal environment includes plans and policies, employees, business objectives etc. The external environment can be subdivided into micro factor and macro factor. Micro factor includes customers, suppliers, competitors, society etc. Macro factor comprise of social, economic, legal, technological and other factors, which are unpredictable and uncontrollable.

2. **Uncertainty**

Business environment is largely uncertain, as it is very difficult to predict future happenings, especially when environmental changes take place too frequently. The enterprises must continuously monitor their environment and adopt suitable business practices not only improve their present performance but also to sustain in the market.

3. **Complexity**

Business environment is very complex as it is very difficult to know the relative impact of the social, economic, political, technological factors change in demand of a product in the market.

4. **Business lacks control over environment**

Business lacks control over external environment. It can't change its external environment, only way to adjust with it.

5. **Environment is dynamic**

Business environment is a constantly changing process. No environment remains constant or static for a longer period of time. The government may change certain policies; there may be changes in consumer tastes, preferences etc. Changes in technology also affect the business. The success of business depends upon awareness and adaptability with the changing environment.

6. **Relativity**

Business environment is a relative concept since it differs from country to country or even state to state. For example, demand for sarees may be high in India, whereas it is almost nil in France.

Dimensions/Elements/Factors of Business Environment

Dimensions of business environment means all the factors, forces and institutions which have direct or indirect influence over the business activities:

1. **Economic Environment**

It consists of economic factors that influence the business of a country. It include factors such as inflation, tax and interest rates,unemployment,fiscal and monetary policies .For example, if the unemployment rate is too high, many people will not be able to afford to purchase things it will badly affect the sales of a business. If interest rates are high, then it will increase the cost of finance of the business. An increase in tax rate surely cut the divisible profit of a business.

2. **Social Environment**

It describes the characteristics of the society in which the business organization exists. Social environment consists of religious aspects, language, customs, traditions, beliefs, tastes, preference, consumption habit etc. Social environment of different market differ vastly.

3. **Political Environment**

It is the outcome of a combination of various ideologies advocated by various political parties. It includes political conditions such as general stability and peace in the country and the political attitude of the elected government towards business etc.

For example, it is very difficult to start a new business in countries like Afganistan,Iraq,Syria etc due to uncertain political situation prevailing there.

Political view of the new government regarding:

- Tax policy
- Employment laws
- Privatization
- Environmental regulations
- Relation between various nations

4. **Technological environment**

It includes forces relating to scientific improvements and innovations, which provide new products, new production method and new methods of operating a business etc.Eg. Companies introduced new models of cars time to time, introduction of online trading system, introduction of Net banking etc.

5. **Legal environment**

Legal environment consists of the legal frame work within which the business has to function, including legislation passed by the government, administration orders, court judgment etc.Eg Advertisements for packets of cigarettes must carry the statutory warning "Cigarette smoking is injurious to health".

Importance of Understanding of Business Environment

In the present day of competitive market, it is essential for a business to remain alert and aware of its environment, because of the following points:

1) **It helps the firm to identify opportunities and get the first mover advantage:**

Early identification of opportunities helps an enterprise to be the first to exploit them, otherwise it will exploit by competitors. For example Maruti became the leader in the small car market, because it was the first to recognize the need for small cars in Indian market, where petroleum prices were rising and there was a large middle class population.

2) **It helps a firm to identify threats and early warning signals**

Environmental awareness can help managers to identify various threats on time and serve as an early warning signal. For inastance, if an Indian company ("More" super market) finds that an MNC ("Walmart") is entering the Indian market, this works as a warning signal for the Indian firm(More). So it can improve the quality of its service, engage in aggressive advertisement, etc.

3) **It helps in assisting in planning and policy formulation**

Since business environment provides both opportunities and threats for the firm, its understanding and analysis can be the basis for planning and policy formulation.

4) **Coping with changes**

The business must be aware of the ongoing changes in the business environment; it may be changes in the customer requirements, emerging trends, new government policies, technological changes etc. If the business is aware of these changes then it can take possible measures to exploit the situation or take remedial measures to survive. For example, when the Android OS market was flourishing and the customers were preferring Android devices for its easy interface and apps, Nokia failed to cope with the change by not implementing Android OS on Nokia devices. They failed to adapt and lost tremendous market value.

5) **It helps in improving performance**

With continuous scan of business environment firms can easily improve their performance. By making changes in the internal environment matching to external environment, organization can prosper and improve their market share. For example Hindustan Motors (manufactures of Ambasssdor Car) which could not cooperate with the changing environment ,gradually lost its market share where Maruti Suzuki still competing successfully with many multinational companies like Honda, Ford etc

6) **Helpful in tapping and assembling resources**

Business men have to supply the goods to market according to the demand in market. To produce goods they need raw materials. They select raw materials keeping in mind the products demanded by the environment/consumers. For example, with the demand of CD in place old video cassette, manufactures are collecting raw materials necessary to manufacture CD, rather than collecting raw materials of Video Cassette.

Economic Environment in India

Economic environment in India consists of various factors which have an impact on trade and industry in India. The important economic factors which have impact on Business firms are:

1. **Economic structure:** In the world there are three types of economic structures, viz.Capitalist, Socialist and Mixed Economic Structure. In Capitalist state businessman takes decisions by giving priority to profit motive. In socialist state government give in priority to welfare of people and in Mixed Economy business policies are taken by considering both profit and welfare of pople.India is a Mixed Economy.
2. **Economic Policies:** Indian Government's important economic policies which influence business decisions are Industrial Policy, Fiscal policies, monetary policy etc.In 1991,July Indian Government declared a new Industrial Policy(announced by Dr.Manmohan Singh, then Fiancé minister), which sought to liberate the Indian industry from licensing system(liberalization),significantly reduce the role of public sector(privatization) and encourage foreign participation in industrial development (globalization).

3. **Economic Planning:** It include Annual Budget, Five Years Plan, NITI (National Institution for Transforming India) Aayog .These plans also influence business decision.
4. **Economic Indicators**: The common economic indicators are National Income, Per Capital Income, Balance of Payment, Value of Export Import, GDP, GNP etc.
5. **Infrastructure:** It refers to basic services or facilities necessary to carry on business activities in a country like transportation,banking,communication,financial institutions etc.

Economic Environment of India since independence

There has been tremendous change in Indian Economic environment since Independence. At the time of Independence agriculture sector was dominated in our economy. Around 85% of population was living in villages. Almost three fourth of total population was occupied in agriculture sector. Business firms were used out dated technology in their production. Lack of adequate infrastructure facilities like road, banking, telecommunication etc.Immediately after independence in order to solve the economic problems, government of India made some plans and policies. These plans and policies were giving importance to public sector. Many areas like telecom, insurance, railway, airway etc were reserved only for public sector and limit the role of private sector. After independence during the first three *Five* Year Plans, the growth objective received greater attention and there was rapid expansion of the public sector. Later on the poor performance of public sector was realized. The reasons for poor performance were unorganized plants, outdated technology, under utilization of capacity, trade unionism, inefficient inventory control, political interference, poor personnel policies etc Poor performance of public sector forced the government to do rethinking on public enterprises. Industrial policy 1991 seeks to restrict the role of public sector.

Features of New Economic Policy 1991

The year 1991 marks a turning point in India’s economic history. A major shift in the industrial policy was made by Government of India led by Mr. P.V. Narasimha Rao on July 24, 1991.The Policy has brought comprehensive changes in economic regulation in the country. As part of the policy, the role of public sector has been redefined. A dedicated reform policy for the public sector including the disinvestment programme was launched under the NIP 1991. Private sector has given welcome in major industries that were previously reserved for the public sector.

Similarly, foreign investment has given welcome under the policy. But the most important reform measure of the new industrial policy was that it ended the practice of industrial licensing in India. Industrial licensing represented red tapism.

The new policy contained policy directions for reforms and thus for LPG (Liberalization, Privatization and Globalization). The 1991 industrial policy contained the root of the liberalization, privatization and globalization drive made in the country in the later period. The policy has brought changes in the following aspects of industrial regulation:

1. **Abolition of Industrial Licensing**

In a major move to liberalise the economy, the new industrial policy abolished all industrial licensing except for certain industries related to security and strategic concerns, and social reasons. Till 1991, 17 industries were reserved for the public sector. Now there are only 3 industries for which licensing is compulsory. These are atomic energy, arms and rail transport.

2. **Public Sector's Role Diluted**

Most of the industries reserved for public sector under earlier policy were dereserved. Industrial policy 1991 seeks to restrict the role of public sector and opened the door to private sector. The government identified strategic and priority areas for the public sector to concentrate. Similarly, loss making PSUs were sold to the private sector. The government has adopted disinvestment policy for the restructuring of the public sector in the country.

3. **Free Entry to Foreign Investment and Technology**

Another major feature of the economic reform measure was it has given welcome to foreign investment and foreign technology. This measure has enhanced the industrial competition and improved business environment in the country. Foreign investment including FDI and FPI were allowed.

4. **Amendment of MRTP Act**

To take away restrictions on investment by business firms under Monopolistic and Restrictive Trade Practices (MRTP) Act

The major changes or impact of the Economic Policy 1991 are:

The industrial policy of 1991 is the big reform introduced in Indian economy since independence. The policy caused big changes including emergence of a strong and competitive private sector and a sizable number of foreign companies in India. The new policy contained policy directions for reforms and thus for LPG (Liberalisation, Privatisation and Globalisation)

<u>Liberalisation</u>

It means liberating economy from unnecessary controls and regulations. The government has removed the industrial licensing requirement from all industries except for a short list of 18 industries; which number has been now reduced to only 3 industries. Except for these 3 industries mentioned in the list, all other industries, irrespective of how big investment is involved, have been freed from the provisions of compulsory licensing.

The Central Government has abolished FERA (Foreign Exchange Regulation Act) and enacted FEMA (Foreign Exchange Management Act). Under the liberalized exchange management system, value of rupee is determined by the market forces of demand and supply. Exporters are free to sell their foreign currency in the open market; while the importers can freely buy it from the market. This is called free convertibility of rupee.

<u>Privatisation</u>

Privatisation refers to giving greater role to private sector and reducing the role of public sector. Privatization generally refers to inducing private sector participation in the management and ownership of Public Sector Enterprises.

To execute the policy of privatization government took the following steps:

Disinvestment of public sector- The Govt. has started the process of disinvestment in those PSU's which had been running into loss. It means that Govt. has been selling out these industries to private sector.

Sale of shares of PSU's- Indian Govt. started selling shares of PSU's to public and financial institution e.g. Govt. sold shares of Maruti Udyog Ltd.The share of private sector has increased from 45% to 55%.

Minimisation of public sector- Previously Public sector was given the importance with a view to help in industrialization and removal of poverty. But these PSU's could not able to achieve this objective and in 1991 policy government gave greater role to the private sector. Number of industries reserved for public sector was reduces from 17 to 3.

Globalisation

Globalisation refers to integration of various economies of world. Globalisation means the mixing of the domestic economy with the rest of the world with regard to foreign investment, trade, production and financial matters. In globalization entire world is considered as a single market. Globalization leads to free movement of people, goods, and services across boundaries. Globalization paves the way to many MNC to Indian market like Pepsi, Coca-Cola, McDonald's, and Kentucky Fried Chicken (KFC Chicken).

Steps taken for globalization:

Reduction in tariffs- Custom duties and tariffs imposed on imports and exports are reduced gradually just to make India economy attractive to the global investors.

Liberalisation on foreign capital policy- The Central Government has abolished FERA (Foreign Exchange Regulation Act) and enacted FEMA (Foreign Exchange Management Act). With this the exchange rate of the rupee today is determined by demand and supply conditions in the foreign exchange markets.

Liberal trade procedure-Import export procedures were simplified.

Impact of changes in Economic Policy on the Business/Effects of Liberalisation and Globalisation

The policy of Liberalization,Privatization and Globalisation (LPG) made a significant change on the working of Indian business firms. The following are the main impacts:

Increasing competition: Due to abolition of licensing requirements and entry of multinational companies(MNC),competition for Indian firms has increased .The companies which could adopt latest technology and which were having sufficient resources could only survive and face the competition. For example ",Western" company which was a leader in T.V market with more than 38% share in T.V market lost its control over the market due to all round competition from MNC like Sony, Samsung etc.By 1995,the Western company almost became unknown in the T.V market

More demanding customers: Increased competition in the market gives the customers wider choice in purchasing better quality goods. Customers have become more demanding because they are well informed.

Market orientation: Today customer is the king. Earlier firms had production oriented i.e., produced first and then go to market but now firms have to study and analyse the market first to identify customer needs and produce goods accordingly i.e,.market oriented.

Rapidly changing technological environment: Prior to new economic policy there was a small internal competition. But after globalization the world class competition started and to face this competition the companies need to adopt world class technology. Rapidly changing technological environment creates tough challenges before smaller firms.

More employment opportunities: The introduction of foreign companies and growth in economy has led to job creation.

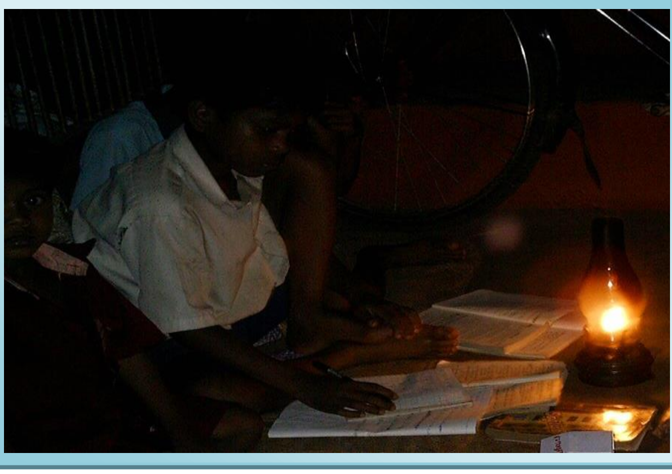
More choice to customers: Globalisation has led to a boom in consumer products market. We have a range of choice in selecting goods unlike the times where there were just a couple of manufacturers. For example before Globalistion ,in case of Indian car market,cutomers had only three options,Ambassador,Maruti,Fiat,but now a days there are lot of choices for Indian customers like BMW,Audi,Honda,Ford.

Global effect: Now world is a single market. Negative factors like war or terrorist attack happened any ware in the world will directly affect the Indian market also.

Impact of Industrial Policy 1991 at a glance:

	1991	2003
India's share in world trade	0.53%	0.86% (+ 65%)
India's foreign currency reserve	1 billion	130 billion
Current account deficit/surplus	Deficit 3% of GDP	Surplus 1 % of GDP

"A dream does not become reality through magic; it takes sweat determination and hard work."*Colin Powell*



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