BUSINESS AND LEGAL ENVIRONMENT

DIGITAL NOTES
ON

BUSINESS AND LEGAL ENVIRONMENT

I MBA - I Semester

Department of MBA

ANNAMACHARYA INSTITUTE OF TECHNOLOGY AND SCIENCES RAJAMPET

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BUSINESS AND LEGAL ENVIRONMENT

UNIT-I: INTRODUCTION TO BUSINESS ENVIRONMENT

1 INTRODUCTION

1.1 Definition of Business The term 'typically' refers to the development and processing of economic values in society. Normally, the term is applied to portion of economic activities whose primary purpose is to provide goods and services for society in an effective manner. It is also applied to economics and commercial activities of institutions which having other purposes.

Business principally comprises of an all profit seeking activities of the organisation which provide goods and services that are necessary to economic system. It is the major economic pulse of a nation, striving to increase society's standard of living. Finally, profits are a primary mechanism for motivating these activities.

Business is in any organisation which makes distribution or provides any article or service to the customers, who are belonging to members of the society. Business may be satisfied customers needs for these purpose customers are able and willing to pay for it.

Business may be defined as "the organized effort by individuals to produce goods and services to sell these goods and services in a market place and to reap some reward for this effort."

Functionally, we may define business as "those human activities which involves production or purchase of goods with the object of selling them at a profit margin".

- The term business refers to the state of being busy for an individual, group, organisation or society.
- It is also interpreted as one's regular occupation or profession or economic activities.
- It deals with particular entity, company, organisation, enterprise, firms or corporation.
- It also interpreted as particular market segment sector like computer business and it included under term business.
- It is wide and willing to use different activities
- It consists of purchase, sale, manufacture, processing, marketing of products, services like manufacturing, trading, transportation, warehousing, banking and finance, insurance and advertising etc.
- It is clearly stated that all business activity's main purpose is to earn profit.
- Profit as a surplus of business and it accrues and distributed to the owners of the business. Business has to pay wages to workers who works in the business.
- People invests money in business due to getting a retain. Retain is profit from the business. This is awarded to investor due to be taking the risk.
- Profit is the motive for the investor who serves, runs business and it is the stimulation effort of the business for growth, survival of business.

BUSINESS AND LEGAL ENVIRONMENT

1.2 Nature of Business

Business may be understood as the organized efforts of enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume. But all businesses share the same purpose: to earn profits. The purpose of business goes beyond earning profit. There are:

- It is an important institution in society.
- Be it for the supply of goods and services
- Creation of job opportunities
- Offer of better quality of life
- Contributing to the economic growth of the country.

Hence, it is understood that the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much.

1.3 Business Today

- **Modern business is dynamic.** If there is any single word that can best describe today's business, it is change. This change makes the companies spend substantially on Research and development (R & D) to survive in the market.
- **Mass production and mass marketing** are the norms followed by business enterprises. The number of companies with an annual turnover of Rs.100 crore each was only three in 1969-70. The figure has gone up by hundreds these days.
- Today's business is characterized by diversification, which may be:
- **Concentric Diversification** - It refers to the process of adding new, but relates products or services. **Horizontal Diversification** - Adding new, unrelated products or services for present customers is called horizontal Diversification.
- **Conglomerate Diversification** - It refers to adding new and unrelated products or services. Going international is yet another trend followed by modern business houses. Business houses are exposed to global competition, which argues well for consumers. Also, occupying a major role is science in the global economic scenario.

1.4 Business in 21st Century Large organizations, with a large workforce will not exist. They will be 'Mini' organizations. Business during the 21st century will be knowledge-based, tomorrow's manager needs not spend his time on file pushing and paper-shuffling. Information technology will take care of most of that work. Organizations will become flat. Linear relationship between the boss and manger and authority flowing downwards and obedience upward will disappear. Employees will have no definite jobs. Most of the jobs will last for two to five years. Remuneration will depend on one's contribution to organization.

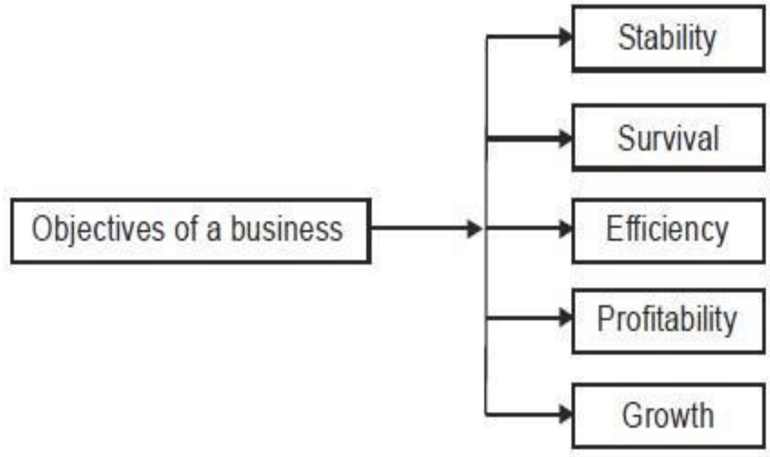
1.5 Characteristics of Business

- **Business is to provide goods and service to the people.** It provides the public with the things it needs and wants in order to survive, enjoy life and improve in a material sense. From the point of view of consumer, business is the satisfier of needs and desire of the customer demands which should be provided by business in order to meet people requirements in society.

- **Goods that have been produced or procured for sale in retail for price enter the realm of business.** This activity of selling results is the creation of the wealth for the society. In satisfying demand, business uses the resources of land, labor and capital. These resources when taken separately have little value; but business combines structures and refines the resources to produce to the value of the society. Further, business employees' people who exchange their talents for wages and salaries. Therefore, these people exchange their compensation for the desired goods and service.
- **Business is profit seeking activity firm.** It supplies goods and services to customers who are satisfy their demand and desire. It adds to society's value by earning of a profit. Profit is the biggest stimulus for maintains the survival of the business and its future development. Society has permits business to earn profit as a reward for assuming the risks of operating a business.
- **Business is also an essential participant in society.** For satisfying society demand which supplying goods and services and earning profits. Business involves the most fundamental activities of the society. As a result, Society has looks to business for something more than products, services and profits. It looks to business for leadership and direction in helping to achieve society's objectives. It expects business to assist in the establishment of a better service to the society.

1.6 Objectives of a Business

In general sense, enterprise pursue multiple objectives rather than a one objective. Strategic manager will be identified a set of main business objectives. These will be pursued by a large cross-section of enterprises. Profitability, productivity, efficiency, growth, technological, dynamism, stability, self-reliance, survival, competitive strength, customer services, financial solvency, product quality, diversification, employee satisfaction and welfare and so on are the major objectives of enterprise. Enterprise looks for balance of these objectives in appropriate and suitable manner. An important business objectives are listed below:



BUSINESS AND LEGAL ENVIRONMENT

1.6.1 Short-term Objectives of a Business

1.6.1.1 Survival

An organisation mission statement reveals the organization's intention to secure its survival through development growth and profitability of the business. It is will and continue the business concern into the future as long as possible perpetuate anxiety strategic managers take more responsibility for survival of the organisation business.

1.6.1.2 Stability

It is the least expensive and risky objectives in form of managerial time and talent and other resources in enterprise. A good and steady enterprise always minimizes its managerial tensions and reduces its dynamic nature decisions which are taken from managers for managing business.

1.6.1.3 Growth

An organisation growth is closely associated with its survival and profitability and equated with dynamism, vigor, promise, and success of a business. Growth refers to overall development of the organisation activities in terms of increase in assets, manufacturing facilities, increase in sales volume in existing or through new product to improve profits and market share.

1.6.1.4 Profitability

Profit is the sole motive of the business enterprise. Private business enterprises are operated on behalf of the owners and its benefits also goes to owners of the enterprise. Profitability clearly indicates of an organization's ability to satisfy the principal; claims and desires of employees and stakeholder of the organisation.

1.6.1.5 Efficiency

It helps to business to achieve goals and success of the business. Efficiency refers to best utilization of available and scarce resources and brings the highest productivity in business activities.

1.6.2 Long-term Objectives of a Business

Short run profit maximization is rarely based on the best approach to be achieving the sustained corporate growth and profitability of the firm. It is recognized by the strategic managers of the firm. Therefore, to achieve long term prosperity purpose strategic managers designed long term objectives. Long term objectives of the firm or company or organisation as listed below:

- Profitability
- Productivity
- Competitive position
- Employee's development
- Employee relationships
- Public responsibility
- Technological leadership

1.6.2.1 Profitability

Profitability is an important functional area of the long-term objectives of the firm. The ability of any business to operate in the long run that depends on attaining on acceptable level of profits. Strategically managed firms characteristically have a profit objective usually expressed in terms to return on equity.

1.6.2.2 Productivity

Productivity is essential need for each strategist in the corporation. Strategic managers try to improve the productivity of their companies. Companies can improve the input–output relationship that results normally increase profitability. Productivity objectives are sometimes stated in terms of desired to achieve by company. This is an equally effective way to increase profitability.

1.6.2.3 Competitive Position

Competitive position can increase profitability and productivity of the company. Companies or firms or organization's competitive position reduces the cost of production of the output. The corporate success depends on the firm's competitive position. It is strongly dominated in the market.

1.6.2.4 Employee Development

It refers to be experienced employees who are the asset of the organisation. For long-term purposes, the company's employees will be needed training for further course of action that effectively and efficiently managed to produce productivity in the competitive position and market. Therefore, it is one of the major long-term objectives of the organisation.

1.6.2.5 Employee Relationships

All companies actively seek good employees who have committed relations with organizational environment. Strategic manger should know the employee needs and expectations. Strategic managers take a decision to welfare programme for the employees of the companies. It can be improved the employee's relationship in the organisation.

1.6.2.6 Technological Leadership

Technological leadership gives clear picture of the organisation goals and objectives for the long term changes in the business scenario. Many companies state their objectives in terms of their technological leadership.

1.6.2.7 Public Responsibility

Business recognizes their social responsibilities towards to customer and society. Public responsibility is to be buildup long-term images in the society by through providing social work to public.

2 ENVIRONMENTS OF BUSINESS

The success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government policies, the business has to make the necessary changes to adapt itself to the new policies. Similarly, a change in the technology may render the existing products obsolete, as we have seen that the introduction of computer has replaced the typewriters; the colour television has made the black and white television out of fashion. Again, a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So, the business units must have to adapt themselves to these changes in order to survive and succeed in business. Hence, it is very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of a business enterprise. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors etc. While some of these factors or forces may have direct influence over the business firm, others may operate indirectly. Thus, business environment may be defined as the total surroundings, which have a direct or indirect bearing on the functioning of business. It may also be defined as the set of external factors, such as economic factors, social factors, political and legal factors, demographic factors, technical factors etc., which are uncontrollable in nature and affects the business decisions of a firm.

2.1 Features of Business Environment

On the basis of the above discussion the features of business environment can be summarized as follows.

- Business environment is the sum total of all factors external to the business firm and that greatly influence their functioning.
- It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.
- The business environment is dynamic in nature, that means, it keeps on changing.
- The changes in business environment are unpredictable.
- It is very difficult to predict the exact nature of future happenings and the changes in economic and social environment.
- Business Environment differs from place to place, region to region and country to country. Political conditions in India differ from those in Pakistan. Taste and values cherished by people in India and China vary considerably.

2.2 Importance of Business Environment

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively.

As stated above, the business environment is multifaceted, complex, and dynamic in nature and has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of the social, political, legal and economic environment helps the business in the following ways:

2.2.1 Determining Opportunities and Threats

The interaction between the business and its environment would identify opportunities for and threats to the business. It helps the business enterprises for meeting the challenges successfully.

2.2.2 Giving Direction for Growth

The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.

2.2.3 Continuous Learning

Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business.

2.2.4 Image Building

Environmental understanding helps the business organisations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power.

2.2.5 Meeting Competition

It helps the firms to analyse the competitors' strategies and formulate their own strategies accordingly.

2.2.6 Identifying Firm's Strength and Weakness

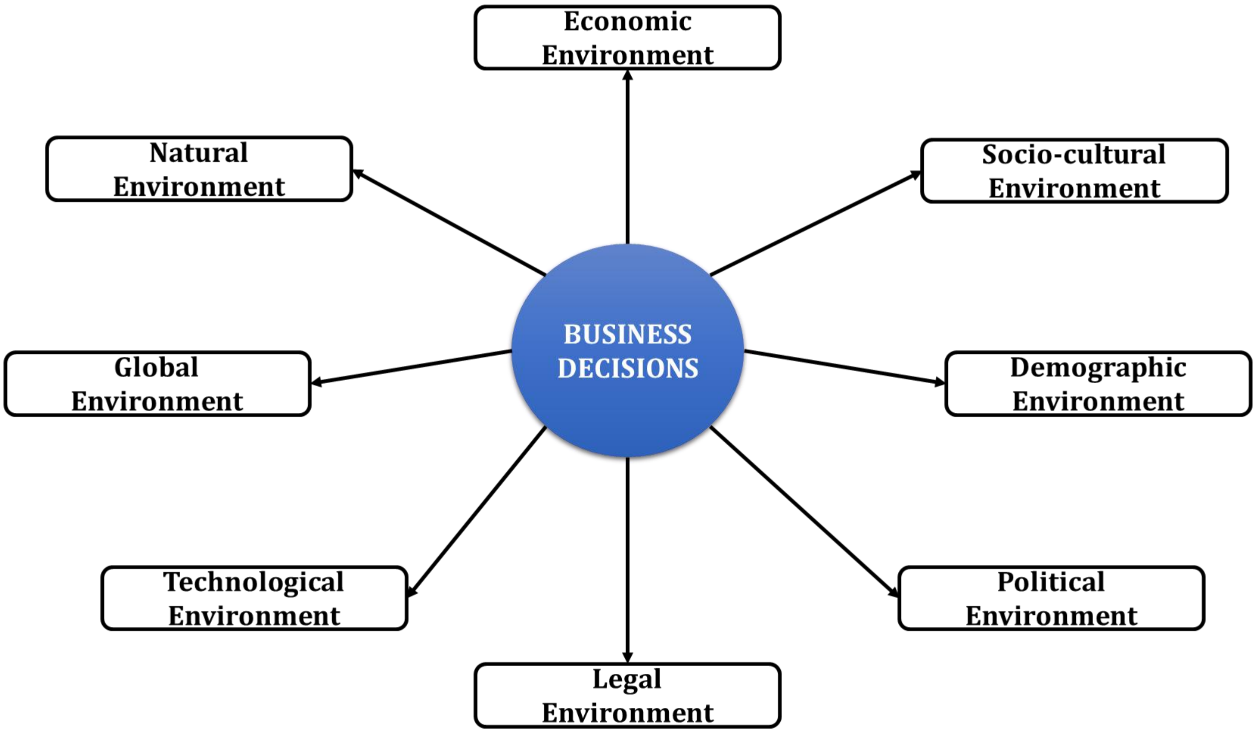
Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments.

2.3 Types of Business Environment

Confining business environment to uncontrollable external factors, it may be classified as (a) Economic environment; and (b) non-economic environment.

The economic environment includes economic conditions, economic policies and economic system of the country. Non-economic environment comprises social, political, legal, technological, demographic and natural environment. All these have a bearing on the strategies adopted by the firms and any change in these areas is likely to have a far-reaching impact on their operations. Let us have a brief idea about each of these areas of business environment.

BUSINESS AND LEGAL ENVIRONMENT



2.3.1 Economic Environment

The survival and success of each and every business enterprise depend fully on its economic environment. The main factors that affect the economic environment are:

Economic Conditions:

The economic conditions of a nation refer to a set of economic factors that have great influence on business organisations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

2.3.1.1 Economic Policies

All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

(i) Industrial policy
(ii) Fiscal policy
(iii) Monetary policy
(iv) Foreign investment policy
(v) Export –Import policy (Exim policy)

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BUSINESS AND LEGAL ENVIRONMENT

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.

2.3.1.2 Economic System

The world economy is primarily governed by three types of economic systems, viz.,

(i) Capitalist economy;
(ii) Socialist economy; and (iii) Mixed economy.

India has adopted the mixed economy system which implies co-existence of public sector and private sector.

2.3.2 Non-Economic Environment

The various elements of non-economic environment are as follow:

2.3.2.1 Social Environment

The social environment of business includes social factors like customs, traditions, values, beliefs, poverty, literacy, life expectancy rate etc. The social structure and the values that a society cherishes have a considerable influence on the functioning of business firms. For example, during festive seasons there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in literacy rate the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more nuclear families with single child concepts have come up. This increases the demand for the different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly.

2.3.2.2 Political Environment

This includes the political system, the government policies and attitude towards the business community and the unionism. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors.

Further, ideology of the political party also influences the business organisation and its operations. You may be aware that Coca-Cola, a cold drink widely used even now, had to wind up operations in India in late seventies. Again the trade union activities also influence the operation of business enterprises. Most of the labour unions in India are affiliated to various political parties. Strikes, lockouts and labour disputes etc. also adversely affect the business operations. However, with the competitive business environment, trade unions are now showing great maturity and started contributing positively to the success of the business organisation and its operations through workers' participation in management.

BUSINESS AND LEGAL ENVIRONMENT

2.3.2.3 Legal Environment

This refers to set of laws, regulations, which influence the business organisations and their operations. Every business organisation has to obey, and work within the framework of the law. The important legislations that concern the business enterprises include:

(i) Companies Act, 1956
(ii) Foreign Exchange Management Act, 1999
(iii) The Factories Act, 1948
(iv) Industrial Disputes Act, 1972
(v) Payment of Gratuity Act, 1972
(vi) Industries (Development and Regulation) Act, 1951
(vii) Prevention of Food Adulteration Act, 1954
(viii) Essential Commodities Act, 2002
(ix) The Standards of Weights and Measures Act, 1956
(x) Monopolies and Restrictive Trade Practices Act, 1969
(xi) Trade Marks Act, 1999
(xii) Bureau of Indian Standards Act, 1986
(xiii) Consumer Protection Act, 1986
(xiv) Environment Protection Act (xv) Competition Act, 2002

Besides, the above legislations, the following are also form part of the legal environment of business.

2.3.2.3.1 Provisions of the Constitution

The provisions of the Articles of the Indian Constitution, particularly directive principles, rights and duties of citizens, legislative powers of the central and state government also influence the operation of business enterprises.

2.3.2.3.2 Judicial Decisions

The judiciary has to ensure that the legislature and the government function in the interest of the public and act within the boundaries of the constitution. The various judgments given by the court in different matters relating to trade and industry also influence the business activities.

2.3.2.4 Technological Environment

Technological environment includes the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for India, they have to be of 220 volts. In the modern competitive age, the pace of technological changes is very fast. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations. Now-adays in fact, no firm can afford to persist with the outdated technologies.

2.3.2.5 Demographic Environment

This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example, a country where population rate is high and children constitute a large section of population, then there is more demand for baby products. Similarly, the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps.

2.3.2.6 Natural Environment

The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. Business is greatly influenced by the nature of natural environment. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

2.3.2.7 Global Environment

The world is becoming smaller. As globalization continues, businesses will be presented with opportunities and face challenges. In this lesson, you'll learn about some of these challenges and how businesses can meet them. In an effort to mitigate global warming, governments, manufacturing industries and small businesses worldwide are focusing on sustainability by encouraging environmentally friendly practices. Going green is a powerful global force that comes at a cost to small business. Every company product must have a stamp of approval proclaiming its production and disposal processes are green. The service industry must observe stringent environmental laws that add to administrative overheads. The net effect is a rise in production costs incurred by the manufacturing sector and the business community as a whole.

3 INDUSTRIAL POLICY OF 1991 AND RECENT DEVELOPMENT

3.1 Industrial Policy - Meaning

Industrial policy means rules, regulations, principles, policies and procedures laid down by government for regulating, developing, and controlling industrial undertakings in the country.

BUSINESS AND LEGAL ENVIRONMENT

It prescribes the respective roles of the public, private, joint, and co-operative sectors for the development of industries.

It also indicates the role of the large, medium and small scale sector. It incorporates tariff policy, labour policy, and the government attitude towards foreign capital, and role to be played by multinational corporations in the development of the industrial sector.

3.2 Objectives of Industrial Policies

A number of objectives have been projected by the Government of India while making industrial policy declarations. Some of the important objectives can be identified as follows:

- Achieving a socialistic pattern of society.
- Preventing undue concentration of economic power.
- Achieving industrial development.
- Reducing disparities in regional development.
- Providing opportunities for gainful employment.
- Achieving a self-sustained economy.
- Achieving faster economic growth.
- Alleviating poverty.
- Protecting and developing a healthy small- scale sector.
- Updating technology and modernization of industry.
- Liberalization and globalization of economy.

3.3 Major Industrial Policies

Industrial policy statements have been announced from 1948 onwards. The prominent Industrial Policies are…

 Industrial Policy Resolution-1948
 Industrial Policy Resolution-1956
 Industrial Policy Statement-1977
 Industrial Policy Statement-1980
New Industrial Policy-1991

3.4 New Industrial Policy-1991

The overall objectives of industrial policy in India have been periodically articulated in the Industrial Policy Resolution of 1948, 1956 & 1977, the Industrial Policy Statement of 1980 and 1990.

On July 24, 1991 the government announced a new Industrial Policy in parliament. The major objective of this policy.

- Development and utilization of indigenous capabilities in technology and manufacturing as well as its up gradation to world standard.

- Dismantling of the regulatory system, development of the capital market and increasing competitiveness for the benefit of the common man.
- Running of the public sector on business lines, and
- Promoting worker's participation in management, enhancing their welfare and equipping them to deal with inevitability of technological change.

In pursuit of the above objectives, the Government have decided to take a series of initiatives in respect of the policies relating to the following areas:

- ***Industrial Licensing***
- ***Public Sector Policy***
- ***Foreign Investment***
- ***Foreign Technology Agreements***
- ***MRTP Act***

3.4.1 Industrial Licensing Policy

Industrial Licensing is governed by the Industries (Development & Regulation) Act, 1951. The Industrial Policy Resolution of 1956 identified the following three categories of industries: those that would be reserved for development in public sector, those that would be permitted for development through private enterprise with or without State participation, and those in which investment initiatives would ordinarily emanate from private entrepreneurs. Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalized from time to time. A full realization of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for the 1990s and beyond it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgement. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts. This can be done only if the role played by the government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change have been with us for some time. The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservations for public sector undertakings has been evolving towards an ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation, while at the same, ensuring that over-riding national interests are not jeopardized.

In the above context, industrial licensing will henceforth be abolished for all industries, except those specified, irrespective of levels of investment. These specified industries (Annex-II), will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and over-riding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. The exemption from licensing will be particularly helpful to the many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. As a whole the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

3.4.2 Public Sector Policy

The public sector has been central to our philosophy of development. In the pursuit of our development objectives, public ownership and control in critical sector of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Today key sectors of the economy are dominated by mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilution. The most striking example is the takeover of sick units from the private sector. This category of Public Sector Units accounts for almost one third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the economy, is the plethora of public enterprises which are in the consumer goods and services sectors.

BUSINESS AND LEGAL ENVIRONMENT

It is time therefore that the Government adopt a new approach to public enterprises. There must be a greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Measures must be taken to make these enterprises more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable must be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following. • Essential infrastructure goods and services. • Exploration and exploitation of oil and mineral resources. • Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate. • Manufacture of products where strategic considerations predominate such as defense equipment. At the same time the public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations, Government will review the existing portfolio of public investments with greater realism. This review will be in respect of industries based on low technology, small scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations or public purpose, and areas where the private sector has developed sufficient expertise and resources.

Government will strengthen those public enterprises which fall in the reserved areas of operation or are in high priority areas or are generating good or reasonable profits. Such enterprises will be provided a much greater degree of management autonomy through the system of memoranda of understanding. Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises. There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to. The country must be proud of the public sector that it owns and it must operate in the public interest.

3.4.3 Policy on Foreign Investment

While freeing Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. In view of the significant development of India's industrial economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy, the relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development.

BUSINESS AND LEGAL ENVIRONMENT

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it has been decided to provide approval for direct foreign investment upto 51% foreign equity in such industries. There shall be no bottlenecks of any kind in this process. This group of industries has generally been known as the "Appendix I Industries" and are areas in which FERA companies have already been allowed to invest on a discretionary basis. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. To the extent that expertise of this nature is not well developed so far in India, Government will encourage foreign trading companies to assist us in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involves interaction with some of the world's largest international manufacturing and marketing firms. The Government will appoint a special board to negotiate with such firms so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest.

3.4.4 Foreign Technology Agreement

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. In the fast changing world of technology the relationship between the suppliers and users of technology must be a continuous one. Such a relationship becomes difficult to achieve when the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty. The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances of his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

With a view to injecting the desired level of technological dynamism in Indian industry, Government will provide automatic approval for technology agreement related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free exchange. Indian companies will be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgement. The predictability and independence of action that this measure is providing to Indian industry will induce them to develop indigenous competence for the efficient absorption of foreign technology. Greater competitive pressure will also induce our industry to invest much more in research and development and they have been doing in the past. In order to help this process, the hiring of foreign technicians and foreign testing of indigenously developed technologies, will also not require prior clearance as prescribed so far, individually or as a part of industrial or investment approvals.

BUSINESS AND LEGAL ENVIRONMENT

3.4.5 Monopolies and Restrictive Trade Practices Act (MRTP ACT)

The principal objectives sought to be achieved through the MRTP Act are as follows: i. Prevention of concentration of economic power to the common detriment, control of monopolies, and ii. Prohibition of monopolistic and restrictive and unfair trade practices.

The MRTP Act became effective in June 1970. With the emphasis placed on productivity in the Sixth Plan, major amendments to the MRTP Act were carried out in 1982 and 1984 in order to remove impediments to industrial growth and expansion. This process of change was given a new momentum in 1985 by an increase of threshold limit of assets.

With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the interference of the Government through the MRTP Act in investment decisions of large companies has become deleterious in its effects on Indian industrial growth. The pre-entry scrutiny of investment decisions by so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly house to obtain prior approval of Central Government for expansion, establishment of new undertakings, merger, amalgamation and takeover and appointment of certain directors. The thrust of policy will be more on controlling unfair or restrictive business practices. The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on acquisition of and transfer of shares will be appropriately incorporated in the Companies Act.

Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation suo-moto or on complaints received from individual consumers or classes of consumers.

Note: The MRTP Limit for MRTP companies was made Rs. 100 Crore. Currently, MRTP act is replaced by Competition Act 2002.

ANNEX I

PROPOSED LIST OF INDUSTRIES TO BE RESERVED FOR THE PUBLIC SECTOR

1. Arms and ammunition and allied items of Defence equipment, Defence aircraft and Warships.

2. Atomic Energy.

3. Coal and Lignite.

4. Mineral Oils.

5. Mining of Iron ore, Manganese ore, Chrome ore, Gypsum, Sulphur, Gold and Diamond.

6. Mining of Copper, Lead, Zinc, Tin, Molybdenum and Wolfram.

7. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.

8. Railway transport.

ANNEX II

LIST OF INDUSTRIES IN RESPECT OF WHICH INDUSTRIAL LICENSING WILL BE COMPULSORY

1. Coal and Lignite.
2. Petroleum (other than crude) and its distillation products.
3. Distillation and brewing of alcoholic drinks.
4. Sugar.
5. Animal fats and oils.
6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
7. Asbestos and asbestos-based products.
8. Plywood, decorative veneers, and other wood based products such as particle board, medium density fibre board, block board.
9. Raw hides and skins, leather, chamois leather and patent leather.
10. Tanned or dressed furskins.
11. Motor cars.
12. Paper and Newsprint except bagasse-based units.
13. Electronic aerospace and defence equipment; All types.
14. Industrial explosives, including detonating fuse, safety fuse, gun powder, nitrocellulose and matches.
15. Hazardous chemicals.
16. Drugs and Pharmaceuticals (according to Drug Policy).
17. Entertainment electronics (VCRs, colour TVs, C.D. Players, Tape Recorders).
18. White Goods (Domestic Refrigerators, Domestic Dishwashing machines, Programmable Domestic Washing Machines, Microwave ovens, Air Conditioners).

ANNEX III

LIST OF INDUSTRIES FOR AUTOMATIC APPROVAL OF FOREIGN

BUSINESS AND LEGAL ENVIRONMENT

TECHNOLOGY AGREEMENTS AND FOR 51% FOREIGN EQUITY APPROVALS

1. Metallurgical Industries i. Ferro alloys. ii. Castings and forgings. iii. Non-ferrous metals and their alloys. iv. Sponge iron and pelletisation. v. Large diameter steel welded pipes of over 300 mm diameter and stainless steel pipes. vi. Pig iron.
2. Boilers and Steam Generating Plants
3. Prime Movers (other than electrical generators) i. Industrial turbines. ii. Internal combustion engines. iii. Alternate energy systems like solar wind etc. and equipment therefor. iv. Gas/hydro/steam turbines upto 60 MW.
4. Electrical Equipment i. Equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers. ii. Electrical motors. iii. Electrical furnaces, industrial furnaces and induction heating equipment. iv. X-ray equipment. v. Electronic equipment, components including subscribers' end telecommunication equipments. vi. Component wires for manufacture of lead-in wires. vii. Hydro/steam/gas generators/generating sets upto 60 MW. viii. Generating sets and pumping sets based on internal combustion engines. ix. Jelly-filled telecommunication cables. x. Optic fibre. xi. Energy efficient lamps and xii. Midget carbon electrodes.
5. Transportation i. Mechanized sailing vessels upto 10,000 DWT including fishing trawlers. ii. Ship ancillaries. iii. (a) Commercial vehicles, public transport vehicles including automotive commercial three wheeler jeep type vehicles, industrial locomotives. (b) Automotive two wheelers and three wheelers. (c) Automotive components/spares and ancillaries. iv. Shock absorbers for railway equipment and v. Brake system for railway stock and locomotives.
6. Industrial Machinery i. Industrial machinery and equipment.
7. i. Machine tools and industrial robots and their controls and accessories. ii. Jigs, fixtures, tools and dies of specialized types and cross land tooling, and iii. Engineering production aids such as cutting and forming tools, patterns and dies and tools.
8. Agricultural Machinery i. Tractors. ii. Self-propelled Harvestor Combines. iii. Rice transplanters.
9. Earth Moving Machinery i. Earth moving machinery and construction machinery and components thereof.
10. Industrial Instruments i. Indicating, recording and regulating devices for pressures, temperatures, rate of flow weights levels and the like.
11. Scientific and Electromedical Instruments and Laboratory Equipment.
12. Nitrogenous & Phosphatic Fertilizers falling under i. Inorganic fertilizers under '18-Fertilizers' in the First Schedule to IDR Act, 1951.

BUSINESS AND LEGAL ENVIRONMENT

13. Chemicals (other than fertilizers). i. Heavy organic chemicals including petrochemicals. ii. Heavy inorganic chemicals. iii. Organic fine chemicals. iv. Synthetic resins and plastics. v. Man made fibres. vi. Synthetic rubber. vii. Industrial explosives. viii. Technical grade insecticides, fungicides, weedicides, and the like. ix. Synthetic detergents x. Miscellaneous chemicals (for industrial use only) a. Catalysts and catalyst supports. b. Photographic chemicals. c. Rubber chemicals. d. Polyols. e. Isocyanates, urethanes, etc. f. Speciality chemicals for enhanced oil recovery. g. Heating fluids. h. Coal tar distillation and product therefrom. i. Tonnage plants for the manufacture of industrial gases. j. High altitude breathing oxygen/medical oxygen. k. Nitrous oxide. l. Refrigerant gases like liquid nitrogen, carbondioxide etc.in large volumes. m. Argon and other rare gases. n. Alkali/acid resisting cement compound o. Leather chemicals and auxiliaries.
14. Drugs and Pharmaceuticals According to Drug Policy.
15. i. Paper and pulp including paper products. ii. Industrial laminates.
16. i. Automobile tyres and tubes. ii. Rubberised heavy duty industrial beltings of all types. iii. Rubberised conveyor beltings. iv. Rubber reinforced and lined fire fighting hose pipes. v. High pressure braided hoses. vi. Engineering and industrial plastic products.
17. Plate Glass i. Glass shells for television tubes. ii. Float glass and plate glass. iii. H.T. insulators. iv. Glass fibres of all types.
18. Ceramics i. Ceramics for industrial uses.
19. Cement Products i. Portland cement. ii. Gypsum boards, wall boards and the like.
20. High Technology Reproduction and Multiplication Equipment.
21. Carbon and Carbon Products i. Graphite electrodes and anodes. ii. Impervious graphite blocks and sheets.
22. Pretensioned High Pressure RCC Pipes.
23. Rubber Machinery
24. Printing Machinery. i. Web-fed high speed off-set rotary printing machine having output of 30,000 or more impressions per hour. ii. Photo composing/type setting machines. iii. Multi-colour sheet-fed off-set printing machines of sizes 18"x25" and above. iv. High speed rotograture printing machines having output of 30,000 or more impressions per hour.
25. Welding Electrodes other than those for Welding Mild Steel
26. Industrial Synthetic Diamonds.
27. i. Photosynthesis improvers. ii. Genetically modified free living symbiotics nitrogen fixer. iii. Pheromones. iv. Bio-insecticides.

28. Extraction and Upgrading of Minor Oils
29. Pre-fabricated Building Material.
30. Soya Products i. Soya texture proteins. ii. Soya protein isolates. iii. Soya protein concentrates. iv. Other specialised products of soyabean. v. Winterised and deodourised refined soyabean oil.
31. (a) Certified high yielding hybrid seeds and synthetic seeds and (b) Certified high yielding plantlets developed through plant tissue culture.
32. All food processing industries other than milk food, malted foods, and flour, but excluding the items reserved for small-scale sector.
33. All items of packaging for food processing industries excluding the items reserved for small scale sector.
34. Hotels and tourism-related industry.

4 RECENT DEVELOPMENTS IN INDIAN ECONOMY

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted a mixed response.

There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced a radical change in economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries, disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channelize foreign capital investment in India.

Let us discuss the developments under three heads, viz.,

(a) Liberalization,
(b) Privatization, and
(c) Globalization

BUSINESS AND LEGAL ENVIRONMENT

4.1 Liberalization

Liberalization refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

(i) abolishing industrial licensing requirement in most of the industries;
(ii) freedom in deciding the scale of business activities;
(iii) freedom in fixing prices of goods and services;
(iv) simplifying the procedure for imports and exports;
(v) reduction in tax rates; and
(vi) simplified policies to attract foreign capital and technology to India

Through this liberalization process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organisations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalization has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

4.2 Privatization

Privatization refers to reducing the role of public sector by involving the private sectors in most activities. Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the postliberalised period. The issues of privatization include:

- reduction in the number of industries reserved for the public sector from 17 to 8 (reduced further to 3 later on) and the introduction of selective competition in the reserved area;
- disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership in business;
- improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results.

In India, as a result of these steps, the post liberalization phase has witnessed a massive expansion of the private sector business in India. You can have an idea of their expansion from the fact that the total capital employed in top 500 private sector companies rose from Rs. 1,39,806 crores in 1992-93 to Rs. 2,34,751 crores in 1994-95 (an expansion of 68% in just two years).

4.3 Globalization

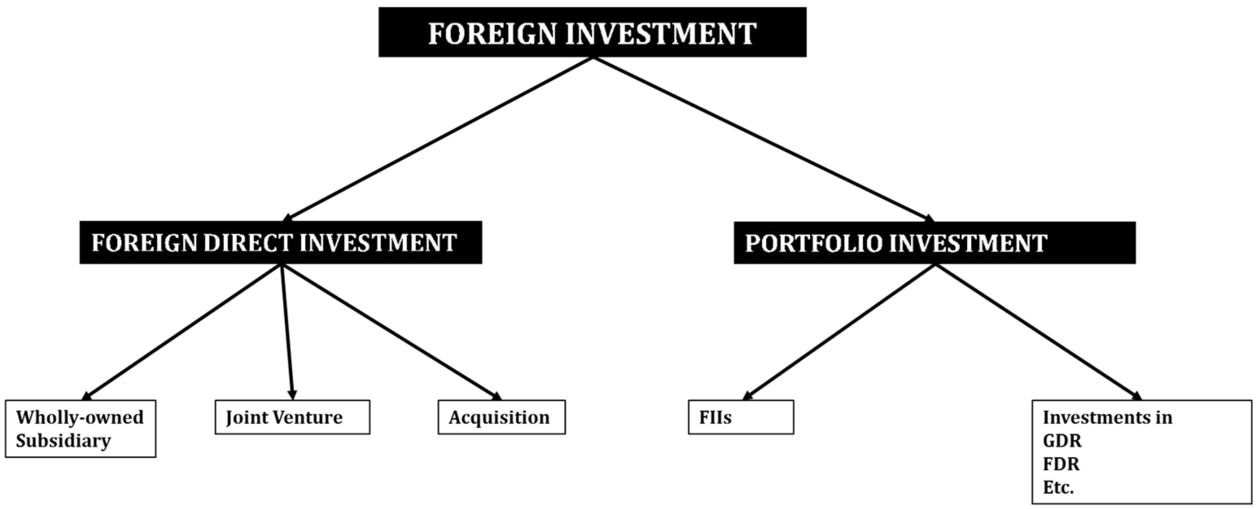
Globalization means ‘integrating’ the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries. To achieve these objectives of globalization, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment and encouragement of foreign technology. These measures are expected to achieve a higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

5 FOREIGN INVESTMENTS IN INDIA

Domestic capital is inadequate for the purpose of economic growth and it is necessary to invite foreign investments (foreign capital).

5.1 Types of Foreign Investments

The following chart shows the different modes of Foreign Investment in India.



5.1.1 Foreign Direct Investment

"Foreign Direct Investment, commonly known as FDI, refers to investment in a foreign country where the investor retains control over the investment".

The FDIs are governed by long-term consideration because these investments cannot be easily liquidated. It typically takes the form of starting a subsidiary, acquiring, a stake in an existing firm, starting a joint-venture in the foreign country. These investments have direct responsibility with the promotion and management of the enterprises. The control is in the form of actual production, effective decision making, marketing, technology etc. The FDI is in three forms---

- Green-field investment (Wholly-owned subsidiary)
- Joint-venturing
- Acquisitions

5.1.1.1 Green-field investment (Wholly-owned subsidiary)

Establishing an entirely new enterprise in a foreign market is known as green-field investment (wholly-owned subsidiary).

BUSINESS AND LEGAL ENVIRONMENT

5.1.1.2 Joint-venturing
Jointly starting an enterprise with another domestic party is called joint-venturing.

5.1.1.3 Acquisitions
Acquiring an existing firm in the foreign country is known as cross-border acquisition.

5.1.2 Portfolio Investment
When the investor makes only investment and does not retain control over the enterprise is known as port-folio investment.

The investor is interested only in return on his capital and does not want control over the use of invested capital. This kind of investments are for short-period and short-term gains; and these can be easily liquidated.

A Foreign Institutional Investor (FII) is an investor or investment fund registered in a country outside of the one in which it is investing. Institutional investors most notably include hedge funds, insurance companies, pension funds and mutual funds. The term is used most commonly in India and refers to outside companies investing in the financial markets of India.

An FII is any type of large investor who does business in a country other than the one in which the investment instrument is being purchased. In addition to the types of investors above, others include banks, large corporate buyers or representatives of large institutions. All FIIs take a position in a foreign financial market on behalf of the home country in which they are registered.

Countries with the highest volume of foreign institutional investments are those that have developing economies. These types of economies provide investors with higher growth potential than in mature economies. This is why these investors are most commonly found in India, all of which must register with the Securities and Exchange Board of India to participate in the market.

If, for example, a mutual fund in the United States sees an investment opportunity in an Indian based company, it can purchase the equity on the Indian public exchange and take a long position in a high-growth stock. This also benefits domestic private investors who may not be able to register with the Securities and Exchange Board of India. Instead, they can invest in the mutual fund and take part in the high growth potential.

5.1.2.1 Forms of Portfolio Investments
The portfolio investments are of the following modes.

- FIIs – Foreign Institutional Investors
- FDR – Foreign Depository Receipts
- GDR – Global Depository Receipts
- ADR – American Depository Receipts
- FCCBs – Foreign Currency Convertible Bonds etc.

BUSINESS AND LEGAL ENVIRONMENT

5.1.3 Regulations for Investing in Indian Companies

All FIIs are allowed to invest in India's primary and secondary capital markets only through the country's portfolio investment scheme (PIS). This scheme allows FIIs to purchase shares and debentures of Indian companies on the normal public exchanges in India.

However, there are many regulations included in the scheme. There is a ceiling for all FIIs that states the max investment amount can only be 24% of the paid-up capital of the Indian company receiving the investment. The max investment can be increased above 24% through board approval and the passing of a special resolution. The ceiling is reduced to 20% of the paid-up capital for investments in public sector banks.

The Reserve Bank of India monitors daily compliance with these ceilings for all foreign institutional investments. It checks compliance by implementing cutoff points 2% below the max investment amounts. This gives it a chance to caution the Indian company receiving the investment before allowing the final 2% to be invested.

5.2 How does a foreign company invest in India?

FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which require prior approval of the government:

i) where provisions of Press Note 1 (2005 Series) issued by the Government of India are attracted.

ii) where more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector.

iii) FDI in sectors/activities to the extent permitted under Automatic Route does not require any prior approval either by the government or the Reserve Bank of India.

iv) The investors are only required to notify the Regional Office concerned of the Reserve Bank of India within 30 days of receipt of inward remittances and file the required documents along with form FC-GPR with that Office within 30 days of issue of shares to the non-resident investors.

5.2.1 Government Route

FDI in activities not covered under the automatic route requires prior Government approval and are considered by the Foreign Investment Promotion Board (FIPB), Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from www.dipp.gov.in. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

5.2.2 General permission of RBI under FEMA

Indian companies having foreign investment approval through FIPB route do not require any further clearance from the Reserve Bank of India for receiving inward remittance and issue of shares to the non-resident investors. The companies are required to notify the concerned regional office of the Reserve Bank of India of receipt of inward remittances within 30 days of such receipt and submit form FC-GPR within 30 days of issue of shares to the non-resident investors.

5.2.3 Which are the sectors where FDI is not allowed in India, under the Automatic Route as well as Government Route?

FDI is prohibited under Government as well as Automatic Route for the following sectors:

i) Retail Trading (except single brand product retailing) ii) Atomic Energy iii) Lottery Business iv) Gambling and Betting v) Business of Chit Fund vi) Nidhi Company vii) Agricultural or plantation activities (cf Notification No. FEMA 94/2003-RB dated June 18, 2003). viii) Housing and real estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005) ix) Trading in Transferable Development Rights (TDRs).

5.2.4 What should be done after investment is made under the Automatic Route or with Government approval?

A two-stage reporting procedure has been introduced for this purpose.

- On receipt of money for investment:
- Within 30 days of receipt of money from the non-resident investor, the Indian company will report to the regional office of the Reserve Bank of India, under whose jurisdiction its registered office is located, containing details such as:
- Name and address of the foreign investor/s
- Date of receipt of funds and their rupee equivalent
- Name and address of the authorised dealer through whom the funds have been received, and
- Details of the Government approval, if any.
- Upon issue of shares to non-resident investors:
- Within 30 days from the date of issue of shares, a report in Form FC-GPR, PART A together with the following documents should be filed with the concerned regional office of the Reserve Bank of India.
- Certificate from the company secretary of the company accepting investment from persons resident outside India certifying that;
- The company has complied with the procedure for issue of shares as laid down under the FDI scheme as indicated in the notification no. FEMA 20/2000-RB dated 3rd May 2000 as amended from time to time
- The proposal is within the sectoral policy / cap permissible under the automatic route of RBI and it fulfills all the conditions laid down for investments under the Automatic approval route namely

BUSINESS AND LEGAL ENVIRONMENT

a) Non-resident entity/ies (other than individuals) to whom it has issued shares does / do not have any existing joint venture or technology transfer or trade mark agreement in India in the same field.

b) The company is not investing in an SSI unit & the investment limit of 24 % has been observed/ requisite approvals have been obtained.

c) Shares have been issued on rights basis and the shares are issued to non-residents at a price that is not lower than that at which shares are/were issued to residents.

OR

d) Shares issued are bonus shares.

OR

e) Shares have been issued under a scheme of merger and amalgamation of two or more Indian companies or reconstruction by way of demerger or otherwise of an Indian company, duly approved by a court in India.

- Shares have been issued in terms of SIA/FIPB approval No. --------------------- dated -------------------
- Certificate from statutory auditors or chartered accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

5.3 Determinants of FDI

5.3.1 Market size

Larger market size should receive more inflows than that of smaller countries having lesser market size. Market size is generally measured by Gross Domestic Product (GDP), GDP per capita income and size of the middle class population.

5.3.2 Economic stability and growth prospects

A country which has a stable macroeconomic condition with high and sustained growth rates will receive more FDI inflows than a more volatile economy. The proxies measuring growth rate are: GDP growth rates, Industrial production index, Interest rates, Inflation rates.

5.3.3 Labour cost

Higher labour cost would result in higher cost of production and is expected to limit the FDI inflows; therefore, we expect the negative and significant relationship between labour cost and FDI. Labour cost can be proxied by wage rate.

BUSINESS AND LEGAL ENVIRONMENT

5.3.4 Infrastructure facilities

The well-established and quality infrastructure is an important determinant of FDI flows. On the other hand, a country which has opportunity to attract FDI flows will stimulate a country to equip with good Infrastructure facilities. Therefore, we expect positively significant relationship between FDI and Infrastructure.

5.3.5 Trade openness

Trade openness is considered to be a key determinant of FDI as represented in the previous literature; much of FDI is export oriented and may also require the import of complementary, intermediate and capital goods. In either case, volume of trade is enhanced and thus trade openness is generally expected to be a positive and significant determinant of FDI.

5.3.6 Currency valuation

The strength of a currency (Exchange rate) is used as proxy for level of inflation and the purchasing power of the investing firm. Devaluation of a currency would result in reduced exchange rate risk. As a currency depreciates, the purchasing power of the investors in foreign currency terms is enhanced, thus we expect a positive and significant relationship between the currency value and FDI inflows.

5.3.7 Gross Capital Formation

In a transition economy, improvements in the investment climate help to attract higher FDI inflows. It translates into higher Gross capital formation which in turn leads to greater economic growth.

5.4 Advantages and Disadvantages of FDI in India

5.4.1 Main advantages of FDI in domestic country

- Inflow of Foreign Capital. Capital base of domestic country increases.
- Increase in tax revenue.
- Boost economy by GDP growth.
- Increase competition, productivity and efficiency.
- Large employment opportunities
- Inflow of technology, expertise and know how.
- Infrastructure facilities improve and it will bring growth and prosperity.
- Reduce cost of production. Prices of products will come down. This will tame inflationary pressure in the economy.
- Increase in international trade.
- High quality products that will help them develop local businesses and industries.
- Decrease in food wastage
- Benefits to the farmers
- Increase in Forex reserves
- Better consumer choice

- Reduction in food inflation
- Increase in economic growth by dealing in various international products.
- Billion dollars will be invested in Indian retail market.

- FDI in defence sector will reduce imports; improve country's capacity to produce defence equipment locally and save foreign money. Definitely, it will create employment opportunities. It will give them a hope that Indian defence equipment will become globally competitive. High technology and expertise will flow to the country.

5.4.1.1 Advantages to Foreign Countries

Source of external capital and increased revenue. FDI can be a tremendous source of external capital for a developing country, which can lead to economic development. For example, if a large factory is constructed in a small developing country, the country will typically have to utilize at least some local labor, equipment and materials to construct it. This will result in new jobs and foreign money being pumped into the economy. Once the factory is constructed, the factory will have to hire local employees and will probably utilize a least some local materials and services. This will create further jobs and maybe even some new businesses. These new jobs mean that locals have more money to spend, thereby creating even more jobs.

Additionally, tax revenue is generated from the products and activities of the factory, taxes imposed on factory employee income and purchases, and taxes on the income and purchases now possible because of the added economic activity created by the factory. Developing governments can use this capital infusion and revenue from economic growth to create and improve its physical and economic infrastructure such as building roads, communication systems, educational institutions and subsidizing the creation of new domestic industries. Development of new industries. Remember that a MNE doesn't necessary own all of the foreign entity. Sometimes a local firm can develop a strategic alliance with a foreign investor to help develop a new industry in the developing country. The developing country gets to establish a new industry and market, and the MNE gets access to a new market through its partnership with the local firm. 3. FDI exposes national and local governments, local businesses and citizens to new business practices, management techniques, economic concepts, and technology.

5.4.2 Disadvantages of FDI in India

Investing in India definitely has some negative sides as well. Most noticeably India considered as a huge market but a major portion of that is a lower and middle class person who still suffers from budget shortage. The infrastructure of the country also needs to be improved a lot and already it is under huge strain. There are also problems exists in the power demand shortfall, port traffic capacity mismatch, poor road conditions deal with an inefficient and sometimes still slow-moving bureaucracy. The huge market in India is an advantage but it is also very diverse in nature. India has 17 official languages, 6 major religions, and ethnic diversity. This makes the tasks difficult for the companies to make appropriate product or service portfolio. India is not a member of the International Centre for the Settlement of Investment Disputes also not of the New York Convention of 1958. That make life bit difficult for the foreign investors. India still has a heavy regulation burden among other countries, for example the time taken to start business or to register a property is higher in India.

India ranks low (134th position) in World Bank's 'Ease of Doing Business'. It has to be seen whether these age old bureaucratic methods can be reformed easily. For example, both exporters and importers need to undertake a huge amount of paper work and get different types of clearances that spawn corruption and delays, all of which can cause patience to run out, making foreign investors pack up and go.

- May cause monopoly by foreign companies in the absence of proper control by domestic Government.
- Internal insecurity: But will it affect internal security of the country? In a country like India, where internal security issues like terrorism are more relevant, allowing 100 % FDI in the major area of protection from enemies may have a chance of giving negative results. It may also affect the domestic companies involved in defence production.
- May exploit the domestic resources without giving benefits to domestic country.
- Domestic companies may feel uprooted.
- Government does not have any clear stands on the FDI. They have not done any survey and cost benefit analysis of this issue.
- As claimed by the government that it will create Jobs, opposition does not buy it but millions of retailers have to shut their shops. Will affect million small merchants in India.
- An economically backward class person may suffer from price raise in future.
- Retailer faces heavy loss of employment and profit.
- Inflation may be increased.
- The rural India will remain deprived of the services of foreign players.

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UNIT-2 Production and Cost Analysis

BUSINESS AND LEGAL ENVIRONMENT

32 **Dr. G. RAMANJANEYULU**
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