CENTRE FOR DISTANCE AND ONLINE EDUCATION
Utkal University, Bhubaneswar-7, Odisha

BUSINESSES AND ECONOMIC ENVIRONMENT

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NAAC A+ ACCREDATED

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DIRECTOR

SYLLABUS

	Business Economic & Environment		
Block No	Block	Unit No	Unit
1	Business Environment & Strategic Management	1	Introduction to Business Environment & Strategic Management
		2	International Environment, External Environment, Political & Business Society
		3	Social Responsibility of Business
		4	Consumerism.
2	Economic Roles of Government	5	Economic Roles of Government
		6	Industrial Policy Monetary and Fiscal Policy
		7	Privatization
		8	Industrial Sickness
3	GATT, WTO, MRTP ACT	9	MRTP Act., Globalization and Liberalization
		10	Labour Welfare and Social Security
		11	GATT & WTO.
4	FINANCIAL ENVIRONMENT, ROLE OF RBI INDUSTRIAL DEVELOPMENT	12	Financial Environment: Financial Institution, RBI,
		13	Stock Exchange, Non- Banking Financial Corporation, Capital Market Reform and Development.
		14	Industrial Development Strategy and Growth under Indian Planning
		15	Commodity Exchange and its Regulation, Price and Distribution Control
		16	Concentration of Economic Power.

Unit 1 Business Environment & Strategic Management

Structure

1.1 INTRODUCTION TO BUSINESS

Business is an important institution in society. Be it for the supply of goods or services, creation of employment opportunities, offer of better quality life, or contribution to the economic growth of a country, the role of business is crucial. So the first question arises in anyone's mind is what really a business is? The following definition is an attempt to provide appropriate answer.

"A Business is nothing more than a person or group of persons properly organized to produce or distribute goods or services. The study of business is the study of activities involved in the production or distribution of goods and services-buying, selling, financing, personnel and the like".

Practically the above said definition is true but in theoretical sense it is incorrect. Before any activities can be considered in the business, there must exist both the goal of profit and the risk of loss. Thus Business can be accurately defined by K. Ashwathapa as "Complex field of commerce and industry in which goods and services are created and distributed in the hope of profit within a framework of laws and regulations".

Understanding the Business: To understand any business the critical step is to explore all the factors related to business and properly judging its impact on the business. There are many factors and forces which have considerable impact on any business. All these forces come under one word called environment. Hence understanding the business means understanding its environment. Environment refers to all external forces which have a bearing on the functioning of business.

From the micro point of view, a business is an economic institution, as it is concerned with production and/or distribution of goods and services, in order to earn profits and acquire wealth. Different kinds of organizations (i.e., sole tradership, partnership, Joint Stock Company and co-operative organization) are engaged in business and are operating from small scale, as in case of grocery in a start, to large scale, as in case of Tata Iron and Steel Co., Bajaj Auto, Maruti Udyog, and Reliance Industries. Whatever may be the nature and scale of operations, a business enterprise possesses the following characteristics:

1.2 Learning Objectives

- Analysis of business environment helps managers to predict future management actions & vision.
- Study into business environment helps managers assess current resources at hand.
- Helps management in planning for & implementing strategies more effectively.

What is Business?

1. Dealings in Goods and Services: The first basic characteristic of a business is that it deals in goods and services. Goods produced or exchanged, may be consumers' goods, such as bread, rice, cloth, etc. or producers' goods such as machines, tools, etc. The consumer goods are meant for direct consumption, either immediately, or after undergoing some processes, whereas the producers' goods are meant for being used for the purposes of further production. Producers’ goods are also known as capital goods. Services include supply of electricity, gas, water finance, insurance, transportation, warehousing, etc.

2. **Production and/or Exchange:** Every business is concerned with production and exchange of goods and services for value. Thus, goods produced or purchased for personal consumption or for presenting to others as gifts do not constitute business, because there is no sale or transfer for value. For example, if a person cooks at home for personal consumption, it is not business activity. But, if he cooks for others in his 'dhaba’ or restaurant and receives payment from them, it becomes his business.

3. **Creation of form, time and place utility:** All business activities create utilities for the society. Form utility is created, when raw materials are converted into finished goods and services. Place utility is created, when goods are transported from the place of production to the place of consumption. Storage of goods creates time utility. This helps

in preserving the goods, when not required and making them available, when demanded by the consumers.

4. **Regularity and Continuity in Dealings:** Regularity of economic transactions is the essence of business. There should be continuity, or regularity of exchange of goods and services for money. An isolated transaction cannot be called a business. For example, if a person sells his flat and earns some profits, it cannot be called a business. But, if he purchases and sells flats regularly to earn his livelihood, it will be called his business.

5. **Profit Motive:** Another important feature of a business activity is its objective. The chief objective of a business is to earn reasonable profits or 'surplus' as it is called in case of public enterprises. The survival of a business depends upon its ability to earn profits. Every businessman wants to earn profits, to get return on his capital and to reward himself for his services. Actually, profit is the spur that helps in the continuation of the business. Profit is also essential for growth. Recreation clubs and religious institutions cannot be called business enterprises, as they have nothing to do with the profit motive.

1.3 Definition of Business Environment and Strategic Management

Environment is defined as something external to an individual or organization. From this angle, business environment refers to all external factors which will influence the activities of business. However, some experts have used the term "environment" in a broader sense. They defined business environment as external and internal factors that have direct or indirect influence on business or business activities. Business environment consists of all the factors that affect a company's operations, actions and outcomes. It is comprised of macro environment and micro environment, the former includes legal and political environment, social environment, economic environment and technological environment, and the later includes customers, competitors, stakeholders, suppliers, banks and so on.

Strategy is an action plan designed to achieve a particular goal. It is the direction and scope of an organization over the long-term: which achieves advantage for the organization through its configuration of resources within a changing environment, to meet the need of markets and to fulfill stakeholder expectation

No business can exist in a vacuum. The rapidly changing business environment might shorten the life of a given strategy. The external changes might influence the activities and quality of decisions of both the firm and its competitors. “Environmental analysis is the critical starting point of strategic thinking.”

We live in dynamic environments that change all the time. Businesses must understand the changes in the environment and how these changes affect their performance. The process of thinking strategically requires that managers understand how the structure and competitive dynamics of their industry affect the performance and profitability of their companies. Armed with an appreciation of the forces in their industry that give rise to opportunities and threats, managers should be able to make better strategic decisions.

Successful managers must recognize opportunities and threats in their firm’s external environment. Regardless of the industry, the external environment is critical to a firm’s survival and success. A host of external factors influence a firm’s choice of direction and action.

The Characteristics Of Strategy Are:

(1) It has a long-term direction.

(2) It defined the scope of an organization’s activities.

(3) It should match activities with environment.

(4) It bounded rationality and resources scarcity.

(5) It has expectation and values.

(6) It is the basis of company operation, the organization structure and daily operation policies should all based on the strategy.

Strategy planning is determined by the external and internal environment, however, it may be ineffective because the environment cannot predict clearly. Therefore, marketers should obtain new information in the business environment continually and make strategic planning that can meet the changing conditions.

1.3 IMPORTANCE OF THE STUDY OF BUSINESS ENVIRONMENT

The benefits of environmental study may be specified as below:

(i) This study helps the firm in the development of broad strategies and long-term policies of the firm.

(ii) To make aware about technological advancement.

(iii) This study should help the management in analyzing the competitor's strategies and planning.

(iv) It provides a rich source of idea and understanding about political changes taking place in environment.

(v) It helps to know about socio-economic changes at the nation and International level on the firm's stability.

(vi) The study of environment should provide inputs for strategic decision making in respect of International Environment and prospective.

(vii) This study helps the firm in the development of long-term policies of the firm.

1.4 Business and its Environment:

A business depends on certain internal and external factors. These factors are treated as given and business enterprise is expected to operate under a particular set of environmental system. These factors are generally uncontrollable and beyond the control of business enterprises. But progress, success and survival largely depend upon their capacity and ability to adapt successfully to environmental changes available in surroundings of a business.

In its operational behavior, an organization interacts with the various forces in its environment. It may be in terms of receiving inputs, returning outputs and using feedback to modify inputs and the transformation process. Moreover, the organization does not operate in a vacuum but must interact with its environment in order to function. However, level of interaction may differ from organization to organization and the impact can vary overtime.

Thus, business organizations deal with the environment by undertaking following transactions:

(I) They Receive Inputs- The manufacturer receives raw materials, a stock broker receives the latest financial information and a local authority receives data on housing needs.

(Ii) They Transform Inputs- The Manufacturer produces the goods from the raw materials the stock broker interprets the information and the local authority produces housing plans.

(iii) They Produce Outputs- The manufacture sell products, the stock broker advice and the local builds houses.

Business environment is the sum total of all the external factors beyond control of business that influence the business in a number of ways. In other words, it consists of two layers of macro level namely general and industry environments. The following picture makes it amply clear. Thus, the business environment is divided into general environment and industry environment.

'General environment' refers to the general and overall environment within which firms operate. It is also known as 'macro' environment. The macro- environment consists of the broader economic, social, demographic, political, legal and technological framework within which the industry and company are placed. It is called as 'indirect action' environment. The forces do not have any immediate direct effect on the operations but they have influence. On the other hand, "industry environment" or "direct action environment" or "tasks environment" or "micro environment" or "operating environment" consists of elements that directly affect the company such as competitors, customers and suppliers. The forces of industry environment directly affect and are affected by the organization's operations. In other words, the task environment is the more specific and immediate environment in which an organization conducts its business.

It implies that the strategists or makers of decision should design those strategies that are matching to the needs of external environment. It is a question of adjusting the organization to these forces so that the firm is in a position to have increased share in market, profitability and other goals and objectives by utilizing its internal strengths and weaknesses.

Managers must have a deep understanding and appreciation of the environment in which they and their organizations function. The environment of business is the 'aggregate of conditions, events and influences that surround and affect it'. Since the organization is part of a broader social system, it has to work within the framework provided by the society and its innumerable constituents.

For the sake of simplicity the environmental forces could be classified into two categories:

1. Internal environment and
2. External environment.

1. Internal Environment:

The internal environment consists of conditions and forces within an organization that affect the organization’s management. Aspects of the internal environment include the organization’s mission, corporate culture, owners and the board of directors, employees, other units of the organization and unions.

2. External Environment:

The external environment consists of those factors that affect a firm from outside its organizational boundaries. Of course, the boundary that separates the organization from its external environment is always not clear and precise. For example, shareholders are part of the organization, but in another sense, they are part of its environment.

Which part of environment is more important?

While analyzing the total (macro] environment, it is more effective to deal with the external forces first and then the internal, although some opine that the reverse order is better. For example, analysis of the internal environment might reveal a cash surplus, and top management might then decide to search the external environment for an investment opportunity, such as an acquisition.

Even here, examining external environment is essential to find whether the timing is right for an acquisition or any other use of cash. While deciding the internal-external order of analysis, one should not lose sight of aspects that work well in one set of conditions and change color in another set of circumstances.

In actual practice, since both external and internal forces interact and impact organizational survival and growth, managers would do well to examine both sets of factors at the same time. The external environment reveals opportunities and threats and the internal environment uncovers strengths and weaknesses.

Literally, environment refers the surroundings external objects or circumstances in which someone or something exists. Here someone or something can be an individual, or a group of people, or an organization. The performance of an individual or an organization depends on the environment- The environment comprises forces which are outside or external to the business and forces that are internal to it.

1.3.2 Internal Environment Factors

Definition

The internal factors refer to anything within the company and under the control of the company no matter whether they are tangible or intangible. These factors after being figured out are grouped into the strengths and weaknesses of the company. If one element brings positive effects to the company, it is considered as strength.

On the other hand, if a factor prevents the development of the company, it is a weakness. Within the company, there are numerous criteria need to be taken into consideration.

Types

There are 14 types of internal environment factors:

1. Plans & Policies
2. Value Proposition
3. Human Resources
4. Financial and Marketing Resources
5. Corporate Image and brand equity
6. Plant/Machinery/Equipments (or you can say Physical assets)
7. Labour Management
8. Inter-personal Relationship with employees
9. Internal Technology Resources & Dependencies
10. Organizational structure or in some cases Code of Conduct
11. Quality and size of Infrastructure
12. Task Executions or Operations
13. Financial Forecast
14. The founders relationship and their decision making power.

1.5 Key Terms

Business: It is the practice of making one's living or making money by producing or buying and selling products (such as goods and services).

Business Environment: It is sum or collection of all internal and external factors such as employees, customers needs and expectations, supply and demand, management, clients, suppliers, owners, activities by government, innovation in technology, social trends, market trends, economic changes, etc**.**

Strategic Management: It involves developing and implementing plans to help an organization achieve its goals and objectives. This process can include formulating strategy, planning organizational structure and resource allocation, leading change initiatives, and controlling processes and resources.

Internal Environment: An internal environment is an important component of the business environment. It concentrates on the various factors that are present within an organization and can affect how its workforce operates or what values the entire organization represents.

External Environment: These are factors are elements that exist outside of a company's internal environment that can affect a company's operations. These outside forces can help the business or present challenges to its current processes.

1.6 Summary

In summary, understanding the business environment and effectively managing strategies are essential for organizations to adapt, thrive, and achieve sustainable competitive advantage in today's dynamic and complex business landscape.

1.7 Check your Progress

1. Define Business. Explain the impact of business environment and business operations.

2. How business environment aids in developing and implementing strategic management?

1.8 References

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Unit 2 EXTERNAL ENVIRONMENT:

Structure

2.1 Introduction to External Environment

Understanding and analyzing the external business environment is crucial for businesses to identify opportunities and threats, anticipate changes, and formulate effective strategies to navigate the complexities of the marketplace and achieve sustainable growth and competitive advantage.

2.2 Learning Objectives

The learning objectives related to the external business environment typically include:

1. Understanding External Factors: Students should be able to identify and comprehend the various external factors that can impact business operations, performance, and strategic decision-making. This includes economic, political, legal, social, cultural, technological, environmental, and competitive factors.
2. Analyzing Environmental Trends: Students should develop the skills to analyze trends and changes in the external environment that may present opportunities or threats to organizations. This involves studying economic indicators, regulatory developments, demographic shifts, technological advancements, and market dynamics.
3. Assessing Industry and Market Conditions: Students should learn to assess industry and market conditions to understand the competitive landscape, industry structure, and market dynamics. This includes analyzing market trends, competitive forces, customer behavior, and industry benchmarks.

4. Evaluating Risks and Opportunities: Students should be able to identify and evaluate the risks and opportunities arising from the external environment. This involves assessing the impact of external factors on business performance, profitability, sustainability, and growth prospects.
5. Strategic Decision-making: Students should understand how external environmental analysis informs strategic decision-making processes within organizations. This includes formulating strategies to capitalize on opportunities, mitigate risks, and navigate challenges posed by the external environment.
6. Adapting to Change: Students should develop the ability to adapt to changes in the external environment and adjust organizational strategies and tactics accordingly. This includes being agile and responsive to shifts in market conditions, regulatory requirements, technological advancements, and consumer preferences.
7. Ethical and Social Responsibility Considerations: Students should consider the ethical and social responsibility implications of external environmental factors on business practices and decision-making. This involves understanding how businesses interact with society, communities, and the environment, and the importance of ethical conduct and corporate social responsibility.
8. Effective Communication: Students should be able to effectively communicate their analyses and findings related to the external environment to various stakeholders, including senior management, investors, customers, and employees. This includes presenting complex information in a clear, concise, and persuasive manner.

By achieving these learning objectives, students can develop a comprehensive understanding of the external business environment and its implications for organizational strategy, decision-making, and performance. They will be better equipped to anticipate changes, identify opportunities, mitigate risks, and contribute to the long-term success and sustainability of businesses in dynamic and competitive markets.

2.3 External Micro Environment:

Micro external forces have an important effect on business operations of a firm. However, all micro forces may not have the same effect on all firms in the industry. For example, suppliers, an important element of micro level environment, are often willing to provide the materials at relatively lower prices to big business firms. They do not have the same attitude towards relatively small business firms. Similarly, a competitive firm will start a price war if its rival firm in the industry is relatively small. If the rival firm is a big one which is a capable of retaliating any adverse action from its rival, a competitive firm will hesitate to start a price war. We explain below important factors or forces of micro-level external environment.

Suppliers of Inputs:

An important factor in the external environment of a firm is the suppliers of its inputs such as raw materials and components. A smooth and efficient working of a business firm requires that it should have ensured supply of inputs such as raw materials. If supply of raw materials is uncertain, then a firm will have to keep a large stock of raw materials to continue its transformation process uninterrupted. This will unnecessarily raise its cost of production and reduce its profit margin.

To ensure regular supply of inputs such as raw materials some firms adopt a strategy of backward integration and set up captive production plants for producing raw materials themselves.

Further, energy input is an important input in the manufacturing business. Many large firms such as Reliance industries have their own power generating plants so as to ensure regular supply of electricity for their manufacturing business. However, small firms cannot adopt this strategy of vertical integration and have to depend on outside sources for supply of needed inputs.

Further, it is not a good strategy to depend on a single supplier of inputs. If there is disruption in production of the supplier firm due to labour strike or lock-out, it will adversely affect the production work of a firm. Therefore, to reduce risk and uncertainty business firms prefer to keep multiple suppliers of inputs.

Customers:

The people who buy and use a firm's product and services are an important part of external micro-environment. Since sales of a product or service is critical for a firm's survival and growth, it is necessary to keep the customers satisfied. To take care of customer's sensitivity is essential for the success of a business firm.

A firm has different categories of customers. For example, a car manufacturing firm such as Maruti Udyog has individuals, companies, institutions, government as its customers. Maruti Udyog, therefore, has catered to the needs of all these types of customers by producing different varieties and models of cars.

Besides, a business firm has to compete with rival firms to attract customers and thereby increase the demand and market for its product. In the present day of intense competition a firm has to spend a lot on advertisements to promote the sales of its product by creating new customers and retaining the old ones. For this purpose, a business firm has also to launch new products or models.

With increasing globalization and liberalization the customers' satisfaction is of paramount importance because the consumers have the option of buying imported products. Therefore, to survive and succeed a firm has to make continuous efforts to improve the quality of its products.

Marketing Intermediaries:

In a firm's external environment marketing intermediaries play an essential role of selling and distributing its products to the final buyers. Marketing intermediaries include agents and merchants such as distribution firms, wholesalers, retailers.

Marketing intermediaries are responsible for stocking and transporting goods from their production site to their destination, that is, ultimate buyers. There are marketing service agencies such as marketing research firms, consulting firms, advertising agencies which assist a business firms in targeting, promoting and selling its products to the right markets.

Thus, marketing is an important link between a business firm and its ultimate buyers. A dislocation of this link will adversely affect the fortune of a company. A few years ago chemists and druggists in India declared a collective boycott of a leading pharma company because it was providing a low retail margin. They succeeded in raising this margin. This shows that a business firm must take care of its intermediaries if it has to succeed in this age of intense competition.

Competitors:

Business firms compete with each other not only for sale of their products but also in other areas. Absolute monopolies in case of which competition is totally absent are found only in the sphere of what are called public utilities such as power distribution, telephone service, gas distribution in a city etc. More generally, market forms of monopolistic competition and differentiated oligopolies exist in the real world.

In these market forms different firms in an industry compete with each other for sale of their products. This competition may be on the basis of pricing of their products. But more frequently there is non-price competition under which firms engage in competition through competitive advertising, sponsoring some events such as cricket matches for sale of different varieties and models of their products, each claiming the superior nature of its products.

The readers will be witnessing how intense is the competition between Coca Cola and Pepsi Cola. Sometimes there has been price war between them to capture new markets or enlarge their market share. Likewise, there is severe competition between the manufacturers of Aerial and Surf washing powders, between manufacturers of various brands of color TV. This type of competition is generally referred to as brand competition as it relates to producing and selling different brands of a product. But not only is there a competition among the producers producing different varieties or brands of a product but also among firms producing quite diverse products as all products ultimately compete for attracting spending by the consumers of their disposable incomes.

For example, competition for a firm producing TVs does not come only from other brands of TV manufacturers but also from manufacturers of air conditioners, refrigerators, cars, washing machines etc. All these goods compete for attracting disposable incomes of the final consumers. Competition among these diverse products is generally referred to as desire competition as all these goods fulfill the various desires of the consumers who have limited disposable incomes.

As a consequence of liberalization and globalization of the Indian economy since the adoption of economic reforms there has been a significant increase in competitive environment of business firms. Now, Indian firms have to compete not only with each other but also with the foreign firms whose products can be imported.

For example, in the USA American firms faced a lot of competition from the Japanese firms producing electronic goods and automobiles. Similarly, the Indian firms are facing a lot of competition from Chinese products. It is important to note that for successful competition the Indian firms have to improve not only the quality of the products but also to enhance their productivity so that cost per, unit can be reduced.

Publics:

Finally, publics are an important force in external micro environment. Public, according to Philip Kotler “is any group that has an actual or potential interest in or impact on a company’s ability to achieve its objective”. Environmentalists, media groups, women associations, consumer protection groups, local groups, citizens associations are some important examples of publics which have an important bearing on environment of the firms.

For example, a consumer protection firm in Delhi headed by Sunita Narain came out with an amazing fact that cold drinks such as Coca Cola, Pepsi Cola, Limca, and Fanta had a higher content of pesticides which posed threat to human health and life. This produced a good deal of adverse effect on the sale of these products in 2003-04. The Indian laws are being amended to ensure that these drinks must not contain pesticides beyond European safety standards.

Similarly, environmentalists like Arundhati Roy have been campaigning against industries which pollute the environment and cause health hazards. Women in some villages of Haryana protested against liquor shops being situated in their localities.

Many citizen groups are actively campaigning against cigarette manufactures for their advertising campaigns luring the people to indulge in smoking. Thus, the existence of various types of publics influences the working of business firms and compels them to be socially responsible.

2.4 External Macro Environment:

Apart from micro-environment, business firms face large external environmental forces. The external macro environment determines the opportunities for a firm to exploit for promoting its business and also presents threats to it in the sense that it can put restrictions on the expansion of business activities. The macro-environment has thus both positive and negative aspects.

An important fact about external macro-environmental forces is that they are uncontrollable by the management of a firm. Because of the uncontrollable nature of macro forces a firm has to adjust or adapt itself to these external forces.

External macro-environmental factors are classified into:

(1) Economic,

(2) Social,

(3) Technological,

(4) Political and legal, and

(5) Demographic.

1. Economic Environment:

Economic environment includes the type of economic system that exists in the economy, the nature and structure of the economy, the phase of the business cycle (for example, the conditions of boom or recession), the fiscal, monetary and financial policies of the Government, foreign trade and foreign investment policies of the government. These economic policies of the government present both the opportunities as well as the threats (i.e. restrictions) for the business firms.

The type of the economic system, that is, socialist, capitalist or mixed provides institutional framework within which business firm have to work. For example, before 1991, the Indian economic system was of the type of a mixed economy with pronounced orientation towards the public sector. Prior to 1991 private sector's role in India's mixed economy was greatly restricted. Many industries were reserved exclusively for investment and production by the public sector.

Private sector operations were limited mainly to the consumer goods industries. Even in these goods the private sector production and operation was controlled by industrial licensing system, Monopolistic and Restrictive Trade Practices (MRTP) Commission.

The private sector was also subjected to various export and import-restrictions. High tariffs were imposed to protect domestic industries and to pursue import substitution strategy of industrial growth.

Now, there have been significant changes in the economic policies since 1991 which have changed the macroeconomic environment for private sector firms. Far-reaching structural economic reforms were carried out by Dr. Manmohan singh during the period 1991-96 when he was the Finance Minister. Industrial licensing has been abolished and private sector can now invest and produce many industrial products without getting license from the government.

Many industries, except only a few industries of strategic importance, which were earlier reserved for the public sector, have been thrown open for the private sector. Import duties have been greatly reduced due to which domestic industries face competition from the imported products. Incentives have been given to boost exports. Rupee has been made convertible into foreign currencies on current account. It is thus evident that new economic reforms carried out since 1991 has significantly changed the business environment.

2. Social and Cultural Environment:

Members of a society wield important influence over business firms. People these days do not accept the activities of business firms without question. Activities of business firms may harm the physical environment and impose heavy social costs. Besides, business practices may violate cultural ethos of a society. For example, advertisement by business firms may be nasty and hurt the ethical sentiments of the people.

Businesses should consider the social implications of their decisions. This means that companies must seriously consider the impact of its actions on the society. When a business firm in their decision making take care of social interests, it is said to be socially responsible.

Social responsibility is the felt obligation or self-enforced duty of business firms to serve or protect social interests. By doing so they promote social well-being. Good corporate governance should be judged not only by the productivity and profits earned by a business firm but also by its social-welfare promoting activities.

It is worth noting that in modern management science a new concept of social responsiveness has been developed. By social responsiveness we mean "the ability of a corporate firm to relate its operations and policies to social environment in way that are mutually beneficial to the company and society at large".

It may be noted that social responsibility or social responsiveness is related to ethics. The discipline of ethics deals with what is good and bad, or right and wrong or with moral duty and obligation. Further, even if managers enjoy full freedom to adopt actions and policies in accordance with the conceived notion of social responsibility, they may not do so if standards applied to evaluate their performance are quite different.

Every manager would like its performance to be positively appraised. Therefore, if the performance of managers of business firms are judged by the amount of profits .they make for the owners of the firms, it is then not proper to expect socially responsible actions from them.

3. Political and Legal Environment:

Businesses are closely related to the government. The political philosophy of the government wields a great influence over business policies. For example, after independence under the leadership of Jawaharlal Nehru India adopted 'democratic socialism as its goal.

In the economic sphere it implied that public sector was to play a vital role in India's economic development. Besides, it required that working of the private sector were to be controlled by a suitable industrial policy of the government. In this political framework provide business firms worked under various types of regulatory policies which sought to influence the directions in which private business enterprises had to function.

Thus, Industrial Regulation Act 1951, Industrial Policy Resolution 1956, Foreign Exchange Regulation Act (FERA), Monopolistic and Restrictive Practices (MRTP) Act were passed to control the business activities of the private sector. Besides, role of foreign direct investment was restricted to only few spheres.

However, since 1991 several structural economic reforms have been undertaken following a change in political philosophy in favor of a free market economy. The collapse of socialism in Soviet Russia, China and East European Countries has brought about a change in political thinking about the roles of public and private sectors in India’s industrial development.

To encourage the growth of the private sector in India, licensing has now been abolished, role of public sector greatly reduced and foreign capital, both direct and portfolio is being encouraged to raise the rate of capital formation in the Indian economy. FERA has been replaced by FEM A (Foreign Exchange Management Act) It is evident from above that with the change in the nature of political philosophy business environment for private firms has greatly changed.

4. Technological Environment:

The nature of technology used for production of goods and services is an important factor responsible for the success of a business firm. Technology consists of the type of machines and processes available for use by a firm and the way of doing things. The improvement in technology raises total factor productivity of a firm and reduces unit cost of output.

The use of a superior technology by a firm gives it a competitive advantage over its rival firms. The use of a particular technology by a firm for its transformation process determines its competitive strength. In this age of globalization the firms have to compete in the international markets for sales of their products. The firms which use outdated technologies cannot compete globally. Therefore, technological development plays a vital role in enhancing the competitive strength of business firms.

It has been generally observed that the competition between firms in the domestic economy and in international markets ensures that the firms will try to improve the technology they use because failure to do so would pose a threat to their survival. In the protected markets, technological improvements are slow and firms are able to survive for a long period without making technological changes.

This is quite evident from the experience of automobile industry in India. Manufacturers of Ambassadors and Fiat Cars not only made no significant changes in their models, but also did not make any improvement in technology for decades because of absence of competition. The users had no choice and Ambassador and Fiat cars survived for decades in the protected environment.

It is when Maruti Udyog Ltd. was started in India using superior technology and introducing more attractive models that there has been a significant improvement in car manufacturing. With liberalization of the Indian economy new car manufacturing firms have entered the industry and are producing different verities and models of cars with improved technology.

Besides, the cotton textile industry is another important example of an industry which due to protection provided to it by imposing high tariffs on imports of cotton textiles became sick. Following trade liberalization many cotton textile firms have closed down because they could not withstand competition. Technological environment affects the success of firms and the need for technological advancement cannot be ignored.

5. Demographic Environment:

Demographic environment includes the size and growth of population, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels of labour force. All these demographic features have an important bearing on the functioning of business firms. Since new workers are recruited from outside the firm, demographic factors are considered as parts of external environment.

The skills and ability of a firm’s workers determine to a large extent how well the organization can achieve its mission. The labour force in a country is always changing. This will cause changes in the work force of a firm. The business firms have to adjust to the requirements of their employees. They have also to adapt themselves to their child care services, labour welfare programmes etc.

The demographic environment affects both the supply and demand sides of business organizations. Firms obtain their working force from the outside labour force. The technical and education skills of the workers of a firm are determined mostly by human resources available in the economy which are a part of demographic environment.

On the other hand, the size of population and its rural-urban distribution determine the demand for the products of industrial firms. For example, when there is good monsoon in India causing increase in incomes of rural population dependent on agriculture, demand for industrial products greatly increases.

In the wake of economic reforms initiated in the early nineties when foreign investors were allowed to make investment in India, they were prompted to invest in India by pointing out that the size of Indian market was quite large. They were told that 200 million Indian people could afford to buy the industrial products and this constituted quite a large market which could be profitably exploited.

Besides, the growth rate of population and age composition of population determine the demand pattern of goods. When the population of a country is growing at a high rate, its child population will be relatively large. This means demand for products such as baby food which cater to the needs of children will be relatively high.

On the other hand, if population of a country is stable and life expectancy of the people is high, this will cause greater proportion of elderly aged people in the population of a country. This means different demand pattern of goods. Thus business firms have to consider all these demographic factors in their planning for production of goods and services and formulation of marketing strategies for sale of their products.

Demographic environment is also important for business firms as it determines the choice of technology by them. Other things being equal, if labour is abundant and relatively cheaper than capital, business firms will prefer relatively labour-intensive techniques for production of goods.

However, for various reasons such as rigid labour laws and low productivity of labour, various tax concessions on investment in capital equipment and machinery, business firms in India are generally seem to be using capital-intensive technologies imported from abroad. This has resulted in the increase in unemployment of labour, especially among the young workers.

Therefore, social and government pressure is increasing on the business firms to create more employment opportunities for labour so as to render help in solving the problem of unemployment. It is quite interesting to note here that to take advantages of relatively cheap labour in India and China that foreign MNCs are setting up manufacturing plants in these countries. It is evident from above that demographic factors play a crucial role in determining the productive activity of business firms.

Natural Environment:

Natural environment is the ultimate source of many inputs such as raw materials, energy which business firms use in their productive activity. In fact, availability of natural resources in a region or country is a basic factor in determining business activity in it.

Natural environment which includes geographical and ecological factors such as minerals and oil reserves, water and forest resources, weather and climatic conditions, port facilities are all highly significant for various business activities.

For example, the availability of minerals such as iron, coal etc. in a region influence the location of certain industries in that region. Thus, the industries with high material contents tend to be located near the raw material sources. For example, steel producing industrial units are set up near coal mines to save cost of transporting coal to distant locations.

Besides, certain weather and climatic conditions also affect the location of certain business units. For example, in India the firms producing cotton textiles are mostly located in Bombay, Madras, and West Bengal where weather and climatic conditions are conducive to the production of cotton textiles.

Natural environment also affects the demand for goods. For example, in regions where there is high temperature in summer there is a good deal of demand for dessert coolers, air conditioners, business firms set up industrial units producing these products. Similarly, weather and climatic conditions influence the demand pattern for clothing, building materials for housing etc. Furthermore, weather and climatic conditions require changes in design of products, the type of packaging and storage facilities.

It may however be noted that resource availability is not a sufficient condition for the growth of production and business activities. For instance, India through rich in natural resources remained poor and underdeveloped because available resources had not been put to use due to lack of adequate capabilities of Indian business class. Thus, it is not the availability of natural resources alone but also the technology and ability to being them into use that determines the growth of business and the economy.

Ecological Effects of Business:

Until recently businesses had generally overlooked the serious ecological effects of its activities. Driven purely by the motive of maximizing profits, they cause irreparable damage to the exhaustible natural resources, especially minerals and forests. By their careless attitude they caused pollution of environment, especially air and water which posed health hazards for the people.

By creating external detrimental diseconomies they imposed heavy costs on the society. Thanks to the efforts by environmentalists and international organizations such as World Bank, the people and the governments have now became conscious of the adverse effects of depletion of exhaustible natural resources and pollution of environment by business activity.

Accordingly, laws have been passed for conservation of natural resources and prevention of environment pollution. These laws have imposed additional responsibilities and costs for business firms. But it is socially desirable that these costs are borne by business firms if we want sustainable economic growth and also healthy environment for human beings.

2.5 Key Terms

External Macro Environment: It refers to all those external environment factors that immensely influence the business success, strategies, and decision making. These external factors that highly influence the business success are not controlled by the organization easily.

Suppliers: Suppliers are another important component of the micro environment. Organizations depend on many suppliers for equipment, raw material, etc. to maintain their production. Suppliers can influence the cost structure of the industry and are hence a major force.

Demographic environment: It is a term used by marketers to describe the characteristics of a population that can be used to influence the success of a business or commercial venture. The most important demographic factors for businesses include age, sex, income, education level, and occupation.

Natural Environment: The natural environment in which a business exists includes ecological and geographical factors that may influence its activities. Natural factors like geography, climatic conditions, the availability of resources, air quality and environmental regulations greatly affect the functioning of a business.

2.6 Summary

Macro environment refers to all those external environment factors that immensely influence the business success, strategies, and decision making. These external factors that highly influence the business success are not controlled by the organization easily.

2.7 Check your Progress

1. What Are the Differences Between a Micro and Macro Environment?
2. How does macro environmental analysis helps managers in decision making?
3. Does natural environment play a role in business management? Explain.
4. How does Macro Analysis of Business Environment aids to develop and maintain international business.

2.8 References

- **Cherunilam, F. (1989). Business Environment. India: Himalaya Publishing House.**
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Unit 3 SOCIAL RESPONSIBILITY OF BUSINESS:

Structure

3.1 Introduction to Social responsibility of business

Social responsibility of business, also known as corporate social responsibility (CSR), refers to the ethical obligations and responsibilities that organizations have towards society and the environment beyond their primary economic objectives of maximizing profits for shareholders. It entails conducting business operations in a manner that contributes positively to society, minimizes negative impacts on the environment, and promotes sustainable development.

Social responsibility of business implies the obligations of the management of a business enterprise to protect the interests of the society. According to the concept of social responsibility the objective of managers for taking business decisions is not merely to maximize profits or shareholders' value but also to serve and protect the interests of other members of a society such as workers, consumers and the community as a whole. Thus, Sachar Committee on Companies and MRTP Acts appointed by Government of India states, "In the development of corporate ethics we have reached a stage where the question of social responsibility of business to the community can no longer be scoffed at or taken lightly. In the environment of modern corporate economic development, the corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the society".

It may be noted that some Indian sociologists and economists relate the idea of social responsibility of business of the Gandhian concept of trusteeship. According to Mahatma Gandhi, capitalist class owns wealth or capital as trustees of the society. The resources and capital they use for production of goods and services, according to him, should be used not to maximize profits for them but for the larger benefit of the society.

However, in our view, it will be too idealistic to expect that business enterprises will be purely guided by the benefits they confer on the society by their activities. The concept of social responsibility as used in management science is that businesses should maximize their profits subject to their working in a socially responsible manner to promote the interests of the society.

Their business activities should not harm other groups such as consumers, workers, and public at large. Mr. N.R. Narayana, Chairman of Infosys makes the idea of social responsibility of business quite clear when in a conference on corporate social responsibility he said, "Corporate's foremost social responsibility is to create maximum shareholders' value working in a way which is fair to all its stakeholders — workers, consumers, the community, government and the environment He further points out. Working in harmony with the community and environment around us and not cheating our customers and workers we might not gain anything in the short run but in the long term it means greater profits and shareholders' value'

3.2 Learning Objectives

Key aspects of social responsibility of business include:

1. Stakeholder Engagement: Recognizing and engaging with various stakeholders, including employees, customers, suppliers, communities, and government entities, to understand their needs and concerns and incorporate their perspectives into business decision-making processes.
2. Ethical Business Practices: Upholding high ethical standards and integrity in all business dealings, including fair treatment of employees, honesty in advertising and marketing, transparency in financial reporting, and compliance with laws and regulations.
3. Environmental Sustainability: Adopting environmentally sustainable practices to minimize ecological footprint, reduce resource consumption, mitigate pollution, and conserve natural resources. This may involve initiatives such as energy efficiency, waste reduction, recycling, and using renewable energy sources.
4. Community Engagement: Contributing to the well-being and development of local communities through philanthropic activities, volunteerism, and investment in community development projects. This can include supporting education, healthcare, infrastructure development, and social welfare programs.
5. Employee Well-being: Prioritizing the health, safety, and well-being of employees by providing a safe and healthy work environment, offering competitive wages and benefits, fostering diversity and inclusion, promoting work-life balance, and investing in employee training and development.
6. Supplier Relations: Ensuring fair and ethical treatment of suppliers and business partners throughout the supply chain, including compliance with labor standards, fair trade practices, and responsible sourcing of materials.
7. Corporate Governance: Establishing robust corporate governance structures and practices to ensure accountability, transparency, and responsible decision-making by management and the board of directors.

8. Responsible Marketing: Conducting marketing and advertising activities in an ethical and socially responsible manner, avoiding deceptive or misleading practices, and promoting products and services that are safe, beneficial, and aligned with societal values.
9. Human Rights: Respecting and promoting human rights principles within the organization's operations and across its value chain, including protecting the rights of workers, indigenous peoples, and marginalized communities.
10. Continuous Improvement: Committing to continuous improvement and accountability in social and environmental performance through regular assessment, measurement, and reporting of CSR initiatives and outcomes.

3.3 Social Responsibility of Business and Social Contract:

It is evident from above; the social responsibility of business implies that a corporate enterprise has to serve interests other than that of common shareholders who, of course, expect that their rate of return, value or wealth should be maximized.

But in today's world the interest of other stakeholders, community and environment must be protected and promoted.

Social contract is a set of rules that defines the agreed interrelationship between various elements of a society. The social contract often involves a quid pro quo (i.e. something given in exchange for another). In the social contract, one party to the contract gives something and expects a certain thing or behavior pattern from the other.

In the present context the social contract is concerned with the relationship of a business enterprise with various stakeholders such as shareholders, employees, consumers, government and society in general. The business enterprises happen to have resources because society consisting of various stakeholders has given them this right and therefore it expects from them to use them to for serving the interests of all of them.

Though all stakeholders including the society in general are affected by the business activities of a corporate enterprise, managers may not acknowledge responsibility to them. Social responsibility of business implies that corporate managers must promote the interests of all stakeholders not merely of shareholders who happen to be the so called owners of the business enterprises.

1. Responsibility to Shareholders:

In the context of good corporate governance, a corporate enterprise must recognise the rights of shareholders and protect their interests. It should respect shareholders' right to information and respect their right to submit proposals to vote and to ask questions at the annual general body meeting.

The corporate enterprise should observe the best code of conduct in its dealings with the shareholders. However, the corporate Board and management try to increase profits or shareholders' value but in pursuing this objective, they should protect the interests of employees, consumers and other stakeholders. Its special responsibility is that in its efforts to increase profits or shareholders' value it should not pollute the environment.

2. Responsibility to Employees:

The success of a business enterprise depends to a large extent on the morale of its employees. Employees make valuable contribution to the activities of a business organization. The corporate enterprise should have good and fair employment practices and industrial relations to enhance its productivity. It must recognise the rights of workers or employees to freedom of association and free collective bargaining. Besides, it should not discriminate between various employees.

The most important responsibility of a corporate enterprise towards employees is the payment of fair wages to them and provide healthy and good working conditions. The business enterprises should recognize the need for providing essential labour welfare activities to their employees, especially they should take care of women workers. Besides, the enterprises should make arrangements for proper training and education of the workers to enhance their skills.

However, it may be noted that very few companies in India follow many of the above good practices. While the captains of Indian industries generally complain about low productivity of their employees, little has been done to address their problems. Ajith Nivard Cabraal rightly writes, "It should perhaps be realized that corporations can only be as effective and efficient as its employees and therefore steps should be taken to implement such reforms in a pro-active manner, rather than merely attempting to comply with many labour laws that prevail in the country. This is probably one area where good governance practices could make a significant impact on the country's business environment."

3. Responsibility to Consumers:

Some economists think that consumer is a king who directs the business enterprises to produce goods and services to satisfy his wants. However, in the modern times this may not be strictly true but the companies must acknowledge their responsibilities to protect their interests in undertaking their productive activities.

Invoking the notion of social contract, the management expert Peter Drucker observes, "The customer is the foundation of a business and keeps it in existence. He alone gives employment. To meet the wants and needs of a consumer, the society entrusts wealth-producing resources to the business enterprise". In view of above, the business enterprises should recognize the rights of consumers and understand their needs and wants and produce goods or services accordingly.

The following responsibilities of business enterprises to consumers are worth mentioning:

1. They should supply goods or services to the consumers at reasonable prices and do not try to exploit them by forming cartels. This is more relevant in case of business enterprises producing essential goods such as life-saving drugs, vegetable oil and essential' services such as electricity supply and telephone services.
2. They should not supply to the consumers' shoddy and unsafe products which may do harm to them.
3. They should provide the consumers the required after-sales services.
4. They should not misinform the consumers through inappropriate and misleading advertisements.
5. They should make arrangements for proper distribution system of their products so as to ensure that black-marketing and profiteering by traders do not occur.
6. They should acknowledge the rights of consumers to be heard and take necessary measures to redress their genuine grievances.

Despite the above responsibilities which are generally regarded as good marketing practices by management experts the business enterprises in India generally do not pay heed to them and as a result consumers are dissatisfied or disappointed in a large number of cases. There has been a growing awareness of consumer rights.

The organized movement to protect consumer rights which is termed as consumerism has been the result of the negligence of business enterprises to their responsibilities to consumers. Besides, due to the indifferent attitude of business enterprises to consumer rights, Government has been compelled to enact Consumer Protection Act to protect consumers' rights and to prevent their exploitation by the businesses.

4. Obligation towards the Environment:

The foremost responsibility of business enterprises is to ensure that they should not damage the environment and for this purpose they should reduce as much as possible air and water pollution by their productive activities. They should not dump their toxic waste products in rivers and streams to avoid their pollution. Pollution of environment poses a great health hazard for the people and is a cause of several respiratory and skin diseases.

In economic theory pollution of environment is regarded as social cost that must be minimized. There is now a growing awareness towards reduction in environment pollution. According to the recent findings the climate change is occurring due to greater emission of carbon dioxide and other pollutants.

Therefore, the corporate enterprises should adopt high standards of environmental protection and ensure that they are implemented regardless of enforcement of any environment laws passed by the government. Many countries including India have passed laws to protect the environment but they are not properly and strictly enforced.

Business enterprises in their attempt to maximize profits recklessly and negligently pollute the environment. Therefore, it is required that government should take tough measures and enforce environment laws strictly if environment is to be protected.

5. Responsibility to Society in General:

Business enterprises function by public consent with the basic objective of producing goods and services to meet the needs of the society and provide employment to the people. The traditional view is that in performing this function businesses maximize profits or shareholders' value and doing so they do not behave in any socially irresponsible way.

According to Adam Smith whose invisible hand theorem is often quoted that while maximizing their profits, businessmen are led by an invisible hand to promote the interests of the society. To quote him, “An individual or business generally, indeed neither intends to promote the public interest, nor knows how much he is promoting it…. He intends only his own gains, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention, by pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it”.

In the present world where there are monopolies, oligopolies in product and factor markets and also there are externalities, especially detrimental externalities such as environment pollution by the activities of business enterprises maximization of private profits does not always lead to the maximization of social benefit.

In fact in such imperfect market conditions, consumers are exploited by raising of prices much above the cost of production; workers are exploited as they are not paid fair wages equal to the value of their marginal product. Besides, there are harmful external effects to which are not given due considerations by private enterprises in making their business decisions. Therefore, there is urgent need to make business enterprises behave in a socially responsible manner and to work for promoting social interests.

In view of the above in the context of modern developments, it is hard to agree with Milton Friedman, a winner of Nobel Prize in economics, who called the idea of corporate social responsibility as a “fundamentally subversive doctrine”. Friedman writes, “There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud”.

However, few economists and rational thinkers will subscribe to Friedman’s views like that of Adam Smith. Thus, authors of a noted textbook on management write, “It is true that Friedman sets a rather high standard when he suggests that businesses should operate within the ‘rules of the game’, practicing neither deception nor fraud. The rules of the game obviously include accepted ethical practices, in addition to international, national and other laws. How many corporations are willing to tell the absolute truth in the advertisements and to engage in open and fair competition avoiding collusion, price fixing and so forth. The fact is that few subscribe to Friedman s hard-line views today”. Business enterprises have a lot of responsibility to the society at large.

1. To take appropriate measures to reduce level of pollution and adopt eco-friendly technologies.
2. To generate sufficient employment opportunities so as to make good contribution to the reduction of poverty in the country.
3. Respect the rights of workers and other employees and take appropriate measures to ensure their safety and to improve their working conditions.
4. To provide quality healthcare to their employees.
5. To invest adequately in the research and development so as to make innovations to improve their productivity.
6. Do not pay excessive remuneration to promoters and senior executives as it creates social resentment.
7. To end cartels that keep prices highly
8. To implement affirmative action and to provide jobs to SCs, STs and OBCs and to give preference to minorities, especially Muslims in providing employment.
9. To resist to pay bribes to officials and therefore do not promote corruption. He thus says, “Corruption need not be the grease that oils wheels of progress. There are many successful companies today that have refused to yield to this temptation. Others must follow”.

3.4 Key Terms

Social Responsibility: Social responsibility is an ethical focus for individuals and companies whereby they seek to take action and be accountable for practices that benefit society. Social responsibility has become increasingly important to investors and consumers who seek investments that not only are profitable but also contribute to the welfare of society and the environment.

Social Contract: The social contract of business theory argues that businesses exist with the permission of society, so long as the business acts in ways that benefit society.

Consumers: A consumer is a person or a group who intends to order, or use purchased goods, products, or services primarily for personal, social, family, household and similar needs, who is not directly related to entrepreneurial or business activities

Shareholders: A shareholder is a person, company, or institution that owns at least one share of a company's stock or in a mutual fund. Shareholders essentially own the company, which comes with certain rights and responsibilities.

3.5 Summary

Overall, social responsibility of business is increasingly recognized as a critical component of corporate strategy and reputation management, with growing expectations from stakeholders for businesses to contribute positively to society while achieving sustainable financial performance. Embracing CSR can enhance brand reputation, attract and retain customers and employees, mitigate risks, and create long-term value for shareholders and society as a whole.

3.6 Check your Progress

1. What Is CSR? **What Are the Benefits of CSR?**

3.7 References

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Unit 4 CONSUMERISM

Structure

4.1 Introduction to Consumerism

Consumerism is a concept which says that enhanced consumption of services and goods in the market is always welcomed. Also, an individual's happiness and well being rely predominantly on purchasing consumer goods and services. With respect to economics, consumerism is mostly related to a Keynesian concept which says that consumer spending is a critical factor which majorly impacts the economy and encourages consumers to go on and spend their money as a key policy objective. Hence, from this perspective, consumerism is considered a positive factor which facilitates economic growth.

4.3 Origins and Evolution

Consumerism has deep roots in human history, but its modern incarnation emerged in the wake of the Industrial Revolution. The advent of mass production, advertising, and credit systems fueled a culture of consumption, transforming economies and social norms. Over time, consumerism evolved from fulfilling basic needs to symbolizing status, identity, and even self-worth.

Why Consumerism is Important?

Healthy consumption is a big positive for the economy as it indicates that people are ready to spend; this ensures that there is a circulation of money in the economy. However, if consumption drops, then it indicates underlying problems. It may be due to a high unemployment rate, increased interest rates, and so on. Hence, consumption can be considered an indicator of the overall economic health of a country.

Consumerism views the consumer as the target of economic policy and a cash cow for the business sector with the sole belief that increasing consumption benefits the economy. Saving can even be seen as harmful to the economy because it comes at the expense of immediate consumption spending.

Consumerism also helps shape some business practices. Planned obsolescence of consumer goods can displace competition among producers to make more durable products. Marketing and advertising can become focused on creating consumer demand for new products rather than informing consumers.

4.4 Consumerism in India:

The term 'consumerism' was first coined by businessmen in the mid-1960s as they thought consumer movement as another "ism" like socialism and communism threatening capitalism. Consumerism is defined as social force designed to protect consumer interests in the marketplace by organizing consumer pressures on business. Consumerism is a protest of consumers against unfair business practices and business injustices. It aims to remove those injustices, and eliminate those unfair marketing practices, e.g., misbranding, spurious products, unsafe products, planned obsolescence, adulteration, fictitious pricing, price collusion, deceptive packaging, false and misleading advertisements, defective warranties, hoarding, profiteering, black marketing, short weights and measures, etc." Consumer organizations could provide united and organized efforts to fight against unfair marketing practices and to secure consumer protection. The balance of power in the marketplace usually lies with the seller. Consumerism is society's attempt to redress this imbalance in the exchange transactions between sellers and buyers. Consumerism challenges the very basis of the marketing concept. Can a free market economy based on competition respond to the rightful public demands? Is there an inherent defect in the market mechanism? Should that defect be corrected by political means, i.e., consumer legislation and Government regulations?

According to P. Drucker, consumerism challenges four important premises of the marketing concept- (1) it is assumed that consumers know their needs. (2) It is assumed that business really cares about those needs and knows exactly how to find about them. (3) It is assumed that business does provide useful information that precisely matches product to needs. (4) It is presumed that products and services really fulfill customer expectations as well as business promises.

4.4.1 Drivers of Consumerism

Several factors contribute to the perpetuation of consumerism:

1. Advertising and Marketing: The proliferation of advertising across various media channels influences consumer behavior by creating desires, promoting lifestyles, and shaping cultural norms.
2. Social Influences: Peer pressure, societal expectations, and the desire to fit in drive individuals to engage in conspicuous consumption and keep up with trends.
3. Economic Systems: Capitalist economies rely on consumption for growth, leading to the constant expansion of markets and the production of new goods and services.
4. Technological Advancements: Innovations in technology, such as e-commerce and social media, have facilitated round-the-clock access to goods and information, further stimulating consumption.

4.4.2 Impacts of Consumerism

While consumerism fuels economic growth and innovation, it also generates various consequences:

1. Environmental Degradation: Excessive consumption contributes to resource depletion, pollution, and climate change, posing significant threats to ecosystems and future generations.
2. Financial Strain: The pressure to consume beyond one's means can lead to debt, financial instability, and inequality, exacerbating socio-economic disparities.

3. Psychological Effects: Consumer culture often fosters feelings of inadequacy, anxiety, and dissatisfaction, as individuals chase unattainable ideals of happiness and fulfillment through material possessions.
4. Cultural Homogenization: Globalization and mass consumption can erode cultural diversity, as standardized products and lifestyles dominate markets worldwide.

4.4.3 Challenges and Solutions

Addressing the negative consequences of consumerism requires concerted efforts at various levels:

1. Sustainable Consumption: Promoting awareness of environmental issues and encouraging responsible consumption habits, such as buying durable goods, reducing waste, and supporting ethical brands.
2. Regulatory Measures: Implementing policies to regulate advertising practices, promote transparency in product labeling, and incentivize eco-friendly production methods.
3. Education and Empowerment: Fostering critical thinking skills and media literacy to help individuals resist manipulative marketing tactics and make informed purchasing decisions.
4. Alternative Models: Exploring alternative economic models, such as degrowth and the sharing economy, that prioritize well-being and sustainability over perpetual growth and consumption.

4.4.4 Consumerism covers the following areas of consumer dissatisfaction and remedial efforts:

(1) Removal or reduction of discontent and dissatisfaction generated in the exchange relationships between buyers and sellers in the market. The marketing activities of the selling firms must ensure consumer satisfaction which is the core of marketing concept. Marketing practices and policies are the main targets of consumerism.

(2) Consumerism is interested in protecting consumers from any organization with which there is an exchange relationship. Hence, consumer dissonance (post-purchase anxiety and doubt) and remedial effort can develop from consumers' relations not only with profit-seeking organizations but also with non-profit organizations, e.g., hospitals, schools, Government agencies, etc.

(3) Modern consumerism also takes keen interest in environmental matters affecting the quality of life.

Consumerism is the public demand both for refinement in marketing practices to make them more informative, more responsive, more sincere, more truthful and more efficient, and for a new concern with factors other than privately-consumed goods and services that determine the quality of life.

Often, the new growing interest for the good life translates itself into demand for more public goods and services such as better highways, more education, better airports, better transport, crime-free cities and better environmental conditions, conservation of natural resources and elimination of environmental pollution and so on. Thus, consumerism represents vital aspects of socially responsible marketing.

4.5 Key Terms

Warranties: Traditionally**,** warranties are factual promises which are enforced through a contract legal action, regardless of materiality, intent, or reliance.

Consumerism: Consumerism is a social and economic order in which the goals of many individuals include the acquisition of goods and services beyond those that are necessary for survival or for traditional displays of status.

Consumption: Consumption is the act of using resources to satisfy current needs and wants. It is seen in contrast to investing, which is spending for acquisition of future income.

Hoarding: Hoarding in economics refers to the concept of purchasing and storing a large amount of product belonging to a particular market, creating scarcity of that product, and ultimately driving the price of that product up**.**

Profiteering: The act or practice of seeking exorbitant profits, especially through the sale of scarce or rationed goods

Black marketing: A black market is any market where the exchange of goods and services takes place in order to facilitate the transaction of illegal goods or to avoid government oversight and taxes, or both.

Short weights: Weight less than the stated weight or less than one is charged for.

4.6 Summary

Consumerism is a complex and pervasive force that shapes our societies and individual lives in profound ways. While it offers opportunities for economic prosperity and personal fulfillment, its unchecked pursuit can lead to environmental degradation, financial instability, and social inequality. By fostering a culture of mindful consumption, promoting sustainable practices, and reimagining our relationship with material possessions, we can strive towards a more balanced and equitable future for all.

4.7 Check your Progress

1. **What is Consumerism? Explain how consumerism is an economic opportunity?**

4.8 References

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Unit 5. Economic Roles of Government

Structure

5.1 Introduction

The role of government in the economy is multifaceted, encompassing a wide range of responsibilities aimed at promoting economic stability, growth, and welfare. This chapter delves into the various economic roles that governments undertake, examining their significance, challenges, and impacts on societies.

5.2 Learning Objectives

- Appreciate the need and rationale of economic roles of the Government plays to develop business, reduce unemployment, empower citizens etc.

5.3 ECONOMIC ROLES OF GOVERNMENT: Government is the supreme authority of any nation. As the representation of the public, government regulates the social and business organization to attain national objective. Business operation and development is achieved within the framework of government policies and regulation. In short, every aspect of business is under government influence.

Government controls the business to protect the public interest as the guardian of the public or consumers, supports the business to develop those as a property or organization, regulates those to give proper direction with long term goals and planned vision. Agencies of the government are established from the grassroots level to the center. Government's policies affect the business activities like acquiring finance to invest, procuring goods and services, producing goods and services, and selling those. Government's Roles are usually:

- **Regulatory role**: Government regulatory the business operation through tax laws. Income tax, Sales tax, value Added tax. Customer tax, Excise tax, Import and Export tax, etc., are regulatory measures of the government. Government's regulatory functions with regard to trade, business and industry aim at laying down the limits for the private enterprise. The regulatory functions of the Government include (i) restraints on private activities, (ii) control of monopoly and big business, (iii) development of public enterprises as an alternative to private enterprises to ensure competitive dualism, (iv) maintenance of a proper socio--economic infrastructure.
- **Customer-patterned**: Government is an important buyer of the business products. Government has different departments and organization. Government buys product for the departments. Thus Government is an important buyer.
- **Patronizing role**: Government is a patron of the business. Government Provides funds to the business and buys product for its uses in the departments and to public for relief and assistances. Government purchases rice and wheat in the

harvesting seasons and distributes those as cheap-price corals to the public in crisis of the goods as Food for Work or controlled price goods, or on open marker sale.

- **Direction-Oriented role**: Government policies provide direction to the business. Fiscal policy, Export and Import policy, Industrial policy,. etc. Provides direction toward which business directs their activities.
- **Promoter of Business:** The promotional role of the government in relation to industries can be seen as providing finance to industry, in granting various incentives and in creating infrastructure facilities for industrial growth and investment. For example, our government has identified certain backward areas as 'No Industry Districts'. To promote development of such areas, Government provides subsidies and tax holiday to attract investment in backward areas. In this way the government will help the process of balanced development and thereby remove regional disparities. The government is assisting the development of small scale industries. The District Industrial Centers are assisting the development of small industries. The government is actively helping the industrial development of the country by providing finance to them through the development banks.
- **Government as an Entrepreneur:** The impressive growth of the public sector in India from a small beginning bears testimony to the role of the government as an entrepreneur. Private investors are solely guided by private profit motive and hence they are not interested in developing products of common public use and social services which yield relatively lower returns. But as a "social entrepreneur" the government does not hesitate to take them up.
- **Government as the Planner:** In its role as a planner, the government indicates various priorities in the Five Year Plans and also the sectoral allocation of resources. Mixed economies are democratically planned economies. The government tries to manage the economy and its business activities through the exercise of planning. Planning is the most important activity in a modern mixed economy. The idea of economic planning can be traced to three different sources: Rationalism, Socialism and Nationalism. Economists advocate a

planned economy on the ground that it can be a rational economy which can utilize the available resources in an optimal manner. In other words, the planned economy is a rational economy which attempts to secure the maximum return with minimum wastage of productive resources.

5.4 Key Terms

Patronizing Role: Governments are meant to guide and direct the pace of economic activity in the country. It also needs to ensure stable growth, high employment, and price stability. Additionally, governments need to adjust tax rates and spending so that economic growth can either accelerate or slow down.

5.5 Check your Progress

1. What is the role of government in the development of nation?

5.6 References

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Unit 6. Industrial Policy: Fiscal & Industrial

Structure

6.1 Introduction to Industrial Policy: Fiscal & Industrial

Industrial policy represents a strategic framework for guiding economic development and structural transformation in modern economies. By leveraging fiscal instruments, sectoral strategies, and innovation initiatives, governments seek to create an enabling environment for industrial growth, innovation, and job creation. As economies evolve in an era of globalization, digitalization, and environmental challenges, industrial policy remains a dynamic tool for shaping the future of industries and ensuring inclusive and sustainable development.

6.2 Learning Objectives

The key components and objectives of industrial policy, focusing on both fiscal and industrial aspects are:

Fiscal Policy in Industrial Development

Fiscal policy plays a crucial role in indutrial development by shaping the overall economic environment and providing targeted support to strategic industries. Governments use various fiscal instruments to incentivize investment, research and development (R&D), and innovation, thereby fostering industrial competitiveness and upgrading.

Tax Incentives: Governments may offer tax breaks, credits, or exemptions to encourage investment in specific industries or regions. These incentives can stimulate capital formation, attract foreign direct investment (FDI), and spur technological advancements.

Subsidies and Grants: Direct financial assistance in the form of subsidies, grants, or loans can support industries facing market failures, high entry barriers, or significant externalities. Subsidies for R&D, training programs, or infrastructure development aim to enhance industry capabilities and competitiveness.

Public Procurement: Government procurement policies can leverage public spending to create demand for domestically produced goods and services, promote innovation, and support local industries. Preferences for domestically sourced products or green technologies can stimulate domestic production and supply chains.

Trade Policies: Tariffs, quotas, and trade agreements influence industrial competitiveness and market access by protecting domestic industries from foreign competition or facilitating export-oriented growth. Trade policies are often integrated with industrial strategies to balance domestic priorities with global market dynamics.

Industrial Policy Instruments

In addition to fiscal measures, industrial policy encompasses a range of interventions aimed at nurturing specific industries and fostering technological progress:

Sectoral Strategies: Governments identify and prioritize key sectors or industries with growth potential, based on comparative advantages, technological capabilities, and market opportunities. Sectoral strategies may involve targeted investments, regulatory reforms, and public-private partnerships to drive development.

Innovation and Technology Policy: Policies to promote innovation and technology adoption are integral to industrial competitiveness. Governments support R&D activities, technology transfer, and intellectual property rights protection to spur innovation ecosystems and enhance industry resilience.

Skills Development: Human capital development is essential for industrial transformation and productivity growth. Governments invest in education, vocational training, and workforce development programs to equip workers with the skills needed for emerging industries and technological advancements.

Infrastructure Investment: Adequate infrastructure, including transportation, energy, and digital networks, underpins industrial competitiveness and connectivity. Governments prioritize infrastructure investments to reduce logistics costs, improve connectivity, and facilitate business operations.

Environmental Sustainability: Industrial policies increasingly focus on promoting sustainable practices and mitigating environmental impacts. Governments implement regulations, incentives, and standards to encourage eco-friendly technologies, resource efficiency, and green industrial practices.

6.3 Fiscal policy:

The success of the economy is commonly measured by a few factors including GDP. Another factor is aggregate demand, which is the sum of goods and services produced by a nation purchased at a certain price point. The aggregate demand curve dictates that at lower price levels, more goods and services are demanded, while there is less demand at higher price points.

Fiscal policy affects these measurements, with the goal to increase GDP and aggregate demand in a sustainable manner. This happens by changing three factors:

. **Business tax policy:** Taxes that businesses pay to the government affects profits and the amount of investment. Lowering taxes increases aggregate demand and business investment spending.

- **Government spending:** Aggregate demand is increased by the government's own spending.
- **Individual taxes:** Taxes on individuals, such as income tax, affects their personal income and how much they can spend, injecting more money back into the economy.

Fiscal policy typically needs to be changed when an economy is running low on aggregate demand and unemployment levels are high.

Fiscal policy is based on the theories of British economist John Maynard Keynes, which hold that increasing or decreasing revenue (taxes) and expenditures (spending) levels influence inflation, employment, and the flow of money through the economic system. Fiscal policy is paramount to successful economic management since taxes, spending, inflation and employment all factor into gross domestic product (GDP). This figure details the value of goods and services produced by a nation within a year.

The two main tools of fiscal policy are taxes and spending. Taxes influence the economy by determining how much money the government has to spend in certain areas and how much money individuals should spend. For example, if the government is trying to spur spending among consumers, it can decrease taxes. A cut in taxes provides families with extra money, which the government hopes will, in turn, be spent on goods and services, thus spurring the economy as a whole.

Spending is used as a tool for fiscal policy to drive government money to certain sectors needing an economic boost. Whoever receives those dollars will have extra money to spend – and, as with taxes, the government hopes that money will be spent on other goods and services.

The key is finding the right balance and making sure the economy doesn't lean too far either way.

Types of fiscal policy

There are two main types of fiscal policy: expansionary and contractionary.

Expansionary fiscal policy

Expansionary fiscal policy, designed to stimulate the economy, is most often used during a recession, times of high unemployment or other low periods of the business cycle. It entails the government spending more money, lowering taxes or both. The goal of expansionary fiscal policy is to put more money in the hands of consumers so they spend more and stimulate the economy. Explained in economic language, the goal of expansionary fiscal policy is to bolster aggregate demand in cases when private demand has decreased.

Contractionary fiscal policy

Contractionary fiscal policy is used to slow economic growth, such as when inflation is growing too rapidly. The opposite of expansionary fiscal policy, contractionary fiscal policy raises taxes and cuts spending. As consumers pay more taxes, they have less money to spend, and economic stimulation and growth slow. Under contractionary fiscal policies, the economy usually grows by no more than 3% per year. Above this growth rate, negative economic consequences such as inflation, asset bubbles, increased unemployment and even recessions may occur.

How fiscal policy affects business

Businesses directly see the effects of an economy's fiscal policy, whether it's in the form of spending or taxation. Fiscal policy can have the four following effects on business:

1. Investment opportunities

Businesses can see investment opportunities from government spending as well as private investment. This commonly happens during an expansionary policy, when more money is flowing into the economy from the government and from other sources since taxation is also low. When a balance between price and demand are met, then businesses can expect to thrive and grow.

2. Slower growth

A contractionary financial policy may kick in to prevent inflation when that balance is broken and demand (and prices) falls. Businesses typically rein in their growth due to rising taxes and take measures to stay in the black with less money flowing through the economy.

3. Taxation changes

Depending on their location, businesses face several levels of taxation, including local, state and federal. Businesses must contend with how their state and local government taxes them and how it interweaves with federal fiscal policy.

4. Unemployment rates

A major objective of fiscal policy is to minimize unemployment. For example, the government can lower taxes to put more money back in consumers' pockets. As such, people may be able to spend more money, and companies may face increased demand. With increased demand may come additional production tasks for companies to complete, and businesses can respond by creating more jobs and hiring more employees. As such, with proper fiscal policy in place, a low unemployment rate may gradually increase.

6.4 Monetary policy:

Monetary policy is an economic policy that manages the size and growth rate of the money supply in an economy. It is a powerful tool to regulate macroeconomic variables such as inflation and unemployment. These policies are implemented through different tools, including the adjustment of the interest rates, purchase or sale of government securities, and changing the amount of cash circulating in the economy. The central bank or a similar regulatory organization is responsible for formulating these policies.

6.3.1 Objectives of Monetary Policy

The primary objectives of monetary policies are the management of inflation or unemployment and maintenance of currency exchange rates.

1. **Inflation**

Monetary policies can target inflation levels. A low level of inflation is considered to be healthy for the economy. If inflation is high, a contractionary policy can address this issue.

2. Unemployment

Monetary policies can influence the level of unemployment in the economy. For example, an expansionary monetary policy generally decreases unemployment because the higher money supply stimulates business activities that lead to the expansion of the job market.

3. Currency exchange rates

Using its fiscal authority, a central bank can regulate the exchange rates between domestic and foreign currencies. For example, the central bank may increase the money supply by issuing more currency. In such a case, the domestic currency becomes cheaper relative to its foreign counterparts.

Depending on its objectives, monetary policies can be expansionary or contractionary.

Expansionary Monetary Policy

This is a monetary policy that aims to increase the money supply in the economy by decreasing interest rates, purchasing government securities by central banks, and lowering the reserve requirements for banks. An expansionary policy lowers unemployment and stimulates business activities and consumer spending. The overall goal of the expansionary monetary policy is to fuel economic growth. However, it can also possibly lead to higher inflation.

Contractionary Monetary Policy

The goal of a contractionary monetary policy is to decrease the money supply in the economy. It can be achieved by raising interest rates, selling government bonds, and increasing the reserve requirements for banks. The contractionary policy is utilized when the government wants to control inflation levels.

Tools of Monetary Policy

In India, RBI, being the central bank, adopts monetary policy, in order to control the credit situation, on the face of business fluctuations. These credit control measures are of two types:

a) Quantitative or general controls

b) Qualitative or selective controls

Quantitative or general controls include Bank rate variations, open market operations and varying reservations. They aim at regulating the overall level of credit in the economy through the commercial banks.

Bank Rate: It's the minimum lending rate at which the central bank discounts bills and securities held by commercial banks. By raising the bank rate, central bank make borrowing costlier, consequently commercial banks borrow less from the central bank. On the other hand commercial banks raise their lending rate. It reduces the money supply in the economy. Reduction in money supply reduces demand for goods and services in the economy, resulting in the check on price rise. On the other hand, by lowering the bank rate, the RBI can make borrowing by commercial banks cheaper. Commercial banks in turn would lower their lending rate, resulting in greater demand for credit. This would encourage investment, output, employment, income and demand. Consequently, prices would start rising.

Open Market Operations: It refers to the sale and purchase of securities by the central bank. When the central bank aims to control inflation, it sells securities in the open market, thereby reducing reserves of commercial banks. This reduces credit in the market. The reduction in money supply helps in checking price rise. Similarly in recessionary conditions, the central bank should buy securities thereby raising money supply in the economy, whose impact would be an increasing in investment, output, income, employment and prices

Varying Reserve Ratios: Changes in reserve ratio can help combat inflation and recession. The portion of deposits which a commercial bank has statutorily to keep with the central bank as deposit is called the reserve funds. In order to reduce credit by the commercial banks many a time the central bank increases the percentage of such deposits. Increase in reserve ratio reduces the bank advance, thereby reducing demand for goods and services, and checks price rise during recession, lowering reserve ratio would lower reserves of commercial banks which would encourage greater lending, thus revising economic activity.

Selective credit controls are used to encourage or discourage specific types of credit for particulars purposes. In order to check the speculative activity in the economy, the central bank changes the margin requirements to be charged by the commercial banks on those activities. When recession is in some specific sectors of economy the central bank can use some selective credit control measures particularly lowering margin requirements which would help in encouraging greater business activity.

How Does Monetary Policy Affect Economic Growth?

The central bank tries to maintain price stability through controlling the level of money supply. Thus, monetary policy plays a stabilizing role in influencing economic growth through a number of channels. However, the scope of such a role may be limited by the concurrent pursuit of other primary objectives of monetary policy, the nature of monetary policy transmission mechanism, and by other factors, including the uncertainty facing policy makers and the stance of economic policies. In addition, the concurrent target of intermediate goals may have implications on the attainment of the ultimate objective of achieving sustainable growth.

The contribution that monetary policy makes to sustainable growth is the maintenance of price stability. Since sustained increase in price levels is adjudged substantially to be a monetary phenomenon, monetary policy uses its tools to effectively check money supply with a view to maintaining price stability in the medium to long term. Theory and empirical evidence in the literature suggest that sustainable long term growth is associated with lower price levels. In other words, high inflation is damaging to long-run economic performance and welfare. Monetary policy has far reaching impact on financing conditions in the economy, not just the costs, but also the availability of credit, banks' willingness to assume specific risks, etc. It also influences expectations about the future direction of economic activity and inflation, thus affecting the prices of goods, asset prices, exchange rates as well as consumption and investment.

A monetary policy decision that cuts interest rate, for example, lowers the cost of borrowing, resulting in higher investment activity and the purchase of consumer durables. The expectation that economic activity will strengthen may also prompt banks to ease lending policy, which in turn enables business and households to boost spending. In a low interest-rate regime, stocks become more attractive to buy, raising households' financial assets. This may also contribute to higher consumer spending, and makes companies' investment projects more attractive. Low interest rates also tend to cause currency to depreciate because the demand for domestic goods rises when imported goods become more expensive. The combination of these factors raises output and employment as well as investment and consumer spending.

6.5 INDUSTRIAL POLICY:

Industrial policy is a document that sets the tone in implementing, promoting the regulatory roles of the government. It was an effort to expand the industrialization and uplift the economy to its deserved heights. It signified the involvement of the Indian government in the development of the industrial sector. With the introduction of new economic policies, the main aim of the government was to free the Indian industry from the chains of licensing. The regulatory roles of the Indian government refer to the policies towards industries, their establishments, their functioning, their expansion, their growth as well as their management.

The industrial growth of a country is guided and regulated through its industrial policies. Let's understand the journey of various industrial policies.

1) **Industrial Policy of 1948**

   The first industrial policy after independence was announced on 6th April 1948. It was presented by Dr. Shyama Prasad Mukherjee then Industry Minister. The main goal of this policy was to accelerate the industrial development by introducing a mixed economy where the private and public sector was accepted as important in the development of the economy. It saw the Indian economy in socialistic patterns. The large industries were classified into four categories:

Industries with exclusive State Monopoly/Strategic industries: It included industries engaged in the activity of atomic energy, railways and arms, and ammunition.

- **Industries with Government control:** This category included industries of national importance. 18 such categories were mentioned in this category such as fertilizers, heavy machinery, defense equipment, heavy chemicals, etc.
- **Industries with Mixed sector:** This category included industries that were allowed to operate independently in the private or public sector. The government was allowed to review the situation to acquire any existing private undertaking.
- **. Industry in the Private sector:** Industries which were not mentioned in the above categories fall into this category. High importance was granted to small businesses and small industries, leading to the utilization of local resources and creating employment.

II. Industrial Policy Resolution, 1956

This second industrial policy was announced on April 20, 1956, which replaced the policy of 1948. The features of this policy were:

- A new classification of Industries.
- Non-discriminatory and fair treatment for the private sector.
- Promotion of village and small-scale industries.
- To achieve development by removing regional disparity.
- Labour welfare.

The IP1956 divided industries into three categories:

.Schedule A industries: The industries that were under the monopoly of the state or government. It included 7 industries. The private sector was also introduced in these industries if national interest required.

- **Schedule B industries:** In this category of industries, the state was allowed to establish new units but the private sector was not denied to set up or expand existing units' e.g. chemical industries, fertilizer, synthetic, rubber, aluminum, etc.
- **Schedule C industries:** So the industries that were not a part of the above-mentioned industries then it formed a part of Schedule C industries.

To summarize, the policy of 1956 in which the state was given a primary role for industrial development as capital was scarce and business was not strong.

III. Industrial Policy Statement, 1973

Industrial Policy Statement of 1973 identified high priority industries with investment from large industrial houses and foreign companies were permitted. Large industries were permitted to start operations in rural and backward areas with a view to developing those areas and enabling the growth of small industries around. And so the basic features of Industrial Policy Statement were:

- The policy was directed towards removing the distortions, it provided for closer interaction between agriculture and industrial sector.
- Priority was given towards generation and transmission of power.
- The list of industries reserved for the small-scale sector was expanded.
- Special legislation was made to protect cottage and household industries were introduced.

IV. Industrial Policy Statement 1977

Industrial Policy Statement was announced by George Fernandez then the union industry minister of the parliament. The highlights of this policy are:

A] Target on the development of small-scale and cottage industries.

- Household and cottage industries for self-employment.
- Tiny sector investment up to 1 lakhs.
- Small-scale industries for investment up to 1-15 lakhs.

B] Large-scale sector

- *Basic industries:* infrastructure and development of small-scale and village industries.
- *Capital goods industries:* meeting the requirement of cottage industries.
- *High technological industries:* development of agriculture and small-scale industries such as petrochemicals, fertilizers and pesticides.

C] Restrict the control of big business houses.

D] Role of the public sector:

- Development of ancillary industries.
- To make available expertise in technology and management in small and cottage industries.

E] Revival and rehabilitation of sick units.

V. Industrial Policy, 1980

The Congress government announced this policy on July 23rd, 1980. The features of this policy are:

- Promotion of balanced growth.
- Extension and simplification of automatic expansion.
- Taking over industrial sick units.

Regulation and control of unauthorized excess production capabilities installed for industrial houses.

- Redefining the role of small-scale units.
- Improving the performance of the public sector.

VI. New Industrial Policy, 1991

The features of NIP, 1991 are as follows:

- Public sector de-reservation and privatization of the public sector through disinvestment.
- Industrial licensing.
- Amendments to Monopolies and Restrictive Trade Practices (MRTP) Act, 1969.
- Liberalized Foreign Investment Policy.
- Foreign Technology Agreements (FTA).
- Dilution of protection to SSI and emphasis on competitiveness enhancement.

The all-around changes introduced in the industrial policy framework have given a new direction to the future industrialization of the country. There are encouraging trends on diverse fronts. Industrial growth was 1.7 percent in 1991-92 that has increased to 9.2 percent in 2007-08. The industrial structure is much more balanced. The impact of industrial reforms is reflected in multiple increases in investment envisaged, both domestic and foreign.

Need, Objectives and Importance of Industrial Policy

The need, objectives and importance of an industrial policy can be explained through following points:

Deployment of Natural Resources

The industrial policy helps in full deployment of natural resources of the country. It helps in identifying, collecting and using resources properly. It facilitates increase in national income of the country.

To Augment Industrial Production

The main objective of the industrial policy is to augment industrial production of the country. It provides an impetus to rapid development of industries and industrial growth.

Modernization

The industrial policy encourages modernization for increasing industrial output and productivity. It envisages the use of modem and latest production techniques m industrial sector. It facilitates maximum output at minimum cost of production.

Balanced Industrial Development

The industrial policy envisages balanced industrial development of the country. It also facilitates balanced development of various sectors of the economy.

Balanced Regional Development

The industrial policy helps in balanced regional development of the country. The industrial policy may contain provisions regarding providing facilities or concessions for rapid development of industrially backward areas/regions of the country.

Coordination between Basic and Consumer Industries

The balanced development of basic and consumer industries is essential for economic growth. The industrial policy encourages development of basic and key industries on the one hand, while attention is paid to the development of consumer industries also on the other. Thus, by balanced and coordinated development of both type of industries it provides a pace to economic growth.

Coordination between Small Scale and Large Scale Industries

The industrial policy plays a vital role in coordinated development of small scale or cottage industries and large scale industries. These industries can be made mutually helpful to each other through the provisions of industrial policy.

Area Determination

The industrial policy determines the area of operation under public and private sector. Proper direction can be shown to private sector through the country’s industrial policy.

Cordial Industrial Relations

A comprehensive industrial policy is needed to establish cordial relations between workers and management. Cordial industrial relations are essential for rapid and sustainable industrialization.

Proper Utilization of Foreign Assistance/investment

An appropriate industrial policy envisages to attract foreign capital and entrepreneurs. It helps rapid industrial development of the country; A well thought of industrial policy checks the demerits of “foreign assistance. The foreign aid can be used in the national interest if an appropriate industrial policy is pursued by the country.

6.6 Key Terms

Fiscal Policy: In economics, fiscal policy is the use of government revenue collection and expenditure to influence a country's economy.

Monetary Policy: Monetary policy is the policy adopted by the monetary authority of a nation to affect monetary and other financial conditions to accomplish broader objectives like high employment and price stability.

6.7 Summary

In conclusion, industrial policy both fiscal as well as monetary policies of government represents a strategic framework for guiding economic development and structural transformation. By combining fiscal incentives with targeted industrial interventions, governments aim to drive industrial growth, innovation, and sustainable development, thereby shaping the future of industries and ensuring inclusive prosperity.

6.8 Check your Progress

1. Explain Industrial Policy in the development of a country.

2. What is fiscal policy? Explain in brief.

3. What is monetary policy? Explain in brief.

6.9 References

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Unit 7. Privatization

Structure

7.1 What is 'Privatization?'

It implies shedding of the ownership or management of a government owned enterprise. Government companies are converted into private companies in two ways (i) by withdrawal of the government from ownership and management of public sector companies and or (ii) by outright sale of public sector companies.

Definition: The transfer of ownership, property or business from the government to the private sector is termed privatization. The government ceases to be the owner of the entity or business.

The process in which a publicly-traded company is taken over by a few people is also called privatization. The stock of the company is no longer traded in the stock market and the general public is barred from holding stake in such a company. The company gives up the name 'limited' and starts using 'private limited' in its last name.

Privatization is considered to bring more efficiency and objectivity to the company, something that a government company is not concerned about. India went for privatization in the historic reforms budget of 1991, also known as 'New Economic Policy or LPG policy'.

7.2 Learning Objectives

Some general learning objectives that could be tailored to fit specific courses or programs:

1. Understanding the Concept of Privatization: Define privatization and differentiate it from other forms of economic organization, such as nationalization and public-private partnerships.

2. Historical Perspectives: Explore the history of privatization, including key milestones, motivations, and trends across different countries and sectors.
3. Economic Theory and Rationale: Examine the economic theories behind privatization, including the role of market competition, efficiency gains, and the allocation of resources.
4. Impact Assessment: Evaluate the impacts of privatization on various stakeholders, including consumers, employees, government, and society at large. Assess both positive and negative effects, such as changes in service quality, prices, employment, and income distribution.
5. Policy Analysis and Design: Analyze the policy frameworks and institutional mechanisms used to implement privatization, including regulatory frameworks, legal frameworks, and governance structures.
6. Case Studies: Explore case studies of privatization initiatives in different sectors (e.g., utilities, transportation, healthcare) and regions, examining the context, objectives, implementation strategies, and outcomes.
7. Ethical and Social Considerations: Consider the ethical and social implications of privatization, including issues related to equity, access to essential services, accountability, and democratic governance.
8. Comparative Analysis: Compare and contrast different approaches to privatization adopted by various countries, regions, or municipalities, identifying best practices, lessons learned, and potential pitfalls.
9. Risk Management: Assess the risks associated with privatization, such as regulatory capture, market monopolization, service disruptions, and adverse social impacts, and explore strategies to mitigate these risks.
10. Future Trends and Challenges: Anticipate future trends in privatization, including emerging sectors, technological advancements, and evolving regulatory landscapes, and discuss the challenges and opportunities they present.

These learning objectives provide a comprehensive framework for studying privatization, encompassing economic, social, political, and ethical dimensions. They can be tailored and expanded upon to suit the specific focus and objectives of a particular course or educational program.

7.3 Objectives of privatization

Above all, the main objectives are-

- To increase the inflow of foreign direct investment to India.
- It improves the financial strength of the company.
- To improve the efficiency of Public Sector Undertaking by giving them power to make decision.
- Finally, promotes government dynamism by reducing government interference.

The methods of privatization of companies are-

1. **Transfer of ownership**

Firstly, under this method, the public sector transfers the ownership, management and control of the entity to the private sector.

2. **Disinvestment**

Secondly, it is the process of withdrawing government investment from the PSUs and sells it to the public.

3. **Public auction**

Further, this method facilitates sale of share of public company or long term assets to raise highest amount for government owned property.

4. **Sales of shares**

Additionally, this method facilitates sale of shares of PSUs through stock exchanges.

5**. Direct negotiations**

Moreover, under this method, the government directly deals with specific private bodies for the privation of PSUs.

6. Lease with a right to purchase: Finally, private company is assumes possession and usage of a state run company. The private company to exercise the option to convert the lease of a property to ownership.

7.4 Conceptualization of privatization in India

Concepts related to privatization in India are-

1. Delegation:

Firstly, the government keeps the ownership and the responsibility of an enterprise. The company will handle the daily activities and deliver the product or service.

2. **Divestment:**

Secondly, the government will sell a majority stake of the enterprise to one or more private companies. It may keep minority ownership.

3. **Displacement:**

However, the first step here will be deregulation; this will allow private players to enter the market. Here the private sector will compete with public companies and ultimately outperform them, causing the public enterprise to be displaced.

4. **Disinvestment**:

Further, directly selling a portion or whole of a public enterprise to private parties.

2.5.2 Advantages and Disadvantages of privatization

Advantages:

- **Improvement in performances**

Private companies work for profits and not to influence people. So, they turn out to be more efficient and work on putting an end to the unnecessary elements. For example, red tape and bureaucracy. Furthermore, employment in private companies is dependent on performance. People who perform well are provided with an incentive or an increment that boosts the performance.

- **Better Service**

Since private companies work for profits, they tend to function better than anybody to come up in the competitive market. Their focus lies on the customer's satisfaction. This motivation does not exist in a government company as they need not worry about competition.

- **Management Development**

Privatization aids in improving the management of a company. This is because, when there is a good or a bad happening in a company, the managers turn out to be accountable. They are responsible and answerable to the owners of the company. Automatically they turn out to be cautious about everything that they do and also about what people under them do.

- **Less Political Intervention**

When the political intervention is driven away, people start working for the betterment of the public. Also as the major decision-making is transferred, the company moves freely and efficiently towards the growth of the economy.

- **Multiplication of Investments**

Privatization is the reason behind the multiplication of investments. This happens through the stock exchange when the owner and the investor gain confidence about their own company. So, this is also a great step towards a good economical impact.

- **Tax Reductions and Job Opportunities**

By privatizing the public sector, the government can pay attention to the reduction of taxes from the residents. Also, through privatizing certain services like prisons, a lot of job opportunities are created.

Disadvantages:

- **Less Transparency**

The fact is private companies are very much less transparent when compared to the government. This paves a pathway for bribery and corruption.

- **Inflexibility**

When there is a contract signed by the government for a particular number of years, the people are locked with the same company for those years whether they like it or not. The contract cannot be withdrawn in a middle way.

- **Higher costs to consumers**

When a sector is privatized and transferred to the wrong company, there are chances that they increase costs that will affect the consumers. *For example, the water supply costs 22% extra when bought from a private company.*

- **Employment Problems**

While privatizing the public sector, there are chances that a person loses their government job or they tend to work with the private firm for a lesser salary amount.

TRENDS AND ISSUES OF PRIVATIZATION IN INDIA:

Privatization in India is undergoing a transformation, and there are many issues to consider. Since 1991, there has been a significant shift in the public's perception of the role of the public sector in the Indian economic system. A number of economists have argued that the financial crisis of 1991 was caused by the inefficiency and ineffectiveness of public sector enterprises.

1 Poor project performance, a lack of continuous technological upgradation, insufficient attention paid to research and development, and a low rate of return on capital investment were all serious issues confronting public sector enterprises in the last few decades. Therefore, rather than serving as an asset to the government, public sector enterprises have become a source of frustration for the government. Therefore, the new industrial policy of 1991 called for the privatisation of publicly owned enterprises. When it came to achieving privatisation, the government chose the route of disinvestment, which involves the sale of public sector equity to the private sector and the general public as a whole. In India, since

7.5 Key Terms

Privatization: Privatization can mean several different things, most commonly referring to moving something from the public sector into the private sector. It is also sometimes used as a synonym for deregulation when a heavily regulated private company or industry becomes less regulated

7.6 Summary

Privatization involves the transfer of ownership, control, or provision of goods, services, or assets from the public sector (government) to the private sector (private individuals or entities). It aims to improve efficiency, innovation, and economic growth by introducing competition, reducing government intervention, and increasing market responsiveness. However, privatization can also raise concerns about equity, access to essential services, and accountability. Its impacts vary depending on factors such as sector, context, and implementation strategy. Successful privatization requires careful planning, regulatory frameworks, and consideration of social, economic, and ethical implications.

7.7 Check your Progress

1. What is privatization? Explain its advantages and disadvantages.
2. Write a brief summary of privatization in India?

7.8 References

- Sathye, M. (2005). Privatization, performance, and efficiency: A study of Indian banks. *Vikalpa*, *30*(1), 7-16.

Ch 8 Industrial Sickness

Structure

8.1 INDUSTRIAL SICKNESS:

What is Industrial Sickness? Industrial sickness can be defined as a steady imbalance in the debt-equity ratio and distortion in the financial position of the unit. A sick unit is one which is unable to support itself through the operation of internal resources. Once the sick units continue to operate below the break-even point (at which total revenue = total cost), industries are forced to depend on the external sources for funds of their long-term survival. According to the criteria accepted by the Reserve Bank of India, "a sick unit is one which has reported cash loss for the year of its operation and in the judgment of the financing bank is likely to incur cash loss for the current year as also in the following year.

The sick industrial companies (special provision) act 1985, defined sickness in terms of "cash losses for two consecutive financial years and accumulated loses equaling or exceeding the net worth of the company at the end of the second financial year".

The definition of sick small scale industry has been modified as, "A small scale, industrial unit should be considered as sick if it has, at the end of any accounting year, accumulated losses equal to or exceeding 50 percent of its peak – net Worth in „the immediately preceding five accounting years"

An industrial unit will be termed as "weak," if at the end of any accounting year it has:

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

(ii) A current ratio of less than 1:1,

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

8.3 Nature, Causes and Symptoms of Sickness:

Nature:

Sickness in industry can be classified into:

(a) Genuine sickness which is beyond the control of the promoters of the concern despite the sincere efforts by them,

(b) Incipient sickness due to basic non-viability of the project, and

(c) Induced sickness which is due to the managerial incompetence and wrong policies pursued deliberately for want of genuine stake.

This is a man-made sickness in which some unscrupulous promoters adopt fraudulent practices to start a concern and to get away with the money obtained by fraud and deceit.

8.4 Causes of Industrial Sickness:

The reasons for industrial sickness in India can be divided into two categories:

1. **Internal causes** – which includes
    - Faults at the initial levels of planning and construction.
    - Financial constraints.
    - Labour and management problems.
    - Defective, inefficient, and age-old machinery.
    - Incompetence on the parts of entrepreneurs.
    - Unskilled laborers to work with modern technology.
2. **External causes** are those which are beyond the control of its management and include –
    - Sudden changes in government policies.
    - Erratic supply of inputs.
    - Non-availability of energy resources and raw materials.
    - Increased competition.
    - Power cuts.
    - Demand and credit restraints.
    - Delay on the part of the Government in sanctioning licenses, permits, etc.

As suitable remedies for the sick industries, the government provides liberal policies, financial assistance from banks and other institutes, exemption from taxes, etc.

The important signals of sickness are:

1. Decline in capacity utilization
2. Irregularity in maintaining bank account
3. Non-submission of the data to bank financial institutions
4. Inventories in excessive quantities
5. Frequent break down in plant/equipments
6. Decline in technical deficiency
7. Decline in the quality of the products/services
8. Shortage of liquid funds for short-term financial obligations
9. Default in the payment of statutory dues
10. Frequent turnover of personnel in the industries.

Some of the important symptoms of Sickness are:

1. Deteriorating financial ratio
2. Delay in the audit of annual account
3. Persisting shortage of cash flow
4. Continuous tumble in the price of the shares
5. Delay in the payment of statutory dues
6. Widespread use of creative accounting
7. Frequent request for loans
8. Morale degradation of the employees
9. Desperation amongst the top and middle managerial level.

2.6.2 The main consequences of enterprises sickness are:

1. Emergence of industrial unrest
2. Wastage of resources
3. Loss of tax payers’ revenues
4. Financial loss to banks/financial institutions
5. Loss of employment opportunities
6. Adverse effect on prospective entrepreneurs
7. Hardship to the public
8. Market fluctuation.

Corrective Measures:

After analyzing the industry type, sickness, causes of sickness and stage of sickness held, the corrective Actions that can be recommended to prevent sickness and to provide the treatment of sickness are as follows:

At Planning Stage:

Keeping the causes of sickness in the planning of any project makes the project born sick. So, preventive measures can be taken to remove the causes of sickness in the project planning. The preventive measures include scientific and systematic selection of project, proper evaluation and implementation by taking the help of experts in every stage. Specifically the location selection, layout and material handing plan should be given proper importance, In every stages of capital budgeting the Chamber of Commerce and Industries may be involved for their more practical outlook.

At The Operation Stages of Normal Units:

To prevent the 'make sickness' of industrial units it is important to routine check up the operation of units by various technical methods like implementing inventory and supply chain management, implementing TQM and quality cycle in significant stages of production, reengineering when necessary And routine checkup of financial reports and keep it at standard level.

For Units Tending to Be Sick:

Regular check up of the managerial practices and removing the deficiency in finance, marketing, human Relation, operation & infrastructure are important to prevent the sickness for the units that tend to be sick.

For Units of Incipient Sick:

Identification and detection of sickness at the incipient stage of sickness are most important for effective decision making. In order to do that, banks and other financial institutions should periodically review the accounts of borrowers to arrest the sickness in incipient stage and co-operate the entrepreneurs to provide effective treatment to remove sickness. It needs integration of diverse viewpoints of management, financial institutions and labor union to come on the unified decision to treat the sickness.

For Sick Units:

To make effective decision regarding the sick units there must be effective division in authority to treat those units. Not only financial measures can treat sick units, other measures must need to rehabilitate those units. The actions of rehabilitation should be started with no delay. Above all in industrial policy of Govt. there must be necessary conservative ways to keep the domestic industrial units alive from liberalization of trade worldwide. The strategies to great sick units must include the strategy to close some units, revive some and combine some with other industrial units and other measures also.

Industrial development of any country depends on the efforts of entrepreneurs. The entrepreneurs are afraid of industrial sickness as it involves the loss of invested capital, career and huge opportunity cost of intelligent entrepreneurs nowadays. The concern authority should come forward with different measures to reduce the risks by removing the causes of sickness as much as possible in industrial units. Along with cooperation of authorities, the proper training of entrepreneurs and flow of necessary information is also important to prevent sickness.

Remedial measures to address industrial sickness

These typically involve a combination of short-term interventions and long-term strategies aimed at restoring the financial health and operational viability of distressed industrial units. Here's a concise summary of some common remedial measures:

1. **Financial Restructuring**: This involves restructuring the company's finances to alleviate debt burdens and improve cash flow. It may include debt rescheduling, debt restructuring, renegotiation of terms with creditors, and debt-for-equity swaps.
2. **Operational Restructuring**: Revamping the company's operations to enhance efficiency and reduce costs. This may involve streamlining production processes, optimizing supply chain management, improving inventory management, and implementing lean manufacturing practices.
3. **Technological Upgradation**: Investing in modern technology and equipment to enhance productivity, quality, and competitiveness. Upgrading obsolete

machinery and adopting new technologies can help improve operational efficiency and meet evolving market demands.

4. **Management Reforms**: Implementing changes in management practices and governance structures to enhance decision-making processes, accountability, and transparency. This may involve appointing new leadership, improving corporate governance mechanisms, and strengthening internal controls.
5. **Market Diversification**: Exploring new markets and diversifying product offerings to reduce dependence on a single market or product. Market diversification can help mitigate risks associated with market fluctuations and increase revenue streams.
6. **Government Support**: Providing financial assistance, tax incentives, subsidies, or other forms of support to distressed industries. Government intervention may also include policy reforms, regulatory relief, and infrastructure development to create a conducive business environment.
7. **Skill Development and Training**: Investing in employee training and skill development programs to enhance workforce productivity, adaptability, and competitiveness. Upskilling employees can improve operational efficiency and support business growth.
8. **Asset Sale or Joint Ventures**: Exploring opportunities for asset monetization, divestment of non-core assets, or entering into strategic partnerships or joint ventures with other companies. Asset sales or collaborations can generate funds, reduce financial strain, and unlock synergies.
9. **Debt Resolution Mechanisms**: Engaging in debt resolution mechanisms such as debt restructuring through schemes like Corporate Debt Restructuring (CDR), Strategic Debt Restructuring (SDR), or Scheme for Sustainable Structuring of Stressed Assets (S4A) to address financial distress and facilitate recovery.
10. **Industry Collaboration and Consortia**: Collaborating with industry associations, research institutions, and government bodies to share resources, knowledge, and best practices. Industry collaboration can foster innovation, economies of scale, and collective problem-solving.

These remedial measures are often implemented in a coordinated manner, tailored to the specific needs and circumstances of each distressed industrial unit. Effective implementation requires a comprehensive assessment of the underlying causes of industrial sickness and a commitment to sustained efforts towards revitalization and sustainability**.**

8.5 Key Terms

Industrial Sickness: Industrial sickness can be defined as a steady imbalance in the debt-equity ratio and distortion in the financial position of the unit. A sick unit is one which is unable to support itself through the operation of internal resources.

8.6 Summary

Industrial sickness refers to the condition where industrial units or enterprises are unable to operate profitably or sustainably due to various factors, leading to their decline or eventual closure. Common causes of industrial sickness include poor management practices, inadequate financial management, obsolete technology, excessive debt burden, inefficient operations, lack of market demand, and external economic factors. Industrial sickness not only affects the viability of individual enterprises but also has broader economic and social implications, including unemployment, loss of productive capacity, and negative effects on suppliers, creditors, and local communities. Effective measures to address industrial sickness may include restructuring, financial assistance, technological modernization, policy interventions, and rehabilitation schemes aimed at revitalizing distressed industries and promoting economic stability and growth.

8.7 Check your Progress

1. Explain the concept of Industrial Sickness. State the reasons for it.
2. What remedial measures are taken to redress the issue?

8.8 References

- Srivastava, S. S. (1986). *Management and monitoring of industrial sickness*. Concept Publishing Company**.**

Unit 9 MRTP Act, Globalization & Liberalization

9.1 Introduction

The Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 was a landmark legislation enacted by the Government of India to prevent the concentration of economic power, control monopolistic practices, and regulate trade practices detrimental to consumers and competition. The Act aimed to promote fair competition, protect consumer interests, and ensure the efficient functioning of markets in India's nascent post-independence economy. Liberalization refers to the relaxation or removal of government restrictions and regulations on economic activities, particularly in trade, investment, and finance. It involves reducing barriers to entry, such as tariffs, quotas, licensing requirements, and other trade barriers, to promote free market competition and efficiency. Liberalization often encompasses deregulation, privatization, and the promotion of market-oriented policies. Globalization refers to the increasing interconnectedness and integration of economies, societies, and cultures across the world through flows of goods, services, capital, technology, information, and people. It is driven by advancements in transportation, communication, and technology, as well as liberalization policies

9.2 Learning Objectives

Key features and objectives of the MRTP Act include:

1. **Prevention of Monopolistic Practices**: The Act aimed to prevent the formation and abuse of monopolies by prohibiting practices such as monopolistic mergers

and acquisitions, price manipulation, and unfair trade practices that could distort competition and harm consumers.

2. **Regulation of Restrictive Trade Practices**: It sought to regulate restrictive trade practices that could hinder competition or limit consumer choice. These practices included agreements or arrangements between businesses that sought to fix prices, limit production, or allocate markets.
3. **Control over Concentration of Economic Power**: The Act provided for the investigation and regulation of enterprises that held significant economic power or dominance in specific industries. This was to ensure that such dominant firms did not engage in anti-competitive behavior that could harm smaller competitors or consumers.
4. **Establishment of the Monopolies and Restrictive Trade Practices Commission (MRTPC)**: The Act established the MRTPC as the regulatory authority responsible for enforcing its provisions. The MRTPC had powers to investigate complaints, inquire into restrictive and monopolistic practices, and take corrective actions to promote competition and protect consumer interests.
5. **Consumer Protection**: The Act aimed to safeguard consumer interests by prohibiting unfair trade practices, false advertising, and deceptive marketing practices. It empowered consumers to file complaints against businesses engaging in such practices and seek redressal through the MRTPC.
6. **Exemptions and Thresholds**: Certain exemptions and thresholds were provided under the Act to balance regulatory oversight with the need for business flexibility and growth. Small-scale industries were exempted from certain provisions, and thresholds were defined to determine when enterprises would be subject to scrutiny under the Act.

9.3 MRTP Act 1969

The Monopolies and Restrictive Trade Practices Act (MRTP) 1969, came into force in June 1970. The Act has three main objectives: (i) to control and regulate concentration of economic power; (ii) to control monopolies and monopolistic trade practices unless any of them can be justified to be in the public interest; and (iii) to prohibit restrictive trade practices.

For entrepreneurs who are covered by the Act, it is not enough to have industrial licensing for the implementation of any programme of substantial expansion or the setting up of a new undertaking. They must have the Central Government's approval before they can go ahead with these proposals. Similarly, mergers, amalgamations or takeovers in which such companies are involved also require prior approval.

Although substantial achievement has been made in the field of industrialization in India during the last two decades under the Industries (Development and Regulation) Act, 1951, it has been felt that the established industrial houses were the main instruments of industrialization. It is essential for a country professing a mixed economy that there is a continual broadening of the entrepreneurial base. In our country, however, industrial licensing has unfortunately failed to achieve this objective on any significant scale. It is this imbalance that the MRTP Act seeks to correct among other things. The central idea of this legislation seems to be not so much to maintain free competition in the Western sense, as to regulate the growth of these so-called monopoly houses in accordance with certain socially desirable priorities.

Four types of undertakings come under the purview of this Act, viz., (i) An undertaking which has gross assets of 20 crore and above, (ii) Inter-connected undertakings which together have assets of 20 crore and above, (iii) A dominant undertaking which has assets of 1 crore and above. A dominant undertaking is one which produces, supplies or controls one-third of any goods in the country, (iv) Interconnected undertakings constituting a dominant undertaking and having aggregate assets of 1 crore or above.

Basically, the MRTP Act follows a middle course between accelerated economic growth and control of concentration of economic power. Monopolies and restrictive trade practice is defined as a trade practice which results in preventing, distorting or restricting competition in any manner and which, in particular, tends to obstruct the flow of capital or resources into the stream of production or to bring about manipulation of prices or conditions of delivery, and thus imposes unjustified costs or restrictions on the consumers.

The eleven types of restrictive trade agreements mentioned in the Act are as follows:

1. Refusal to deal with particular dealers or classes of dealers
2. Exclusive dealerships
3. Price fixing in a concerted manner
4. Forced buying by the purchasers of a product of another producer
5. Discriminating between dealers in granting special benefits or concessions
6. Resale price maintenance
7. Exclusive distributorship
8. Allocation of areas or markets to sole distributors
9. Restrictions on the manufacture of process
10. Boycott from trade association membership
11. Price control arrangements

These features have been borrowed from similar provisions in the British law on restrictive trade practices. The applicability of some of them in Indian conditions will be doubtful. In our conditions of shortages, the distribution and pricing of many commodities is often controlled and supervised by the government authorities and they are often party to such agreements. This Act will not apply to these agreements, although technically they are restrictive ones.

Amendments

The MRTP Act was amended in 1982, 1984, 1985 and 1991. In the 1982 amendments, dominant undertaking was redefined. A dominant undertaking is one which produces, supplies or controls one-third of any goods in the country. After this amendment, the market share of dominant undertakings became one-fourth instead of one-third.

The amendment of 1985 raised the asset threshold of undertaking from Rs 20 crore to Rs 100 crore for applying the provisions of the Act relating to the prevention of concentration of economic power.

Changes under the New Industrial Policy Statement of 1991

The new industrial policy acknowledges that with the growth of industrial structure and the need for achieving economies of scale for higher productivity and competitive advantage in the international market, the interference of government through the MRTP Act on the investment decisions of large companies has become deleterious in its effect on Indian economy growth. The new industrial policy has made drastic changes in the MRTP Act. The Act had laid down that dominant undertakings with assets of one crore or more and other undertakings which either individually or together with interconnected undertakings had assets of Rs 100 crore or more should obtain the prior permission of the central government for establishment of new undertaking, expansion of existing undertakings, merger, amalgamation or takeover. The new policy has repealed these provisions. Henceforth, the Act will be confined mostly to the achievement of prevention of restrictive and unfair trade practices. Thus, the 'M' has almost been thrown out of the MRTP Act. With the removal of barriers to competition, the emergence of a competitive environment is assured.

9.4 GLOBALIZATION

Globalization intends to integrate the Indian economy with the world economy. Globalization is considered to be an important element in the reforms package. It has four parameters:

(i) Reduction of trade barriers so as to permit free flow of goods and services across national frontiers

(ii) Creation of an environment in which free flow of capital can take place

(iii) Creation of an environment permitting free flow of technologies among nation-states

(iv) Creation of an environment in which free movement of labour can take place in different countries of the world

The advocates of globalization limit the definition of globalization to only three components viz., unhindered trade flows, capital flows and technology flows. They insist that the developing countries accept their definition of globalization and conduct the debate on globalization within the boundaries set by them. But many economists in developing countries believe that this definition is incomplete. If the ultimate aim of the globalization movement is to integrate the world into one global village, then the fourth component of unrestricted movement of labour cannot be left out.

The emergence of the global economy was the result of private initiative rather than carefully orchestrated national maneuvers, yet today it determines the course of national economic policies. The globalized economy represents the following:

1. Activity taking place on an increasingly supranational scale
2. Manufacturing is no longer confined to stand-alone factories within state boundaries, but involves sourcing materials/components/sub-assemblies across geographies wherever cost/quality parameters are met.
3. Labour and processes are outsourced from wherever they are most economically available at desired quality levels.
4. Financial operations are conducted around the world as matters of routine.
5. These events indicate the start of a new period of economic theory—a new globalism distinct from the relatively recent post-war period which was dominated by internationalism.
6. Following on after an era after World War II, when nations took the lead in initiating economic activity, acting in concert through the creation of an international economic system for trade and payments.
7. Successive rounds of multilateral tariff reduction.
8. A new era of globalization now sees corporate taking the lead, establishing their hold in world markets for goods and services.
9. Their activities are widening and deepening the economic interdependence of nations to the extent of creating a borderless economy.
10. This is quite unlike the earlier phase, which was characterized by exchange of goods, services, capital and technology and where FDI was insignificant.
11. Technological change and deregulation has seen transnationals integrate their activities across a borderless world, to reduce costs, while consolidating home markets and taking on global ones.
12. Economic interdependence is increasingly production based, not trade based.
13. Trade and technology transactions are taking place increasingly between transnationals, not the market.

Thus, globalization refers to:

1. The multiplicity of linkages and interconnections between states and societies that comprise the present world system
2. The process by which events, decisions, and activities in one part of the world come to have significant consequences for individuals and societies in quite distant parts of the globe
3. Globalization has two distinct phenomena:

   (i) Scope (or stretching), i.e., widening of the extent and form of cross- border transactions

   (ii) Intensity, i.e., deepening of the economic interdependence between the actions of globalizing entities located in one country and those located in other countries
4. The two most important causes of globalization are:

   (i) The pressure on business enterprises by consumers and competitors alike, to continually innovate and come up with new products while improving existing ones. Escalating R&D costs coupled with shrinking product lifecycles are compelling corporations both to downsize the scope of their value-added activities and to venture further afield in search of wider markets.

(ii) The renaissance of market-oriented policies pursued by national governments and regional authorities. In the last five years alone, while more than thirty countries have abandoned centralized planning as the main mode of allocating search resources, over eighty countries have liberalized their inward FDI policies, including China and India.

Moreover, the undernoted factors have worked to stimulate cross border corporate integration, both within TNCs and between independent firms:

1. The privatization of state-owned enterprises.
2. Liberalization and deregulation of markets.
3. Removal of a bevy of structural distortions.

Globalization of the Indian Economy

Globalization of the Indian economy implies the following:

1. Commodity as well as factory market is functioning under the influence of market forces generated in the world economy.
2. Gain in efficiency to compete in world markets.
3. Exports increase; influx of foreign exchange and private foreign capital.
4. Higher growth path with stability.
5. Better balance of payments position relieves tension of default on IBRD loan instalments.
6. Towards ultimate full convertibility on capital and current accounts is enabled.
7. There is need to become globally competitive by creating stable micro- and macro-economies without any vested interests.

   The argument in favour of integrating the Indian economy with the global economy has long been put forward by the IMF and the World Bank as the answer to the failure of the hitherto followed economic policies. The slowdown of the world economy after 9/11 and the meltdown of the South Asian economies showed that the global economy is unlikely to work very well unless there is globalization of both production and consumption. Yet, complete globalization would also mean vulnerability to shocks that are transmitted throughout the global economic system; India was insulated from the fallout of the Baring's Bank collapse and the subsequent meltdown of the South Asian economies, because it was not an active member of any trading blocs in the region.

Globalization is viewed as a two-way action plan, envisaging:

1. Free competition
2. High productivity
3. Selling to one market—a global one, where all are in open competition
4. This facilitates integration with the global mainstream
5. Promotes in sourcing cheapest suppliers, in open global competition
6. Boosts industrial development and employment
7. Makes for better quality, export earnings and economic stability

Independent India inherited an inward-oriented policy and in the early years of planning an import substitution regime with anti-export bias was considered to be quite appropriate. India's trade regime remained basically inward-looking until export incentives were introduced in the mid-1960s. In the 1970s, many more export incentives were introduced but this did not help export promotion much. The 1980s witnessed attempts toward export promotion and trade liberalization under the Sixth and Seventh Plans. Despite the efforts towards liberalization, India's trade regime remained more or less inward-looking.

Owing to greater reliance on the working of the closed economy, the Indian economy has generated a high cost-inefficient industry, which has prohibited the optimum utilization of factors of production. Despite all potentialities, Indian industries are not competing with the global industries with respect to cost and quality. Protection has always given an avenue to develop a high cost industry. Under the shadow of FERA and MRTP Acts, monopoly houses have developed. It is the closeness of the Indian economy that prohibits introduction of the advanced technologies of the developed nations. So the globalization of the economy is essentially needed.

Globalization will provide an opportunity for India to become an important production centre of the world. It will also provide an opportunity to the Indian companies to become multinational concerns. At the same time, it can attract foreign investors so as to make India a centre of the world market. India can utilize these avenues very well on account of its competitive edge over other countries due to its large skilled labour.

The strategy adopted since July 1991 for further integration of the Indian economy with the world economy includes exchange rate adjustment to improve competitiveness of exports, reduction in tariffs and a more open policy towards direct foreign investment and technology.

The new economic policy aims at making the Indian economy competitive and much better integrated with the world economy. We are now clearly in a new and different world. India cannot expect large inflow of external funds while there is an irrational exchange rate policy. India has no alternative but to integrate its economy into the global mainstream to boost its economic growth. As most of the countries in the world are steadily reorienting their economies to market-friendly forces, it will be suicidal on the part of India to remain in isolation. Competition from abroad would lead to improvement in quality, productivity, efficiency and cost-effectiveness.

For integrating the Indian economy with the world economy not only faster export growth, but also free access to imports is necessary; accordingly, import duties have been brought down substantially. High tariffs have created a high-cost industrial structure and Indian competitiveness has been affected by this. When many other countries had substantially reduced the tariffs, India's tariff structure also needed to be lowered.

Since globalization requires the creation of suitable environment for free flow of direct foreign investment, the new industrial policy of 1991 permits approval for foreign direct investment up to 51 per cent foreign equity in the case of high-priority industries. This obviously opens the door for multinationals in a big way. The foreign investment will bring in new technology and marketing expertise from which the country will benefit. The market-friendly approach of the new economic policy is expected to create a suitable environment for the entry of foreign capital on a large scale.

An open policy towards technology transfer is also an important requirement for globalization of the Indian economy. One obstacle to the much-needed inflow of technology has been the cumbersome approval process involving delays and uncertainties. To overcome this problem, the new industrial policy recommends that automatic approval be given by the government for technology agreements related to high priority industries, and similar facility be provided to non-priority industries also if expenditure in foreign exchange is not involved.

The new economic policy, which advocates a market-friendly approach and removal of bureaucratic controls, is expected to attract foreign capital and technology and also facilitate easy movement of goods through substantial reduction in tariffs, and thus pave the way for further integrating the Indian economy with the global economy.

The external environment is going to be more dynamic and complex. There will be less social protection for inefficiency. There will be noticeable fights in the marketplace for innovation and competitiveness. Unless we increase our productivity and efficiency, we will not be able to go beyond 'the Hindu rate of growth'.

India's globalization efforts are hindered by the lack of a favorable international environment. At a time when advanced countries, particularly the US, are adopting a protectionist policy with Super 301 threat, it is very difficult to accomplish the objective of globalization of the Indian economy.

Further, openness of the economy to the world competition is an invitation to multinationals. The role of multinationals is not salubrious for poor countries.

Also, globalization would imply certain consequences which may not be always beneficial to the developing countries. One major implication of globalization is the internationalization of prices. Globalization would also imply the equalization of domestic prices with international prices. This would mean that the firms in the developing economies should enhance their competitive strength. If some of the commodities have relatively lower prices due to subsidization, the policy prescription would be that subsidies should be withdrawn so that the prices would attain a parity with prices prevailing in the international markets. In recent times, fertilizer prices in India had been raised and the subsidies were withdrawn. The aftermath of the withdrawal of subsidies would be a hefty increase in the prices of agricultural commodities. This would mean that Indian prices must rise to US levels. So, as a result of globalization, inflationary tendencies would persist as prices are expected to rise by 15 to 20 per cent.

9.5 LIBERALIZATION

Liberalization took place on two fronts—domestic liberalization and trade liberalization. Experiments with domestic liberalization began in the mid-seventies. A formal liberalization of economic policy in India started in 1973, when a number of industries were thrown open for participation by large business houses and companies covered under the MRTP and FERA acts. However, the then international and national situation as created by hike in petroleum prices and labour unrest at home did not allow for any major change in the industrial structure.

The real beginning of liberalization may well be said to have taken from 1975 with the modification of the licensing procedure and recognition of additional capacities. The government exempted the medium entrepreneurs from the licensing provisions of the Industrial Development and Regulation Act in respect of a large number of industries. The government also announced the facility of utilizing installed capacity without limit in certain cases coming under the purview of MRTP and FERA acts.

Between 1975 and 1979, the licensing policy was further liberalized. The government allowed exemption from licensing for investment up to Rs 3 crore in 1978 and to Rs 5 crore in 1983. The liberalization process gathered momentum in 1980 with the announcement of industrial policy statement. The statement focused attention on the need for promoting competition in the domestic market, technological Upgradation and modernization. The policy laid the foundation for an increasingly competitive export base and for encouraging foreign investment in high technology. The logic behind liberalization is the withering effects of sheltered market on industries and other competitive sectors.

Since 1985-1986, the liberalization process which till then primarily consisted in removing the supply constraints, entered a new phase with the introduction of liberalization measures on the demand front as well, especially on the demand of consumer durables.

A number of policy measures were taken with a view to

(1) limiting the role of licensing,

(2) expanding the scope for contribution to growth by large houses,

(3) encouraging modernization,

(4) raising the investment limits for the promotion of the small scale sector,

(5) providing fiscal incentives for the same and

(6) encouraging existing industrial undertakings in certain industries to achieve minimum economic levels of operations.

Some important liberalization measures are as follows:

1. Delicensing of a number of industries since June 1988. The number of industries subject to statutory licensing stands reduced to only 18 after the announcement of the new industrial policy in July 1991.
2. The exemption limit for industrial licensing has been raised since June 1988 from Rs 5 crore to Rs 25 crore for those units that are set up in the non-backward areas and Rs 75 crore for those units that are set up in the backward areas.
3. Broadbanding of certain industries (40 in all) with a view to providing flexibility to manufacturers to produce a range of products.

4. The government liberalized the operations of the MRTP Act from time to time. As a result, large business houses have been given the green signal to enter a number of industrial fields which were formerly closed to them. For the sake of production, even the illegally set up industrial capacity was regularized. The MRTP Act itself provided for the following two significant exemptions: (a) expansion of production up to 25 per cent will not be subject to the MRTP clearance and (b) expansion of a large house in so far as it relates to production of the same or similar types of goods already being manufactured by it is outside the purview of the MRTP Act, so long as the undertaking is not a dominant undertaking and so long as the proposal has been cleared under the Industries (Development and Regulation) Act, 1951.
5. The 1973 industrial policy statement opened up a large number of industries to the large industrial/business houses. These included not only the core industries but also industries having direct linkages with such core industries and industries with a long-term export potential. Initially, there were nineteen such industries and gradually their number increased to thirty-five.
6. Raising of investment limits for the small scale sector and providing fiscal incentives for growth.
7. Exempting from licensing requirements 100 per cent export-oriented units. Since February 1990, even the units which undertake to export 60 per cent of their total production have been exempted from these requirements.

The main aim of liberalization was to dismantle the excessive regulatory framework which acted as a shackle on freedom of enterprise. Over the years, the country had developed a system of licence-permit-control raj. The aim of the new economic policy was to save the entrepreneur the unnecessary harassment of seeking permission from the bureaucracy to start an undertaking.

Similarly, the big business houses were unable to start new enterprises because the MRTP Act had prescribed a ceiling on the asset ownership to the extent of Rs 100 crore. In case a business house had assets more than Rs 100 crore, its application was rejected. It was believed that on account of the rise in prices, this limit had become outdated and needed reviewing. The second objection by the private sector lobby was that it prevented big business houses from investing in heavy industry and infrastructure, which required lumpsum investment. The NDA in its election manifesto had suggested that the asset limit of MRTP companies should be raised to Rs 1000 crore. The government thought it wise to abolish the limit altogether so that big businesses could establish big projects in the core sectors—heavy industry, petrochemicals, electronics, etc. The Government was of the view that in the context of liberalization, the MRTP limit had become irrelevant and needed to be scrapped.

The major purpose of liberalization was to free the large private corporate sector from bureaucratic controls. It therefore, started dismantling the regime of industrial licensing and control. In pursuance of this policy, the industrial policy of 1991 abolished industrial licensing for all projects except for a small set of eighteen industries.

The list of industries in which industrial licensing is compulsory is as follows:

1. Coal and lignite
2. Petroleum and its distillation products
3. Distillation and brewing of alcoholic drinks
4. Sugar
5. Animal fats and oils
6. Cigars and cigarettes
7. Asbestos and asbestos-based products
8. Plywood and other wood-based products
9. Raw hides and skins
10. Tanned furskins
11. Paper and newsprint
12. Electronics, aerospace and defence equipment
13. Industrial explosives
14. Hazardous chemicals
15. Drugs and pharmaceuticals

9.6 Key Terms

MRTP: This Act was enacted to prevent the concentration of economic power to common detriment, control of monopolies, and prohibition of monopolistic and restrictive trade practices (MRTP) and matters connected therewith.

Globalization: Globalization, is the process of interaction and integration among people, companies, and governments worldwide.

Privatization: Privatization can mean several different things, most commonly referring to moving something from the public sector into the private sector. It is also sometimes used as a synonym for deregulation when a heavily regulated private company or industry becomes less regulated.

Amendments: An amendment is a change or addition to the terms of a contract or document or law (In case of Government with majority). An amendment is often an addition or correction that leaves the original document substantially intact. Other times an amendment can strike the original text entirely and substitute it with new language.

Industrial Policy 1991: Dubbed the "The New Industrial Policy", 1991 had the main objective of providing facilities to market forces and to increase efficiency. The government allowed Domestic firms to import better technology to improve efficiency and to have access to better technology.

9.7 Summary

Overall, the MRTP Act of 1969 played a significant role in shaping India's regulatory framework for competition and trade practices during its implementation. However, over time, it was recognized that the Act had limitations and needed to be replaced with a more modern and comprehensive competition law. Consequently, the MRTP Act was repealed and replaced by the Competition Act of 2002, which established the Competition Commission of India (CCI) as the primary regulatory authority for promoting and sustaining competition in Indian markets.

Moreover, liberalization and globalization are interconnected processes that involve opening up economies to international trade, investment, and competition, leading to increased economic integration and interconnectedness at the global level.

9.8 Check your Progress

1. Explain in brief the MRTP Act 1969 and how this Act help develop the Business Environment in India.

2. How has Globalization aided in the development of Indian Economy? Explain the merits and demerits.

3. “Liberalization paved way for Indian Entrepreneurs to be more active in the economic activity of the country”. Justify this statement

9.9 References

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Unit 10 LABOUR WELFARE AND SOCIAL SECURITY

Structure

10.1 Introduction

Old philosophy was the greatest good of the greatest number. But in a welfare state, the new slogan is ‘the good of all’.

The productivity philosophy is the modern landmark in labour welfare where welfare is provided with a view to higher and better productivity. The final stage in the evolution of labour welfare philosophies has been the concept of the welfare state under which the worker acquires a fundamental right to welfare as a citizen of a welfare state. Labour welfare may be viewed as efforts to make life worth living for a worker.

Personnel Management is a success if ‘I’m O.K.—You’re O.K.,’. You are O.K., if your welfare is O.K.

‘The welfare of the labour classes must be one of the first cares of every employer. Any betterment of their conditions must proceed more from the employers downward rather than be forced up by demands from below, since labour, contented, well-housed, well-fed, well looked-after, is not only an asset to the employer, but serves to raise the standards of industry and labour in the country.’ This statement was made in 1917 by Dorab Tata, successor of J.N. Tata when the industrial revolution had just taken root in this country and brought in its wake some exploitation of workers. Enlightened employers like Tata stressed the need of labour welfare.

10.2 Learning Objectives

1. **Health and Safety**: Ensure a safe and healthy work environment for employees by implementing measures to prevent accidents, occupational hazards, and work-related illnesses. This includes providing proper ventilation, sanitation facilities, safety equipment, and training on occupational health and safety practices.

2. **Social Security**: Provide social security benefits and financial protection to workers and their families in times of sickness, disability, old age, unemployment, or other emergencies. This may include health insurance, disability benefits, retirement pensions, and unemployment insurance schemes.

3. **Living Standards**: Improve the living standards and quality of life of workers and their families by offering amenities and services such as affordable housing, clean drinking water, sanitation facilities, education, childcare, and recreational activities.

4. **Fair Wages and Benefits**: Ensure that workers receive fair and equitable wages, benefits, and working conditions commensurate with their skills, qualifications, and contributions. This involves adhering to minimum wage laws, providing overtime pay, paid leave, bonuses, and other benefits.

5. **Labour Rights and Representation**: Safeguard the rights of workers and empower them to voice their concerns, negotiate for better working conditions, and participate in decision-making processes. This includes respecting freedom of association, collective bargaining rights, and ensuring effective grievance redressal mechanisms.

6. **Training and Skill Development**: Promote lifelong learning and skill development opportunities for workers to enhance their employability, productivity, and career advancement prospects. This may involve providing training programs, vocational education, and on-the-job skill enhancement initiatives.

7. **Work-Life Balance**: Support work-life balance initiatives to help employees manage their personal and professional responsibilities effectively. This includes offering flexible work arrangements, paid time off, parental leave, and support for care-giving responsibilities.

8. **Employee Engagement and Recognition**: Foster a positive work culture that values employee engagement, recognition, and appreciation. This involves promoting teamwork, communication, employee involvement in decision-making, and recognizing and rewarding employee contributions and achievements.

9. **Community Development**: Contribute to the development of local communities by investing in social infrastructure, environmental sustainability initiatives, and community development projects that benefit workers and their families.

10. **Compliance and Ethical Practices:** Ensure compliance with labour laws, regulations, and ethical standards related to labour welfare and promote responsible business practices that prioritize the well-being and rights of workers.

10.3 Evolution of Labour Welfare

The welfare work as a movement began in England in the early years of the Industrial Revolution. The miserable working conditions of the factory system during its first phase shocked some social-minded employers. Philosopheres like Comte, J.S. Mill and George Eliot all advocated the cause of the laborers and enunciated the 'concept of scientific meliorism'. In England, in the first quarter of the 19th century, Robert Owen's attempt to improve the workers' conditions by ensuring shorter hours of work, and minimum wage and by providing housing and sick benefits, was one of the pioneering efforts towards labour welfare.

In 1817, Robert Owen first advocated an eight-hour working day for workers. In 1833, the Frst Factory Act was passed which prohibited the employment of very young children, limited the number of hours of work, insisted upon time for meals and also appointed Factory Inspectors to ensure the implementation of the Act. This Act was not applicable to mines where there was child labour. In 1842, a bill was introduced in the Parliament prohibiting the employment of boys under 13 and excluded all women and girls from the pits. In 1844, a new Factory Act was passed which limited the hours of labour of children under 16 to 6½ per day.

Earlier, the Factory Act was applied only to textiles. It was only in 1878 that the Factory Act was passed which was applied to industry as a whole.

At this time, social conscience was awakened and a struggle for the elementary standards of industrial living began. The implementation of welfare schemes began with a four-pronged attack:

- The State tried through legislation, to regulate industrial and social affairs;
- Some enlightened employers sought to provide much better conditions that the law demanded;
- Trade unions fought to bring about an improvement in the working conditions of labour and
- Voluntary organizations expanded in number.

In France, in the second quarter of the 19th century, Leclaire introduced the concept of profit sharing, jointly administered benefits and other democratic ideals. In the USA, Francis Cabot pioneered some welfare work. The movement during this period everywhere was dominated by humanitarianism and a belief in human perfectibility and the possibility of reconstruction of character. It was paternalistic and arbitrary. The underlying theme of the welfare movement in the initial period was mercy to be shown by the fortunate superiors to the unfortunate inferiors.

During the second half of the 19th century, the concept of welfare began to influence the welfare movement in Europe.

The 20th century is called the age of the common man. Humanitarianism was not replaced by genuine economic justification through more efficient performance and lower unit costs.

From the beginning of this century, both the government and the industry have been continuously trying to improve working conditions.

In the USA, during the Second World War, welfare work developed and became a part of a more highly organized managerial function. There were several influences which gave impetus to the evolution of industrial welfare.

First, the research into scientific management and industrial psychology has underlined the importance of human resources in industries.

Secondly, one of the outcomes of the World War was a much stronger organized labour.

The origin of labour welfare activity in India goes back to 1837 when, following the abolition of slavery in 1833, British Colonies started importing Indian labour. Labour welfare activity was largely controlled by legislation, the earliest Act being the Apprentices Act of 1850. The next Act was the Fatal Accidents Act of 1853, which provides compensation to the families of workmen who lost their lives as a result of accident. Then came the Merchant Shipping Act of 1859, which regulated the employment of seamen and provided for their health, and protection. A series of laws between 1863 and 1901 were enacted in respect of indenture labour for the plantation industry.

The first Indian Factories Act was passed in 1881 which marks the beginning of a series of labour laws which brought about improvements in the working conditions of Indian labour.

The Indian Factories Act was again passed in 1891, Its major provisions are:

- A midday break of half-an-hour was made compulsory.
- A weekly off-day was prescribed
- Women were allowed to work for a maximum of 11 hours with a break of 1½ hours.

This Act was in force for nearly 20 years. The Act of 1991 covered for the first time seasonal factories. The Factories Act of 1922 was applicable to all the factories employing more than 20 workers. It was provided that men and women shall not work for more than 60 hours a week. The minimum age of child labour was raised from 9 to 12 years. The next Factories Act was passed in 1934, bringing about changes in regulations on safety, health and ventilation.

After independence, the labour welfare movement acquired new dimensions. The Factories Act of 1948 replaced all previous legislations on labour welfare. Over the last 50 years, the leadership of the labour welfare movement has increasingly passed into the hands of the Government.

10.3.1 Concept of Labour Welfare

Labour welfare activities are a useful adjunct to motivational approach and help in maintaining positive attitudes towards the job and the organization once such attitudes have been fostered.

The concept of 'welfare' is necessarily dynamic, bearing a different interpretation from country to country and from time to time and even in the same country, according to the value system, social institution, degree of industrialization on general level of social and economic development. Even within one country, its content may be different from region to region. Since the concept of 'labour welfare' is flexible, it is difficult to give precise definition of the term. Mr. Arthur James Todd has rightly remarked that a series of sharply diverse opinions exist on the motives and merits of industrial welfare work. Different people have given merits of industrial welfare work. Different people have given different interpretations to it. One definition given to welfare work is that it is anything done for the comfort and improvement, intellectual and social, of the employees, over and above wages paid, which is not a necessity of the industry nor required. According to an ILO Report, workers' welfare may be understood as including such service, facilities and amenities, which may be established in, or in the vicinity of undertakings to enable the persons employed in them to perform their work in healthy, congenial surroundings and provided with amenities conducive to good health and high morale. A resolution adopted by the International Labour Conference in June, 1956 has mentioned some of these services and amenities. These include—

- feeding facilities in or near the undertaking,
- rest and recreation facilities and
- transportation to and from work where ordinary public transport is inadequate.

The Labour Investigation Committee has cleared the scope of the welfare activities in the most comprehensive manner. It prefers to include under welfare activities anything done for the intellectual, physical, moral and economic betterment of the workers, whether by employer, by Government or by other agencies, over and above what is laid down by law or what is normally expected as part of the contractual benefits for which the workers may have bargained. Thus, under the definition, the Committee includes housing, medical, and educational facilities for rest and recreation, co-operative societies, day nurseries and creches, provision of sanitary accommodation, holiday with pay, social insurance measures undertaken volutarily by employers alone or jointly with workers, including sickness and maternity benefit schemes, provident funds, gratuities and pensions, etc.

Looking at the problem from a different angle, we may say that labour welfare work is associated, on the negative side, with the counter-acting of the baneful effects of the large-scale industrial system of production on the personal, family and social life of the worker. On the positive side, it deals with the providing of opportunities for the worker and his family for a good life as understood in its most comprehensive sense. This personal objective alone is not adequate. Labour welfare is also fundamentally in the interest of the larger society as the health, happiness and efficiency of each individual connotes the general well-being of all. Taken thus, labour welfare is an essential part of social welfare. It means the adjustment of the labourer's work-life and family-life to the community and social life around.

10.3.2 Objectives of Labour Welfare

In a developing economy, labour is an underprivileged, weaker and vulnerable section of society. Labour is an underprivileged group educationally, socially and culturally. Apart from this, the real need for labour welfare arises from two basic conditions generally known as the 'long arm of the job' and 'social invasion of the factory'.

The working environment of any job in a factory or a mine imposes some adverse effects on the worker because of the heat, noise, fumes, etc. involved in the manufacturing process. There are also occupational hazards and environmental problems inherent in the manufacturing process itself which cannot be removed. As a result, ameliorative services, protective devices and compensatory benefits have to be provided for the welfare of labour. This is metaphorically referred to as the long arm of the job which stretches out its adverse effects on to the worker, long after his normal 8-hour shift is over, thus affecting his physical and mental well-being.

As against the long arm of the job, there is also a social invasion of the factory. When a worker comes to his work-place, he is not an isolated individual but a member of a society—a father of son, a husband of a wife and a citizen of country. Hence he brings with him the cultural background of his family and the community to which he belongs as also the social and emotional roblems of his group. The bulk of our labour force comes originally from rural society and settle in the urban slums of congested, unhealthy, industrialised cities. Rural habits and cultural patterns are often transmitted to the working environment and consequently problems of irregularity, absenteeism etc. arises. Thus, when labour joins industry the resulting social changes are referred to as the social invasion of the factory. Hence the need to provide welfare services to minimize social problems.

10.3.3 Importance of Welfare Work

Like Great Britain, in India too, practice of personnel management grew out of the roots of labour welfare, when as far as in 1932 Jamshedji Tata made pioneering effort in this direction at the TISCO.

The usefulness of welfare work cannot be over emphasized. Welfare activities influence the sentiment of the workers. When the workers feel that the employers and the state are interested in their happiness, their tendency to grouse and grumble will steadily disappear. The development of such a feeling powered the way for industrial peace. Secondly, the provision of various welfare measures such as good housing, canteens, medical and sickness benefits etc., makes them realize that they have also some stake in the undertaking in which they are engaged and so they think thrice before taking any reckless action which might prejudice the interests of the undertaking. Thirdly, welfare measures, such as cheap food in canteens free medical and educational facilities, etc. indirectly increase the real income of the workers. If the workers go on strike they will be deprived of all these facilities. Hence, they try to avoid industrial disputes as far as practicable and do not go on strike on flimsy grounds. Fourthly, welfare activities will reduce labour turnover and absenteeism and create a permanent settled labour force by making service attractive to labour. Bombay Textile Labour Enquiry Committee aptly remarks: Whatever improves conditions of work and life for the employees, whatever leads to the increasing adaptation of the worker to his task and whatever makes him feel contented will lessen his desire or need to leave it for a time and lighten for him and the industry the burden of absenteeism. Fifthly, welfare activities will go a long way to better the mental and moral health of workers by reducing the incidence of vices of industrialization. Removed from native village and thrust into a strange and unfavorable environment, the workers are liable to fall a prey to drinking, gambling and prostitution. Congenial environment as a result of welfare measures will act as a deterrent against such social vices. Lastly, welfare measures will improve the physique, intelligence, morality and standard of living of the workers which, in turn, will improve their efficiency and productivity. A high standard of efficiency can be expected only from persons who are physically fit and free from mental worries, that is, only fro persons who are properly trained, properly housed, properly fed and properly clothed.

Trade union leaders do not always look upon welfare measures of employers with favor. They allege that by providing welfare schemes employers will buy off the independence of the workers and will so entrap the workers as to force them to live as slaves. Welfare facilities are sometimes provided by employers not for making the workers happy but for doing away with the influence of trade unionism over them.

Welfare Activities may be divided into Two Groups

- Welfare within the precincts of an establishment: medical aid, creches, canteens, supply of drinking water, etc. These are also known as intra-mural activities; and
- Welfare outside the establishment; provision for outdoor and indoor recreation, housing, adult education etc. These activities are also known as extra-mural activities.

Welfare within the precincts of the establishment: It is the employer's responsibility to provide facilities within the precincts of an establishment as they form a part of working conditions. This has also been the underlying principle of the policy adopted by the Government. For many components of such welfare, legislation in the country has set certain minimum standards. Improvement upon them has been left to the employers.

10.4 Government Policy

The Factories Act, 1948, made a provision for washing facilities, seats for occasional rest for workers obliged to work standing, shelters or rest rooms and a lunch room if employing over 150 workers and lockers for keeping workers' clothes during working hours. Factories employing more than 500 workers were required to appoint welfare officers to see that the welfare aspects of the factory legislation were properly attended to within the establishment itself. In the case of mines, provision of cool drinking water and a canteen of prescribed standard were obligatory even before 1948. Such facilities had been left to the employers' discretion in plantations. All these and other requirements acquired a statutory force as a result of the Plantations Labour Act, 1951 and the Mines Act, 1952.

The First Plan, in recognizing that the Factories Act, 1948 was a comprehensive measure, emphasized its effective implementation. The Plan made similar suggestions in respect of plantations. No special mention was made about mines in view of the legislation which was passed in the year the Plan was published. The policy chalked out in the First Plan continued to be followed during the Second Plan. To understand the changes which have taken place in different aspects of labour, including welfare within the precincts of the establishment, a scheme for a comprehensive survey of labour conditions was recommended in the Plan. In view of the close association between efficiency and welfare, the Government at one time thought of securing voluntary acceptance of a Code of Efficiency and Welfare which was drawn up by a committee appointed by it but it could not be implemented. Some elements of the Code were subsequently included in the Industrial Truce Resolution, 1962. The Third Plan reiterated the proposition made in the earlier Plans that legislation enacted for the protection, safety and welfare of workers was adequate and better enforcement was needed. In the Fourth Plan, the Industrial Safety, Health and Hygiene Divisions of the Central and Regional Labour Institutes were proposed to be strengthened. The activities of the National Safety Council would be intensified. The Director General of Mines Safety would concentrate on more effective administration of mine safety legislation.

In the Fifth Plan, the ESI scheme was extended to cover the families of insured persons for medical care under the scheme.

Provisions for family pension was introduced under the Provident Fund Scheme. Welfare funds were setting up to look after the welfare of more and more workers. In the State Plans, provisions had been made for programmes of labour welfare centers. For promoting industrial safety in an increasing measure, provisions were made for setting up safety cells in various States.

In the Sixth Plan, stress was given on the expansion of social security measures. A phased programme for the expansion of the scheme has been drawn up. There are already statutory welfare schemes for workers in mining industries. The State governments have urged to undertake welfare programmes for the benefit of workers and artisans in the rural sector particularly for those engaged in agriculture, fishing, weaving and leather processing.

In the Seventh Plan, welfare of unorganized urban labour, child labour and women labour has been highlighted. For this purpose, Rs 485.14 crore were spent. An outlay of Rs 1315.39 crore has been provided for labour welfare in the Eighth Plan.

According to the Rege Committee, there was a need to prescribe minimum standards of welfare to be observed by employers in different industries, since barring a few enlightened employers, others took a most indifferent attitude towards welfare work.

10.4.1 Government Policy: Safety, Health and Welfare of Workers in Factories

The Factories Act, 1948, is the principal legislation for regulating various aspects relating to safety, health and welfare of workers employed in factories. This Act is a Central enactment, which aims at protecting workers employed in factories from industrial and occupational hazards. State Governments and Union Territory Administrations frame rules under the Act and enforce provisions of the Act and rules through their factory inspectorate.

Prescribing a 48-hour week for adult workers, the Factories Act forbids employment of children under 14 years of age in any factory. Minimum standards of lighting, ventilation, safety and welfare services, which employers must provide in their factories, have also been laid down. Factories employing 30 women workers are required to provide a crèche for their children, shelters, restrooms and lunch-rooms are required to be provided by factories employing over 250 workers. Factories with 250 workers or more have to appoint welfare officers. The Factories Act was amended in 1987 in order to impose a general duty on employers to ensure health and safety of workers and on designers, manufacturers, importers and suppliers to ensure that articles designed, manufactured, etc., are without risk to the health and safety of the workers. A new chapter for regulating the safety and health aspect in hazardous industries was incorporated in the Act.

1. **Safety in Ports and Docks:** Provisions relating to safety, health and welfare of workers employed in docks are contained in the Dock Workers (Safety, Health and Welfare) Act, 1986 and rules framed there under. The Act came into force from April, 1987. Enforcement of this Act in all the major ports is the responsibility of the Ministry of Labour and Employment and this responsibility is discharged through the DGFASLI (Directorate General Factory Advice Service and Labour Institutes), Mumbai.
2. **Safety in Mines:** Provisions for safety, health, and welfare of workers employed in mines are contained in the Mines Act, 1952, and rules framed there under. These provisions are enforced by the Ministry of Labour and Employment through the Directorate General of Mines Safety. The Directorate General with its headquarters at Dhanbad and its zonal, and regional offices spread all over the

mining areas in the country undertakes its functions, inspection of mines, investigation of all fatal accidents, grant of statutory permission, exemptions, and relaxations in respect of various mining operations, approval of mines safety equipment, safety promotional incentives, including organization of national awards and national safety conferences, etc.

3. **National Safety Council:** The National Safety Council was set up in 1966 to promote safety consciousness among workers to prevent accidents, minimize dangers and mitigate human suffering, arrange programmes, lectures and conferences on safety, conduct educational campaigns to arouse consciousness among employers and workers and collect educational and information data. National Safety Day is celebrated on 4th March every year to mark the foundation day of the National Safety Council.
4. **National Safety Awards:** To give recognition to good safety performance on the part of the industrial undertakings and to stimulate and maintain the interest of both the management and the workers in accident prevention programmes, the Government instituted in 1965 the National Safety Awards. The scheme is applicable to factories and docks. The National Safety Awards for mines were instituted in 1983.
5. **Social Security:** Social security is a new and dynamic concept in the evolution of social philosophy. It has largely influenced the socioeconomic policies of modern Welfare States. It springs from a deep desire of mankind to free itself from the fear of want. The quest for social security and freedom from want has been the consistent urge of man through the ages. This urge has assumed several forms according to the needs of the people and their level of social consciousness, the advancement of technology and the pace of economic development. From its modest beginning in a few countries in the early decades of the present century, social security has now become a fact of life for millions of people throughout the world. Social security measures have introduced an element of stability and protection in the midst of the stresses and strains of modern life. It is a major aspect of public policy today and the extent of its prevalence is an index of the progress made by a country towards the ideal of a

Welfare State. From birth to death, a man (or a woman) faces a number of contingencies and risks which include employment injury, occupational disease, disablement, ill-health, sickness, maternity, old age, and unemployment. During these contingencies it is not possible for the man or the woman to work. Social security aims to help individuals in such times of contingencies. Social security is considered indispensable to strike at the root of poverty, unemployment and disease. A comprehensive definition of social security has given in an ILO report entitled,

Approaches to Social Security

- Social security is the security that society furnished through appropriate organization, against certain risks to which its members are exposed. These risks are essentially contingencies against which an individual of small means cannot effectively provide by his own ability or foresight alone or even in private combination with his follows. It is characteristic of these contingencies that they imperil the ability of the workman to support himself and his dependants in health and decency. As the State is an association of citizens which exists for the sake of their general well-being, it is a proper function of the State to promote social security. While all state policy has some bearing on social security, it is convenient to regard as social security services only such schemes as provided by the citizens with benefits designed to prevent or cure diseases, to support him when unable to earn and restore him to gainful activity.
- According to President Wilson, there are some whose adverse circumstances make them unable to obtain the mere necessities of existence without the aid of others. To these less fortunate men and women, aid must be given by the Government not as a matter of charity but as a social duty.
- Social security measures provide healthy industrial relations. For industrial peace, social security to industrial workers is of fundamental importance because a social security system based on social insurance creates an attachment for labour with the concern to which they belong. Social insurance establishes a financial partnership between employers and employees and this fortifies the ground for peace in industry.

10.5 Social Security Legislation in India

1. **The Workmen Compensation Act, 1923**: A beginning was made in Social Security with the passing of the Workmen's Compensation Act, 1923. The Act provides for the payment of compensation to workmen and their dependents in case of injury and accident (including certain occupational diseases), arising out of and in the course of employment and resulting in disablement and death. The Act applies to persons employed in factories, mines, plantations, mechanically propelled vehicles, construction works and certain other hazardous occupations. Minimum rates of compensation for permanent total disablement and death are fixed at Rs 90,000 and Rs 89,000 respectively. Maximum amount for death and permanent total disablement can go upto Rs 4.56 and Rs 5.48 lakh respectively, depending on age and wages of workmen.
2. **Maternity Benefit Act, 1961:** The Maternity Benefit Act, 1961, regulates employment of women in certain establishments for a certain period before and after childbirth and periods for maternity and other benefits. The Act applies to mines, factories, industry, plantation, shops and establishments employing ten or more persons except employees covered under the ESI Act. The State Governments can extend it to any other establishments.
3. **The Employees' State Insurance Act, 1948:** The ESI Act is applicable in the first instance, to non-seasonal factories using power and employing ten or more persons and non-power using factories employing twenty or more persons. It covers employees drawing wages not exceeding Rs 7,500/- with effect from April 2004. The Act provides medical care in kind and cash benefits in the contingency of sickness, maternity and employment injury and pension for dependents in the event of death of a worker because of employment injury. Full medical care including hospitalization is also being progressively made available to members of the family of the insured persons. With effect from April 2005, the ESI Corporation has introduced 'Rajiv Gandhi Shramik Kalyan Yojana' for the workers covered under the scheme, who lost their jobs involuntarily due to retrenchment, closure of factories, and permanent disability not arising out of

employment injury. The beneficiaries under this scheme are entitled to get a monthly cash allowance of about 50–53% of the wage as well as medical care for themselves and their dependant family members, for a maximum of six months. The main benefits provided under the Act are medical care for the entire family of the insured person, cash compensation for loss of wages on account of sickness, temporary and permanent disablement arising out of employment injury, periodical payments to dependants of insured person who dies due to employment injury, maternity benefit in cash to insured women and funeral expenses. As on December 2005, there are 144 ESI Hospitals, 42 Annexes, and 27097 beds, 1427 ESI dispensaries, 2135 clinics of Insured Medical Practitioners under the scheme. The total number of insured persons is 86.17 lakh and the total number of beneficiaries under the scheme is 334.33 lakh.

4. **The Payment of Gratuity Act, 1972:** The Payment of Gratuity Act, 1972 is applicable to factories, mines, oil fields, plantations, ports, railways, motor transport undertakings, companies, shops and other establishments. The Act provides for payment of gratuity at the rate of fifteen days' wages for each completed year of service subject to the maximum of 3.50 lakh. In case of seasonal establishments, gratuity is payable at the rate of seven days' wages for each season.
5. **The Employees' Provident Funds and Miscellaneous Provisions Act, 1952:** Retirement benefits in the form of provident fund, family pension and deposit-linked insurance are available to employees under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Presently, the Act covers 180 specified industries. Coverage under this Act is presently restricted to employing twenty or more persons. The rate of contribution is 12 per cent in respect of 175 industries. Under this Act, employers are required to make a matching contribution.
6. **Employees' Provident Fund Scheme, 1952:** The Employees' Provident Fund Scheme seeks to provide financial security for employees in an establishment by providing a system of compulsory savings. The scheme covers employees getting wages not exceeding Rs 6,500 per month. As on March 2006, 38,445

new establishments and factories were brought under the purview of the Act. A Death Relief Fund has been set up under the Employee's Provident Fund Scheme. The benefit from the Fund upto Rs 2,000/- is admissible to the nominees or heirs of such deceased member whose pay, at the time of death does not exceed Rs 1,500 per month.

7. **Employees' Deposit Linked Insurance Scheme, 1976:** Another important social security measure, the Employees' Deposit Linked Insurance Scheme, 1976, was introduced for members of the Employees' Provident Fund and exempted Provident Funds with effect from August 1976. On the death of an employee, while in service, who is a member of the Employees' Provident Fund or of the exempted Provident Fund, the persons entitled to receive the provident fund accumulations would be paid an additional amount equal to average balance in the provident fund account of the deceased during the preceding twelve months. The maximum amount of benefit payable under the scheme is Rs 60,000 and the employees do not have to make any contribution.
8. **Employees' Pension Scheme, 1995:** Employees' Pension Scheme, 1995 was introduced for the industrial workers from November, 1995. Under the Scheme, pension at the rate of 50 per cent of pay is payable to the employees on retirement, on completion of 33 years qualifying service. A minimum of ten years service is required for entitlement to pension. Depending upon the salary and service of the employees at the time of death, the scheme also provides for grant of family pension ranging from Rs 450 per month to Rs 2,500/- per month. In addition, children's pension at the rate of 25 per cent of widow pension subject to a minimum of Rs 150 per child is also available upto two children.

10.6 Key Terms

Labor Welfare: This refers to all the facilities for laborers to improve their working conditions, provide social security, and raise their standard of living. Several state legislatures have enacted an Act exclusively focusing on the welfare of the workers, known as the Labour Welfare Fund Act.

Social Security: It is the protection that a society provides to individuals and households to ensure access to health care and to guarantee income security, particularly in cases of old age, unemployment, sickness, invalidity, work injury, maternity or loss of a breadwinner.

10.7 Summary

The labour welfare programs aim to create a conducive and supportive work environment that promotes the physical, mental, and socio-economic well-being of workers, enhances their job satisfaction and productivity, and contributes to sustainable development and social justice.

Social security systems are essential for promoting social justice, economic stability, and human dignity by ensuring that all individuals have access to essential social protections and services throughout their lives. The design and implementation of social security programs vary across countries, depending on factors such as economic conditions, social policies, and cultural norms.

10.8 Check your Progress

1. Write a brief on labor Welfare origins and its current status in India.
2. Explain the concept of social welfare and various measures undertaken to protect the rights of the community.
3. What are the different legislations under the labor welfare schemes in India?

10.9 References

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Unit 11 GATT AND WTO

Structure

11.1 Introduction

After the Second World War, many countries got together to work on the ways and means to promote international trade. The result was the signing of a general agreement on tariffs and trade in 1947.

The signing of the final act of the Uruguay Round by member nations of GATT in 1994 paved the way for the setting up of the World Trade Organization (WTO). GATT was not really an organization, it was merely a legal arrangement. On the other hand, the WTO is an international organization set up as a permanent body, designed to play the role of a watchdog in the spheres of trade in goods, trade in services, foreign investment, intellectual property rights, etc.

11.2 Learning Objectives

1. Understanding the Historical Context:
    - Explain the historical background leading to the establishment of GATT and the circumstances that necessitated its creation after World War II.
2. Knowledge of GATT Provisions:
    - Identify and describe the key provisions of GATT, including principles such as Most Favored Nation (MFN) treatment, National Treatment, and the reduction of tariffs and non-tariff barriers.
3. GATT Rounds and Negotiations:
    - Describe the different rounds of GATT negotiations, such as the Uruguay Round, and explain their significance in shaping global trade rules.

4. Comparison of GATT and WTO:
    - Differentiate between GATT and WTO in terms of their scope, functions, and institutional structures.
5. Understanding the WTO Framework:
    - Explain the objectives, functions, and organizational structure of the WTO, including its role in trade negotiations, dispute settlement, and policy monitoring.
6. WTO Agreements and Trade Rules:
    - Identify and describe key agreements under the WTO framework, such as the Agreement on Agriculture, Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and General Agreement on Trade in Services (GATS).
7. Trade Policy Analysis:
    - Analyze the impact of GATT/WTO agreements on international trade, economic development, and global economic integration.
8. Dispute Resolution Mechanism:
    - Explain the dispute settlement mechanism of the WTO, including the process of dispute resolution, the role of panels and the Appellate Body, and the enforcement of rulings.
9. Critiques and Debates:
    - Evaluate the strengths and weaknesses of the GATT/WTO framework, including critiques related to its effectiveness in addressing trade imbalances, development issues, and environmental concerns.
10. Application of Trade Principles:
    - Apply GATT/WTO principles to real-world trade scenarios, analyzing their implications for trade policy formulation and decision-making at the national and international levels.

11.3 GATT

An attempt to create an international organization to look after matters of trade and commercial policy were made as early as 1947. Although a charter for an International Trade Organization was drafted at the Havana Conference, it was never ratified due to differences between those who wanted a free multilateral trading system and those who placed emphasis on full employment policy on a national basis. However, the American proposal for a general agreement on tariffs and trade was agreed upon, and many nations signed. So emerged the General Agreement on Tariffs and Trade with no formal organization and no elaborate secretariat. It is through increasing liberalization of world trade and through GATT negotiations that the World Trade Organization emerged in 1995.

The two outstanding features of the GATT were the principle of non-discrimination and the principle of reciprocity, with the purpose of promoting fair and free international trade among members. To ensure non-discrimination, the members of the GATT agreed to apply the principle of MFN (Most Favoured Nation) to all import and export duties. This means that each nation shall be treated as well as the most favoured nation. However, the GATT did not prohibit economic integration such as the formation of free trade areas or customs unions, provided that the purpose of such integration was to facilitate trade between constituent territories and not to raise barriers to the trade of other parties.

Protection to domestic industries is given only through customs tariffs, thereby prohibiting import quotas and other restrictive trade practices.

The GATT office periodically convened conferences of nations for Multilateral Trade Negotiations, called rounds. Several rounds of trade negotiations conducted under the auspices of GATT, resulted in significant reductions in the average level of world trade tariffs.

The last round of multilateral trade negotiations known as the Uruguay Round, which was the eighth round, centred around three main issues:

(i) Trade-Related Intellectual Property Rights (TRIPs)

(ii) Trade-Related Investment Measures (TRIMs)

(iii) Trade in Agricultural Commodities

The Third World Countries have been dissatisfied with the GATT negotiations. Liberalization of trade-related intellectual property rights would mean that the less-developed countries would have to compete with the advanced countries or multinational companies. TRIPs, covering copyrights, patents and trademarks is likely to harm the indigenous technology and nascent industries—particularly the pharmaceutical and drug industry. GATT covers the service sectors as well under TRIMs. This is likely to affect the employment conditions in the developing countries as they will be swamped by professionals from the advanced industrial countries. Agriculture is another controversial issue under the GATT. While the US insisted on free trade in agriculture and withdrawal of state subsidies, the EEC countries, particularly France, which heavily subsidize their agriculture, objected. The US threatened to use a law called Super 301, under which punitive action is taken against countries which do not follow a free trade regime.

11.4 WTO

On January 1 1995, the first and most powerful world trade regulating agency, namely World Trade Organization (WTO) came into existence. India is one of its 132 founding members. The WTO is the umbrella organization responsible for overseeing the implementation of all agreements that have been negotiated just before it came into existence. It is also responsible for the settlement of disputes among its members. Finally, periodic review of the trade policies would also be initiated under the auspices of WTO.

Before the WTO came into existence, international trade in merchandise was guided by the rules and provisions of the GATT. The GATT rules, however, could not absorb the complexities of world trade, which had been growing steadily since the Bretton Woods days, both in terms of commodity coverage and the nature of regulators applied by the regional trade blocks. Moreover, the GATT umbrella did not cover trade in services.

The avowed goal of the WTO is to create a fair and equitable, rule-based multilateral trade system. The most appealing aspect is that the new multilateral trade regime would be transparent and non-discriminatory. For the world trading community as a whole, every initiative on trade liberalization should ensure rewards in the form of large and expanding markets and greater trade flows for all participating members. All quantitative restrictions (quotas, import licensing, etc.) would be replaced by tariff so as to make the process more transparent and open to international public scrutiny; all reductions and adjustments in tariffs would be effected through negotiations and are to be notified to the WTO. Then, all kinds of subsidies would be reduced in due course by the developed countries so that the developing economies under their sheer comparative cost advantage could gain larger access to the markets in the developed world.

The two most significant principles of the WTO agreements are the Most Favoured Nation and the National Treatment Clause. Under the former, no discrimination is to be exercised among member countries; any trade concession offered by one member to another must be offered to all members. Under the latter, imported products and domestic products are to be accorded the same treatment; moreover, besides import duty, no extra tax other than one also levied on domestic products is to be imposed. Foreign companies' investors and the Government must feel assured that trade barriers would not be raised arbitrarily by any trading partner. Lastly, the new trade regime should work to a greater advantage of the less-developed countries; they must be given more time to adjust, greater flexibility and some special privileges.

On a broad plane, the canvas of WTO agreements is spread over three compartments; goods, services and intellectual property rights. First, trade in goods of all descriptions (agricultural or industrial) is to be governed under the GATT reformulations. Second, trade in services of all kinds is to be regulated under the General Agreement on Trade in Services. Third, trade- related aspects of Intellectual Property Rights would set out the terms and conditions for the international flow of intellectual property.

Evaluation: The new trading system of the WTO seems to lay undue emphasis on the private sector and competition and fails to recognize the strategic role which the state plays in promoting the right kind of development with emphasis on equity and social infrastructure. Over-emphasis on competition seems to have eroded the concept of public good and thereby provided a partial view of the development process.

One of the objectives of trade negotiations under the GATT is providing a freer trading environment for the movement of goods and services. This objective is based on the assumption that free trade is an optimal modality for global welfare. But free trade does not necessarily imply fair trade. Given the differences in the initial conditions, total free trade seems to aggravate the gap between the rich and the poor countries. The new trading system under the WTO fails to recognize this adverse impact of liberalization of trade on the norms of fairness.

The WTO and Its Functions

The new World Trade Organization (WTO), which replaced the General Agreements in Tariffs and Trade (GATT) came into effect from January 1, 1995 with the backing of at least eighty-five founding members including India. The WTO is now the third economic pillar of worldwide dimensions, along with the World Bank and the IMF.

As many as seventy-seven of the 125 countries, which signed the Uruguay Round trade accord in April 1994 at a conference in Marrakesh, have officially notified the GATT that they would join the WTO.

The new trade body—WTO—with powers to settle trade disputes between nations and to widen the principle of free trade to sectors such as services and agriculture, covers more areas than GATT, whose rules had been in operation for the last 50 years. The WTO envisages the reduction of tariffs by more than one-third and is concerned with further opening of markets. It is expected that the world trade would be stimulated strongly in the long run as a result of the coming into being of the new trade body—WTO. According to an estimate made by the GATT, in 2005 turnover through international trade could be as high as $510 billion annually.

Like the GATT, the WTO agreement will regulate the commodities trade, but in addition it will also deal with services across borders like insurance and tourism. The new WTO conditions also protect intellectual property like patents, copyrights and brands. Agriculture and textiles are completely covered by the WTO agreements. The highest WTO body is a ministerial conference which will meet at least once in two years.

The WTO has been entrusted with the following functions:

1. The WTO would facilitate proper implementation of multinational trade agreements.
2. It will review trade policies undertaken by the member countries.
3. It will act as a forum for the negotiation of disputes among the member countries over trade-related problems.

4. The WTO will work in cooperation with the IMF and the World Bank. India's Commitments to the WTO:

1. Tariff Lines: As a member of the WTO, India has bound about 67 per cent of its tariffs lines whereas prior to the Uruguay Round only 6 per cent of the tariff lines were bound. For non-agricultural goods with a few exceptions, ceiling bindings of 40 per cent ad valorem on finished goods, and 25 per cent on intermediate goods, machinery and equipment have been undertaken. The phased reduction to these bound levels is being undertaken over the period March 1995 to the year 2005. In textiles, where reduction will be achieved over a period of 10 years, India has reserved the right to revert to duty levels prevailing in 1990, if the integration process, envisaged under the Agreement on Textiles, does not materialize in full. Under the Agreement of Agriculture, India's bound rate ranges from 100 to 300 per cent.
2. Quantitative Restrictions: Quantitative restrictions on imports maintained on balance of payments grounds were notified to WTO in 1997 for 2714 tariff lines at the eight digit level. In view of the improvements in India's balance of payments, the Committee on Balance of Payments Restrictions had asked India for a phase-out for the quantitative restrictions. An agreement between the USA and India was reached, envisaging the phasing out of all quantitative restrictions by India, by April, 2001. In line with this agreement, India removed quantitative restrictions on 714 items in the EXIM Policy announced on March 31, 2000 and on the remaining 715 items in the EXIM Policy announced in March, 2001.
3. TRIPs (Trade-related Intellectual Property Rights): The ruling of the two WTO Dispute Settlement Panels following the complaints made by the USA and the European Union that India had failed to meet its commitments under Article 70.8 and Article 70.9 made it obligatory for the Government of India to make appropriate amendments to the Patents Act, 1970, by April 1999. The Patents (Amendment) Act, 1999 was passed by the Parliament in March 1999, to provide for Exclusive Marketing Rights. In respect of plant varieties, a decision has been taken to put in place a sui generis system as it is perceived to be in our national interest.

As far as copyrights and related rights are concerned, the Copyright Act, 1957 as amended in 1994 takes care of our interests and meets the requirements of the TRIPs Agreement except in the case of terms of protection of performers' rights. A Bill to increase this term to 50 years was passed by the Parliament in December, 1999.

4. TRIMs (Agreement on Trade-related Investment Measures): Under the TRIMs agreement, the developing countries have a transition period of five years up to December 31, 1999 during which they can continue to maintain measures consistent with the Agreement provided these are duly notified. The Government of India notified two TRIMs, viz., that related to local content requirements in the production of certain pharmaceutical products and dividend balancing requirement in the case of investment in twenty-two categories of consumer items.
5. GATS: Under the General Agreement on Trade in Services (GATS), India has commitments in thirty-three activities. Foreign service providers will enter these activities. According to the Government of India, the choice of the activities has been guided by considerations of national benefit.
6. Customs Valuation Rules: India's legislation on Customs Valuation Rules, 1998, has been amended to bring it in conformity with the provisions of the WTO Agreement on implementations of Article VII of GATT 1994 and the Customs Valuation Agreement.

11.5 Benefits to India:

1. The World Bank and the GATT secretariat have estimated that the income effects of the implementation of the Uruguay Round package will add between 213 and 274 billion US dollars, annually, to world income. According to the Government of India, since our country's existing and potential export competitiveness lies in clothing, agriculture, fishery products and processed food, it is logical to believe that India will obtain large gains in these sectors.
2. The phasing out of the MFA (Multi-Fibre Arrangement) by 2005 will benefit India as the exports of textiles and clothings will increase.

3. The third benefit that India expects relates to the improved prospects for agricultural exports as a result of a likely increase in the world prices of agricultural products due to reduction in domestic subsidies and barriers to trade. While on the one hand earnings from agricultural exports are likely to increase, on the other hand, India has ensured that all major programmes for the development of agriculture will be exempted from the disciplines in the Agricultural Agreement. Thus, the operation of the public distribution system will not be affected by the provisions of the Agreement; agricultural subsidies granted by developing countries need not be withdrawn till such time they remain within the prescribed limits specified in the Agreement; and protection necessary for developing the agricultural sector in the underdeveloped countries might be continued. In fact, India hopes that the reduction of subsidies in the USA and the European Community will enable it to increase its earnings from agricultural exports.

4. The Uruguay Round Agreement has strengthened multilateral rules and disciplines. The most important of these relate to antidumping, subsidies and countervailing measures, safeguards and disputes settlement. This is likely to ensure greater security and predictability of the international trading system and thus create a more favourable environment for India in the new world economic order.

Disadvantages to India: The most important advantage of the new world economic order claimed by its supporters is that it will increase the volume of trade substantially and as a result, India's export earnings will expand considerably. However, the estimates of quantitative gains by India may prove wrong. The gains expected by the Government of India on account of tariff reductions on goods may also not materialize as the number of goods of export increase to India is very small.

The most serious disadvantages to India are likely to flow from the Agreements pertaining to the TRIPs, TRIMs and services.

Protection of intellectual property rights—patents, copyrights, trademarks, etc. has been made more stringent in the Uruguay Round. This has been done to protect the interests of multinational corporations and developed countries as the agreement on TRIPs is highly weighted in favour of patent-holders. As correctly pointed out by Muchkund

Dubey, intellectual property rights protection is anti-competition and anti- liberalization and goes against the spirit of opening up the world economy and global integration. It is to be noted that the TRIPs Agreement goes against the Patent Act of India, 1970, in almost all important areas. Under the Indian Patents Act, only process patents can be granted in food, chemicals and medicines. TRIPs Agreement provides for granting product patents in all these areas. TRIPs Agreement provides that the general term of a patent shall be 20 years. The Indian Patents Act provides for a general term of 14 years for both product as well as process patents.

11.6 Key Terms

GATT: The General Agreement on Tariffs and Trade is a legal agreement between many countries, whose overall purpose was to promote international trade by reducing or eliminating trade barriers such as tariffs or quotas**.**

WTO: The World Trade Organization is an intergovernmental organization headquartered in Geneva, Switzerland that regulates and facilitates international trade. Governments use the organization to establish, revise, and enforce the rules that govern international trade in cooperation with the United Nations System.

11.7 Summary

The real beginning of liberalization may well be said to have taken place from 1975 with the modification of the licensing procedure and recognition of additional capacities. The government has been liberalizing the operations of the MRTP Act from time to time as a result of which the big business houses have been allowed to enter a lot of industrial fields which were once denied to them. As part of liberalization, a number of policy measures were taken with a view to limiting the role of licensing, expanding the scope for contribution to growth by large houses.

The WTO has been given the power to settle trade disputes between nations and to widen the principle of free trade to sectors such as service and agriculture, covering more areas than GATT, whose rules have been in operation for the last fifty years. It has been entrusted with the function of facilitating proper implementation of multinational trade agreements, reviewing trade policies undertaken by the member countries, acting as a forum for the negotiation of disputes among the member countries over trade- related problems and working in cooperation with the IMF and the World Bank.

11.8 Check your Progress

1. Write a brief note on GATT and the reasons for its dissolution.

2. Explain the role of WTO in governing ethically the global business scenario.

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Unit 12 FINANCIAL ENVIRONMENT

Structure

12.1 INTRODUCTION

The Ministry of Finance is responsible for administration of finances of the Government. It is concerned with all economic and financial matters affecting the country as a whole.

Banking: The Banking Companies Act was passed in February 1949 which was subsequently amended to read as Banking Regulation Act 1949. This Act provides the legal framework for regulation of the Banking system by R.B.I.

The largest bank, The Imperial Bank of India was nationalized in 1955 and renamed as the State Bank of India, followed by forming of its seven Associated Banks in 1959. With a view to bringing the commercial banks into the mainstream economic development with definite social objectives, the Government issued an ordinance on July 1969 acquiring ownership and control of fourteen major banks in the country. Six more commercial banks were nationalized from 15 April 1980

As certain weaknesses were found to have developed in the banking system during the late 1980s, the Government of India felt that these had to be removed. A high-level committee on the Financial System was set up in 1991 under the Chairmanship of M. Narashimham and comprehensive reforms in the banking system were introduced in 1992-93.

Another high-level committee under the chairmanship of M. Narasimham was constituted by the Government of India in 1997 to review the record of implementation of financial systems reform recommended in 1991 by the Committee on Financial System and chart the reforms necessary in the years ahead. The Committee submitted its report to the Government in 1998. Some of the recommendations of the committee were accepted and implemented.

Recent major initiatives undertaken for strengthening the financial sector relate to guidelines to banks on asset liability management and integrated risk management systems, compliance with accounting standards, asset classification, etc. The guidelines on setting up of off-shore banking units in special economic zones. A fair practices code for lenders, corporate governance, anti-money laundering measurers are other important developments that have taken place in the banking sector.

In 1993, in recognition of the need to introduce greater competition, new private sector banks were allowed to be set up in the banking system. These new banks had to satisfy certain requirements.

12.2 Learning Objectives

This unit teaches you about:

- The functions of commercial banks

- The types of transactions provided by commercial banks
- The types of risk managed by banks
- The main functions of RBI
- The growth of stock exchanges
- The functions of a stock exchange
- The various categories of non-banking financial companies
- Development banking

12.3 FINANCIAL INSTITUTIONS: COMMERCIAL BANKING SYSTEM

Commercial Banking System in India consisted of 218 scheduled commercial banks as on 31 March 2006. Of the scheduled commercial banks, 161 are in the public sector, of which 133 are regional rural banks and these account for about 75.2 per cent of the deposits of all scheduled commercial banks. The regional rural banks were specially set up to increase the flow of credit to small borrowers in the rural areas.

Among the public sector banks as on 31 March 2006, the nationalized banks group is the biggest unit with 33,868 offices, deposits aggregating 1013,664 crore and advances of 721066 crore. The State Bank of India group with 13,820 offices, has deposits aggregating 490375 crore and advances of 350.961 crore. The nationalized banks accounts for 67.3 per cent of the aggregate banking business conducted by the Public Sector banks and 48.0 per cent of the aggregate business of all schedule commercial banks.

12.3.1 Functions of Commercial Bank

The functions of a commercial bank are:

- to change cash for bank deposits and bank deposits for cash
- to transfer bank deposits between individuals and/or companies
- to exchange deposits for bills of exchange, government bonds, the secured and unsecured promises of trade and industrial units
- to underwrite capital issues. They are also allowed to invest 5% of their incremental deposit liabilities in shares and debentures in the primary and

secondary markets. The commercial banks have set up subsidiaries to provide advice on portfolio management or investment counselling. They also offer their constituents services to pay insurances, advise on tax problems and undertake executive and trustee services.

12.3.2 Payment Systems

Commercial banks are institutions which combine various types of transactions services with financial intermediation. First, banks provide three types of transactions to convert deposits into notes and coins to enable holders of deposits to undertake transactions in cash. Second, bank deposits are used as a means of settling debts. Third, where exchange control does not exist, banks exchange cash and deposits from one currency into cash and deposits of another currency.

Commercial banks earlier had a monopoly on transaction services. Other financial intermediaries such as savings and loans, saving banks and credit unions in the United States have been authorized to offer transaction accounts. Money market mutual funds, another type of financial service organizations have developed financial product against which checks may be written.

Commercial banks are at the very centre of the payment systems. Bank money constitutes 38 per cent of the money supply (M1) of the Indian economy. An efficient payment system is vital to a stable and growing economy and the banks role is important.

In advanced economies, commercial banks are also at the heart of the electronic payment system which is replacing paper-based payment methods. In USA electronic payment between commercial banks are done through Fedwire which is a wholesale wire transfer system operated by the Federal Reserve System. About 3,00,000 transfers per day amounting to $1 trillion are made. Large banks in New York operate a private electronic transfer system called CHIPS (The Clearing House Interbank Payments System) which transfers $1 trillion a day involving international movement of funds.

Finally, Swift (the Society for Worldwide Interbank Financial Telecommunication) based in Brussels is operated by 2000 banks, brokerage firms and non-banking financial institutions worldwide.

12.3.3 Intermediation

Commercial banks undertake the important process of financial intermediation whereby the funds or savings of the surplus sectors are channelled to deficit sectors. Commercial banks along with other financial institutions channel the funds of surplus economic units to those wanting to spend on real capital investments. Funds are transferred through lending by banks or by creation of financial liabilities such as bonds and equity shares. Banks intermediate by obtaining the funds of savers in exchange for their own liabilities such as entries in a passbook and then in turn make loans to others. Financial intermediaries including banks buy and sell the right to future payments. Banks collect deposits from savers by offering interest. In 1998- 99 savings of the households in the form of bank deposits constituted 36.9 per cent of the total financial savings. Deposits of commercial banks can be of any denomination which have the characteristics of low risk and high liquidity. The small deposits are put together to make large loans.

Through their intermediary activities, banks provide a package of information and risk sharing services to their customers. While doing so, they take on part of their risk. Banks have to manage the risks through appropriate structuring of their activities and hedge risks through derivative contracts to maximize their profitability.

12.3.4 Transformation Services

Banks combine various types of transformation services with financial intermediation. They provide three transformation services when they undertake an intermediation process. First, liability, asset and size transformation consisting of mobilizing funds and their allocation (provision of large loans on the basis of numerous small deposits). Second, maturity transformation by offering the savers, relatively short-term claim on liquid deposits they prefer and providing borrowers long-term loans which are better matched to the cash flows generated by their investment. Finally, risk transformation by transforming and reducing the risk involved in direct lending by acquiring more diversified portfolios than individual savers can. Commercial banks, by effectively appraising credit requests, can channel funds into productive uses.

12.3.5 Transformation Services and Risks

Banks incur risks while undertaking transformation services. In the past three decades, banks abroad assumed new roles and accepted new forms of financial intermediation by undertaking currency and interest rate swaps and of dealing in financial futures, options and forward agreements. These new instruments reflect considerable flexibility in responding to market situations and adjusting continually the assets and liabilities both on and off the balance sheet, while enhancing profitability.

12.3.6 Risk Management: Basic Function of Bank

Risk is inherent in banking and is unavoidable. The basic function of bank management is risk management. In the words of Alan Greenspan, Chairman of the Federal Reserve Board of US (Conference at Federal Reserve Bank of Chicago, May 12, 1994), 'traditional banking can be viewed at an elemental level as simply the measurement, management and acceptance of risk, and banking involves understanding, processing and using massive amounts of information regarding the credit risks, market risks and other risks inherent in a vast array of products, and services, many of which do not involve traditional lending, deposit taking and payment services.'

12.3.7 Mismatch, Source of Risk

If banks had balance sheets where all assets are exactly matched by liabilities of the same maturity, the same interest rate conditions and the same currency, then the only balance sheet risk would be credit risk. Such exact matching does not occur in practice and even if we assume that it does, it would offer reduced profit opportunities. Mismatching within limits is an inherent feature of banking. Risks arise from the common cause of mismatching. When maturities of assets exceed those of liabilities, liquidity risk is inevitable; when interest rate terms differ there is inevitably interest rate risk; and when currency denomination of assets differ there is inevitably currency risk. When transactions are undertaken for settlement at a later date, there exists a risk of the other party to a transaction not completing the transaction as agreed. Banks should have the capacity to anticipate change and to act so as to structure and restructure a bank's business to profit from it or minimize losses.

12.3.8 Credit Analysis: Traditional Technique

For banks, the traditional activity was balance sheet lending and the risk management technique was credit analysis. Banks always managed assets and liabilities and took decisions on liabilities they were able to create and the assets they would acquire. These decisions reflected long run choices and relatively stable roles and did not require management in the near term. Variations in interest rate usually followed changes in the discount rate of the Central Bank and the type and terms of loans were subject to official constraints, notably on pricing. The source of funds was core deposits which were not sensitive to interest rates but increased with national income. They were also stable. Since interest rates were regulated, banks concentrated on asset management.

Banks in the process of providing financial services, assume various kinds of risks, credit, interest rate, currency, liquidity and operational risks. To some extent, these risks could be managed through sound business practices and the others through a combination of product design and pricing. In the past, banks concentrated on asset management with liquidity and profitability being regarded as two opposing considerations. As a result, banks ended up distributing assets in such a way that for the given liquidity level, the return was the maximum.

12.4 Overall Risk of a Bank

A bank's overall risk can be defined as the probability of failure to achieve an expected value and can be measured by the standard deviation of the value.

12.4.1 Types of Risk

Banks have to manage four types of risk to earn profits for maximizing shareholder wealth. These are credit risk, interest rate risk, liquidity risk and operational risk. In addition, there is a systematic risk arising due to various disruptions in the working of a major bank which in no time could spread to other banks or the whole financial system. Credit risk arises when a bank cannot get back the money from loan or investment. Interest rate risk arises when the market value of a bank asset, loan or security falls when interest rates rise. The solvency of the bank would be threatened when the bank cannot fulfil its promise to pay a fixed amount to depositors because of the decline in the value of the assets caused by increase in interest rate. Liquidity risk arises when the bank is unable to meet the demands of depositors and needs of borrowers by turning assets into cash or borrow funds when needed with minimal loss. Finally, operational risk arises out of the inability to control operating expenses, especially non interest expenses such as salaries and wages. In a competitive environment, high operational expenses would jeopardize the banks' prospects to survive. Empirical analysis reveals that a bank's risk exposure depends upon volatility of interest rates and asset prices in the financial market, the bank's maturity gaps, the duration and interest elasticity of its assets and liabilities and the ability of the management to measure and control the exposure.

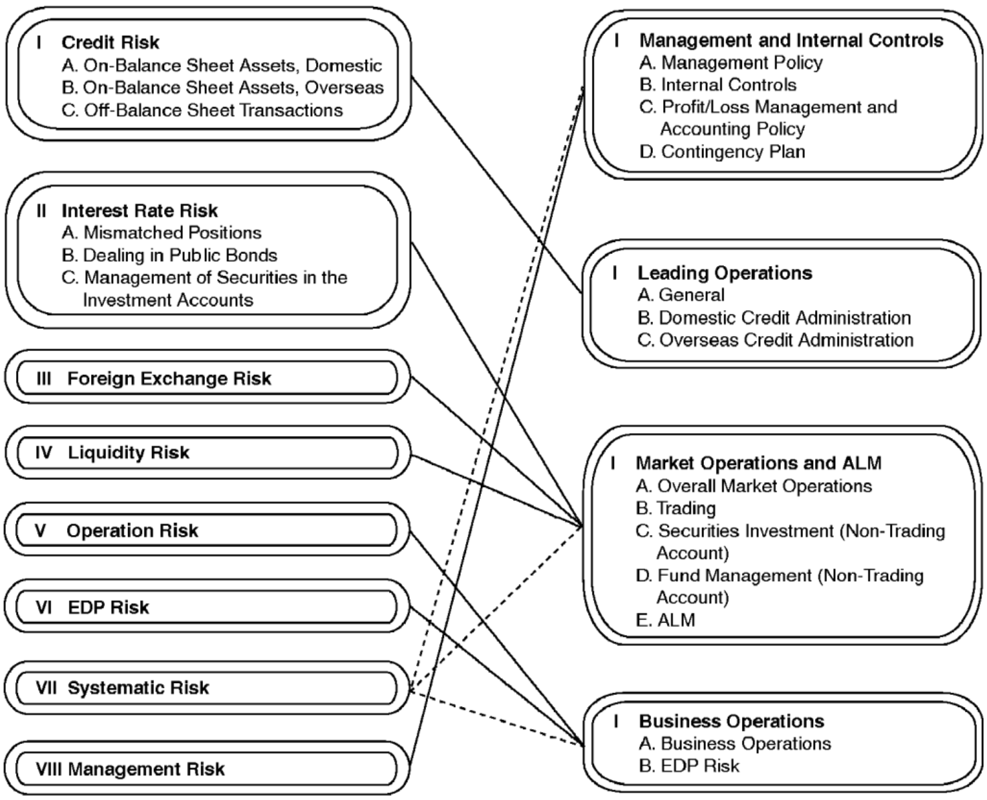

Fig. 4.1 Check List of Risk Management

12.4.2 Interest-sensitive Assets

These risks are a part of either assets or liabilities or both of a bank. Assets are managed through money market instruments such as interbank lending, treasury bills, and repos. Shortening the maturity of these assets makes them interest-sensitive. Shifting liabilities such as interbank borrowing, issue of CDs while shortening the maturity of the liability side of the balance sheet makes liabilities more interest-sensitive and increases the risk of the bank's portfolio.

12.4.3 Credit Risk

The assets of a bank, whether a loan or investment, carries credit risk. Credit risk is the risk of losing money when loans default. Credit risk or default risk gives rise to problems for the bank management. The principal reason for bank failures is bad loans. Banks can raise their credit standards to avoid high-risk loans. Guarantees and collateral can reduce risk. After the loan is made, compliance can be ensured by monitoring the behaviour of the borrower which reduces risk. Credit risk can be transferred by selling standardized loans. Loans portfolio can be diversified by making loans to a variety of firms whose returns are not perfectly and positively correlated.

RBI guidelines envisage that banks should put in place the loan policy covering the methodology for measurement, monitoring and control of credit risk. Banks are also expected to evolve the comprehensive credit rating system that serves as a single point indicator of diverse risk factors of counter parties in relation to credit and investment decisions.

12.4.5 Interest Rate Risk

Interest rate risk management may be approached either by on-balance adjustment or off-balance sheet adjustment or a combination of both. On-balance sheet adjustment involves changes in the bank's portfolio of assets and liabilities as interest rates change. When medium or long-term loans are funded by short-term deposits, a rise in the rate of interest will increase the cost of funds but the earnings on the assets will not, thereby reduce the margin or spread on the assets. The problem could be resolved by adopting adjustable interest rate on loans on the assets side of the balance sheet and increasing the maturity pattern of deposits on the liability side of the balance sheet. These decisions relating to the bank's portfolio of assets and liabilities are represented on balance sheet adjustments.

The interest rate risk position can also be adjusted by the bank by making off- balance sheet adjustments which involve the use of various non-traditional financial instruments referred to as derivatives such as futures, options, swaps or creation of synthetic loans through use of futures.

12.4.5 Liquidity Risk

Liquidity risk refers to the bank's ability to meet its cash obligations to depositors and borrowers. A liability-sensitive position reduces the liquidity position of a bank. The mismatch between short-term liabilities and long-term assets creates a severe funding problem as the liabilities mature. Again, if the duration of assets exceeds the duration of liabilities, the ability to realize liquidity from the assets of the bank is reduced. Liquidity needs are increasingly met by deposit and non-deposit sources of funds paying market rates of interest. Banks have decreased the quantity of liquid assets they hold for the purpose of deposits withdrawal and loan demand. Liability management has replaced asset management as a method to fund liquidity needs. The effect of replacement of asset management by liability management would be enhancement of credit risk since liquid assets have been replaced by loans. The replacement of short- term assets by long-term assets would also require an increase in gross rates of return since upward sloping yield curves require higher rate of return on long-term assets than on short-term assets.

Asset liquidity is a reserve that a bank can fall back upon when the bank's access to funds is reduced. Liquid assets can also be used to fund loans when interest rates are relatively high. Short-term assets are a less expensive source of funds than relatively high interest rate deposits.

12.4.6 Foreign Exchange Risk

Foreign exchange risk arises out of the fluctuations in the value of assets, liabilities, income or expenditure when unanticipated changes in exchange rates occur. An open foreign exchange position implies a foreign exchange risk. When a bank owns an uncovered claim in foreign currency, it is said to be long and when it has uncovered liability in foreign currency it is said to be short. There are several techniques available to hedge or cover exposure to foreign exchange risk. These techniques help in arranging offsetting commitments in order to minimize the impact of unfavourable potential outcomes. Forward contracts, money market alternatives, foreign currency futures, currency swaps and foreign currency options are used to cover exposure to foreign exchange risk.

12.4.7 Derivatives

Derivatives are used by banks to hedge risks, to gain access to cheaper money and to make profits. Banks undertake fee-generating activities that include a variety of commitments, and contingent claims that corporations demand such as financial guarantees and securitisation. Banks also help customers to cope with financial market volatility by offering various derivative securities services such as forward contracts, futures, swaps and options. These activities do not appear on the balance sheet of banks. The capital requirement for off-balance sheet activities is comparatively low. Mismatch of interest rate terms can result in large losses when market rates change. Mismatch of currency denomination of assets and liabilities can result in large losses when exchange rates vary.

12.4.8 Treasury Function

To take advantage of the opportunities provided by the development of new financial markets, and the internationalization of banking while managing risk, has led to the growth of treasury function within banks. The role of the new treasury department is to manage a wide range of short-term assets and liabilities. The dealers employed in the treasury department are constantly trading in wholesale deposits, interbank deposits, certificates of deposit, foreign exchange, repurchase agreements, securities, financial futures and options. Apart from trading in short-term assets and liabilities, the treasury department monitors the bank’s position with respect to earnings and risks due to maturity gaps and interest rate or foreign currency exposures. The treasury department usually reports to a high-level treasury or asset and liability management committee. The committee after taking into account the entire balance sheet of the bank as well as off-balance sheet liabilities, decides the treasury policy.

12.4.9 Monitoring Risks

To monitor risks, various techniques, maturity profile, rate of interest ladder and concept of duration have been developed. A maturity profile shows all assets and all liabilities by maturities to enable the calculation of mismatches within each period. The rate-of-interest ladder classifies all assets and liabilities by repricing dates and allows the calculation of rate of interest risk for each period. Duration presents the interest exposure.

Asset and liability management is not a static technique but a dynamic approach to deal with the problem banks face and the changes in banks' goals. Frozen lending was offset by increasing flexibility by making new loans against the provision of tradable assets which could be sold before expiry in case of need. Against a background of rapid growth in the banking business, integrated approach to managing all assets and all liabilities evolved as balance sheets became more complex and as the volatility of interest rates and exchange rates increased. In the eighties, the rescheduling of debt of developing countries on account of their serious payment difficulties involved conversion of short-term and medium-term assets as long-term assets became frozen. Banks abroad met the problem by raising long-term funds including capital liabilities. In the process, banks could meet the rise in capital adequacy norms stipulated by bank supervisors. Banks shifted their focus from growth to profitability and asset quality. Banks also started lending against negotiable assets and to the packaging for resale of conventional bank loans. Borrowers were encouraged to raise funds directly through issue of negotiable short-term papers by providing guarantees, standbys and back-up facilities. Banks benefited from fee income without expanding the balance sheet which would worsen capital ratios. Of course, off-balance sheet contingent liabilities went up.

There was a deliberate attempt to extend asset liability management beyond the range of on-balance sheet assets and liabilities, which arises from the bank acting as principal in direct transactions with borrowers and lenders of money. Asset and liability management has helped to bring about securitization of banking, blurring the distinction between commercial banking and investment banking.

12.4.10 RBI Guidelines for Risk Management

Consequent to the liberalization of the domestic market in India, the volatility in interest/ exchange rates would be transmitted to the financial sector as a whole. To address these risks, banks have to undertake a comprehensive asset liability management

(ALM) strategy. The objectives of ALM are to control volatility of net interest income and net economic value of a bank.

RBI issued guidelines on 21 October 1999 for risk management in banks which broadly cover credit, market and operational risks. Earlier guidelines were issued on 10 October 1999 on asset-liability management system which covered management of liquidity and interest rate risks. Together they are purported to serve as benchmark to banks.

12.4.11 Credit Risk

Banks should put in place the loan policy covering the methodologies for measurement, monitoring and control of credit risk. Banks should also evolve a comprehensive credit-rating system that serves as a single point indicator of diverse risk factors of counter parties in relation to credit and investment decisions.

Proposals for investment should be subjected to the same degree of credit risk analysis as loan proposals. Portfolio quality should be evaluated on an ongoing basis rather than near about balance sheet date. Risk evaluation should be on the basis of total exposure, credit and investment decisions combined.

As regards off-balance sheet exposures the current and potential credit exposures may be measured on a daily basis. A suitable framework to provide a centralized overview of the aggregate exposure on other banks is to be evolved. The banks should also develop an internal matrix that reckons the counter party and country risk.

12.4.11 Liquidity Risk

Banks should put in place prudential limits on interbank borrowings, especially call fundings, purchased funds, core deposits to core assets, off-balance sheet commitments and swapped funds. Liquidity profile should be evaluated under bank specific and market crisis scenarios. Contingency plans should be prepared to measure the ability to withstand sudden adverse swings in liquidity conditions.

Interest Rate Risk

A time-frame should be fixed for moving over to value at risk (VAR) and duration approaches for measurement of interest rate risk.

Market Risk

Explicit capital cushion, based on international standards, should be provided for the market risks to which banks are exposed.

Operational Risk

In view of the phenomenal increase in the volume of financial transactions, proper systems for measurement, monitoring and control of operational risk should be set up. Suitable methodologies for estimating and maintaining economic capital should be developed.

The design of the risk management should be oriented towards the banks' own requirement dictated by the size and complexity of business risk philosophy, market perception and the existing level of capital. Banks can evolve their own systems compatible with the type and size of operations as well as risk perception. It is neither possible nor necessary to adopt a uniform risk management system in all banks on account of the diversity and varying size of balance sheet items.

The success of ALM depends on the effective existence of

(1) Information and policies and

(2) Risk management systems.

There should be asset-liability managers and an asset-liability committee (ALCO) that manages the bank's balance sheet in such a manner so as to minimize the volatility in its earnings, liquidity and equity to changes in market conditions. The successful pursuit of the objective would manifest in stable net interest margins, optimal earnings, adequate liquidity and effective control of financial risk. For this purpose, the information base in a bank must be sound and strong. ALCO must be aware of policies which would address asset liability management goals and risk limits and by information that relates directly to its asset liability position.

Risk Management Systems

Measurement, control and monitoring of risk will help banks to attain the objectives. Techniques such as gap, duration and value at risk are suggested to analyze risk. Strengthening of information technology in commercial banks is a prerequisite for effective implementation of ALM system. The role of a broad-based ALCO in advising boards of banks is emphasized.

Deposit Mobilization and Deployment

There has been a substantial increase in the deposits of scheduled commercial banks post nationalization period. At the end of June, 1969, deposits of these banks aggregated to July 4646 crore. As on 31 March 2006, this amount has increased to 2093042 crore. Deposit amount with the public sector banks was 3871 crore in June, 1969. As on 31 March 2006, this amount stood at 1574664 crore.

Advances to Priority Sector

Extension of credit to small borrowers in the hitherto neglected sectors of the economy has been one of the key tasks assigned to the public sector banks in the post-nationalization period. To achieve this objective, banks have drawn up schemes to extend credit to small borrowers in sectors such as agricultural, small-scale industry, road, water transport, retail trade and small business which traditionally had very little share of the credit extended by banks.

12.5 Credit Flow to Weaker Sections

With a view to augmenting credit flow to small and poor borrowers, commercial banks were advised by the RBI to provide at least 10 per cent of their net bank credit on 25 per cent of their priority sector advances to weaker sections comprising small and marginal farmers, landless labourers, tenant farmers and share croppers, artisans of the village and cottage industries where individual credit limits do not exceed 50,000/- beneficiaries of Government sponsored schemes such as Swarnajayanti Gram Swarozgar Yojana for rural poverty. Swarnajayanti Shahari Rozgar Yogna, etc. with a view to bringing in urban poor into formal financial system; banks have been advised to grant loans to the distressed urban poor to repay their debt to non-institutional lenders, against appropriate security. Such loans to the urban poor may be classified under the weaker section within the priority sector.

1. **Credit Flow to Agriculture**

Banks were initially given a target of extending 15 per cent of the total advances as direct finance to the agriculture sector to be achieved by March, 1985. This target was subsequently raised to 18 per cent to be achieved by March 1990. At the end of March 2006, public sector banks had extended 154000 crores constituting 15.22 of the net bank credit to the agricultural sector. Private sector banks extended 36,186 crores to agriculture as at the end of March, 2006. Differential Rate of Interest Scheme Under the Differential Rate of Interest Scheme, introduced in 1972, public sector banks are required to fulfil the targets of lending at least one per cent of the advances at the end of the preceding year to the weakest of the weak sections of the society at an interest rate of 4 per cent per annum.

2. **Swarnajayanti Gram Swarozgar Yogna**.

The Union Ministry of Rural Development launched a poverty alleviation programme, SGSY, with effect from April 1999, which has replaced IRDP and its allied schemes. The scheme aims at establishing a large number of micro enterprises in the rural areas of the country. The objective of the scheme is to bring every assisted family above the poverty line in three years by providing them income generating assets through a mix of bank audit and government subsidy.

3. **Prime Minister's Rozgar Yogna**

The scheme was launched on 2 October 1993, and initially was in operation in the urban areas. From 7 April, 1994 onwards the scheme is being implemented throughout the country. The objective of the scheme is to provide self-employment opportunities to the educated unemployed youth in the age group of 18.35 years. In the northeastern states the age group is from eighteen to forty, there is a ten year relaxation for SC/ST, ex-servicemen, physically handicapped and women in the upper age limit.

4. **Regional Rural Banks**

Regional Rural Banks were set up to take banking services to the doorsteps of rural masses, especially in remote rural areas with no access to banking services. These banks were originally intended to provide institutional credit to the weaker sections of the society.

5. **Small Industries Development Bank of India**

The Small Industries Development Bank of India was established as a principal financial institution for the promotion, financing and development of industries in the small-scale sector.

6. **Export-Import Bank of India**:

The Export-Import Bank of India was established for financing facilitating and promoting foreign trade in India. During the year ended 31 March 2006. EXIM Bank sanctioned loans of 20,489 crore.

7. **National Housing Bank:**

The National Housing Bank (NHB), the apex institute of housing finance in India was set up as a wholly owned subsidiary of the RBI. The Bank started its operations from July 1988. The authorized paid-up capital of the Bank stood at 450 crore and reserve and surplus were 1201.32 crore as on 30 June 2005. The Bank is the regulator and supervisor of Housing Finance companies in the country.

8. **NABARD:**

The National Bank for Agriculture and Rural Development came into existence on 12 July 1982. It was established for providing credit for promotion of agriculture, small scale industries, college and village industries, handicrafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas. Paid-up capital of NABARD is stood at 2000 crore as on 30 March 2006. The profit after tax stood at 357 crore during year 2005-2006.

9. **Indian Bank Abroad:**

As on 30 June 2006, eighteen Indian Banks—twelve from the Public sector and six from the private sector—had operations overseas.

International Monetary Fund: India is a founder member of IMF. The Finance Minister is the ex-officio governor on the board of governors of the IMF and the Governor of RBI is India's alternate governor. India is represented at the IMF by an Executive Director.

Quota: India's current quota in the IMF is SDR (Special Drawing Rights) 4158.20 millions in total quota of SDR 213 billion, giving a share holding of 1.95 per cent.

10 World Bank Lending to India:

India has been borrowing from the World Bank through International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) for various development projects in the areas of poverty alleviation, infrastructure, rural development, etc. IDA funds are one of the most concessional external loans for the Government of India and are used largely in social sector projects that contribute to the achievements of the Millennium Development Goals. IBRD funds are relatively costlier but cheaper than commercial external borrowings.

11 Asian Development Bank:

The Asian Development Bank and International Partnership of 63 member countries was established in 1966, with its headquarters at Manila, Philippines. India is a founder member. The Bank is engaged in promoting economic and social progress of its developing members in the Asia and Pacific region. Its Principal functions are as follows

(1) to make loans and equity investments for the economic and social advancement of its developing member countries

(2) to provide technical assistance to the preparation and execution of development projects and programmes.

(3) to respond to the request for assistance in coordination of development policies and plans in the developing countries and respond to the requests for assistance in coordinating development policies and plans of developing member countries.

India's subscription to the Bank's capital stock as on 31 December 2004 is 6.424 per cent of all the member countries.

12. Investment Commission:

The investment commission was set up in December 2004 with a view to making the environment of India attractive for the investor. The commission has the broad authority of the Government to engage, discuss with and invite domestic and foreign business to invest in India. The commission in its reports in February 2006 titled, Investment strategy for India, has served that for sustaining growth over 8 per cent per annum will require an increase in investment in the economy from 28 per cent of GDP to about 32 per cent of GDP over the 5 years, this translates to a cumulative investment of about $1.5 trillion.

Insurance Division: the Life Insurance Corporation of India with its central office in Mumbai and seven zonal offices at Mumbai, Kolkata, Delhi, Chennai, Hyderabad, Kanpur and Bhopal operates through 101 divisional offices including one salary scheme division at Mumbai and 2048 branch offices. The corporation also transacts business abroad and has offices in Fiji, Mauritius and UK.

12.6 Social Security Group Insurance Scheme:

A social security fund was set up in 1988-89 for providing social security through group insurance to the weaker sections of the society. The SSF is administrated by LIC for meeting the insurance requirement of the segment.

People belonging to twenty four occupational groups have been covered under the scheme. The scheme has been replaced by the Janashree Bima Yojana from August 2000.

The Janashree Bima Yojana was launched on August 10,2000. The scheme has replaced the social security insurance scheme and the rural group life insurance scheme.

Krishi Shramik Samajik Suraksha Yojana: The multi benefit scheme for the agricultural workers, commenced on 1 July 2001, provides Life Insurance Protection, periodical lump sum survival benefit and pension to those who were between the age of eighteen-fifty years.

Shiksha Sahayog Yojana: The scheme was launched on 31 December 2001, with the object of lessening the burden of meeting the educational expenses of their children. It provides scholarships to students of parents living below the poverty line.

Agricultural Insurance Company of India Limited: A separate organization for agricultural insurance called Agricultural Insurance Company of India Limited has been incorporated under the Companies Act 1956 in December 2002 with capital participation from General Insurance of India, four public sector general Insurance companies and NABARD.

Disinvestment: The disinvestments of Govt equity in Central Sector Enterprises began in 1991-92 till 1999-2000, it was primarily through sale of minority shares in small lots. From 1999-2000 till 2003-04, the emphasis of disinvestments changed in favour of strategic sale, viz. sale of a large block of shares.

Pension Reforms: In August 2003, the Government decided to introduce a new restructured, defined contribution pension system called New Pension System for new entrants to the central Govt service, except to armed Forces in the first stage.

RBI

The Reserve Bank of India was established on 1 April 1935, under the Reserve Bank of India Act, 1934. The Bank's share capital was 5 crore. In the terms of the Reserve Bank (Transfer to Public Ownership) Act, 1948, the entire share capital was deemed to be transferred to the Central Government. The Reserve Bank entered upon its career as a state-owned institution from 1 January 1949. The Act of 1948 empowered the Central Government to issue such directions to the Bank as it might consider necessary in the public interest after consultation with the Governor of the Bank.

Main Functions of the Bank

The main functions of the Reserve Bank are to act as the note-issuing authority, banker's bank, banker to the government and to promote the growth of economy within the framework of the general economic policy of the government, consistent with the need to maintain price stability. It also performs a wide range of promotional functions to support the pace of economic development. The Reserve Bank is the controller of foreign exchange and watchdog of the entire financial system. It is the sponsor bank of a wide variety of top-ranking banks and institutions such as SBI, IDBI, NABARD and NHB. It sits on the board of all banks and counsels the Central and State governments and all public sector institutions on monetary matters. No other central bank, even in the developed world, is saddled with such onerous responsibilities and functions.

Money Supply Measures

As per the recommendations of the Working Group on Money Supply (1997), four monetary aggregates are compiled on the basis of the balance sheet of the banking sector in conformity with the norm of progressivity in terms of liquidity: M0 (monetary base) (weekly), M_1 (narrow money), M_2 and M_3(broad money) (fortnightly). Further, three liquidity aggregates in order of progressivity viz., L_1, L_2 and L_3 (quarterly) are computed incorporating deposits with post office savings banks, term deposits, term borrowings and certificates of deposits of term lending institutions (FIs) and public deposits of NBFCs on an aggregation basis.

Issue of Currency

The Reserve Bank is the sole authority for the issue of currency in India. Rupee coins/notes and subsidiary coins are issued by the government of India but they are put into circulation only through the Reserve Bank.

In India, currency forms 59.0 per cent of narrow money (M1) and 18.0 per cent of broad money (M2), and a significant portion of money supply (1998-99). Currency notes are legal tender in payment or on account, without limit. One rupee notes and coins are legal tender for unlimited amounts, fifty paise coins for a sum not exceeding ten rupees and smaller coins for any sum not exceeding one rupee.

The Act permits the issue of notes in the denominations of rupees two, five, ten, twenty, fifty, hundred, five hundred, one thousand, five thousand and ten thousand. At present, denominations up to 1000 are being used. The affairs of the bank relating to note issue and its general banking business are conducted through two separate departments, the Issue and Banking Department.

The Issue Department is liable for the aggregate value of currency notes of the Government of India and the currency notes of the Reserve Bank in circulation and it maintains eligible assets for equivalent value. It is responsible for getting its periodical requirements of notes printed from the currency presses of the Government of India, distribution of currency among the public and withdrawal of unserviceable notes and coins from circulation. The Issue Department deals directly with the public in the exchange of currency for coins and vice versa and exchange of notes of one denomination for another.

The assets which form the backing for the note issue are kept wholly distinct from those of the Banking Department. In practice, the distinction between the Issue Department and the Banking Department has little economic significance, since there are frequent shifts between the assets of the two departments. However, not all assets of the Banking Department are eligible for being held in the Issue Department like State Government securities and small coins. This is to provide a safe check on the issue of currency.

The expansion and contraction of currency in circulation is effected through the Banking Department. Cash deposits and withdrawals by scheduled banks are handled by the Banking Department. The Banking Department replenishes its currency when necessary from the Issue Department against transfer of eligible assets. Similarly, surplus cash is returned to the Issue Department in exchange for equivalent assets.

There is no ceiling on the amount of notes that can be issued and the notes are issued against 100 per cent cover of approved assets which in practice consists of gold (11,738 crore), foreign securities (45,200 crore), Government of India rupee securities (86,427 crore) and rupee coins (51 crore). Table 4.1 presents the Balance sheet of the Reserve Bank as on June 30, 2000. Total assets amounted to 1,58,481 crore against which liabilities consisting of notes held in the Banking Department amounted to 15 crore and notes in circulation 2,01,501 crore.

Banker to Government

The Reserve Bank is the banker to the Government of India statutorily and to state governments by virtue of agreements entered into with them. The Bank accepts money on deposit, withdrawal of funds by cheques, receipt and collection of payments to the government and transfer of funds by various means throughout India. The terms and conditions on which the bank acts as a banker to the Central and State Governments are set out in separate agreements which the bank has entered into with them. Under the agreement, the Reserve bank is required to transact the general banking business of the Central Government and keep accounts in its books. The Central Government earlier maintained a minimum cash balance of 50 crore. Whenever the balance fell below it, the account was replenished by the creation of treasury bills known as ad hocs which are held in the Issue Department. During the period 1985-92 net RBI credit to the Central Government accounted for over 96 per cent of the monetary base. Under an agreement between the Government of India and the Reserve Bank in September 1994, the net issue of ad hocs should not exceed 5,000 crore at the end of the financial years 1995-96 and 1996-97 and 9,000 crore for more than ten consecutive working days at any time during the year 1996-97. The impact on monetization was reduced as a result. During the period 1993-98 RBI credit to Central Government was reduced to 65 per cent of monetary base. The practice of automatic monetization of the budgetary deficit was abandoned in April 1997. But the size of the market borrowing has to be reasonable to reduce the pressure on monetization. RBI is involved in underwriting government securities. It acts as a principal and as an agent in the securities market. The flexibility in respect of the extent of its support to government programmes is notional. The Reserve Bank's subscription to total primary issues was 38,205 crore (46 per cent) in 1998-99 and amounted to 21,000 crore (31 per cent) in 1999-2000.

Ways and Means Advances

Under the agreement between the Government of India and the Reserve Bank (March 26, 1997) the bank will provide Ways and Means Advances (WMA) to the Government, as and when required at an interest rate mutually agreed from time to time. These advances will have to be repaid within three months. When 75 per cent of the agreed level of Ways and Means Advances are utilized, the RBI will trigger fresh floatation of government securities. For the first half of 1997-98 the limit of WMA was 12,000 crore and for second half it was 8,000 crore; and for 1998-99, 11,000 crore for first half and 7,000 crore for second half. The limits remained the same in 1999- 2000.

The WMAs for State Governments in 1996-97 were, normal 2234.40 crore and special 851.20 crore. These limits are 168 times and 64 times their minimum cash balances, respectively. Normal WMA was enhanced to 3,685 crore from 31 March 1999. As on 31 March 2000 the aggregate outstanding level of WMA and overdrafts of State Government from RBI was 7,519 crore.

Public Debt

Public debt management policy determines the composition of debt while the size of the debt is determined by budgetary requirement. In September 1994, limits were defined for net issue of ad hoc treasury bills through which budgetary deficits were automatically covered. This was to do away with the practice of automatic monetization of the Central Government budgetary deficits and to pave the way for independent market intervention through open market operations. Further, the introduction of the auction system for treasury bills and securities has let the interest rate be market- determined. While the institutions, banks, LIC and PFs have to statutorily buy government securities, the interest rate on their holdings is market-determined.

Maturity Pattern

There has also been a shortening of maturity structure during 1991-98. The outstanding market loans under five-year maturity have gone up from 8.6 per cent in 1991 to 41 per cent in 1998. As against this, the longer loans of over 10-year maturity have declined from 85.8 per cent to 18.2 per cent. The maturity structure of debt has significantly shifted in favour of medium and short-term borrowings. The shortening of the maturity structure is conducive to open market operations to impact liquidity. A prudent debt management policy would warrant a shortening of maturity structure if its interest rates are perceived as being high; and lengthening of maturity structure is warranted if interest rates are perceived as being low and expected to rise. Irrespective of expectations about interest rate changes, excessive maturities at the short end have to be avoided since it would lead to bunching of redemptions and roll-over problems.

Ownership of Securities

The ownership of government securities continues to be skewed in favour of captive investors, with commercial banks and insurance companies holding the largest share. The share of ownership of commercial banks between 1991 and 1995 has gone up from 59.4 per cent to 75.5 per cent but has declined to 63 per cent in 1997; and insurance companies, from 12.3 per cent in 1991 to 18.0 per cent in 1998. The holdings of the Reserve Bank have, however, registered a steep decline from 20.3 per cent in 1991 to 2 per cent in 1995. But, in 1998 it had gone up to 10.7 per cent. The investor base has expanded to a certain extent with finance companies, corporates and financial institutions investing in government securities.

The concentration of the debt market in a few large investors introduces an element of rigidity in the downward adjustment of interest rate on government securities especially when the targeted market programme is fulfilled.

Secondary Debt Market

Debt management policy can be effective if there is a secondary market with depth. First, the move to market-related rates of interest is likely to strengthen the development secondary market. This enables the primary and secondary markets to give effective signals to each other.

Second, the system of primary dealers would enable the development of an orderly market. Primary dealers act as market makers for securities by giving two-way quotes. They are not final investors but should have the financial capacity and skills to bid in the primary auctions and hold the securities till they are able to access them in the secondary market. Primary dealers are approved by the RBI and help in the placement of government securities in primary issues by committed participation in auctions. The primary dealers act as a conduit for open market operations by the Reserve Bank and provide signals for market intervention. The Reserve Bank announced on 29 March, 1995, guidelines and procedures for enlistment of primary dealers in government securities. These guidelines relate to the commitment to bid minimum amount, underwrite a predetermined part, achieve a minimum turnover, maintain minimum capital standards on risk-weighted assets and be subject to Reserve Bank regulation. The Bank in turn would extend facilities like current account/ subsidiary ledger account (SGL), liquidity support linked to bidding commitments, freedom to deal in money market instruments and favoured access to open market operations. PDs are paid commission on primary purchases (including underwriting).

The development of the debt segment in the National Stock Exchange and duplication of transactions recorded by the Reserve Bank under the SGL Account has imparted a greater element of transparency. Finally, the system of delivery versus payment (DVP) in government securities introduced in Mumbai in July 1995, to synchronize the transfer of securities with the cash payment would reduce the settlement risk in transactions and prevent diversion of funds in the case of transactions through SGL. Liquidity of securities should improve with the setting up of the Securities Trading Corporation of India (STCI). Along with the existing Discount and Finance House of India (DFHI) the holding of government securities would become, attractive.

REPOs

REPO and reverse REPO operated by RBI in dated government securities and Treasury bills (except 14 days) help banks to manage their liquidity as well as undertake switch to maximize the return. REPOs are also used to signal changes in interest rates. REPOs bridge securities and banking business.

An REPO is the purchase of one loan against the sale of another. They involve the sale of securities against cash with a future buyback agreement. There are no restrictions on the tenor of REPOs. They are well established in the US and spread to the Euro market in the second half of the 1980s to meet the trading demand from dealers and smaller commercial banks with limited access to international interbank funding. REPOs are a substitute for traditional interbank credit.

REPOs are part of open market operations undertaken to influence short-term liquidity. With a view to maintaining an orderly pattern of yields and to cater to the varying requirements of investors with respect to maturity distribution policy or to enable them to improve the yields on their investment in securities, RBI engages extensively in switch operations. In a triangular switch, one institution’s sale/purchase of security is matched against the purchase/sale transaction of another institution by the approved brokers. In a triangular switch operation, the selling bank’s quota (fixed on the basis of time and demand deposit liabilities) is debited (the Reserve Bank being the purchaser). The objective behind fixing a quota for switch deals is to prevent the excessive unloading of low yielding securities on to the Reserve Bank. The Bank maintains separate lists for purchase and sale transactions with reference to its stock of securities and the dates of maturity of the different loans.

REPO auction was allowed since 1992-93. Since November 1999, REPOs are offered on a daily fixed rate basis to provide signals to money market rates and impart stability to short-term interest rates by setting a floor to call rates. Particulars of transactions in government securities including treasury bills put through SGL accounts were released to press since 1 September, 1994. Between 1992 and 1995, RBI engaged in fourteen days REPOs which coincided with CRR maintenance period. Since November, 1996, three to four days REPOs were offered. REPO facility with the RBI in government dated securities was extended to STCI and DFHI to provide liquidity support to their operations. A system of delivery versus payment (DVP) in government securities was introduced in July 1995 to synchronize the transfer of securities with the cash payment thereby reducing the settlement risk in securities transaction and also preventing diversion of funds in the case of transactions through SGL.

REPOs and Reverse REPOs

In order to activate the REPOs market so that it serves as an equilibrating force between the money market and the securities market, REPO and reverse REPO transactions among select institutions have been allowed since April 1997 in respect of all dated Central Government securities besides Treasury Bills of all maturities. A system of announcing a calendar of REPO auctions to enable better treasury management by participants was introduced in January 1997.

Reverse REPOs ease undue pressure on overnight call money rates. PDs are allowed liquidity support in the form of reverse REPO facility.

Reverse REPO transactions can be entered into by non-bank entities who are holders of SGL accounts with the Reserve Bank (from April 1997) with banks, primary dealers in Treasury Bills of all maturities and all dated central government securities. The first step of the transaction by non-bank entities should be by way of purchase of securities eligible for REPOs from banks/primary dealers and the second step will be by way of selling back securities to banks/primary dealers. Non-bank entities are however not allowed to enter into REPO transactions with banks/primary dealers. The transactions have to be effected at Mumbai.

Interbank REPOs

Commercial banks and select entities can conduct REPO transactions in PSU bonds and private corporate debt securities. These transactions provide liquidity support to the debt market. DVP was introduced in April 1999 as a regulatory safeguard.

In July 1999, non-bank participants in the money market were allowed to access short-term liquidity through REPOs on par with banks and PDs.

It may be noted that according to the international accounting practices, the funds advanced by the purchaser of a security under a firm repurchase agreement are generally treated as collateralized loan and the underlying security is maintained on the balance sheet of the seller.

Liquidity Adjustment Facility (LAF)

Liquidity Adjustment Facility (LAF) is operated by RBI through REPOs and reverse REPOs in order to set a corridor for money market interest rates. This is pursuant to the recommendations of the Committee on Banking Sector Reforms. LAF was introduced in stages. In the first stage with effect from 5 June, 2000 RBI introduced variable REPO auctions with same day settlement. The amount of REPO and reverse REPO are changed on a daily basis to manage liquidity. The auctions are held in Government-dated securities and treasury bills of all maturities except fourteen day treasury bills for parties holding SGL account and current account with RBI in Mumbai. While liquidity is absorbed by RBI to minimize volatility in the money market, LAF can also augment liquidity through export credit refinance and liquidity support to primary dealers. The funds made available by RBI through LAF would primarily meet the day to day liquidity mismatches in the system and not the normal financing requirements of eligible institutions. The fortnightly average utilization including export credit refinance has ranged between 4,119 crores and 7,697 crores during April-October 1999.

Cash Reserve Ratio

The variation of reserve requirement changes the amount of cash reserves of banks and affects their credit-creating capacity. The requirements may be stipulated as a proportion of aggregate outstanding deposits or on the increment after a base date. Reserve Bank regulates the liquidity of the banking system through two complementary methods: cash reserve ratio (CRR) involving deposit of a proportion of deposits as cash by the bank with the Reserve Bank; and statutory liquidity ratio involving the maintenance, of a proportion of its deposit liabilities in the form of specified liquid assets. The cash reserve ratio could vary between 3 per cent and 15 per cent of their total demand and time liabilities. Additional cash reserves (since 1956) may also be required, computed with reference to the excess of the bank's total demand and time liabilities over the level on a base date. This is subject to the condition that the additional cash reserve does not exceed 100 per cent of the excess and also that the total reserves do not exceed 15 per cent (since 1962) of their total demand and time liabilities. CRR has been reduced to 10 per cent in January 1997 and further to 8 per cent (in stages of 0.25 per cent per quarter over a two-year period) and interbank deposits have been exempted from April 1997.

Statutory Liquidity Ratio

Under the Banking Regulation Act (Sec 24(2A)) as amended in 1962, banks have to maintain a minimum liquid assets of 25 per cent of their demand and time liabilities in India. The Reserve Bank has, since 1970, imposed a much higher percentage of liquid assets to restrain the pace of expansion of bank credit. SLR was fixed at 31.5 per cent of the net domestic and time liabilities (NDTL) on the base date 30-9-1994; and for any increase in NDTL over the level as on 30 September 1994, the SLR was fixed at 25 per cent. Interbank deposits have been taken out of NDTL in April 1997. The overall effective SLR was estimated at 28.2 per cent at the end of March, 1995, and reduced to 25 per cent in October, 1997. The average investments in government securities to deposits (IGS-D ratio) actually increased from 25.3 per cent in 1980s to 30.4 per cent in 1990 on account of introduction of prudential norms which imparted discipline in extending credit and auctions of government securities at market-related rates.

Selective Credit Controls

Selective credit controls are the most widely used qualitative controls to regulate the distribution or direction of bank resources to particular sectors of the economy in accordance with policy objectives. In India, the objective of selective credit control is to prevent speculative holding with the help of bank credit of certain essential commodities like food grains, sugar, cotton and basic raw materials and thereby checking an undue rise in their price.

The main instruments of selective credit control are minimum margin for lending against selected commodities, ceilings on the levels of credit and charging a minimum rate of interest on advances against specified commodities. While the first two instruments control the quantum of credit, the third works as a leverage on the cost of credit.

Selective credit controls have been dispensed with as a part of banking sector reforms.

Advances to Priority Sector

Social control over banks initiated in 1969 introduced reforms to correct the functioning of the banking system and to promote purposeful distribution of bank credit. It was found that for various historical reasons, the bulk of bank advances was directed to the large and medium scale industries and big and established houses while agriculture, small-scale industries and exports which were emerging as priority sectors did not receive adequate attention. The nationalization of fourteen major commercial banks in July 1969, led to considerable reorientation of bank lending towards the priority sectors. Priority sector lending was stipulated at one-third of the outstanding credit by March 1979, and 40 per cent by 1985. Since 1977-78, export credit has been excluded from computation of total priority sector advances, but refinance was provided.

Forty per cent of the priority sector advances were earmarked in 1985 for agriculture and allied activities; advances to weaker sections in agriculture and allied activities should be 50 per cent of lending for agriculture; and advances to rural artisans, craftsmen and cottage industries should be 12.5 per cent of the total advances to small scale industries. Effective from April 1993, foreign banks were advised to bring their priority sector advances from 15 per cent hitherto fixed to 32 per cent by March, 1994.

Table 4.2 presents the advances to the priority sector in select years. Advances to priority sector have gone up from 14.6% of bank credit in 1969 to 25 per cent in 1976, 42.9 per cent in 1986, 42.3 per cent in 1990, 37.8 per cent in 1996 and 43.6 per cent in 2000. The major portion of advances to the priority sector was to agriculture followed by small scale industrial units.

Supervision System

The Board for Financial Supervision (BFS) under the chairmanship of the Governor of the Reserve Bank became functional on November 16, 1994, with Deputy Governor as Vice-Chairman and six other members. An advisory council was also constituted. The BFS was set up to ensure implementation of regulations in the areas of credit management, asset classification, income recognition, capital adequacy and treasury operations of commercial banks. Effective from April 1995, the BFS started supervising all-India financial institutions and from July 1995, non-banking financial companies. Operational support to BFS is rendered by the Department of Supervision within the Reserve Bank.

Under the direction of the BFS, the time span for inspection of banks and discussions with the management has been substantially reduced so that the necessary rectification measures under a monitorable action plan (MAP) are promptly initiated by banks. The system of supervisory visits to newly licensed private banks which were initiated in 1995 with the object of monitoring a proper build-up of portfolios, system and controls and compliance were extended to licensed foreign banks in 1996.

Based on the visits, necessary corrections in specified policy and operational areas were suggested.

The BFS reviewed and approved the recommendations of the Working Group on the Review of the System of On-site Supervision set up in 1995 (Chairman S. Padmanabhan). The major recommendations of the group include adoption of a discriminative approach to supervision as between sound banks and problem banks, bestowing greater supervisory attention and resources on the latter, introduction of a supervisory rating system facilitating such classification and conducting targeted appraisals of major portfolios and control systems in between statutory full scope inspections.

CAMEL

The Padmanabhan Working Group recommended the adoption of six rating factors for Indian banks, viz., CAMEL and Systems (CAMELs); and four rating factors for foreign banks, capital adequacy, asset quality, compliance and systems (CACS).

CAMEL refers to a system of bank-rating initially introduced in the US as an effective supplement to bank supervision. It refers to the five key criteria–capital adequacy (C), asset quality (A), management (M), earnings (E) and liquidity (L) against each of which a bank's financial health is evaluated on a scale of 1 to 5 with 1 as the highest rating and 5 as the lowest. Banks with composite CAMEL ratings of 1 and 2 are deemed to be sound and are generally permitted to operate without any restrictions. Banks that receive CAMEL ratings of 4 or 5 are designated as problem banks to be subjected to close surveillance and regulatory restrictions.

The BFS also reviewed (1995-96) the recommendations of the Working Group set up for framing a supervisory framework for NBFCs (Chairman P.R. Khanna). The Khanna Group recommended a stratified approach to supervision of NBFCs related to the size of the operations and assets, adoption of different approaches with varying emphasis, on-site inspections and off-site monitoring for different segments and introduction of supervisory rating system for companies at the top end.

The Department of Supervision within the RBI which supports the Board for Financial Supervision introduced a new prudential supervisory reporting (PSR) from September 1995. Quarterly reports on assets, liabilities and off-balance sheet exposures, risk weighing of these exposures, capital base and CRAR ratios, unaudited operating results for the quarter, volume of NPAs and changes thereof in the quarter and large credit exposures on single borrowers as well as borrowers' group exposures have to be submitted. Domestic banks are further required to submit half-yearly reports on two additional areas-profile of ownership, control and management, and connected and related lending.

Autonomy for Central Bank

Autonomy for Central Bank is a crucial issue. The Reserve Bank of India Act does not assure autonomy to the bank. It is true that the Central Bank can only be independent within the government but not from the government. In US, there are adequate safeguards to ensure that the Federal Reserve is not compelled to act against its own judgement. In India, there have been historic accords limiting the access of the Government to RBI but they are breached in practice, RBI should not be involved in underwriting government securities. It acts as a principal and as an agent in the securities market. The dual role of RBI as an issuer and regulator of debt gives rise to conflict of policies of debt management and monetary policy. The advisory group on monetary and financial policies headed by M. Narsimham suggested (September, 2000) the separation of debt management and monetary policy functions and the setting up of an independent debt management office by the government.

Further, the fiscal profligacy of the government is abetted by the system of pre-emption of a large portion of net accrual of bank deposits through the prescription of statutory liquidity ratio. The Indian banking system was operating for a long-time with a high level of reserve requirements in the form of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio. As per law SLR is 25 per cent and CRR is 3 per cent. Through policy prescriptions they were raised to 54 per cent of deposits before reforms were initiated in 1992. Progressive reduction has brought down the effective SLR from 37.4 per cent in the prereform period to 25 per cent and the effective CRR from 16.5 per cent to 8 per cent. The statutory prescriptions are now about 35 per cent, doubling the proportion of banks resources available for commercial sector. The additional resources will also increase the profitability of bank since CRR is not adequately remunerated. Reduction in statutory pre-emption is constrained as long as fiscal deficit remains high. The Report of the Committee on the Financial System, 1991 has pointed out that SLR should not be used to mobilize resources for financing budgetary deficits, but as a prudential measure. It has also stated that CRR should be used for pursuing monetary policy objectives.

In the context of globalization of the financial system the Reserve Bank needs autonomy to define benchmarks or anchors such as inflation and money supply to guide policy and use its judgement to assess the impact of the ever changing financial environment on the design and implementation of policy. Reform of the banking system is not complete unless it includes the Central Bank. The emphasis on market as a source of financial discipline requires an autonomous Central Bank which can strike the right balance with the operation of market forces. The responses would be quick and effective only if the Central Bank is autonomous.

Central banks which are mandated to pursue monetary and financial stability should enjoy autonomy in the execution of policy and be accountable for the achievement of the objective. There is consensus that the monetary authority's primary objective should be price stability, that the Central bank should have sufficient independence to vary its operational instrument and its main instrument is its control over short-term interest rates. The profound transformation of the financial environment had a major effect both on the relationship between the monetary policies across countries and their design within the countries. Central banks while defining benchmarks or anchors to guide policy to achieve monetary and financial stability have to take into account the increasing constraints that result from the growing power of markets to arbitrage across currencies, instruments and institutions as well as across legal, regulatory and tax jurisdictions. The increasing power of markets put a premium on transparency to guide market expectations, market incentives and credibility of policies. The market orientation of the framework has to be strengthened by the following ways:

- Enlisting and upgrading the market's disciplinary mechanism.
- Enlarging the domain and improving the quality of public disclosure.
- Designing regulatory constraints such as capital standards so as to make them less vulnerable to financial arbitrage.
- Limiting the impact of those forms of intervention that provide perfection without commensurate oversight which reduce the incentive to prudent behaviour.

  Central bank's initiatives for stability require supporting policies in terms of sustainable fiscal positions and greater flexibility in labour market. Further, the effectiveness of market forces depends on fostering ownership structures through privatisation which are more responsive to market and removing obstacles to the adjustment of capital and labour. The systemic orientation has to be sharpened by upgrading payment and settlement systems to contain the knock-on effects of failures of institutions. A right balance between the market and the Central bank as a source of financial discipline has to be struck.

Monetary Policy in India

The objectives of monetary policy are price stability and growth. RBI also attempts to maintain orderly conditions in the foreign exchange market and curb destabilizing and self-fulfilling speculative activities. To avoid undue volatility the exchange rate objective was accorded precedence in the recent past. The objectives are pursued through ensuring credit availability with stability in the external value of the rupee as well as the overall financial stability.

Monetary policy is implemented with the help of an intermediate target which the bank could influence. Central banks depending upon their institutional and financial structure and the level of maturity of markets use three types of nominal anchors or targets to serve as guide posts in the conduct of monetary policy. These are monetary targeting (broad money), exchange rate and inflation. RBI sets indicative broad money (M3) expansion target in line with the expected rate of growth of GDP and a tolerable level of inflation. The broad money expansion has to take into account reserve money expansion, which is influenced by net RBI credit to government and net foreign exchange assets. The other indicators which support broad money expansion are movements in interest rates, exchange rates and availability of credit.

The underlying operating target for achieving the intermediate target, bank reserves while the supplementary target is short-term interest rates as indicated by overnight call money rates. Bank reserves are changed through variation in the cash reserve ratio (which is being emphasised) and open market operations both outright and REPOs. The excess liquidity in the system is mopped up by sale of securities by RBI. Reforms in the government securities market which ensured market-related interest rates provided some of the basic conditions for developing a secondary market. The short- term liquidity management is aided by conduct of REPOs by RBI on a regular basis. The REPO rates and the amounts tendered in the REPO auctions apart from reflecting liquidity condition, provide a floor for the overnight call money rate.

The bank rate since April 1997 is used as a reference rate and signalling device by RBI to reflect the stance of monetary policy. Liquidity is augmented through Liquidity

Adjustment Facility (LAF) and export credit refinance to banks and liquidity support to primary dealers. On the other hand, liquidity is absorbed through fixed rate REPO and open market operations in dated government securities and treasury bills by RBI. In the absence of formal corridor for market interest rates, the bank rate and fixed REPO rate act as the ceiling and floor respectively for short-term interest rates.

The rate of interest and the amount are varied in the LAF to respond to day-to- day liquidity conditions in the system. LAF is not meant for funding financial requirements of eligible institutions. It would impart greater degree of stability to the short-term money market rates and facilitate the emergence of a short-term rupee yield curve.

12.7 Key Terms

1. **Regulatory Framework:** The set of laws, rules, and regulations established by government authorities to govern the conduct of businesses and financial institutions. It includes regulations related to company registration, securities trading, taxation, consumer protection, and other aspects of business operations.
2. **Monetary Policy:** The set of actions undertaken by a country's central bank (such as the Reserve Bank of India) to regulate the money supply, interest rates, and credit conditions in the economy. Monetary policy aims to achieve macroeconomic objectives such as price stability, full employment, and economic growth.
3. **Fiscal Policy:** The government's use of taxation and expenditure policies to influence economic activity and achieve macroeconomic objectives. Fiscal policy measures include taxation rates, government spending on infrastructure projects, subsidies, and welfare programs.
4. **Capital Markets:** Financial markets where long-term debt and equity securities are bought and sold. Capital markets provide a platform for businesses to raise capital through instruments such as stocks, bonds, and derivatives. They also facilitate investment and trading activities by individuals, institutions, and governments.
5. **Interest Rates:** The cost of borrowing money or the return on investment for lenders. Interest rates are determined by factors such as central bank policy

decisions, inflation expectations, and supply and demand dynamics in the credit markets. Changes in interest rates impact borrowing costs, investment decisions, and economic activity.

6. **Inflation:** The rate at which the general level of prices for goods and services rises over time. Inflation erodes the purchasing power of money and affects consumers' buying decisions, business planning, and financial market dynamics. Central banks aim to maintain price stability by targeting a moderate level of inflation.
7. **Exchange Rate:** The value of one currency relative to another in the foreign exchange market. Exchange rates fluctuate based on factors such as supply and demand for currencies, interest rate differentials, inflation differentials, and geopolitical events. Changes in exchange rates impact international trade, foreign investment, and corporate earnings.
8. **Risk Management:** The process of identifying, assessing, and mitigating risks that could potentially impact a business's financial performance and objectives. Risks may include market risk, credit risk, operational risk, liquidity risk, and regulatory risk. Effective risk management strategies involve implementing controls, diversifying exposures, and hedging against adverse events.
9. **Financial Stability:** The condition in which the financial system functions smoothly and can absorb shocks without disruption to economic activity. Financial stability is essential for sustainable economic growth, investor confidence, and the efficient allocation of resources. Policymakers monitor indicators such as bank capital adequacy, asset quality, and systemic risk to safeguard financial stability.
10. **Corporate Governance:** The system of rules, practices, and processes by which companies are directed, controlled, and managed. Corporate governance aims to ensure transparency, accountability, and integrity in corporate decision-making and protect the interests of shareholders, stakeholders, and other relevant parties. Key elements of corporate governance include board oversight, disclosure standards, and ethical conduct.

12.8 Summary

The financial environment for businesses in India offers opportunities for growth and investment, but navigating the regulatory landscape and managing risks are critical for success. Adaptability, innovation, and strategic planning are key to thriving in India's dynamic business environment.

12.9 Check your Progress

1. Discuss the impact of regulatory frameworks on the financial environment of businesses in India. Include examples of key regulations and their implications for business operations, compliance, and market dynamics. How do regulatory changes influence corporate strategies and investor sentiments?
2. Examine the role of monetary policy in shaping the financial environment for businesses. Analyze the objectives, tools, and transmission mechanisms of monetary policy, with a focus on its impact on interest rates, credit conditions, and capital allocation. How do businesses adapt their financial strategies in response to changes in monetary policy?
3. Evaluate the significance of capital markets in facilitating corporate finance and investment activities. Describe the functions and components of capital markets, including stock exchanges, bond markets, and derivative markets. How do businesses utilize capital markets to raise funds, manage risks, and enhance shareholder value?
4. Analyze the relationship between fiscal policy and the financial environment for businesses. Discuss the objectives, instruments, and effectiveness of fiscal policy measures in influencing economic activity, business confidence, and investment decisions. How do changes in fiscal policy impact corporate profitability, consumer behavior, and market conditions?
5. Explain the concept of risk management and its importance in navigating the financial environment for businesses. Identify common types of risks faced by businesses, such as market risk, credit risk, and operational risk. How do businesses assess, mitigate, and monitor risks through risk management strategies, including diversification, hedging, and internal controls?

6. Investigate the role of technology and innovation in transforming the financial environment for businesses. Explore emerging trends in financial technology (fintech), digital payments, and blockchain technology. How do technological advancements disrupt traditional business models, enhance efficiency, and create new opportunities for businesses in India?
7. Assess the impact of globalization on the financial environment for businesses in India. Discuss the opportunities and challenges associated with foreign investment, trade liberalization, and cross-border capital flows. How do businesses navigate global economic integration, geopolitical risks, and currency fluctuations to achieve sustainable growth and competitiveness?
8. Examine the concept of financial stability and its implications for businesses operating in India. Identify systemic risks and vulnerabilities in the financial system, such as banking sector stability, asset price bubbles, and contagion effects. How do policymakers promote financial stability through regulatory reforms, macroprudential policies, and crisis management mechanisms?
9. Discuss the importance of corporate governance in fostering trust and confidence in the financial environment for businesses. Describe key principles of corporate governance, including board independence, transparency, and accountability. How do businesses implement effective corporate governance practices to enhance shareholder value, mitigate agency conflicts, and build stakeholder trust?
10. Analyze the macroeconomic factors influencing the financial environment for businesses in India. Consider variables such as economic growth, inflation, exchange rates, and employment levels. How do businesses assess macroeconomic trends and incorporate macroeconomic analysis into their strategic decision-making processes?

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Unit 13 STOCK EXCHANGE

Structure

13.1 Introduction

A stock exchange is a centralized marketplace where securities such as stocks, bonds, derivatives, and other financial instruments are bought and sold. It provides a platform for investors to trade securities issued by publicly listed companies and other entities. Stock exchanges play a crucial role in the functioning of capital markets by facilitating capital formation, price discovery, liquidity provision, and risk management.

13.2 Learning Objectives

1. **Understanding Stock Exchanges:** Define what a stock exchange is and describe its role in the financial markets**.**
2. **Listing Process:** Explain how companies get listed on stock exchanges and the requirements they need to fulfill.
3. **Trading Mechanics:** Describe how trading occurs on a stock exchange, including the role of buyers, sellers, and intermediaries.
4. **Market Indices:** Introduce popular stock market indices and explain their significance as benchmarks for market performance.
5. **Regulatory Framework:** Outline the regulatory oversight of stock exchanges and the importance of investor protection measures.

Growth of Stock Exchanges

The Bombay Stock Exchange was established in 1875. The stock exchanges of Calcutta and Chennai were started in 1908 and the Delhi Stock Exchange in 1947. Table 4:1 presents the organization of stock exchanges in India. There are 23 stock exchanges in the country and their organization varies. Some are public limited companies (fifteen), while others are limited by guarantees (five) or are voluntary non-profit making organizations (three). The Government of India ensures broad uniformity in structure while granting recognition. As of 1995 only eight exchanges have been granted permanent recognition. The rest have to renew it every year until permanent recognition is granted.

To become a member of the stock exchange one has to pay an entrance fee or acquire a specified number of shares, the value of which ranges from .250 [as in the Canara (Mangalore) Stock Exchange] to 1,01,000 (as in the U.P. (Kanpur) Exchange). The security deposits to be made by members also vary from 10,000 (in the Kanpur exchange) to 2,00,000 (in the Bombay Exchange). Further, the exchanges also differ in size (the Canara Exchange being the smallest with just 146 members and Calcutta the biggest with 949 members) and in the matter of the annual subscription to be paid by the members. Here again, a member of the Canara exchange needs to pay only
1,000 as against his counterpart in Bombay who has to pay 5,000.

The stock exchanges are managed by a governing body which consists of a President, a Vice-President, an Executive Director, elected Directors, public representatives and nominees of the government. The governing body is responsible for policy-making and for ensuring the smooth functioning of the exchange. The executive functions are discharged by the Executive Director or the Secretary.

The legislative jurisdiction over stock exchanges is vested in the Union Government by the Constitution of India. The Union Government enacted the Securities Contracts Regulations Act (SCR Act) in 1956, to regulate the functioning and the trading of the stock exchanges. The SCR Act and the Securities Contracts Regulation Rules (1957) together constitute the legal framework which not only regulates the stock exchanges, but also protects the interests of the investors.

The Securities Contracts Regulation Act, 1956 provides inter alia

- for recognition of stock exchanges and regulation of their functioning
- licensing dealers
- recognition of contracts
- controlling speculation
- restricting rights of equitable holders of shares
- empowering government to compel any public limited company to get its shares listed.

Under the Securities Contracts (Regulation) Act, the government has promulgated the Securities Contracts (Rules) 1957 for bringing into effect the objects of the legislation. The rules are statutory and constitute a code of standardized regulations applicable to all recognized exchanges.

The Securities and Exchange Board of India Act, 1992 provides for the establishment of Securities and Exchange Board of India (SEBI) to protect the interest of the investors, and to promote, develop and regulate the securities market. Though each exchange has its by-laws and regulations, they all aim at the regulation and control of transactions in the exchange.

Under the SCR Act, an exchange is defined as any “body” of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. The SCR Act stipulates that a stock exchange must be recognized by the Government of India. The 23 exchanges that are operating in the country are recognized by the government. The other statutes applicable to stock exchanges are the Companies Act 1956, the Income Tax Act 1961, and the Foreign Exchange Management Act 1999.

12.3 Functions of a Stock Exchange

The stock exchanges provide an organized marketplace for the investors to buy and sell securities freely. The market for these securities is an almost perfectly competitive one because a large number of sellers and buyers participate. The shares listed, however vary broadly in terms of credit rating and often involve carrying cost. The shares however are not really homogeneous like a commodity in a perfectly competitive market. The stock exchanges provide an auction market in which members of the stock exchange participate to ensure continuity of price and liquidity to investors.

The active bidding and the resulting two way auction trading ensure that the bargains struck are the fairest, predetermined by the basic laws of supply and demand.

The efficient functioning of the stock exchange creates a conducive climate for an active and growing primary market for new issues. An active and healthy secondary market in existing securities, leads to a better psychology of expectations; considerable broadening of investment enquiries renders the task of raising resources by entrepreneurs easier. Good performance and outlook for equities in the stock exchanges imparts buoyancy to the new issue market.

A) Continuous Market

As seen earlier, the basic function of a stock market is the creation of a continuous market where securities are bought and sold in volume with little variation in the current market price as trades succeed one another. A continuous market provides liquidity through the sale or purchase of securities quickly and easily, at a price that varies little from the previous selling price. The indicators of a continuous market are:

(i) Frequency of sales

(ii) Narrow spread between bids and offers

(iii) Prompt execution of orders

(iv) Minimum price changes between transactions as they occur

The benefits of a continuous market are that, it creates marketable liquid investments and facilitates collateral lending. Listed shares are good collateral for secured loans although the margin is as high as 50 per cent (which used to be 75 per cent before 1993).

B) Frequency of Sales

The primary criterion for a good market is whether investors can sell their portfolio-holding quickly with minimal price fluctuation at the time of sale. Liquidity occupies a central place in evaluating the efficiency of an exchange.

The characteristics of a liquid market are depth, breadth and resiliency. A market has depth if the buy and sell orders are forthcoming around the price at which the share is transacting. A market that lacks depth is shallow. The adequate volume of the orders gives breadth to the market, in the absence of which the markets are termed thin. Further, the response of the orders to price changes renders the market resilient.

C) Empirical Measurement of Liquidity

Empirically, liquidity is measured by the number of days a company's share is traded, out of the number of days in the year when the market is open. Normally, a share is considered actively traded and liquid if it is traded on 50 per cent of the days when the market is open. On the Bombay Stock Exchange only 27.56 per cent of the shares of companies listed were traded for more than 100 days (which more or less conforms in 1999-2000). In March 2000 of the total listed companies of 8027 only 41 per cent were traded. Liquidity of the market is also measured by the variation of price from one trade to another. If the difference between the lowest asked (or offered) price and the highest bid-price is wide, the market is said to lack depth and considered shallow. Actually, the bid-asked spread is an inverse measure of liquidity. For example, in the United States, variation of one-eighth point in the price from the immediate preceding trade is considered liquid. In our own country, the minimum tick starts from Re 0.25.

D) Fair Price Determination

The prices in the stock market are determined by the interplay of the forces of supply and demand. As seen earlier, active bidding and a two-way auction trading takes place in the stock exchange. The result is as near a market for free trading and free competition as can be found anywhere. The bargains that are struck are at the fairest price, determined by the basic laws of supply and demand.

The functioning of the market has been subject at times to manipulation. The year 1991-92 witnessed large scale bull runs, to push up prices and create artificial value. On the other hand, the prices in the market were at times pushed down by bear raiders without regard to their fundamental values. Manipulation cannot, of course, occur if the exchanges are alert. In the long-run interests of the securities market, such price manipulations should be discouraged.

The performance of the stock exchange is also subject to speculation which at times drives up the prices above the investment worth, and at others below it. The stock market prices were dormant for considerable stretches of time, especially prior to 1987. But since 1988-89 they have been above their investment worth with some of the shares selling at 50-70 times their earnings in 1991.

There is no obvious relationship between book value/par value and market value in the matter of many shares. The massive flow of funds into the stock market, from individual investors (some of whom where disinvesting from contract business, transport and other retail trades) and the mutual funds, without any corresponding increase in the supply of scrips led to the surge in demand for shares in the years 1990-91 and 1991-92. This in turn pushed up the price. This massive flow of funds into the stock market, no doubt motivated by the prospect of capital gains, resulted in a typical situation of too much money chasing too few scrips. Obviously, there weren’t enough shares to absorb the demand.

Under normal circumstances, one would leave the situation to the forces of the market– what the buyers and the sellers are willing to bid and to offer. But in India, conscious policy is adapted to make shares attractive to the foreign institutional investors who evaluate our market in relation to other emerging markets. The stabilization of the stock market prices around a reasonable level (for PE Ratios to be at mid teens) would be desirable.

E) Aid to Financing Industries

Listed companies find it helpful to sell further issues of their shares in the primary market based on the good performance of their earlier ones. An active market and a good market price for the company's shares (reflecting the past performance and future prospects) makes the task of raising funds through further issues easier. Rights themselves have an immediate and a wide market in the stock exchanges, provided the price including the premium reflects a fair value. Thus, stock exchanges enable a company to market further issues successfully by creating a continuous market for the rights.

F) Other Functions

The market prices established in stock exchange trading are useful for tax purposes. The stipulation on disclosures and transparency ensure that the investors have access to information on the listed companies, particularly with regard to their financial conditions. This serves to protect the investor's interests by eliminating the dishonest and irregular practices rampant in the brokerage trade.

13.4 Trading in Stock Exchanges

Trading in stock exchanges takes place either on the basis of the auction system on a trading floor (which is order-driven or customer-driven) or a broker-dealer market (which is quote-driven or dealer-driven). Every one of the world's stock markets uses one of the two trading systems or a hybrid of both.

In an order-driven system, customers buy and sell orders, reach a central point where they are matched. In a quote-driven system, dealers compete to give the customers the best price. Electronic trading simply carries out the same functions, automatically; in the order-driven markets it matches the buyer and the seller and in quote-driven ones it finds the customer the best price available.

The New York Stock Exchange (NYSE) is an order-driven auction market while the National Association of Security Dealers Automated Quotation System (NASDAQ)–a computerized network which serves over the counter—is quote-driven or dealer-driven. Here we have order-driven auction markets in general, at all the major stock exchanges except Bombay. Bombay has a hybrid market, auction system but quote-driven.

13.4.1 Bombay Stock Exchange

Bombay Stock Exchange had a turnover of 6,85,028 crore and a market capitalization of 9,12,842 crore in 1999-2000. The increase in volumes was facilitated by an increase in the number of cities covered by BOLT network to over 275 in March 2000 and an increase in the number of Trader Work Station to 3803. The market capitalization of BSE as a ratio of GDP works out to 65 per cent. A weekly trading and settlement cycle for all scrips and screen-based trading facility in odd lots through BOLT terminals have been adopted. ATrade Guarantee Fund (CTGF) to protect the interests of investors was set up for the safety of the market on 12-5-1997.

Under the Regulations now in force, members of recognized stock exchanges are permitted to enter into transactions in securities as under:

(a) For ‘spot delivery’, i.e., for delivery and payment on the same day as the date of the contract or on the next day.

(b) For ‘hand delivery’, i.e., for delivery and payment within the time or on the date stipulated when entering into the bargain, which shall not be more than fourteen days following the date of the contract.

(c) For ‘Special delivery’, i.e., for delivery and payment within any time exceeding 14 days following the date of the contract as may be stipulated when entering into the bargain and permitted by the Governing Board or the President.

13.4.2 National Stock Exchange (NSE)

The NSE was incorporated in November 1992 with an equity capital of 25 crore. The International Securities Consultancy (ISC) of Hong Kong has helped in setting up the NSE. ISC has prepared the detailed business plan, including the installation of hardware and software systems. Financial institutions, Insurance companies, Banks, SBI Capital Markets Ltd., Infrastructure Leasing and Financial Services Ltd. and Stock

Holding Corporation Ltd. were all promoters of the NSE. It aims at promoting professionalism in the capital market and providing better securities trading facilities to investors nationwide. NSE transcends geographical barriers and overcomes fragmentation by providing a screen-based trading system instead of the conventional trading ring. This results in greater depth and liquidity of the market and reduces the transaction costs.

NSE is not an exchange in the traditional sense where brokers own and manage the exchange. It has a two tier administrative set up involving a company board and a governing board of the exchange. NSE is a professionally managed national market for shares, PSU bonds, debenture and government securities with all the necessary infrastructure and trading facilities.

13.4.3 Calcutta Stock Exchange

An association under the name of the Calcutta Stock Exchange Association was formed on 15 June 1908 by the brokers which was later incorporated as a limited liability company with an authorized capital of 30 lakh divided into 300 shares of 1,000 each. Its membership was 210 in number. 1,000 shares were split into four shares of 250 in 1958. The Calcutta Stock Exchange was granted permanent recognition on 14 April 1980.

13.5 NON-BANKING FINANCIAL CORPORATION

Definition of Non-banking Finance Company

According to the Reserve Bank (Amendment Act) 1997, a Non-banking Finance Company (NBFC) means

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme or arrangement or in any other manner or lending in any manner;

(iii) such other non-banking institution or class of such institutions as the bank may, with the previous approval of the Central Government specify’.

The definition excludes financial institutions besides institutions which carry on agricultural operations as their principal business.

Non-banking finance companies consist mainly of finance companies which carry on hire purchase finance, housing finance, investment, loan, equipment leasing or mutual benefit financial companies, but do not include insurance or stock exchanges or stock broking companies.

The non-bank finance companies are categorized into the following:

(i) Equipment leasing company (ELC)

(ii) Hire purchase company (HPC)

(iii) Housing finance company (HFC)

(iv) Investment company (IC)

(v) Loan company (LC)

(vi) Mutual benefit financial company (MBFC), i.e., nidhi companies

(vii) Miscellaneous non-banking company, i.e., chit fund companies

A residuary non-banking company receives deposits under any scheme or arrangement, as a huge amount or in installments or in any other manner and does not fall into any of the above categories.

Thus, a non-banking, non-financial company is defined as an industrial concern or a company whose principal activity is agricultural operations or trading in goods and services or real estate and is not classified as a financial or a miscellaneous or a residuary non-banking company.

13.5.1 Mutual Benefit Finance Companies (MBFCs)

Mutual benefit finance companies (nidhis) were exempt from most of the provisions of the Reserve Bank's, NBFC's directions. However, on 8 July 1996 the RBI imposed, a ceiling of 15 per cent interest rate on deposits and prohibited them from issuing advertisements in any form and paying any brokerage for soliciting deposits. NBFCs' deposit interest rates were freed on 24 August 1996 along with the rationalization measures for registered NBFCs. The ceiling however does not apply unless MBFCs have positive net owned funds (NOFs) as on 31 March 1996, it will be able to repay the amount of their liabilities including the interest payable to their depositors and have the ratio of NOF to deposits not exceeding 1:20 as on the date of application.

Again, on January 15, 1997, the prescribed ratio of NOF to deposits not exceeding 1:20 was made applicable only on the incremental deposit liabilities after January 15, 1997. However, MBFCs with NOF to deposit ratio of 1:20 or less on January 15, 1997, should not exceed the prescribed ratio of 1:20 on the aggregate deposit liabilities.

13.5.2 Regulation of Non-banking Companies

The four categories of non-bank finance companies (ELC, HPC, IC and LC) submit statutory annual schedules and returns to the Reserve Bank. The Reserve Bank has issued a separate set of directions of financial, miscellaneous and residuary non-banking companies governing their deposit acceptance activity. The activity of deposit acceptance by non-banking, non-financial companies (manufacturing companies) is being regulated by the Government of India, under Acceptance of Deposits Rules, 1975, framed under section 58A of the Companies Act.

The regulation of the deposit acceptance activities was undertaken initially to effectively supervise, control and regulate them. In order to moderate the deposit mobilization of NBFCs and protect depositors, the quantum of deposits was linked to Net Owned Fund (NOF) which is the aggregate of the paid-up capital and free reserves reduced by balance of loss, deferred revenue expenditure and other intangible assets. Investments in same group or other NBFC beyond 10 per cent of owned fund were also excluded from NOF. The regulations did not extend to the assets side of NBFCs.

13.5.3 Financial Sector Reform

In view of the important role of NBFCs in the financial system, the need for subjecting them to financial reform was felt. The committee on the Financial System recognized that NBFCs should have prudential norms and guidelines as in the case of commercial banks. For this purpose, a working group on Financial Companies was constituted in May 1992 under the chairmanship of Dr. A.C. Shah.

13.5.4 Liberalization Measures for NBFCs (1996)

The RBI announced liberalization measures for NBFCs on July 24, 1996. They are aimed at encouraging disciplined NBFCs which are run on sound business principles. The two major classifications of NBFCs are:

(I) Equipment leasing and hire purchase companies (financial companies)

(II) Loan and investment companies. These were further divided into four major categories by the RBI circular. They are:

(i) Registered finance companies complying with credit rating requirements and prudential norms.

(ii) Registered finance companies complying with either credit rating requirements or prudential norms.

(iii) Registered finance companies complying with neither the credit rating requirements nor prudential norms.

(iv) All other finance companies.

Category (i) finance companies will now enjoy the following benefits:

(a) No ceiling on deposits

(b) Freedom to determine the rate of interest on deposits

(c) SLR reduced from 15 per cent to 12.5 per cent

For category (ii) companies, only the maximum ceiling on deposits will be removed and other benefits available to category (i) will not be available.

Category (iii) companies will not enjoy the above benefits and will have to comply with the following requirements:

(a) The overall ceiling on deposits reduced with immediate effect from ten times the net owned funds (NOF) to seven.

(b) Rate of interest and SLR requirements remain unchanged.

Category (iv) companies have to reduce their deposits with immediate effect from ten times of NOF to five. The benefits listed under categories

(i) and (ii) will be available only on obtaining a certificate of compliance from the RBI. There is no ceiling on the maximum amount of deposits which can be accepted by the finance companies and the rate of interest offered on them. The rate of interest may vary from company to company depending on their resource mix and advances portfolio.

Category (i) finance companies may have to face severe competition from (iii)and (iv) category companies in their efforts to mobilize deposits since these companies are likely to offer higher incentives on their deposits through the broker network. As a result, the interest rate will be fixed based on marketability of fixed deposit schemes by each of these companies.

There is a greater risk of interest mismatch from this source of funding since the interest rate in a free market is related to the competitiveness of the company. However, in case of bank funding, even though such a risk is present, the maturity mismatch is almost ruled out. Even though cash credit limits are sanctioned for a period of one year, the limits are renewed by the banks every year except usually. Again, bank funding is cheaper compared to the cost of sourcing fixed deposits. Hence, finance companies which rely more on bank funding stand to gain in the process.

13.5.6 Reserve Bank of India (Amendment) Act, March 1997

The amended provisions based on the recommendations of the Shah Committee pertain to,

- Minimum NOF of 25 lakh (which can be raised to 2 crore)
- Compulsory registration with RBI
- Maintenance of liquid assets
- Creation of reserve fund into which 20 per cent of net profit should be transferred

The broad thrust of the Act has been to provide a greater degree of comfort and safety to depositors while promoting at the same time the development of financial sector simultaneously.

13.5.7 Assets of NBFCs

The main task of NBFCs is to continue to play an expanded role as financial intermediaries and widen the capital market offering competition to banks and providing better service and higher return to investors. The achievement of the above tasks depends on financial discipline and effective deployment of funds.

Application of Prudential Norms

The committee on Reform of the Financial System (1991) envisaged the application of prudential norms to govern the functioning of the financial companies since they have to be within the mainstream of the overall financial sector reforms. The working group on financial companies (Chairman A.C. Shah) suggested regulatory and control measures to ensure healthy growth of operations of these companies. It recommended a shift in the regulatory approach from the liability to the asset side, to strengthen the financial companies.

Further, the expert group constituted by the bank under the chairmanship of P.R. Khanna for designing a supervisory framework for NBFCs, has suggested a comprehensive framework for their regulation and supervision. These measures should encourage healthy and orderly growth of NBFCs and also ensure the solvency and safety of the financial system.

The recommendations were implemented in phases. In April-May 1993 the bank brought within the definition of ‘deposit’ intercorporate loans and borrowings by private limited NBFCs from shareholders. Further, NBFCs which have NOF of 50 lakh and above we are required to register with the Reserve Bank. In June 1996, 797 companies were registered.

In line with commercial banks, detailed prudential guidelines were issued to NBFCs in June 1994. The registered NBFCs with NOF of 50 lakh and above were required to achieve a minimum capital adequacy norm of 8 per cent by March 31, 1996 and also obtain a minimum credit rating of P2 in the case of CRISIL, A2 in the case of ICRA, PR in the case of CARE and Ind D.2 in the case of DCR India. Equipment leasing and hire purchase finance companies (EL & HP) which comply with the directions, guidelines and minimum credit rating have been freed of interest rate controls and limits on deposits from the market on July 1996. On 24 July 1996, the EL & HP companies which do not comply will be subject to an interest rate ceiling of 15 per cent on deposits.

Of the 677 reporting companies in 1999, about 77 per cent reported CRAR of 20 per cent and above, while the CRAR of 12.4 per cent companies was below 10 per cent.

13.5.8 Interest Rate of NBFCs

Registered mutual benefit financial companies (MBFCs) popularly known as Nidhis were exempted on 24 August 1996 from the interest rate ceiling of 15 per cent imposed on July 8, 1996 if they complied with the Government of India Directions (December 4, 1995), had positive NOF and had a NOF to deposits ratio of 1:20. The ban on advertisements and payment of brokerage will continue. MBFCs have to apply for exemption of interest rate ceiling to RBI.

13.5.9 Investment Norms for NBFCs

The provisions of the RBI (Amendment) Act, 1997 (section 45 B) stipulated the requirement of maintenance of assets in the approved securities whose market value shall not be less than 5 per cent or such higher percentage not exceeding 25 per cent as the RBI may specify the deposits outstanding at the end of the last working day of the second preceding quarter. Every NBFC shall create a reserve fund and transfer therein at least 20 per cent of its net profit every year. NBFCs are required in terms of the directive dated May 2, 1997 to maintain liquid assets equivalent to 10 per cent of their deposit liabilities in specified approved securities.

The loan and investment companies, which are required to maintain reduced percentage of liquid assets at 7.5 per cent under the existing directions (1977), shall however continue to invest not less than 5 per cent of their deposit liabilities in such securities as hitherto approved. The residuary non-banking companies are also required to continue maintaining liquid assets of not less than 10 per cent of their total liabilities to depositors in approved securities.

The earlier requirements for NBFCs making investments (of two and a half per cent or 5 per cent of the deposits, as applicable) in other specified assets such as balance with banks and trustee securities has been discontinued.

The RBI raised the liquid assets to be deposited with commercial banks by NBFCs (equipment leasing and hire purchase companies and loan and investment companies) registered with the RBI on 18 June 1997 from 10 per cent to 12.5 per cent. This was to be raised further to 15 per cent effective from January and April 1, 1998. In the case of other companies which were maintaining a 5 per cent ratio, the bank raised the limit to 10 per cent on April 1, 1998 and 12.5 per cent on October 1, 1998.

For the residuary non-banking companies however, the reserve ratio remains unchanged at 10 per cent.

13.5.10 Deployment of Funds

The funds deployed are classified into four groups.

Loans and advances: Loans and advances at 47,881 crore (50.2 per cent) represented the largest portion of the 95,393 crore deployed by financial companies. Funds lent to other companies accounted for the largest portion (35.2 per cent of total) in the loans and advances group.

Investments: Investments by financial companies accounted for 23,694 crore or 24.8 per cent of the total funds deployed. Investment in shares and debentures of other companies accounted for 12.7 per cent. Next are securities of Central and State governments or bonds guaranteed by the government which accounted for 5 per cent and fixed deposits with banks for 5 per cent of total funds deployed.

Equipment leasing: The next important group for deployment of funds is equipment leasing which accounted for 14,417 crores or 15.2 per cent of fund deployed. Vehicle lease in this group for 8,402 crore or 8.9 per cent of total funds deployed accounted for the largest portion; and plant and machinery for 4,353 crore or 4.8 per cent.

Hire purchase: Hire purchase was the smallest in the four groups which accounted for 9,401 crore or 9.8 per cent of total funds deployed. In this group, hire purchase of automobiles accounted for 6,090 crore or 6.4 per cent of funds deployed and the next important purpose was hire purchase of industrial machinery, tools and equipment at 2,533 crore or 2.7 per cent.

13.6 RBI Study on Performance of Financial and Investment Companies

To bring the position up to date, the information in the latest RBI Study of Financial and Investment Companies 1997-98, published in RBI Bulletin, April 2000 is presented. The 695 companies (excluding ICICI and HDFC) are classified on the basis of 50 per cent of annual income from the activity into share trading and investment holding, loan finance, hire purchase finance and leasing companies. Where there is no predominant activity, the company was classified into diversified groups. Share trading companies (271) accounted for the highest paid-up capital (39.3 per cent of total) while their income accounted for 2nd lowest proportion. Their net assets formed 3 largest of the total. Leasing companies which accounted for 6.8 per cent of total paid-up capital accounted for 12.1 per cent of main income and 7.5 per cent of net assets. Hire purchase companies which accounted for third lowest proportion of total paid-up capital of 10.3 per cent accounted for second largest income (29.7 per cent) and net assets (24.1 per cent). Diversified companies (125) accounted for the second largest proportion of paid-up capital of 695 companies and the highest proportion of main income 43.3 per cent as well as highest proportion of net assets (40.8 per cent). Diversified companies (91) are the most dominant segment during all the five years from 1993-94 to 1997-98. They accounted for 21-24 per cent of total paid-up capital, 30-43.9 per cent of total main income and 34-42.6 per cent of total net assets of all the selected 695 companies. Companies (106) belonging to hire purchase finance and leasing groups taken together formed 14.9 per cent of total paid-up capital, accounted for 41.8 per cent of total main income and 31.6 per cent of total net assets in 1997-98.

CAPITAL MARKET REFORM AND DEVELOPMENT

Development banking is the financing of projects assessed on the basis of their viability to generate cash flows to meet the interest and repayment obligation. They have an in-built promotional aspect because projects have to fall within the overall national industrial priorities, located preferably in backward areas and promoted by entrepreneurs. In the late forties, soon after the Second World War there was a paradigm shift in the approach to lending for industrial projects from security for the loan to income or cash flow from the project. This required a new set of institutions providing finance on a medium and long-term basis from 5 to 7 or even 10 years. Their approach to appraisal had to take into account the time value of money, which involved the use of discounted cash flow techniques. The projects represented income streams and their viability was assessed on that basis and not on the basis of any security provided for the loan. Until the emergence of a vibrant capital market in the nineties, development banks for almost four decades played a vital role in promoting an industrial structure conforming to national priorities, located in backward areas and encouraging entrepreneurs.

1. **Project Identification**

A project is a proposal for capital investment to develop facilities for providing goods and services. The investment proposal may be for setting up of a new unit, expansion or improvement of existing facilities. The project, however, has to be amenable for analysis and evaluation as an independent unit.

The Stages of Project Selection

The identification of project ideas is followed by a preliminary selection stage. The objective at this stage is to decide whether a project idea should be studied in detail and what should be the scope of further studies. The findings at this stage are embodied in a prefeasibility study or opportunity study. For the purpose of screening and priority fixation, project ideas are developed into prefeasibility studies. Prefeasibility studies give the output of plant, economic size, raw material requirement, sales realization, total cost of production, capital input/output ratio, labour requirement, power and other infrastructural facilities. The project selection exercise should also ensure that it conforms to the overall economic policy of the government.

2. **Feasibility Study**

After ensuring that a project idea is suitable for implementation, a detailed feasibility study giving additional information on financing, breakdown of cost of capital and cash flow is prepared. The feasibility study is the final document in the formulation of a project proposal. Feasibility studies can be prepared either by the entrepreneurs or consultants or experts. The cost of a feasibility study can be debited to project cost and can be counted as part of the promoter’s contribution.

3. **Project Report**

The feasibility study is followed by the project report, firming up all the technical aspects such as location, factory layout specifications and process techniques design. In a way, the project report is a detailed plan of the follow-up of the project through the various stages of implementation.

4. Appraisal of Project

Project evaluation is indispensable because resources are scarce and alternative opportunities in terms of projects exist for commitment of resources. Project selection can only be rational if it is superior to others in terms of commercial profitability (net financial benefits accruing to owners of project) or on national profitability (net overall importance of the project) to the nation as a whole. The purpose of the project appraisal is to ensure that the project is technically sound, provides reasonable financial return and conforms to the overall economic policy of the country. In view of the importance of the competitive status of unit, performance measures have to be applied in a liberalized industrial environment.

5. Financial Appraisal

Financial appraisal is concerned with assessing the feasibility of a new proposal for investment for setting up a new project or expansion of existing productive facilities. In appraising a project, the project's direct benefits and costs are estimated at the prevailing market prices. This analysis is used to appraise the viability of a project as well as to match projects on the basis of their profitability. It may be noted that financial appraisal is concerned with the measurement of profitability of resources invested in the project without reference to their source.

Financial appraisal uses two popular methods and two discounted cash flow techniques to evaluate the cash flows and profitability of investment.

The two popular methods are the simple rate of return and payback period. They employ annual data at their nominal value. They do not take into account the life span of project but rely on one year.

6. Financial Analysis

An integral aspect of financial appraisal is financial analysis which takes into account the financial features of a project, especially the source of financing. Financial analysis helps to determine the smooth operation of the project over its entire life cycle. The two major aspects of financial analysis are liquidity analysis and capital structure analysis. For this purpose, ratios are employed which reveal existing strengths and weaknesses of the project.

Liquidity Ratios

Liquidity ratios or solvency ratios measure a project's ability to meet its short-term obligations. Two ratios are calculated to measure liquidity–the current ratio and the quick ratio.

Current Ratio

The current ratio is defined as current assets [cash, bank balances, investment in securities, accounts receivable (sundry debtors and inventories)] divided by current liabilities [accounts payable (sundry creditors), short-term loans from banks and advances from customers].

7. **Current assets Current liabilities**

The current ratio measures the assets closest to being cash over those liabilities closest to being payable.

8. **Acid Test or Quick Ratio**

Since inventories among current assets are not very liquid, the quick ratio excludes them. The quick ratio includes only assets which can be readily converted into cash and can stand a better test of liquidity.

9. **Capital Ratios**

Long-term solvency ratios measure the project's ability to meet long-term commitments to creditors. The creditors' claims on a firm's income arise from contractual obligations which must be honoured. The larger the amount of these claims, the higher the chances of their not being met. Legal action may be initiated to enforce the fulfilment of the claims. The two long-term solvency ratios are debt utilization ratio and coverage ratio.

10 Debt Utilization Ratio

Debt utilization ratio measures a firm's degree of indebtedness which measures the proportion of the firm's assets financed by debt relative to the proportion financed by equity.

10. **Total debt Total assets**

Debt equity ratio is the value of total debt divided by the book value of equity. While calculating debt, short-term obligations of less than one year duration are excluded.

11. **Fixed Assets Coverage Ratio**

Two other ratios relating to long-term stability used by Development Finance Institutions (DFIs) in appraisal of projects are fixed assets coverage ratio and debt coverage ratio. The fixed assets coverage ratio shows the number of times assets cover loan.

12. **Debt Coverage Ratio**

The debt coverage ratio measures the degree to which fixed payments are covered by operating profits. The ratio emphasizes the ability of the project to generate adequate cash flow to service its financial charges (non-operating expenses). Debt coverage ratio measures the number of times earnings cover the payment of interest and repayment of the principal. A debt coverage ratio of 2 is considered good.

13. **Interest Coverage Ratio**

The interest coverage ratio measures the number of times interest expenses are earned or covered by profits.

14. **The Break-Even Point (BEP)**

An essential aspect of financial appraisal is the determination of BEP. Unless it is determined, other measures make no sense. To calculate and project cash flows, it is important to assess the BEP. Break-even is that level of production and sales at which total revenues are exactly equal to operating costs. BEP occurs at that production level at which net operating income (sales – operating cost) is zero. It indicates the volume necessary for profitable operation of the project. With the help of break-even analysis, the quantity required to be produced at a given sales price per unit to cover total fixed cost and variable cost can be found. If BEP is too high, the price assumed for the output may have to be reviewed. In summary, the viability of a project can be assessed with the help of break-even analysis.

15. Technical Appraisal

Objectives

Technical appraisal is primarily concerned with the project concept covering technology, design, scope and content of the plant as well as inputs and infrastructure facilities envisaged for the project. Basically, the project should be able to deliver marketable product from the resources deployed at a cost which would leave a margin adequate to service the investment and plough back a reasonable amount to enable the enterprise to consolidate its position.

Project Concept: Project concept comprises various important aspects such as plant capacity, degree of integration, facilities for by-product recovery and flexibility of the plant. Accurate assessment of plant capacity on a sustained basis is of crucial importance.

Capacity of Plant: In traditional manufacturing systems, capacity is defined as the maximum output attainable. The operating conditions which influence capacity are product specification, product mix and raw material composition.

The concept of capacity is however meaningless in flexible manufacturing because of multiple outputs. Given the responsiveness of flexible manufacturing systems to consumer demands the output composition is likely to change every month or even week. Capacity in such a context may be defined in terms of machine hours.

13.7 Flexibility of Plant and Flexible Manufacturing Systems

While assessing a project, flexibility of the plant should be allowed in the design of individual pieces of equipment. Flexible manufacturing systems are the emerging systems to manufacture what the customer wants. These systems help in production of a large variety of products in small batch sizes. The days of assembly line manufacturing emphasizing economies of scale are over. Especially in the global market where products are custom made, the plant should have the characteristic of flexibility. Even otherwise flexibility imparts strength to the project to withstand market fluctuations and variations in the quality of inputs.

1. **Evaluation of Technology**

Outstanding features of technology process, engineering design and plant and machinery are established facts and can be checked from published information on the process or from prospective collaborators/consultants and on the basis of similar plants in operation elsewhere. However, considerable skill is required in evaluating the claims of emergent technology, products and equipment design.

The design and layout of the plant in technical appraisal should ensure ease of operation and convenience of maintenance and uncomplicated expansion of the stream capacity, should the need arise.

Above all, in technical appraisal one should be alert and apply trained and informed skills. For example, the availability of soft water is essential for a textile processing plant. It is on record that a public sector textile process plant was set up without checking the quality of water. The result was a large additional investment to cure water.

2. **Inputs**

In technical appraisal, inputs are scrutinized for availability and quality dependability. If there are seasonal variations, especially, in the case of agricultural inputs, variations in price have to be checked. Similarly, power quality has to be checked in terms of variation in supply voltage and inline current frequency and duration of blackouts. Finally, the quality and availability of water which shows seasonal trends especially in case of a project requiring water as an input should be checked.

3. **Location**

While it is easy to enumerate desirable factors to be taken into account while determining location, in practice, various constraints dictate location away from the ideal one. The ideal factors are of course proximity to the market and inputs, preferably where well-developed infrastructure exists. In some industries, effluent disposal facility is necessary. Pollution control restricts the use of steam boilers, while power scarcity restricts the installation of induction furnaces which are environment-friendly. Anti-pollution regulations may also force the choice of large size plants to curtail noise pollution or to instal anti-vibration equipment with adverse impact on costs.

4. **Interdependence of the Parameters of Project**

Finally, the technical appraisal of the individual project may be supplemented by a supplementary review of the project in terms of interdependence of the basic parameters of the project which are, plant size, location and technology.

5. **Project Charts and Layouts**

Project charts and layouts have to be prepared to define the scope of the project and provide the basis for detailed project engineering. These are general functional layout, material flow diagram, production line diagram, utility layout and plant layout.

6. **Cost of Production**

Estimates of production costs and projection of profitability is the concluding part of the technical appraisal. Cost of production is worked out taking into account the build up of capacity utilization, consumption norms for various inputs and yields and recovery of by-products. In estimating production, a general build-up starting with 40 per cent and reaching a normal level of 80 per cent in three to four years time is provided.

Assessing Competitive Status for a Project/Unit

The competitive status of a manufacturing unit is evaluated by eight performance measures, some of which form part of technical appraisal.

- Manufacturing Lead Time (MLT)
- Work-In-Process (WIP)
- Machine utilization
- Throughput
- Capacity
- Flexibility
- Performability
- Quality

7. **Economical Appraisal**

Aspect of Economic Appraisal

Economic appraisal of a project deals with the impact of the project on economic aggregates. We may classify these under two broad categories. The first deals with the effect of the project employment and foreign exchange and the second deals with the impact of the project on net social benefits or welfare.

Security Margin

The term loan is sanctioned against the security of fixed assets. The security margin represents the excess value of fixed assets over the term loan. Normally, the term loan is 75 per cent of the value of fixed assets. The security margin is 25 per cent.

Terms and Conditions for Grant of Loans

Term loans are granted subject to the following terms and conditions:

1. Clean title to land as security.
2. Insurance of assets, building and machinery separately.
3. Scrutiny of articles of association to ensure that it does not contain any restrictive clause against covenants of the financial institutions.
4. Lien on all fixed assets.
5. Personal and corporate guarantees of major shareholders and associate concerns.
6. Undertaking from promoters to finance shortfalls in funds/cost overrun.
7. Approval of appointment of managerial personnel by DFI.
8. Further capital expenditure only on the approval of DFI.
9. Payment of dividend and issue of bonus shares subject to the approval of the financial institution.
10. Undertaking for non-disposal of promoters' shareholding for a period of 3 years. After the loan is sanctioned, the requirements to be met are:

I. Acceptance of terms and conditions of loans
II. Deposit of legal charges
III. Details for plot or land for project
IV. Search report and title seeds for the land
V. General body resolutions for creation of charge over assets
VI. Pollution clearance
VII. Legal documents to create a charge in proposed assets
VIII. Personal guarantees and undertakings along with income tax and wealth tax clearance of the promoters and director

IX. Architects and auditor’s certificate for civil construction

Before the loan is disbursed, documents have to be executed and submitted. Stamp duty and registration fees have to be paid, subscribed and paid-up capital is to be brought in by the promoters as required by the DFI and creation and registration of charge on the present and future assets of the company.

13.8. DEVELOPMENT FINANCE INSTITUTIONS

13.8.1Industrial Development Bank of India (IDBI)

The Industrial Development Bank of India (IDBI) which was established in 1964 under an Act of Parliament is the principal financial institution for providing credit and other facilities for development of industry, coordinating working of institutions engaged in financing, promoting or developing industrial units and assisting development of such institutions. IDBI has been providing direct financial assistance to large and medium industrial units and also helping small and medium industrial concerns, (the small industries sector has been transferred to the Small Industries Development Bank) through banks and state-level financial institutions.

13.8.2 Industrial Credit and Investment Corporation of India (ICICI)

Industrial Credit and Investment Corporation of India (ICICI) was established in 1955 as a public limited company to encourage and assist industrial units in the country. It provides term loans in India and foreign currencies, underwrites issues of shares and debentures, makes direct subscription to the issues and guarantees payment for credit made by others.

13.8.3 Industrial Finance Corporation of India (IFCI)

The Industrial Finance Corporation of India (IFCI) was set up under a statute in 1948 but has recently been converted into a public limited company to give flexibility to its operations. Assistance is available to units in the corporate cooperative sectors for new units, expansion diversification and modernization programmes in the form of rupee loans and foreign currency loans underwriting and direct subscription to shares, debentures, guarantees for deferred payments foreign currency loans.

13.9 Key Terms

1. **Listed Company**: A company whose shares are traded on a stock exchange.
2. **Stock**: A type of security that represents ownership in a corporation. Also known as shares or equity.
3. **Market Capitalization**: The total value of a company's outstanding shares, calculated by multiplying the current market price per share by the total number of outstanding shares.
4. **Initial Public Offering (IPO)**: The process through which a private company offers its shares to the public for the first time, allowing it to raise capital by listing on a stock exchange.
5. **Secondary Offering**: The sale of additional shares by a company that is already publicly listed on a stock exchange.
6. **Bull Market**: A financial market characterized by rising prices and investor optimism, often associated with strong economic growth and positive sentiment.
7. **Bear Market**: A financial market characterized by falling prices and investor pessimism, often associated with economic downturns and negative sentiment.
8. **Bid Price**: The price at which a buyer is willing to purchase a security on a stock exchange.
9. **Ask Price**: The price at which a seller is willing to sell a security on a stock exchange.
10. **Spread**: The difference between the bid price and the ask price of a security, representing the transaction cost for buyers and sellers.
11. **Volume**: The total number of shares traded on a stock exchange during a specific period, typically measured on a daily basis.
12. **Liquidity**: The ease with which a security can be bought or sold in the market without significantly affecting its price. High liquidity indicates a large number of buyers and sellers, while low liquidity indicates fewer participants.

13. **Market Order**: An order to buy or sell a security at the prevailing market price, executed immediately upon placement.
14. **Limit Order**: An order to buy or sell a security at a specified price or better. It may not be executed immediately if the specified price is not met.
15. **Ticker Symbol**: A unique combination of letters representing a specific security listed on a stock exchange, used for trading and identification purposes.
16. **Dividend**: A portion of a company's earnings distributed to its shareholders, typically in cash or additional shares.
17. **Index**: A statistical measure that tracks the performance of a specific group of stocks or securities, representing the overall market trend.
18. **Volatility**: The degree of variation in the price of a security over time, indicating the level of risk associated with an investment.
19. **Market Maker**: A brokerage firm or individual that provides liquidity by quoting bid and ask prices for a security and stands ready to buy or sell at those prices.
20. **Regulatory Compliance**: Adherence to rules, regulations, and standards set by regulatory authorities governing the operation of stock exchanges, ensuring fair and transparent trading practices.

13.10 Summary

The winds of change are reshaping the nature of banking and financial markets. Technological advances by reducing costs give individuals and businesses direct access to markets reducing the need for banks to offer certain services. The de-segmentation of the financial services industry, restructuring of banking industry, mergers and amalgamations of banks, integration of markets by exchanges and growth of the financial information business as well as the Internet have been the major sources of change.

Global markets are integrated by the exchanges which link up across borders. This results in reduction of costs, lower trading fee and longer trading hours. The switch from floor trading to screen-based trading has also opened the doors to remote membership and broader participation.

13.11 Check your Progress

QUESTIONS AND EXERCISES

1. Explain the functions of commercial banks.
2. What are the types of risk that banks manage? Explain.
3. Explain the main functions of the RBI.
4. Autonomy for central Bank is a crucial issue. Explain.
5. Discuss the monetary policy in India.
6. Describe how trading occurs on a stock exchange, including the role of buyers, sellers, and intermediaries.

13.12 References

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Unit 14 INDUSTRIAL DEVELOPMENT STRATEGY

Structure

14.1 Introduction

The industrial development strategies are generally divided into two types: industrial development strategy by introducing external capital (ISEC) and industrial development strategy by utilizing local resource (ISLR).

The first strategy, ISEC, is the strategy mainly by inviting enterprises to set up factories in industrial estates with basic infrastructure such as land, traffic system, water supply and electric power. The second strategy, ISLR, is the strategy for generating value added products and promoting industry by highly advanced utilization of local resources such as mineral, agricultural, forestry, and marine resources; traditional technology and culture; and human resource.

However, the above categorization is used for convenience to show the industrial development approach. Industry is not developed by only one approach. Industrial development strategy practically lays special emphasis on ISEC in some stage or condition and on ISLR in another stage or condition.

In a stage of the regional industry being focused on the primary industry, the industry mainly produces agricultural, forestry, and marine goods or makes materials for such production. The industrial development relies inevitably on ISLR under this circumstance.

In the process of industrialization, industrial agglomeration is observed in the urban area, and then income disparities are increased between urban and rural areas. The principal strategy to reduce income disparities is inviting enterprises having excellent factories in the urban area to set up branch factories in the rural area. The income disparities give the rural area a labor wage advantage that can attract industries.

In the stage of further industrial development with industrial agglomeration being observed in the rural area as well, expanding the strategy of inviting enterprises become possible utilizing agglomerated industry, technology, human resources, etc. Simultaneously, for further ISLR, it is possible to prepare conditions such as spinouts from engineers or the development bodies and product innovation by linkage with industry, academy, and government or with other industries.

ISEC and ISLR are apt to be considered as opposing each other, as ISEC is for inviting industries from outside and ISLR, for establishing industries by one’s self. However, they have many common points to prepare conditions for industrial development and to promote industry matching with the regional circumstances. Emphasis is put on the preparation of production environment when ISEC is applied. Emphasis is put on human resource development and preparation of supporting system for start-up new businesses and industries when ISLR is applied. In spite of such differences, they have many common factors, i.e. preparation of production bases, labor force development, human resource development, and preparation of the environment for industrial development such as linkage between industry-academia-government and the living environment, etc.

In other words, it is not easy to develop a new local industry in a region where people have a negative attitude toward the idea of introducing enterprises from outside, and it is not possible to attract enterprises to the region where the new local industry is nipped off.

Recently, more importance is attached on environmental consideration and zero-emission in both cases of ISEC and ISLR. For energy use, further utilization of locally available natural energy is demanded. For advancing zero-emission, more importance is attached on the linkage among industries and regions as well as on recycling in enterprises. It is much better to use ISEC and ISLR in a harmonized way instead of alternative way.

14.2 Learning Objectives

I. Appreciate the need and rationale of Industrial development strategy
II. Enumerate the industrial growth in India under planning

14.3 GROWTH UNDER PLANNING:

Positive Features of Industrial Growth during the Plan Period:

The trend in industrial growth over about 60 years appears to be impressive. During this period, both the pattern and the structure of Indian industries have undergone a significant change.

1. Significant Growth Rate:

The trend in industrial production in India shows a compound growth rate of 6 p.c. The growth rate for the period 1951-55 was 5.7 p.c., 7.2 p.c. in 1955-56 and 9 p.c. in 1960-65. Thus, from the 50s to the mid- 60s, there was a significant acceleration in the industrial growth. It declined to a very low level around 3.7 p.c. in 1966-70. This period was marked by recession in Indian industries.

However, industrial production started picking up after the mid-70s. Still then, the recovery was not high enough. The growth rate of industrial production was around 5-2 p.c. during 1975-83. The decade of 1980s, however, showed a remarkable growth of the industrial sector following liberalization measures introduced in the mid-1980s, But the decade of 1990s did not augur well.

The early years of reform yielded unsatisfactory dividends as far as growth of the industrial sector was concerned. After responding to economic reforms with vigour and registering a robust growth rate of 12.8 p.c. in 1995-96, there had been a slowdown in industrial expansion since 1996-97 when growth rate decelerated to 5.6 p.c. against a growth rate of 13 p.c. in 1995-96.

Declining trend continued in 1998-99 with overall industrial production registering 4.1 p.c. growth during 1998-99. Minor recovery took place in 1999-2000 when overall growth rate increased to 6.7 p.c. The position deteriorated again in the next year when trends in industrial growth and by sectors also suggested an all-round slowdown in industrial activity in 2000-01 (2.7 p.c.) and 2001- 02 (2.8 p.c.).

Industrial growth rate, however, picked up in the Tenth Plan when the growth rate rose to 8 p.c. against the target industrial growth rate of 10 p.c.

2. Increase in the share of Industrial Sector in National Income:

The contribution of the industrial sector towards national income is rising continuously. Its share was 16.1 p.c. in GDP in 1950-51. It rose to 25.2 p.c. in 1990-91. This indicates industrialization. Since then it is on the declining trend. It has come down to 24.9 p.c. in 2007-08.

3. Expansion of Public Sector:

Over the planning period, public sector has registered a phenomenal growth. The idea for giving emphasis to the public sector was to provide a firm base for setting up core industries like power, coal, steel, fertilizers, atomic energy and machine building in the public and to leave the rest for the private sector.

The Seventh Plan has, however, shown preference to the private sector. The Eighth, Ninth and the Tenth Plans, of course, have placed great emphasis on this private sector.

4. Strengthening of Industrial Base:

Besides these quantitative aspects of industrial growth, we also find large progress in strengthening the base of future industrial growth. From the very beginning of the planning period, basic and capital goods industries received utmost attention. Consequently, its performance in total industrial output and gross value added become remarkable as compared to consumer goods industries.

These industries are the base of industrialization. Because of the strengthened industrial base including adequate building up of infrastructural facilities, other industries registered a better growth, particularly intermediate goods industries. This, of course, is not a mean achievement.

5. Modernization:

India has now a large variety of industries producing goods of varied nature which shows the degree of modernization. Some modern industries have really come up and they are competing effectively with the outside world. Modernization is also evident in the field of technological and managerial skills.

This has reduced our dependence greatly on foreign experts and technologists. On the contrary, India is exporting trained personnel in relatively less developed countries.

6. Self-Reliance:

Another positive aspect of industrial growth is the attainment of the goal of self-reliance. We have achieved self-reliance in machinery, plant and other equipment. Today, the bulk of the equipment required for industrial and infrastructural development is produced within the country.

14.4 INDUSTRIAL GROWTH UNDER INDIAN PLANNING:

The Real Growth and Industrial Development in India started during the period of five-year plans.

First Five Year Plan (1951-56): The main objective of the first-year plan was on agricultural development. Therefore the Importance was given to existing Industries rather than the establishment of new industries like cotton, woolen, and jute textiles, cement, paper, medicines, paints, sugar, etc.

Second Five Year Plan (1956-61): This plan was given Importance to the establishment of heavy industries only, The main thrust of industrial development was on iron and steel, Heavy engineering, and fertilizer industries. Three new iron and steel plants were located in Bhilai, Durgapur, and Rourkela.

Third Five Year Plan (1961-66): There was an emphasis on the expansion of basic industries like iron and steel, fossil fuel, and machine building. The Ranchi Machine Tool and three more HMT units were established. Machine building, Locomotive, and Railway coach make.

Annual Plans (1966-1969): The period between 1966 and1969 was the period of annual plans. The Industrial period could not make much progress during the annual plans period.

Fourth Five Year Plan (1969-74): Industries like sugar, cotton, jute, vanaspati, metal-based and chemical industries were given much importance and It was during this plan, Much progress was made in alloys, tools aluminum, automobiles tires, electronic goods, Machine Tools, Tractors and special steel.

Fifth Five Year Plan (1974-79): The Main Importance was given to the rapid growth of steel plants and exports. The Steel Plants at Salem, Vijayanagar, and Visakhapatnam were proposed to create additional capacity, and the **Steel Authority of India Ltd. (SAIL)** was constituted, moreover, Drug manufacturing, oil refining, chemical fertilizers, and heavy engineering industries made steady progress.

Sixth Five Year Plan (1980-85): The Main objective was on producing goods to exploit the domestic and international marketers and priority was given to industries like aluminum, automobiles, electric equipment, and thermostats. Production Targets were achieved in industries like commercial vehicles, drugs, T.V, automobiles, cement, Coal, Jute industry, railway wagons, Sugar industry, etc.

Seventh Five Year Plan (1985-90): Target mainly on electronic industries. Industrial dispersal, Self-employment, exploitation of local resources, and proper training were the preferred areas of the plan.

Eighth Five Year Plan (1992-1997): The Period between 1990 and 1992 was the period of annual plans. There was a major change in the industrial policy of the government of India which was initiated in 1991. The policy of liberalization was adopted for the investment of foreign multinationals. Emphasis was given to the removal of regional imbalances and encouraging the growth of employment in small and tiny sectors.

Ninth Five Year Plan (1997-2002): The main emphasis during this plan was on cement, coal, crude oil, consumer goods, electricity, Infrastructure, refinery, and quality steel products.

Tenth Five Year Plan (2007-12): During this plan, the main emphasis was on modernization, technology, up gradation, reducing transaction costs, and increasing exports and also to enhance exports and to increase global competitiveness and achieve balanced regional development.

Eleventh Five Year Plan (2007-12): This Plan gave priority to industry, infrastructure, and employment. The plan recognized that there should be a rapid industrial development that brings a faster reduction in poverty, generates employment, and ensures essential services such as health and education to all sections of the society.

Twelfth Five Year Plan (2012-2017): The planning commission focus on instilling “inclusive growth” is making headway. The Plan is expected to create employment through developing India’s manufacturing sector and move the nation higher up the value chain is a boon for Industry, The planning commission indicated that it aims to have industry & manufacturing related activities grow by 11% during this plan period, contrasted to 8% over the previous 11th five-year plan.

14.4.1 Planning Commission

The Planning Commission was an institution in India that was responsible for formulating five-year plans for economic and social development. It was established in 1950 by a resolution of the Government of India. The Planning Commission played a central role in India's development process by setting targets and allocating resources for various sectors of the economy.

Key functions and objectives of the Planning Commission included:

1. **Formulating Five-Year Plans**: The primary function of the Planning Commission was to formulate comprehensive five-year plans outlining strategies for economic and social development in India.
2. **Allocation of Resources**: It allocated financial resources to different sectors of the economy based on the priorities outlined in the five-year plans.
3. **Monitoring Plan Implementation:** The Planning Commission monitored the implementation of various programs and projects to ensure that targets were being met.
4. **Promotion of Balanced Development**: It aimed to promote balanced development across different regions and sectors of the economy to reduce disparities and promote inclusive growth.
5. **Policy Formulation:** The Planning Commission played a key role in formulating policies related to industrial development, agriculture, infrastructure, education, and healthcare.
6. **Coordinating with States:** It worked closely with state governments to coordinate planning efforts at the national and state levels.

The Prime Minister of India served as the Chairman of the Planning Commission, and it consisted of members representing different sectors of the economy and society.

In 2014, the Government of India announced the dissolution of the Planning Commission and its replacement with NITI Aayog (National Institution for Transforming India) to adapt to the changing economic landscape and promote cooperative federalism. NITI Aayog took over the role of formulating strategies for economic and social development, with a greater emphasis on decentralized planning and involvement of state governments.

14.4.2 NITI Aayog

NITI Aayog, or the National Institution for Transforming India, is a policy think tank and advisory body of the Government of India, established on January 1, 2015, to replace the Planning Commission. The primary aim of NITI Aayog is to foster cooperative federalism by involving the states in economic policy-making in India.

Some key functions and objectives of NITI Aayog include:

1. Formulating Strategies: It formulates strategies and policies for the economic and social development of India.
2. Monitoring and Evaluation: It monitors and evaluates the implementation of various programs and initiatives to ensure effective outcomes.
3. Collaboration with States: NITI Aayog acts as a platform for cooperative federalism, facilitating collaboration between the central government and the states.
4. Research and Analysis: It conducts research, analysis, and data-driven policy formulation to address various socio-economic challenges facing the country.
5. Promotion of Innovation: NITI Aayog promotes innovation and entrepreneurship by supporting initiatives such as Atal Innovation Mission and Start-up India.
6. Special Initiatives: It undertakes special initiatives and projects in critical areas such as education, health, infrastructure, agriculture, and sustainable development.

The Vice Chairman of NITI Aayog is usually a renowned economist or policymaker, and the Prime Minister of India serves as its ex-officio Chairman. NITI Aayog plays a crucial role in shaping India's development agenda and fostering inclusive growth across the country.

14.5 Key Terms

Growth Planning: Plans set forthwith to aid economic development with the country.

Industrial Planning: Plans are made for period of 5 years to aid and develop the industrial sector and help in addressing the unemployment issue.

14.6 Summary

The aim of the unit to help readers understand the role & importance of the Government with economic activity and with the overall role of developing & empowering the society with employment and empowerment.

14.6 Check your Progress

1. **Explain the role of government in developing the society through growth planning.**
2. **Describe the role of 5 year plans in the development of the Indian economy.**
3. **What**

Unit 15 MAJOR COMMODITIES EXCHANGE IN INDIA

Structure

15.2 Learning Objectives

III. Understand how commodity exchanges operate and regulated in India

IV. Explain how the Government controls price?

V. Understand the Public Distribution System in India

VI. Analyze the extent, Forms and Causes of Concentration of economic power

15.3 COMMODITY EXCHANGES AND THEIR REGULATION:

What Is a Commodities Exchange?

A commodities exchange is a legal entity that determines and enforces rules and procedures for trading standardized commodity contracts and related investment products. A commodities exchange also refers to the physical center where trading takes place. Traders rarely deliver any physical commodities through a commodities exchange. Instead, they trade futures contracts, where the parties agree to buy or sell a specific amount of the commodity at an agreed upon price, regardless of what it currently trades at in the market at a predetermined expiration date.

There are **6** major commodity trading exchanges in India as listed below.

1. **Multi Commodity Exchange – MCX.** This was founded by Financial Technologies almost 20 years ago and has a leadership position in commodity futures on base metals, precious metals, and energy.
2. **National Commodity and Derivatives Exchange – NCDEX** is also around 20 years old and while it also offers most of the commodity futures for trading, it has a leadership position in trading agricultural commodities
3. **National Multi Commodity Exchange – NMCE**
4. **Indian Commodity Exchange – ICEX**
5. **Ace Derivatives Exchange – ACE**
6. **The Universal Commodity Exchange – UCX**

In addition to the above, the **NSE** and the **BSE** have also been authorized to offer trading in commodities by **SEBI**, although it will be in a phased manner. That is yet to pick up meaningfully.

15.4 HOW DOES THE COMMODITY MARKET WORK IN INDIA?

There are two distinct markets viz. the spot market and the derivatives market. The spot market is a market for delivery of commodities on spot or that is normally 4-5 days. The futures markets will be delivered after a specific period; normally 1 month, 2 months, or 3 months. The working of commodity markets in India is basically about the futures market but the spot market is equally important.

How does the commodity market work in spot and futures? The spot market is controlled by specific states and does not come under SEBI purview. It is only the commodity futures, and that too the exchange-traded futures, that come under SEBI purview. There is still a thriving commodity forward market that is on an OTC (Over The Counter) basis and where contracts are customized to the specific requirements of the individual parties. So in a nutshell; there is the commodity spot market, the commodity forwards market, and the commodity futures market with SEBI regulating only the third aspect of commodities.

Commodities were permitted in **2001** and in **2002;** the MCX and the NCDEX started functioning. However, the volumes picked up very sharply only in select commodities. To begin with, the commodity exchanges were only offering futures on commodities. However, being a commodity market, the commodity futures offered speculation-based trading and delivery-based trading. That means the exchange had tie-ups with warehouses to supply the underlying commodity at an assured price to the two parties. The risk belonged to the two parties and the exchange was only a facilitating platform.

In terms of regulation, the commodity markets were regulated under the aegis of the Forward Market Commission or FMC till **2015**. After the National Spot Exchange (NSEL) scam in **2013**, there was a major furor over the functioning and regulation of the FMC and subsequently, the regulation of the commodity futures market was fully transferred to SEBI. Since **2015**, it is the Securities and Exchange Board of India (**SEBI)** has been regulating the commodity markets. Commodity trading in these exchanges requires standard agreements as per the instructions so that trades can be executed without visual inspection. In general, Like in any futures exchange, the trades on the commodity futures exchanges are also standardized in terms of quality, lot sizes, delivery dates, expiry, etc so that entry and exit become simple.

The trading in commodity options was introduced in **2017,** but it is yet to take off in a big way although the traction is visible in several commodities. In India, the volumes on options are predominantly the volumes on options on commodity futures and not on spot commodities. That is the difference between trading options in commodities in the Indian context.

15.4.1 Classifications of commodity futures trading in India

In India, there are broadly 4 categorizations of commodity futures.

- **Commodity futures on Precious Metals** include gold and silver futures contracts on the commodity exchanges. These contracts are extremely liquid and MCX has a leadership position in futures and options on precious metals.

- **Commodity future on Base Metals or Industrial Metals** includes factory commodities like futures contracts on copper, zinc, aluminum, etc on the commodity exchanges. These contracts are also extremely liquid and MCX has a leadership position in futures and options on these base or industrial metals.
- **Commodity futures on precious metals** include commodities like futures contracts on gold and silver on the commodity exchanges. Both the gold and silver contracts are among the most liquid contracts in the exchanges and MCX once again has a leadership position in futures and options on these precious metals.
- **Commodity futures on agriculture commodities** include essentially cash crops like cotton, guar, guar gum, palm oil, etc. These contracts are also extremely liquid and it is NCDEX that has a leadership position in futures and options on these agricultural commodities.

In India, many of the contracts are not permitted like many of the food crops are not allowed to be traded in commodity futures due to fears that they could lead to unnecessary speculation and price rise.

15.4.2 How do commodity futures help?

While speculating on price is surely one advantage of these commodity futures, another very important aspect of commodity futures is to hedge risk. For example, a company that needs to procure copper throughout the year and expects prices to rise can hedge risk by purchasing copper futures. Similarly, a copper miner and smelter can sell copper futures in the commodity market to lock in the selling prices. In both cases, they may lose out if the price moves in their favor but the commodity futures lock in prices and give greater certainty to the business. That is the key application of these commodity futures.

One of the best ways to invest in commodities is via the futures contract route, especially the exchange-traded commodity futures. It represents an agreement to buy or sell a specific quantity of a commodity at a set price at a future date. Such contracts can be for delivery or purely speculative for playing the expected price movement. Futures are available in most commodity categories. Traders use these contracts as protection from the risks associated with the price swing of an underlying finished product or raw material. Trading in commodities involves a high amount of risk for amateur investors since the levels of knowledge of the commodity and global trends are a must.

15.4.3 Who regulates the commodity derivatives market in India?

Securities and Exchange Board of India (SEBI) regulates the commodity derivatives market in India since September 28, 2015. Before September 28, 2015, the Commodity derivatives market was regulated by erstwhile Forward Markets Commission (FMC).

What is the need for regulating the commodity derivatives market?

Regulation is needed to ensure fairness and transparency in trading, clearing, settlement and management of the market institutions including stock exchanges, clearing corporations, and broking houses, and also to maintain the integrity of the marketplace, so as to protect and promote the interest of various stakeholders and investors.

15.5 PRICE AND DISTRIBUTION CONTROL:

The equilibrium price of a commodity is determined by the free play of the forces of demand and supply of the commodity without any intervention of the government. But sometimes the price so determined is very high when there is shortage of some commodity in the market. In such a situation some consumers can not afford to buy the commodity due to its high price. So in order to protect the interest of consumers the government has to fix the price of the commodity which is generally lower than the equilibrium price. In the same way when there is bumper crop of food grains, the price of food grains is determined at a lower level. At this price the farmers are unable to meet their cost of production even. So, the farmers are badly affected due to heavy fall in price. In such cases the government fixes the price of food grains which is higher than the equilibrium price in order to protect the interest of producers specially farmers. So, sometimes the government does not allow free play of the forces of demand and supply for determination of price of some commodities in order to protect the interest of consumers or producers. Government can fix the price of the commodity either below the equilibrium price or above the equilibrium price. Such a price is called administered price (Government determined price). Administered price may be in the form of:

(i) Control Price

(ii) Support Price

(iii) Token Price

(iv) Dual Price

Control Price: In order to protect the interest of consumers government fixes the maximum price of the commodity. This maximum price is generally lower than the equilibrium price. This is called control price or ceiling price. This price is fixed by the government because poor people cannot afford to buy the commodity at equilibrium price. This situation arises when the production of a commodity is less than its demand. As the price of the commodity fixed by the government is less than the equilibrium price, it may create excess demand of the commodity which means the buyers are willing to buy more than what the sellers are willing to sell. In India government has a control price or ceiling price of the commodities which it considers essential for the masses. For examples some goods such as wheat, rice, sugar, kerosene oil etc. have a control price. Due to excess demand for the commodity at ceiling price government resorts to rationing. Rationing means fixing of quota per head per unit of time. Due to excess demand of the commodity at ceiling price the problem of black marketing may also arise. Black marketing is a situation in which the seller illegally charges the price of the commodity which is much higher than the control price. The problem of black marketing can be solved through dual price policy.

1. **Support Price:** Sometimes, in order to protect the interests of producers especially farmers', government fixes the minimum price of the commodity which has to be paid to the producers. This price is generally higher than the equilibrium price. This problem arises when the producers do not cover even their cost of production at equilibrium price. This price fixed by government to safe guard the interests of producers, is called support price. It may create the situation of excess supply of the commodity. It means the sellers are willing to sell more than what the buyers are willing to buy. In India low price of food grains such as wheat, rice etc. adversely affects the farmers. They may lose their interest in producing food grains. This may result in acute shortage of food grains. Therefore, the system of support price is usually followed in case of

agricultural products. The system of support prices assures the farmers that they will be able to sell their products at least at this price. In case of excess supply of the commodity at support price government is ready to purchase any quantity of the commodity to make buffer stock of the commodity.

2. **Token Price:** There are some goods and services which are considered necessary for the existence of life e.g. medical services, health services and education services. Poor people are unable to make use of these services at prevailing market prices. Therefore, government and some private 'Charitable Institutions' provide these services at a price which is much below even their per unit cost of production. Such a price is called token price for these goods and services. The tuition fees charged in government schools is much below the cost incurred per student by the government. Token price is charged in order to prevent the wasteful use of these services. Otherwise these services can be made available free of cost also. If these services are provided free some people may try to stay in hospital for a longer period in order to get free shelter and free food.

3. **Dual Price:** As explained earlier that price control may lead to the shortage of the commodity because sellers are not willing to supply adequate quantity of the commodity at the price fixed by the government as the price is lower than the equilibrium price. This may also lead to black marketing of the commodity. To avoid this situation government adopts dual price policy under this policy a part of the production of the good is sold at control price through fair price shops and the remaining part is sold at prevailing market price which is determined by the forces of demand and supply. At this market price any quantity of the commodity can be bought. For example government sells wheat, rice and sugar to BPL (Below poverty line) card holder at control price through fair price shops and the producers are also allowed to sell their remaining production at equilibrium price in open market.

Precisely, there are **four objectives** of price controls which are described below:

1. To protect the interests of the susceptible sections of the customers given the income distribution.
2. To enable investment in priority industries which are essential for laying the foundation for speedy economic growth of the country.
3. To avoid monopolistic exploitation by a few firms belonging to a single industry.
4. To ensure a reasonable degree of price stability.

In current scenario, private sector trade channels in India cannot be solely relied upon due to their malpractices and their general tendency to exploit the shortage period. Adulteration, hoarding, cornering, profiteering, black marketing and other anti-social and unethical practices are worst practices which make people cry for public distribution system and people has to suffer a lot due to such malpractices. The basic lawful frame for product control is provided by the **Essential Commodities Act, 1955**. The Essential Commodities Act, 1955 was passed to ensure the easy availability of essential commodities to customers and to shield them from mistreatment by dishonest traders. The Act provides for the regulation and control of production, distribution and pricing of commodities which are declared as essential for maintaining or increasing supplies or for securing their impartial distribution and availability at fair prices. Exercising powers under the Act, various Ministries/Departments of the Central Government and under the delegated powers, the State Governments/UT Administrations have issued orders for regulating production, distribution, pricing and other aspects of trading in respect of the commodities declared as essential. The enforcement/ implementation of the provisions of the Essential Commodities Act, 1955 lies with the State Governments and UT Administrations.

This Act provides, in the interest of the general public, for government control over the production, supply and distribution of essential commodities which are listed. These commodities fall into three classes:

1. Food items
2. Raw materials for industries
3. Products of the centrally-controlled industries.

The Central Government is authorized to declare any commodity as a vital commodity for the purpose of the Act. The Government has now itemized over sixty commodities as essential commodities. In this Act, essential commodity means any of the following classes of commodities:

1. Cattle fodder including oil cakes,
2. Coal including coke and other derivatives
3. Component parts of automobiles
4. Cotton and woolen textiles
5. Drugs
6. Foodstuffs including edible oils
7. Iron and steel,
8. Paper and newsprint
9. Petroleum and petroleum products
10. Raw cotton
11. Raw jute
12. Any other class of commodity which the Central Government may declare to be an essential commodity for the purpose of this Act.

Under essential commodity act, all power emanates from the central government and state government or the authorities subordinates to it acts as the delegate of the centre within the scope of the authority assigned to it and subject to any condition imposed or directions given by central government regarding the exercise of the delegated powers. This enables the government to keep an overall control over various state governments and also create uniformity of practice all over the country.

15.6 PUBLIC DISTRIBUTION SYSTEM: Poor people cannot afford to buy even the essential commodities at their market price. To help these people, one of the methods adopted in India is public distribution system under this system essential commodity like wheat, rice, sugar etc. are made available to the common man at cheaper rate through fair price shops called ration shops. These commodities are sold through an identification paper called ration card. Following are the essential elements of public distribution system in India.

1. Subsidy: Government gives subsidies on the commodities sold through public distribution system. Therefore, the prices of the commodities sold under this system are relatively lower.

2. Fixed quantity (Rationing): Government fixes the quantity (quota) per head per unit of time on the basis of minimum requirement of a person. Every household is issued a ration card mentioning the number of persons in the family. Every household can buy the fixed quantity of the commodity according to the number of persons in the family from the fair price shops.

3. Fair price shops (FPS): Government sells these commodities through fair price shops popularly known as ration shops. These shops are opened in all parts of the country. The government supplies these commodities to the owner of these shops according to the number of ration cards registered with each shop. The owners of these shops are paid a commission on their total sales.

15.7 Key Terms

Commodity: In economics, a commodity is an economic good, usually a resource, that specifically has full or substantial fungibility: that is, the market treats instances of the good as equivalent or nearly so with no regard to who produced them.

Exchange: An exchange, bourse, trading exchange or trading venue is an organized market where tradable securities, commodities, foreign exchange, futures, and options contracts are bought and sold.

15.8 Summary

A commodity exchange, also known as a commodity market or commodity trading platform, is a centralized marketplace where various commodities, such as agricultural products, metals, energy resources, and financial instruments based on commodities, are bought and sold. These exchanges provide a platform for producers, consumers, traders, and investors to trade commodities, manage price risks, and discover fair market prices.

15.9 Check your Progress

1. What is the historical evolution of commodity exchanges in India, and how have they evolved over time to their current form?

2. Discuss the role of commodity exchanges in India's economic landscape, highlighting their significance in facilitating trade, price discovery, and risk management

3. Highlight recent developments in India's commodity exchange industry, such as regulatory reforms, product innovations, and market trends.

15.10 References

- "Managerial Economics: Principles and Worldwide Applications" by Yogesh Maheshwari:
- "Managerial Economics" by D.N. Dwivedi

Unit 16 CONCENTRATION OF ECONOMIC POWER:

Structure

16.1 Introduction

Concentration of economic power means centralization of effective control over important economic activities (Industry, Agriculture, Transport etc.) to decide, to make jobs available and on the stream of income and wealth in the hands of some persons or groups. In India concentration of economic power has been occurred through monopoly. Thus monopoly is the means through which concentration of economic power flourishes and its flourishing enhances the power of monopolistic institutions.

To check concentration of economic power and diffuse and decentralize economic power has become the accepted goal of a modern economy. Concentration of power in a few hands is a negation of social justice since it leads to larger inequalities of income and wealth.

In free enterprise economies and in mixed economies with an important role for the private sector there exists a tendency for the economic power to be concentrated in a few hands. In India a few big business houses each being controlled by members of a family or house wield large economic power.

The economic power is manifested in the control by few big businessmen over the price of industrial products, the attempt and pattern of investment and the choices of technology and therefore over the creation of employment opportunities in the economy.

16.2 Learning Objectives

- To understand that economic concentration has negative social effect whereas rational diffusion of wealth should aid the development of the society holistically.

16.3 Extent, Forms and Causes of the Concentration of Economic Power in India:

Extent of the Concentration of Economic Power in India:

In a developing economy such concentration of economic power widens the gap of disparity in income and wealth, which is harmful to the development of the country. This malady is growing fast in **India.** Many committees were formed to study it and to suggest remedies.

1. Mahalanobis Committee (1960):

According to this committee, the working system of the planned economy has encouraged the growth of big companies in Indian industries. These received financial assistance from Indian Industrial Finance Corporation, National Industrial Development Corporation etc., which are public institutions. These have derived more profit of tax reliefs and other facilities.

2. Monopoly Enquiry Commission (1964):

Monopoly Enquiry Commission (1964) has studied the extent, effect and causes of this concentration and concludes that, “Concentration has been promoted more by way of planned economy which was adopted for rapid industrialization in the country.” The main causes, according to the commission, are defective licensing system and discrimination in availability of institutional loans.

3. Other Committees:

Hazari Committee Report (1966) and Batta Committee (1967) have also underlined that big houses had adopted corrupt means for getting licenses. 8% big houses received 38% licenses.

Extent of Concentration:

According to the Mahalanobis Committee, in 1960-61 86% companies (which have paid up capital less than Rs. 5 lakh) had only 14.6% of the total paid up capital in the country while Big Companies having paid up capital above 50 lakh, and which are only 1.6% in number had 58.1% of the total paid up capital of the corporate world in the country.

Monopoly Enquiry Commission found out that there is high grade of concentration in 65 commodities, medium in 10, low in 8 and zero in 17, and 2259 goods under study. These are controlled by 82 Industrial houses.

According to the Sachhar Committee, "Top 20 houses had 89.4% growth in their assets during 1972-78." They had assets of Rs. 648 crores in 1951, which were multiplied nine times up to 1978 (5795 crores).

16.3.1 Forms of Concentration of Economic Power:

1. Product-Wise Concentration:

When a production or distribution of any commodity or service is controlled by any person or group, it is called product-wise concentration.

It is divided in three parts:

(a) High Concentration:

On 75% or more by 3 main producers or distributors.

(b) Medium Concentration:

On 60% to 75% by 3 main producers or distributors.

(c) Low Concentration:

On 50% to 60% of production or distribution by 3 main producers, if the concentration is less than 50% it will not be considered as concentration.

2. Country-Wise Concentration:

If ownership or control of most enterprises engaged in production or distribution of different goods is in the hands of one person, family or industrial group it is called country-wise concentration.

16.3.2 Causes of Concentration of Economic Power in India:

In a rapidly rising and growing economy like India some degree of inequality and concentration of economic power and wealth in a few hands is to be expected, but the disturbing things is that the degree of inequality and concentration is very much more that can be justified on a ground.

The following are the major causes for concentration of wealth and economic power in few hands:

1. Government Policies:

The Dutta Committee (1969) pointed out nearly that the Government of India never specified clearly to the licensing authority the objective of preventing concentration of economic power or monopoly.

2. Rule of Government Financial Institutions:

The financial institutions contributed to the growth of concentration of wealth and economic power. The financial institutions were set up with the ideal of helping the private sector. But the large industrial houses managed to influence its lending policies of those institutions. The Dutta Committee found that about 56 per cent of the total assistance provided by the IFC, IDBI etc. had gone to the large industrial houses.

3. Guidelines of Large Industrial Houses:

So, after independence the Government of India launched upon a programme of massive economic development. The government provided financial, tax benefits, etc. for the promotion of the private sector. The industrial houses which were already in the field saw the abundant chances for their growth and expansion. They took full advantage of the concessions.

4. Role of Commercial Banks:

Before Bank nationalization the large industrial houses controlled the banking system. The bank deposits coming from the general public were used exclusively for financing industries owned and managed by large industrial houses. Even after nationalization in 1969 there was not much of a change in the lending policy of the nationalized banks.

5. Inter-Company Investments:

Inter-company investment means, purchasing shares of a company by other company. Big companies or Industrial groups' purchases stock of other companies on large scale and make them as their subsidiaries.

6. Technological Progress:

Big firms can reduce the production cost through modern technology due to their sound financial condition. Thus they get large economies and become more powerful.

7. Managing Agency System:

This system has greatly controlled in the development of big companies by providing financial assistance. These maintained their credit through intercompany investments. Though the system was abolished in 1970, its dominance still remained upon industrial groups.

8. Monopolistic and Restrictive Trade Practices:

Monopolistic firms adopt such practices as creating artificial shortage of goods, and get high prices, decide high distribution rates of goods, exploit the consumer by distributing market among themselves. Sell goods on different prices to different purchasers, rejecting sales to some buyers or by other producers etc.

9. Strict Import Policy:

After independence the Government had given protection to various industries, and restricted imports. This resulted in imposing monopoly by some Indian producers upon the market.

10. Foreign Collaboration:

After independence India has accepted foreign collaboration on large scale. Foreign industrialists prefer to collaborate with big firms. Thus their dominance got increased.

11. Taxation Policy:

Government offers many concessions on starting new industries, such as relief in income tax and sales tax. Grants are also provided. Big industries derived utmost advantage from this.

16.3.3 Evils of Concentration of Economic Power:

1. Concentration of economic power is associated with monopolies and therefore with high prices and exploitation of consumers.
2. The small scale units are not in a position to compete with them without the development of small and cottage industries concentration of economic power cannot be diffused.
3. The large profits made by the rich people are usually spent on luxurious consumption, this creates demonstration effect and as a result propensity to consume of the other people is raised. This reduces the rate of saving.
4. The big businesses block the entry of new young entrepreneurs in the industrial field by the use of their advertising strength and large resources and influence.
5. Big businesses use their resources to corrupt officials and politicians. To quote the words of the commission appointed by the government of India, “We cannot ignore the unfortunate reality that some big business houses do not hesitate to use their deep pockets to try to corrupt public officials in the attempt to continue and increase their industrial domain.”

In view of the serious evils of concentration of economic power steps should be taken to check this concentration and ensure wider diffusion of economic power. Small scale industries, cooperative enterprises should be encouraged.

16.4 Key Terms

Economic Power: The concentration of economic power refers to the situation where a small number of firms or entities possess a significant share of economic resources, market control, or influence within an industry or economy. This concentration can manifest in various forms, including market dominance by a single firm (monopoly), control by a few large firms (oligopoly), or substantial market share held by a limited number of firms (monopolistic competition). Here are some key points regarding the concentration of economic power.

16.5 Summary

Overall, understanding the concentration of economic power is crucial for policymakers, businesses, and consumers alike, as it can have far-reaching implications for market dynamics, economic efficiency, and social welfare within an economy.

16.6 Check your Progress

- Explain the role of various committees' in mitigating the evil of economic power concentration.
- Explain the concept of "Concentration of Economic Power" and its causes and steps taken to mitigate it.

16.7 References

- Kotwal, Ashok, Bharat Ramaswami, and Wilima Wadhwa. "Economic liberalization and Indian economic growth: What's the evidence?" *Journal of Economic Literature* 51, no. 4 (2013): 1151-1229.
- Maheshwari, S. N. "Concentration of Economic Power and Economic Development in India." *Social Scientist* 6, no. 11 (1978): 47-58.