



# **Business Environment & Law**

**The Socio-Political Environment of Business**





# **Business Environment and Law**

## **Block**

# **1**

## **THE SOCIO-POLITICAL ENVIRONMENT OF BUSINESS**

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## **COURSE INTRODUCTION**

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Business organizations are increasingly exposed to various challenges in the environment they function. Businesses have come to appreciate the fact that with increasing concentration of property and people and increasingly complex servicing, manufacturing, and industrial processes, they are exposed to greater risk and that they must manage risks' more efficiently and effectively in order to be competitive.

Managers require relevant skills to comprehend the legal risks that are associated with transactional and functional aspects of business. Awareness of legal and regulatory risks and their evaluation in taking decisions helps in the proper orientation of business strategies to meet the competition.

Business Environment and Law examines key issues in the environment and the legal and regulatory framework that affect organizations and their businesses. The course is divided into two major parts.

The first part of the course introduces students to the various components of the business environment. The course enables students to gain an understanding into the social, demographic, cultural, political, economic, financial, trade, technological, legal, regulatory, tax, and ethical environments, and how these environments play a vital role in affecting the business of an organization.

The second part of the course provides the foundation that is essential for managers to take the dynamic decisions within the legal and regulatory framework. The course discusses the legal issues in substantive business areas such as the law of contracts that deals with the classification, validity, essential features, and parties to a contract, and remedies to various parties, and other miscellaneous aspects. It also provides the provisions pertaining to special contracts such as contract of agency, indemnity and guarantee and, bailment and pledge. The course also introduces the current provisions pertaining to the Companies Act, 2013, and the tax laws such direct and indirect tax law.

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## **BLOCK I: THE SOCIO-POLITICAL ENVIRONMENT OF BUSINESS**

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*The first block* deals with the fundamental concepts relevant to business environment and consists of four units. The first unit provides an introduction to business environment. The second unit discusses the demographic and social environment, the third unit deals with the cultural environment, and the fourth unit examines the political environment of business.

*Unit 1* Business Environment: An Introduction - discusses the dimensions and components of business environment. These include the external and internal environments. The unit also explains the importance of business environment.

*Unit 2* Demographic and Social Environment - deals with the demographic environment and social environment of business. The unit examines the definition of these environments and their impact on business.

*Unit 3* Cultural Environment - describes the cultural environment of business, which is also another external environment factor. The unit conveys the essence and manifestation of culture, while explaining its elements such as language, aesthetics, religion and education. The unit also examines various concepts related to culture such as culture change, cultural analysis, cultural adaptation, and the cultural sensitivity of the industrial and consumer markets.

*Unit 4* Political Environment - gives an overview of the political environment of business, and how it affects business (domestic or international). The unit examines the classification of government based on political systems and economic systems. It discusses the complexities involved in business due to the political environment. The unit also explains the factors contributing to political instability, and the concept of political risk.

## Unit 1

# Business Environment: An Introduction

### Structure

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- 1.1 Introduction
- 1.2 Objectives
- 1.3 Dimensions of the Business Environment
- 1.4 Importance of the Business Environment
- 1.5 Components of the Business Environment
- 1.6 External and Internal Environment
- 1.7 Summary
- 1.8 Glossary
- 1.9 Self-Assessment Test
- 1.10 Suggested Readings / Reference Material
- 1.11 Answers to Check Your Progress Questions

### 1.1 Introduction

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In this unit, we introduce you to the business environment. Businesses operate in the society and continue to grow by using resources from it. It also faces unprecedented harm, generally called as the risk, from the dynamics of society. Individuals, businesses, and the society face possibilities of risk, as they continue to grow economically. Business operations are greatly influenced by various vibrant factors surrounding it. The environmental factors surrounding the business and its operations are known as the business environment. The factors may be internal or external to the business. Risk is an outcome of the dynamic environment. The environment comprises external and internal factors. These factors make up the business environment of an organization, and hence it is required to study it in order to understand how to manage risk.

This unit will give you an overview of business environment, and explain the importance of business environment. We shall then move on to discuss the dimensions and components of business environment. Finally, we would be discussing about external and internal factors influencing the business environment.

### 1.2 Objectives

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By the end of this unit, you should be able to:

- Define the dimensions of the business environment.

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- Recognize the importance of the business environment.
- Explain the components of the business environment.
- Identify the external factors and the internal factors in the environment.

### **1.3 Dimensions of the Business Environment**

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The dictionary meaning of the term ‘Environment’ is: (1) surrounding external objects and (2) influences of circumstance under which someone or something exists. The environment of an organization is constituted by an “aggregate of all conditions, events and influences that surround and affect it”. Due to its complex, dynamic, multifaceted nature, and far reaching impact, the business environment exhibits many characteristics. Consequently, it is necessary to study and understand the factors, external and internal factors, to understand the complex nature of each business operation. Thus, the business environment is the situation where the business operates and the combination of various factors that influences the day to day operations of a business. Every business enterprise has to cope with internal as well as external factors.

Internal factors are the conditions and events that exist within the business organization. These factors exist, operate and influence the business. The company’s personnel, strategy, structure, and its functional, operations, marketing, and technical capabilities are all internal factors. These factors can be modified with greater ease to suit the environment. External factors are beyond the control of a company such as economic, socio-cultural, regulatory and legal, and demographic factors.

Business environment can also be categorized into economic and non-economic environment. The economic environment consists of factors such as the fiscal policy, monetary policy, industrial policy, the physical limits on output, the price and income equations, nature of the economic system, and the pace of economic development. The non-economic environment includes social, cultural political, legal, and technological factors. The economic environment has non-economic implications just as the non-economic environment has economic implications.

Environmental factors influencing the business vary from country to country and region to region. The business environment is a highly complex and dynamic phenomenon. Managers often take a lifetime to understand the complex nuances of business environment of a particular country. Considerable skill and dexterity is required in adjusting, coping with, and managing the business environment. A study of the critical elements of the business environment is required to facilitate the development of these skills. An understanding of this turbulent and dynamic environment also helps in effective decision-making by business managers.

### **1.4 Importance of the Business Environment**

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Organizations are open systems as they are affected by, and in turn affect, their external environment. External environment refers to all the relevant forces



## Unit 1: Business Environment: An Introduction

outside the firm's boundaries. The word 'relevant' indicates those factors which managers must pay attention to help their organizations compete effectively and survive. Irrelevant forces are generally not of immediate importance, though they might be relevant in future.

As many of these factors are of an uncontrollable nature, companies are often affected by recession, government interference, competitor's actions, etc. Managers cannot ignore these forces as they are uncontrollable, and use them as excuses for poor performance. They should instead stay well-informed on the external developments and react accordingly.

Of late, change is invading all areas of our life at a dramatically accelerating rate. It is in this ever-changing environment that managers must take decisions. Based on the impact of the external and the internal environment on the organization, managers make certain business decisions. These decisions may sometimes, in turn, affect the external environment.

In spite of the uncertainties of the present age, managers must choose investment programs, organize facilities, set prices for products, and design advertising campaigns. Also, before making any decision, the business environment must be taken into consideration.

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### **Check Your Progress-1**

Indicate your choice of the correct answer from the options given by circling it.

1. \_\_\_\_\_ is constituted by an aggregate of all conditions, events, and influences that surround and affect it.
  - a. Risk
  - b. Change
  - c. Environment
  - d. Demography
2. In which of the following basic categories can business environment be divided?
  - a. Local and Regional
  - b. Regional and National
  - c. External and Internal
  - d. Financial and Non-Financial
3. Which among the following comprises factors such as the fiscal policy, monetary policy, industrial policy, the physical limits on output, the price and income equations, nature of the economic system, and the pace of economic development?
  - a. Internal environment
  - b. Economic environment

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- c. Non-economic environment
  - d. Both (b) and (c)
4. \_\_\_\_\_ includes social, cultural, political, legal, and technological factors.
- a. Economic environment
  - b. Non-economic environment
  - c. Internal environment
  - d. None of the above
5. By which other term can internal factors affecting a business environment also be referred to?
- a. Controllable factors
  - b. Uncontrollable factors
  - c. Relevant factors
  - d. Global factors
6. By which other term can external factors affecting a business environment also be known as?
- a. Controllable factors
  - b. Uncontrollable factors
  - c. Relevant factors
  - d. Global factors

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### 1.5 Components of the Business Environment

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Organizations have to classify the relevant environment into components or sectors in order to cope with its complexity, comprehend the different influences operating on the organization, and relate the environmental changes to its strategic management process. To do so, it is necessary to consider a variety of relevant factors in the environment, such as the size of the organization, level and scope of the organization to perform a variety of activities, geographical spread of markets, nature of products, type of technology used, and managerial philosophy. An organization's environment can be classified into -- demographic, social, cultural, political, economic, financial, trade, technological, legal, regulatory, tax, and ethical.

As external factors are beyond the control of the firm, the success of the firm will depend to a large extent on its adaptability to the environment. In other words, the ability of the firm to properly design and adjust the internal (controllable) variables to take advantage of the opportunities and to control the threats from the environment determines the success of the firm.

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A firm may achieve external economies of scale if there are changes in the external environment such as improvements in the transport facilities and communication. A firm can also achieve internal economies of scale if there are changes in the internal environment such as introduction of advanced equipment, use of mass production techniques, etc.

**Activity:** Karthik owns a small firm in India that conducts training programs for individuals and companies from time-to-time to introduce them to the current trends in the field of business. Started in 2019, due to recession, the firm began facing problems. Karthik couldn't understand the reason why this happened as he believed that his firm would not be affected by any such happenings. How would you make Karthik understand the impact of such occurrences on any business including his own?

**Answer:**

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### 1.6 External and Internal Environment

All the factors outside the organization which provide opportunities or pose a threat to the organization make up the external environment. And all the factors within an organization which impact strengths or cause weaknesses constitute the internal environment. Refer to figure 1.1 for a graphic representation of the external and internal environments of an organization. Understanding the external environment with regard to the Opportunities and Threats and the internal environment with regard to the Strengths and Weaknesses is crucial for the growth and profitability of any organization. These are described as follows.

- **Opportunity:** A favorable condition in the environment of an organization which enables the organization to consolidate and strengthen its position.
- **Threat:** An unanticipated condition in the organization's environment which creates a risk for or causes damage to the organization.
- **Strength:** The inherent capacity which an organization can use to gain strategic advantages over its competitors.
- **Weakness:** An inherent limitation or constraint which creates strategic disadvantages.

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Source: ICMR.

### Check Your Progress-2

Indicate your choice of the correct answer from the options given by circling it.

7. Which of the following factors may contribute to the external economies of scale for an organization?
  - a. Use of advanced technology in the manufacturing process
  - b. Seeking expert advice for re-launching a product
  - c. Improvement in the air and road links
  - d. Increasing bulk purchases of raw materials and components
8. \_\_\_\_\_ refers to a favorable condition in the environment of an organization which enables the organization to consolidate and strengthen its position.
  - a. Strength
  - b. Weakness
  - c. Opportunity
  - d. Threat

## Unit 1: Business Environment: An Introduction

9. What is the inherent capacity of an organization which can be used to gain strategic advantage over its competitors known as?
  - a. Strength
  - b. Weakness
  - c. Opportunity
  - d. Threat

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### 1.6.1 External Environment

Broadly, the external environment encompasses a variety of factors such as social changes, demographic variables, political system, technology, government policies, legal regime, or public attitude toward business, energy sources, availability of raw materials and other resources, and several other macro level factors operating at international, national and local levels'

The individual factors of the external environment are demographic environment, social environment, cultural environment, political environment, economic environment, financial environment, trade environment, technological environment, legal environment, regulatory environment, tax environment and ethical environment.

These are described below in detail.

#### Demographic Environment

Demographic environment factors include size, growth rate, age composition, and gender composition of the population. They also include family size, educational levels, and economic stratification of the population. All these demographic factors are relevant to business. The demand for goods and services is affected by demographic factors such as the size of population, population growth rate, age and gender composition, life expectancy, family size, spatial dispersal, occupational status, and employment pattern.

For instance, a rapidly increasing population leads to growing demand for many products. A high population growth rate also indicates an enormous increase in the supply of labor. Therefore, population growth rate is an important environmental factor that affects business. Many multinational corporations have been encouraged to invest in developing countries like India and China as a result of the cheap labor and presence of a growing market.

The occupational and spatial mobility of the population have their own implications for business. Easy mobility of labor between different occupations and regions makes its supply relatively smooth, which in turn affects the wage rate.

Heterogeneity of labor in terms of language, caste, religion, and ethnicity makes personnel management a complex task. Also, heterogeneity of population in terms of varied tastes, preferences, beliefs, and temperaments results in differing demand patterns and calls for different marketing strategies.

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### **Social Environment**

Social environment factors include human relationships and its developments. The form and function of such relationships have a bearing on the organization's business. Buying and consumption habits of people, their languages, beliefs, values, customs, tradition, tastes, and preferences are some vital factors and influences operating in the social environment.

Primarily, social environment affects the strategic management process within the organization in the areas of mission, setting of objectives, and decision-making related to products and markets. Some of these factors that affect business are given below.

- Social concerns such as the role of business in society.
- Social attitudes and values such as the society's expectations from business.
- Family structures and changes in them such as the increase in the number of nuclear families.
- Role of women in society, and their status in it.
- Educational levels and gender inequality in the levels.
- Awareness and work ethics.

### **Cultural Environment**

Knowledge of the cultural environment is important to understand the business environment in its totality as cultural norms largely drive consumer needs and buyer behavior. Cultural elements such as language, education, and religion play a vital role in shaping a company's marketing mix program. Analysis of these elements helps in finding out market opportunities. Companies often gain a competitive edge by meeting cultural needs that have been so far ignored by their competitors.

Cultural blunders may prove expensive for multinational companies. Such blunders may lead to embarrassment, lost customers, legal consequences, missed opportunities, expensive damage control, and tarnished reputation. Thus, it is imperative to gather a deep understanding of cultural differences and grasp the intricacies of foreign markets in this era of globalization.

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### **Check Your Progress-3**

Indicate your choice of the correct answer from the options given by circling it.

10. Which of the following is studied with reference to the size, growth rate, age composition, gender composition, life expectancy, etc., of the population?
  - a. Social environment
  - b. Cultural environment
  - c. Ethical environment
  - d. Demographic environment

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11. The study of factors such as family structures and changes in them, role and status of women in society, and educational levels and gender inequality in educational levels which affect a business organization is part of
  - a. Demographic environment
  - b. Social environment
  - c. Cultural environment
  - d. Internal environment
12. In Japan, a company began selling its golf balls in packs of four. The company felt that these convenient packs would help in increasing its sales. However, the sales failed to do well. It was later found that the word 'four' when pronounced in Japanese sounded like the word 'death'. These kinds of cultural blunders may prove expensive for multinational organizations, and may lead to \_\_\_\_\_.
  - i. Missed opportunities
  - ii. Lost customers
  - iii. Legal problems
  - iv. Costly damage control
  - a. Only i, ii, and iii
  - b. Only i, iii, and iv
  - c. Only ii, iii, and iv
  - d. i, ii, iii, and iv

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### Political Environment

The term 'political environment' refers to factors related to the management of public affairs and their impact on an organization's business. The political environment is closely related to the economic system and the economic policy. It is the aggregate of government actions. It is a set of political factors and government activities operating at local, regional, national and international level. Political environments may range from a democratic system to communism with other variations between these ideological extremes.

The government makes, amends, alters, repeals various business laws and policies in consistence with their political mandate or manifesto. In most countries, a number of laws regulate business conduct apart from those that control investment and related matters. These laws cover issues like standard of product, packaging, and promotion. Some governments specify certain standards for the products, including packaging, while others prohibit the marketing of certain products. Promotional activities are subject to various types of controls in most nations.

For instance, India is a democratic country with a stable political system. The government plays an active role as a planner, promoter, and regulator of economic activity. The Indian government has considerable influence over the various business aspects in the country.

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### **Economic Environment**

Economic environment factors include macro level factors related to the areas of production and distribution of wealth that affect an organization's business. A few important factors and influences operating in the economic environment are given below.

- Economic stages that exist at a given time in a country.
- The economic structure that is adopted by a country, i.e., capitalistic, socialistic, or mixed economy.
- Economic planning such as 5-year plans and budgets.
- Economic policies, i.e., monetary, industrial, and fiscal policies.
- Economic indices such as national income, per capita income, disposable personal income, GDP (Gross Domestic Product), distribution of income, rates of savings and investment, value of imports and exports, and balance of payments.
- Infrastructural factors such as financial institutions, banks, communication facilities, modes of transport, and energy sources.

Business managers are aware of the importance and impact of the economic environment on their organizations. In the annual reports of most companies, information is provided on the prevailing economic environment and the specific aspects of the environment that have an impact on their organization and the business they are in.

The economic policy of the government also has a great impact on business (adverse, favorable, or neutral). The incentives and disincentives offered in the government policies affect businesses. The government may provide concessions and other forms of support to an industry belonging to the priority sectors (in terms of the government policy). On the other hand, the government policy may not support industries that are regarded as non-essential. Thus, economic system is a very important determinant of the scope of private business and is therefore a very important external factor influencing business.

### **Financial Environment**

The international financial environment is constantly changing with growth in income, balance of payments position, inflation, fluctuations in exchange rate, and unpredictable political events in various countries. Business enterprises are closely linked with the financial markets and institutions. The financial system constitutes an integral part of the economic system. It consists of the flow of savings, financial intermediaries, financial instruments, and securities that facilitate the transfer of funds. Reforms and regulations in the money and capital markets have contributed greatly to the changing business environment. Professional financial managers are trying to tackle these factors, and reduce the uncertainty arising out of the dynamic nature of the financial environment.



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### Trade Environment

Due to globalization, businesses are now compelled to look beyond the physical boundaries of their home countries. The need to think and act from a global perspective has become a universal rule of business. Globalization refers to the process of integration of the world into one huge market. The aim today is to reduce the gap between domestic prices and world prices, and to lower the trade barriers, tariff and non-tariff, and liberalize the trade regime. A tariff is a tax levied by the government on the exports and imports in a country. Non-tariff barriers are trade barriers that are used to control imports. These include import bans, export subsidies, countervailing duties, and anti-dumping measures (Countervailing duties and antidumping measures are actually non-tariff barriers. However, they take the form of tariffs once they are enacted).

### Technological Environment

The technological environment factors are related to applied knowledge and the materials and machines used in the production of goods and services. Given below are some factors and influences operating in the technological environment.

- Sources of technology (company, external, and foreign sources), cost of acquisition of technology, and collaboration in and transfer of technology.
- Technological development, stages of development change, rate of change of technology, and research and development.
- Impact of technology on human beings, the main-machine system, and the effects of technology on environment.
- Communication and infrastructural technology and technology in management.

In the Indian context, there is variation in the state of technological development among various industry sectors. Generally, the technological aspect of competition is considered to vary with customer needs and government policy.

Foreign technical collaborations at the macro level are popular in India. This is because companies operating in a highly competitive environment often use technology as a weapon to compete. The development of technology in a particular company, and also in the industry as a whole, is affected by collaboration in and transfer of technology.

**Activity:** Mobi International is a US-based mobile phone supplier. The company is planning to set up a manufacturing facility in India. Before doing this, the company wants to analyze the external business environment in India. How should the company go about it, and what factors of the external environment should the company consider?

**Answer:**

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### **Check Your Progress-4**

Indicate your choice of the correct answer from the options given by circling it.

13. Which of the following factors given below is (are) **not** part of the economic environment?
  - i. Monetary, industrial, and fiscal policies
  - ii. Capitalist, socialistic, or mixed economy
  - iii. Factors related to the management of public affairs and their impact on an organization's business
  - iv. Infrastructural factors such as financial institutions, banks, communication facilities, modes of transport, and energy sources.
  - a. Only ii and iv
  - b. Only iii
  - c. Only i, ii, and iii
  - d. Only iv
14. Which of the following environments includes macro level factors such as national income, per capita income, and balance of payments that affect an organization's business?
  - a. Trade environment
  - b. Economic environment
  - c. Financial environment
  - d. Political environment
15. \_\_\_\_\_ refers factors related to the management of public affairs and their impact on an organization's business.
  - a. Political environment
  - b. Economic environment
  - c. Trade environment
  - d. Financial environment
16. What is the process of integration of the world into one huge market referred to as?
  - a. Liberalization
  - b. Privatization
  - c. Globalization
  - d. Capitalization
17. \_\_\_\_\_ factors are related to applied knowledge and the materials and machines used in the production of goods and services.
  - a. Trade environment
  - b. Technological environment

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- c. Economic environment
- d. Financial environment

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### Legal Environment

Organizations being corporate entities have to abide by the law of the land. Legal systems with varied complexity and dimension differ from country to country, thus making it essential for the multinational companies to cope with the widely differing laws in the countries where they are operating. In some countries, the laws specify virtually every detail, while in others, they serve only as a broad guideline and their interpretation is left to the courts. Therefore, a foreign enterprise has to be scrupulously careful to abide by the local laws and regulation.

While businesses have crossed national boundaries, there is no international body to make rules and oversee their fulfillment by different parties. The jurisdiction of laws gains importance when a conflict occurs between contracting parties and the question arises as to which nation's laws be applied to resolve the problem. In order to control foreign businesses in their economies, host countries enact laws, which take several forms such as tariffs, antidumping laws, export/import licensing investment regulations, legal incentives, and restrictive trading laws.

### Regulatory Environment

The regulatory environment factors are related to the planning, promotion, and regulation by the government, of those economic activities that affect an organization's business. Given below are some of the important factors and influences operating in the regulatory environment.

- The constitutional framework, directive principles of state policy, fundamental rights, and division of legislative power between central and state governments.
- Policies related to distribution and pricing, and their control.
- Policies related to imports and exports.
- Policies related to the public sector, small-scale industries, sick industries, development of backward areas, control of environmental pollution, and customer protection.

The economic activities of a country are regulated by public authorities in the larger interests. Business and industry operate within a regulatory environment. A two-way relationship exists between industry and the regulatory environment. The industry functions according to the policies, procedures, and rules laid down by the government. However, the industry tries to influence the government through lobbying, creation of public awareness, press advertisements, and the parliamentary process. Thus, the regulatory environment is one of the most important components that the strategic managers of any organization have to consider.

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The exercise of the regulatory mechanism takes place through various administrative controls over business. Some of these controls include industrial policy and licensing; capital issues control and control over stock exchanges; control over foreign exchange and import and export control; control over foreign investment and foreign collaboration; control over commodities' pricing and distribution; control over development and regulation of industries; control through consumer protection; and control of environmental pollution.

The government is often blamed by the industry for exercising excessive control through a plethora of rules and regulations. On the other hand, companies are sometimes accused of failing to work within the framework of national priorities, and failing to live up to the expectations of society in general.

The Indian government also framed a number of regulations to restrict the concentration of economic power, monopolistic undertakings, and large industrial houses in the country. For instance, the Competition Act was passed in 2002 to ensure economic development of the country. The act was framed to protect consumers' interests, ensure freedom of trade carried on by others, promote and ensure competition in market, and prevent practices having adverse effect on competition.

### **Tax Environment**

Governments design tax systems in order to raise revenue and to promote economic and social goals. At times, governments try to stimulate overall national economic activity through tax reduction, while at other times, they try to increase tax revenues through tax hikes. The government may extend tax concessions to certain industries to stimulate productive activity. Similarly, tariffs may be imposed by the government on imported manufactured goods to discourage the outflow of foreign exchange reserves or to shelter a domestic industry from the onslaught of foreign competition.

The tax system may be so designed as to discourage or encourage certain social behavior. The heavy taxation imposed on tobacco and alcohol, and fines on pollution help in not only raising revenue, but also discourage use of such products. They are also imposed as a type of social levy for the perceived harm that their use causes society.

### **Ethical Environment**

Ethics denotes what is wrong and what is right. Ethics in business is application of ethical standards during business operations and includes ethical behavior of the people participating in the business. There are certain dos and don'ts in every society. The principles of morality or rules of conduct are referred to as ethics. Ethics aims to identify the rules that should govern the behavior of people as well as "goods" that are worth seeking. An ethical issue is a situation, problem, or opportunity in which an individual must choose among several actions that must be evaluated as right or wrong. Similarly, the moral principles and standards that guide behavior in the world of business comprise business ethics and corporate governance. The demand for ethical behavior in business has increased due to the unethical activities of various organizations. Decisions

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made on the basis of ‘what is right’ and ‘what is wrong’ constitute an organization’s ethical environment. Managers are realizing the importance of separating management from ownership of a company to ensure the observance of a code of conduct.

For business to survive, they have to adopt to external environment and the best example is how small businesses have adopted themselves to survive in the pandemic. The details are provided in Exhibit 1.1.

### **Exhibit 1.1: How Small Businesses are Adapting to Survive in the Covid Period**

Businesses, especially MSMEs faced volatility due to dynamic nature of external environment and Covid -19 changed the ways MSMEs, did business prior to the pandemic. Micro, Small and Medium Enterprises (MSMEs), are the backbone of Indian Industry and contribute 29 percent to India’s GDP and generate over 11 crore jobs. Covid 19 had a devastating effect on this sector with virtually poor cash flow, lower demand for the products and on -payment of salaries to the workers. There is a famous proverb which states that “Necessity is the mother of invention” and this proved to be cent percent true for many MSMEs which started finding new ways for survival.

#### **Finding new ways for survival**

1. A company manufacturing personal hygienic products in Himachal Pradesh switched to manufacturing hand sanitisers, reducing the capacity of manufacturing the original product because both the products are somewhat connected to each other and hand sanitizers are peripheral to personal hygienic products.
2. Fine-dining restaurant “The Table” in South Mumbai was closed and the promoter switched to launch a takeaway service “The mag street Kitchen” in a smaller place of 2,500-sq. ft. space which could provide accommodation facilities to the employees to return to work after lock down eased. Baked goods as well as items from its Indian food service could be ordered through app. With good response, the promoter wants to double the service.
3. The promoter of a cement bag manufacturing company in Kolkata shifted to manufacturing of bags to store essential food items. Since food grains need to be stored for longer time than cement, the company rejigged the input composition marginally and the company’s marketing team could get a new set of clients and the activity is on.
4. A company manufacturing lab-testing equipment switched to production of PPEs Kits.
5. Nao Spirits, the company behind the gin, engaged the clients through 2-minute do-it-yourself cocktail-making tutorials on Instagram which has gin as the base for all the cocktails.

*Contd. ....*

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Many MSMEs have been using various options available to keep themselves in business by changing the line of activity and switched to social media to keep in touch with their clients to navigate the challenges posed by the pandemic.

Source: <https://www.forbesindia.com/article/coronavirus/covid19-how-small-businesses-are-adapting-to-survive/59273/1>, 8th May 2020

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### **Check Your Progress – 5**

Indicate your choice of the correct answer from the options given by circling it.

18. Which of the following statements is **false** regarding legal environment?
  - a. Organizations being corporate entities have to abide by the law of the land.
  - b. Legal systems are broadly the same and do not differ from country to country, thus making it easy for the multinational companies to cope with the laws in the countries where they are operating.
  - c. In some countries, the laws specify virtually every detail, while in others, they serve only as a broad guideline and their interpretation is left to the courts.
  - d. Host countries enact various laws in order to control foreign businesses in their economies.
19. Identify from the following the factors that operate in the regulatory environment.
  - i. The constitutional framework, directive principles of state policy and the fundamental rights.
  - ii. Policies related to distribution and pricing, and their control.
  - iii. Policies related to imports and exports.
  - iv. Policies related to small-scale industries, sick industries, development of backward areas, control of environmental pollution, and customer protection.
  - a. Only i, ii, and iii
  - b. Only i, iii, and iv
  - c. Only ii, iii, and iv
  - d. i, ii, iii, and iv
20. The exercise of the regulatory mechanism takes place through various administrative controls over business. Which of the following controls are used as part of the regulatory mechanisms?
  - i. Industrial policy and licensing
  - ii. Capital issues control and control over stock exchanges

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- iii. Control over foreign investment and foreign collaboration
  - iv. Control over commodities' pricing and distribution
  - v. Control through consumer protection
  - a. Only i, ii, and iii
  - b. Only i, iii, iv, and v
  - c. Only ii, iv, and iv
  - d. i, ii, iii, iv, and v
21. \_\_\_\_\_ refers to the principles of morality or rules of conduct.
- a. Change
  - b. Ethics
  - c. Culture
  - d. Politics
22. Tariffs are imposed by the government to
- i. to discourage the use of certain products as their use is perceived to harm the society.
  - ii. to raise revenue and to promote economic and social goals.
  - iii. to discourage the outflow of foreign exchange reserves in case of imports.
  - iv. to shelter a domestic industry from the onslaught of foreign competition.
- a. Only i, ii, and iii
  - b. Only i, iii, and iv
  - c. Only ii, iii, and iv
  - d. i, ii, iii, and iv
23. Decisions made on the basis of 'what is right' and 'what is wrong' constitute an organization's \_\_\_\_\_ environment.
- a. Political
  - b. Trade
  - c. Ethical
  - d. Economic
- 

### 1.6.2 Internal Environment

The internal environment comprises resources, synergy, and distinctive competencies of a firm. These factors together determine its organizational capability in terms of its strengths and weaknesses existing in the different functional areas of marketing, operations, personnel, financial, and technical. Thus the firm's capabilities in the above mentioned functional areas in addition to the firm's strategy and structure make up the dynamics of its internal environment.

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### **Strategy**

The word strategy is derived from the Greek work 'strategia', which connotes the art and science of directing military forces. Thus, strategy constitutes a well thought out systematic plan of action to defend oneself or to defeat rivals. Glueck defined strategy as a unified, comprehensive, and integrated plan relating the strategic advantages of the firm to the challenges of the environment. It is designed to ensure that the basic objective of the enterprise is achieved.

Strategy involves establishing the proper organization-environment fit or matching the organizational factors with the environmental factors. It involves an analysis of the organizational factors (strengths and weaknesses) and the environmental factors (opportunities and threats) in the business environment. Thus strategy serves as a blueprint indicating the courses of action to achieve the desired objectives. Strategy influences an organization's internal environment in the following ways.

- It determines organizational tasks.
- It influences the choice of technology in the organization as well as the people responsible for accomplishment of tasks.
- It determines the specific environment within the organization as well as that within which the organization operates. In other words, strategy defines a business environment and gets defined by the latter.

### **Organizational Structure**

Some of the important factors influencing business decisions are the organization structure, composition of the Board of Directors, the extent of professionalization of management, etc. The structure of an organization is affected by a number of factors like the size of the business, the nature of the business, the diversity of the business, the characteristics of the market, the characteristics of the strategy, and the future plans of the organization.

Changes in the strategy of an organization may necessitate changes in the structure. Organization structures need to be flexible so as to enable the organization to quickly and effectively respond to market changes. A hierarchical and rigid system leads to slower decision making, thus affecting the company's position in the highly competitive business environment where decisions and actions have to be taken quickly.

### **Marketing Capability**

These factors are related to pricing, promotion, and distribution of products or services, and all related aspects that have an impact on the organization's capacity and ability to implement strategies to market its products or services. The factors that influence the marketing capability of an organization are given below.

- Product-related factors such as variety, differentiation, positioning, and packaging.



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- Price-related factors like pricing objective, policies, changes, and protection.
- Promotion-related factors such as promotional tools, sales promotion, advertising, and public relations.
- Integrative and systematic factors like marketing mix, distribution systems, company image, marketing organization, marketing system, marketing management, and information system.

### **Operation Capability**

These factors are related to the production of products or services, use of material resources, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to produce its products or services. The factors that influence the operations capability of an organization are given below.

- Factors related to the production system such as capacity, location, layout, product or service design, degree of automation, and extent of vertical integration.
- Factors related to the operation and control system such as aggregate production planning, material supply, inventory, cost and quality control, and maintenance system and procedure.
- Factors related to R&D such as product development, patent right, level of technology used, and technical collaboration and support.

### **Personnel Capability**

These factors are related to the existence and use of human resources and skills, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to attract and retain its human resources. The factors that influence the personnel capability of an organization are given below.

- Factors related to the personnel system such as manpower planning system, selection, development compensation, communication and appraisal, and the personnel department's position within the organization procedures and standards.
- Factors related to organizational and employees' characteristics such as corporate image, quality of managers, staff and workers, employer's perception about and image of the organization, availability of development opportunities for employees, and working conditions.
- Factors related to industrial relations such as the relationship between union and management, collective bargaining, safety, welfare and security, employee satisfaction, and employee morale.

### **Financial Capability**

These factors relate to the availability, usage, and management of funds and all related aspects that have a bearing on the organization's capacity and ability to

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implement its strategies towards procurement and disbursement of funds. The factors that influence the financial capability of an organization are given below.

- Factors related to the sources of funds such as the capital structure, procurement of capital, financing pattern, availability of working capital, borrowings, capital and credit availability, reserves and surplus, and relationship with banks, lenders, and financial institutions.
- Factors related to the use of funds, capital investment, fixed assets acquisition, current assets, loans and advances, dividend distribution, and relationship with shareholders.
- Factors related to management of funds such as financial accounting and budgeting, management control system, state of financial health, cash, inflation, credit, return and risk management, cost reduction and control, and tax planning and control.

### Technical Capability

Organizations cannot face challenges of the 21<sup>st</sup> century by replacing existing work structures, procedures, and technologies. They need a strategy for organizational fitness including leveraging on limited resources to achieve dramatic, rapid, and continuous improvement. Most product development organizations recognize that the capability of their technical staff is critical to improving their productivity and quality in achieving their business goals.

**Activity:** TPL, a tyre manufacturing company has been facing problems with regard to its products. The company was receiving several complaints regarding the poor quality of its tyres from its customers. Upon investigation, the company's top Management found that the problems occurred due to a poor quality control system.

It also found out that the machinery at the manufacturing facility was poorly maintained. What is this area of internal environment that has been looked into by the management? What are the other areas that make up the dynamics of the company's internal environment?

**Answer:**

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### Check Your Progress-6

Indicate your choice of the correct answer from the options given by circling it.

24. \_\_\_\_\_ can be defined as a unified, comprehensive, and integrated plan relating the strategic advantages of the firm to the challenges of the environment.
- a. Strategy

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- b. Structure
  - c. Ethics
  - d. None of the above
25. Which among the following involves an analysis of the organizational factors, that is, strengths and weaknesses, and the environmental factors, that is, opportunities and threats, in the business environment?
- a. External environment analysis
  - b. Strategic analysis
  - c. Economic environment analysis
  - d. Structural analysis
26. In which of the following ways does strategy influence an organization's internal environment?
- i. It determines organizational tasks.
  - ii. It influences the choice of technology in the organization as well as the people responsible for accomplishment of tasks.
  - iii. It determines the specific environment within the organization as well as that within which the organization operates. In other words, strategy defines a business environment and gets defined by the latter.
- a. Only i and ii
  - b. Only i and iii
  - c. Only ii and iii
  - d. i, ii, and iii
27. The \_\_\_\_\_ is affected by a number of factors like the size of the business, the nature of the business, the diversity of the business, the characteristics of the market, the characteristics of the strategy, and the future plans of the organization.
- a. organizational personnel
  - b. organizational structure
  - c. organizational size
  - d. organizational strategy
28. \_\_\_\_\_ type of organization structures lead to slower decision making, affecting the organization's position in the highly competitive business environment where decisions and actions have to be taken quickly.
- a. Rigid
  - b. Flexible
  - c. Hierarchical
  - d. Both (a) and (c)
29. Which among the following is **not** a factor that influences the marketing capability of an organization?
- a. Positioning
  - b. Pricing objective

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- c. Distribution system
  - d. Return and risk management
30. \_\_\_\_\_ factors are related to the production of products or services, use of material resources, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to produce its products or services.
- a. Marketing capability
  - b. Financial capability
  - c. Operations capability
  - d. Personnel capability
31. Identify the factors that influence the operations capability of an organization.
- i. Extent of vertical integration
  - ii. Risk management
  - iii. Cost and quality control
  - iv. Manpower planning system
- a. Only i and ii
  - b. Only i and iii
  - c. Only ii and iv
  - d. Only i, ii, and iii
32. \_\_\_\_\_ factors are related to the existence and use of human resources and skills, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to attract and retain its human resources.
- a. Technical capability
  - b. Personnel capability
  - c. Marketing capability
  - d. Operations capability
33. Which of the following statements is **false** regarding financial capability factors?
- a. These factors relate to the availability, usage, and management of funds and all related aspects that have a bearing on the organization's capacity and ability to implement its strategies towards procurement and disbursement of funds.
  - b. It includes factors related to the sources of funds such as capital structure, procurement of capital, financing pattern, availability of working capital, borrowings, and capital and credit availability.
  - c. It includes integrative and systematic factors like marketing mix, distribution systems, company image, marketing organization, marketing system, marketing management, and information system.

## Unit 1: Business Environment: An Introduction

- d. It includes factors related to the use of funds, capital investment, fixed assets acquisition, current assets, loans and advances, dividend distribution, and relationship with shareholders.

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### 1.7 Summary

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- Environment can be defined as surrounding external objects or influences of circumstance under which someone or something exists. The environment of an organization is constituted by an aggregate of all conditions, events, and influences that surround and affect it.
- Every business enterprise has to cope with internal as well as external factors.
- Business environment is complex and dynamic. Managers have to consider the impact of the external and the internal environment on the organization while making decisions.
- All the factors outside the organization which provide opportunities or pose a threat to the organization make up the external environment.
- All the factors within an organization which impact strengths or cause weaknesses constitute the internal environment.
- The individual factors of the external environment are demographic environment, social environment, cultural environment, political environment, economic environment, financial environment, trade environment, technological environment, legal environment, regulatory environment, tax environment and ethical environment.
- The individual factors of the internal environment exist in the functional areas of marketing, operations, personnel, financial, and technical, in addition to the firm's strategy and structure.

### 1.8 Glossary

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- **Economic environment:** It comprises factors such as the fiscal policy, monetary policy, industrial policy, the physical limits on output, the price and income equations, nature of the economic system, and the pace of economic development.
- **Environment:** Surrounding external objects or influences of circumstance under which someone or something exists. The environment of an organization is constituted by an aggregate of all conditions, events and influences that surround and affect it.
- **External environment:** All the factors operating outside the organization which provide opportunities or pose a threat to the organization.
- **Internal environment:** All the factors operating within an organization which impact strengths or cause weaknesses.
- **Non-economic environment:** It includes social, cultural political, legal, and technological factors.

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- **Opportunity:** A favorable condition in the environment of an organization which enables the organization to consolidate and strengthen its position.
- **Strategy:** It can be defined as a unified, comprehensive, and integrated plan relating the strategic advantages of the firm to the challenges of the environment.
- **Strength:** The inherent capacity which an organization can use to gain strategic advantages over its competitors.
- **Threat:** An unanticipated condition in the organization's environment which creates a risk for or causes damage to the organization.
- **Weakness:** An inherent limitation or constraint which creates a strategic disadvantages.

### 1.9 Self-Assessment Test

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1. "Before making any decision, managers have to take into consideration the business environment." Explain the importance of business environment in managerial decision-making.
2. "An organization's growth and profitability depends on its understanding of the external and the internal environment." Explain the external environment factors and the internal environment factors that affect an organization.

### 1.10 Suggested Readings / Reference Material

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### 1.11 Answers to Check Your Progress Questions

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Following are the answers to the Check Your Progress questions given in the Unit.

#### 1. (c) Environment

Environment can be defined as surrounding external objects and influences of circumstance under which someone or something exists. The environment is constituted by an aggregate of all conditions, events, and influences that surround and affect it.

#### 2. (c) External and Internal

Business environment can be divided into external and internal environment. Internal factors are generally considered controllable factors as the business enterprise has control over these factors. External factors are beyond the control of a company.

#### 3. (b) Economic environment

Business environment can be categorized into economic and non-economic environment. Economic environment comprises factors such as the fiscal policy, monetary policy, industrial policy, the physical limits on output, the price and income equations, nature of the economic system, and the pace of economic development.

#### 4. (b) Non-economic environment

Business environment can be categorized into economic and non-economic environment. The non-economic environment includes social, cultural political, legal, and technological factors.

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### **5. (a) Controllable factors**

Internal factors are generally considered controllable factors as the business enterprise has control over these factors. The company's personnel, strategy, structure, and its functional, operations, marketing, and technical capabilities are all internal factors.

### **6. (b) Uncontrollable factors**

External factors are beyond the control of a company such as economic, sociocultural, regulatory and legal, and demographic factors. Therefore, they are called as uncontrollable factors.

### **7. (c) Improvement in the air and road links**

A firm may achieve external economies of scale if there are changes in the external environment such as improvements in the transport facilities and communication.

The other three options help a firm in achieving internal economies of scale.

### **8. (c) Opportunity**

All the factors outside the organization which provide opportunities or pose a threat to the organization make up the external environment. Opportunity refers to a favorable condition in the environment of an organization which enables the organization to consolidate and strengthen its position.

### **9. (a) Strength**

All the factors within an organization which impact strengths or cause weaknesses constitute the internal environment. Strength is the inherent capacity of an organization which can be used to gain strategic advantage over its competitors.

### **10. (d) Demographic environment**

Demographic environment is studied with reference to the size, growth rate, age composition, gender composition, life expectancy, etc., of the population.

Demographic environment factors affect the demand for goods and services.

### **11. (b) Social environment**

Social environment factors include human relationships and the developments. The form and function of such relationships have a bearing on the organization's business. The study of factors such as family structures and changes in them, role and status of women in society, and educational levels and gender inequality in educational levels which affect a business organization is part of social environment.



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**12. (d) i, ii, iii, and iv**

Cultural blunders may prove expensive for multinational companies. Such blunders may lead to embarrassment, lost customers, legal consequences, missed opportunities, expensive damage control, and tarnished reputation. Thus, it is imperative to gather a deep understanding of cultural differences and grasp the intricacies of foreign markets in this era of globalization.

**13. (b) Only iii**

All the given options are part of the economic environment, except option iii.  
Option iii is part of the political environment.

**14. (b) Economic environment**

The economic environment factors include macro level factors such as national income, per capita income, and balance of payments that affect an organization's business.

**15. (a) Political environment**

Political environment refers factors related to the management of public affairs and their impact on an organization's business. It is closely related to the economic system and the economic policy.

**16. (c) Globalization**

Economic reforms worldwide have compelled businesses to come out of their domains and see beyond the physical boundaries of the country, thus leading to globalization.

Globalization is the process of integration of the world into one huge market.

**17. (b) Technological environment**

Technological environment factors are related to applied knowledge and the materials and machines used in the production of goods and services. Some of the factors and influences operating in the technological environment include sources of technology, cost of acquisition of technology, technological development, effects of technology on environment, and technology in management.

**18. (a) Legal systems are broadly the same and do not differ from country to country, thus making it easy for the multinational companies to cope with the laws in the countries where they are operating.**

All the statements are true regarding legal environment, except statement (b). The correct statement is 'legal systems with varied complexity and dimension differ from country to country, thus making it essential for the multinational companies to cope with the widely differing laws in the countries where they are operating.'

## **Block 1: Business Environment and Law**

**19. (d) i, ii, iii, and iv**

All the statements given are factors that operate in the regulatory environment.

**20. (d) i, ii, iii, iv, and v**

All the statements given are controls used as part of the regulatory environment.

**21. (b) Ethics**

The principles of morality or rules of conduct are referred to as ethics. Ethics aims to identify the rules that should govern the behavior of people as well as “goods” that are worth seeking.

**22. (d) i, ii, iii, and iv**

Tariffs are imposed by the government to discourage the use of certain products as their use is perceived to harm the society; to raise revenue and to promote economic and social goals; to discourage the outflow of foreign exchange reserves in case of imports; and to shelter a domestic industry from the onslaught of foreign competition.

**23. (c) Ethical**

Decisions made on the basis of ‘what is right’ and ‘what is wrong’ constitute an organization’s ethical environment. An ethical issue is a situation, problem, or opportunity in which an individual must choose among several actions that must be evaluated as right or wrong.

**24. (a) Strategy**

Strategy can be defined as a unified, comprehensive, and integrated plan relating the strategic advantages of the firm to the challenges of the environment. It involves establishing the proper organization-environment fit or matching the organizational factors with the environmental factors.

**25. (b) Strategic analysis**

Strategy involves an analysis of the organizational factors, that is, strengths and weaknesses, and the environmental factors, that is, opportunities and threats, in the business environment. Strategy serves as a blueprint indicating the courses of action to achieve the desired objectives.

**26. (d) i, ii, and iii**

Strategy influences an organization’s internal environment in the following ways - it determines organizational tasks; it influences the choice of technology in the organization as well as the people responsible for accomplishment of tasks; and it determines the specific environment within the organization as well as that within which the organization operates. In other words, strategy defines a business environment and gets defined by the latter.

## **Unit 1: Business Environment: An Introduction**

### **27. (b) organizational structure**

The organizational structure is affected by a number of factors like the size of the business, the nature of the business, the diversity of the business, the characteristics of the market, the characteristics of the strategy, and the future plans of the organization. Organization structures need to be flexible so as to enable the organization to quickly and effectively respond to market changes.

### **28. (d) Both (a) and (c)**

Organizational structures which are rigid and hierarchical lead to slower decision making, affecting the organization's position in the highly competitive business environment where decisions and actions have to be taken quickly. They need to be flexible to enable the organization to quickly and effectively respond to market changes.

### **29. (d) Return and risk management**

Positioning, pricing objective, and distribution system are all factors that influence the marketing capability of an organization. Return and risk management is a factor that influences the financial capability of an organization.

### **30. (c) Operations capability**

Operations capability factors are related to the production of products or services, use of material resources, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to produce its products or services. Some of the factors and influences affecting operations capability of an organization are capacity, location, layout, aggregate production planning, patent right, level of technology used, etc.

### **31. (b) Only i and iii**

Extent of vertical integration, and cost and quality control are the factors that influence the operations capability of an organization. Risk management is a factor that influences the financial capability of an organization, while manpower planning system is a factor that influences the personnel capability of an organization.

### **32. (b) Personnel capability**

Personnel capability factors are related to the existence and use of human resources and skills, and all related aspects that have a bearing on the organization's capacity and ability to implement strategies to attract and retain its human resources. Some of the factors and influences affecting personnel capability are manpower planning system, corporate image, quality of managers, working conditions, collective bargaining, safety, employee morale, etc.

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- 33. (c) It includes integrative and systematic factors like marketing mix, distribution systems, company image, marketing organization, marketing system, marketing management, and information system.**

All the statements are true regarding financial capability factors except statement (c). Integrative and systematic factors like marketing mix, distribution systems, company image, marketing organization, marketing system, marketing management, and information system are part of the marketing capability.

## Unit 2

### Demographic and Social Environment

#### Structure

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- 2.1 Introduction
- 2.2 Objectives
- 2.3 Understanding Demographies
- 2.4 Demographic Classification
- 2.5 Society
- 2.6 Social Class
- 2.7 Group
- 2.8 Family
- 2.9 Summary
- 2.10 Glossary
- 2.11 Self-Assessment Test
- 2.12 Suggested Readings / Reference Material
- 2.13 Answers to Check Your Progress Questions

#### 2.1 Introduction

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In the previous unit, we have discussed about the external and internal environments of a business organization. We have learnt that the external environment is constituted by several individual factors. In this unit, we will discuss two of the external environment factors – demographic environment and social environment – and understand their importance in the study of business environment.

An understanding of the demographic environment is important for a business as it involves people for whose consumption goods and services are produced. Demographics influence consumption behaviors directly and indirectly by influencing other attributes of individuals such as their personal values and decision styles (which in turn influence consumption).

Social stratification has always existed in one form or the other in all societies. A study of social class differences helps marketers understand consumer behavior, segment markets appropriately, and subsequently, develop marketing strategies.

Man, being a social animal, interacts with others regularly. Most times, our social behavior and relationships are motivated by the desire to satisfy our needs. Thus, the impact of social groups affects many buying decisions. The family provides an opportunity to jointly examine demographic, economic,

## **Block-1: Business Environment and Law**

sociological, and biological variables. Family demography is concerned with the factors that determine the number, size, composition and change in families.

This unit will give you an overview of the demographic environment, and discuss the classification of demographics. We shall then move on to discuss aspects of the social environment. We will discuss social class and social status, and then study how social classes are determined. Finally, we would discuss the importance of analyzing the family life cycle in business.

### **2.2 Objectives**

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By the end of this unit, you should be able to:

- Define the demographic environment.
- Identify the various demographic variables such as income, lifestyle, education, gender, social class, occupation, and age.

### **2.3 Understanding Demographics**

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Demographics are the studies of a population based on factors such as age, race, sex, and economic status, level of education, income level and employment. It helps the business organization to understand the quantum and quality of business and potential opportunities of business. It describes a population in terms of its size, structure, and distribution. Size means the number of individuals in a population; structure describes the population in terms of age, income, education, and occupation among other things; and distribution of the population describes the location of individuals in terms of geographic region and rural, urban, or suburban location.

A sound knowledge of different demographic variables such as age, income, lifestyle, and education is essential for designing and marketing products and services. Demographic variables are the most popular bases for distinguishing consumer groups and their behavior. Consumer wants, preferences, and usage rates are often associated with demographic variables. They influence consumer behavior and contribute to the overall demand for various products and services.

### **2.4 Demographic Classification**

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Markets comprise innumerable buyers. Buyers differ in their wants, purchasing power, buying attitudes, and buying habits. So, it may not be practically feasible to develop a single product or service that would appeal to all consumers. The concept of market segmentation proves helpful in this situation. Market segmentation aims at dividing the market into distinct subset of consumers with homogeneous needs or characteristics and selecting one or more segments to target them. Income, lifestyle, education, gender, social class, occupation, and age are the demographic variables. These have been traditionally used by marketers to segment the market.

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### **2.4.1 Income**

Income determines both purchasing power and status. Higher the income, greater the purchasing power. However, income per se generally does not cause or direct consumption to nearly the extent that education and occupation do. Occupation and education influence preferences for products and services; income only provides the means to acquire these products and services. Income is generally more effective as a segmentation variable, when used along with other demographic variables.

### **2.4.2 Lifestyle**

The lifestyle of an individual is the pattern of living expressed through his/her activities, interests, and opinions. Lifestyle patterns include the ways people spend time, the extent of their interaction with others, and their general outlook on life and living. People determine their own lifestyles, but the pattern is also affected by demographic factors such as age, education, income, and social class. Lifestyles impact the consumer buying decision process in many ways. They also influence the consumers' product needs and brand preferences.

### **2.4.3 Gender**

Gender has always been a distinguishing segmentation variable. Firms design products that are specifically meant for either men or women. Of late, gender roles have changed in many ways; it is no longer an accurate way to distinguish consumers in some product categories. Demographic classification on the basis of gender has also changed with time in the case of many products. Many product categories have been affected by the increased number of women in the workforce. For product manufacturers or service providers, study of this classification is very important to help them position the product properly.

### **2.4.4 Education**

Education has traditionally been a highly valued factor in many cultures, and is a direct measure of status. The higher one's educational level, the more status one has in the society. Education has a strong influence on one's tastes and preferences. It also influences how one thinks, makes decisions, and relates to others. It also influences what one can purchase by partially determining one's income and occupation.

### **2.4.5 Social Class**

A social class is a hierarchical division of a society into relatively distinct and homogeneous groups whose members have similar attitudes, values, and lifestyles. An individual's education, occupation, ownership of property, income level, and heritage (racial/ethnic background, parents' status) influence his/her social standing. Social standing ranges from the lower class (those with few or none of the socioeconomic factors desired by society) to the upper class (those with many of the socioeconomic characteristics considered desirable by society). Individuals with different social standings tend to have different needs

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and consumption patterns. Many companies design products and services for specific social classes.

### 4.6 Occupation

Occupation provides status and is linked to education and income. The type of work one does and the types of individuals one works with over time also directly influence one's values, lifestyles, and all aspects of the consumption process. Media preferences, hobbies, and shopping patterns are also influenced by occupational class.

### 4.7 Age

Age is used as a basis for understanding and segmenting a market as the product and service needs vary with consumer age. It is also the most frequently used demographic variable in market segmentation. This is because the life cycle has been divided up by society into easily recognizable groups that are clearly differentiated from each other – infants, children, teenagers, young adults, and so on. Also, knowing someone's age can often tell you a lot about them. Disposable income generally increases with age (at least until retirement).

The Exhibit 2.1 describes the demographic dividend that India will enjoy for next two decades.

#### Exhibit 2.1

##### **Human Capital: Gaining from Differential Demographic Dividend**

As per United Nations Population Fund (UNFPA) demographic dividend is defined as “the economic growth potential that can result from shifts in a population's age structure.

In this aging world, India has the youngest population and the age wise distribution are:

- Age group under 19 years of age- 35%
- Age group between 20-59 years- 54.6 %
- Age group above 60 years – 10.10 %

This is the greatest advantage for India,

The factors taken into consideration by UNPFA are

1. Population growth rate has been decreasing by 50 %
2. Tamil Nadu has registered TFR value of 1.5 being the lowest as against 2.5 in UP. States like Bihar, Odisha and Uttar Pradesh are at the early stages of demographic transition and enjoy the higher share of young population.
3. Covid-19 has created a unique opportunity to retain skilled labour that has returned home in those states where the TRF is lower
4. In case of states where the TRF is higher, the number of young populations will be higher.

*Contd. ....*



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5. These states are expected to enjoy higher potential demographic dividend in the next 20 years which can be exploited 6. This can aid in attracting investment in industrial sector which includes agro-processing industries as well.
7. Other work force intensive sectors can create more capacity to absorb the large labour pool.
8. Attracting FDI, easing the conditions for doing business can support in improving the investment climate, creating more job opportunities and improve overall growth.
9. Start-up India and Make in India are having a positive impact on skill development
8. This can create opportunity to absorb the large labour force and in turn convert into comparative advantage to India.

Many economists are of the view that India is on the right side of the demographic transition and will aid in boosting the socio-economic development.

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### **Check Your Progress-1**

Indicate your choice of the correct answer from the options given by circling it.

1. Which of the following is correct with reference to the demographics?
  - a. Size describes the population in terms of age, income, education, and occupation among others.
  - b. Structure means the number of individuals in a population.
  - c. Distribution of the population describes the location of individuals in terms of geographic region and rural, urban, or suburban location.
  - d. All of the above
2. Which of the following statements is true with reference to demographics in the environment?
  - i. Demographics describe a population in terms of its size, structure, and distribution.
  - ii. A sound knowledge of different demographic variables such as age, income, lifestyle, and education is essential for designing and marketing products and services.
  - iii. Demographic variables are the most popular bases for distinguishing consumer groups.
  - iv. Consumer wants, preferences, and usage rates are often associated with demographic variables.
    - a. Only i, ii, and iii
    - b. Only i, iii, and iv
    - c. Only ii, iii, and iv
    - d. i, ii, iii, and iv

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3. Which of the following aims to divide the market into distinct subsets of consumers with homogeneous needs or characteristics?
    - a. Socialization
    - b. Segmentation
    - c. Stereotyping
    - d. None of the above
  4. \_\_\_\_\_ is a hierarchical division of a society into relatively distinct and homogeneous groups whose members have similar attitudes, values, and lifestyles.
    - a. Social class
    - b. Socialization
    - c. Social standing
    - d. Social mobility
- 

### **2.5 Society**

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Society is composed of a group of people. A society is the largest membership group. Typically, it has territorial boundaries, but these may not be precise. Societal boundaries are often marked by language and religion, which are important features by which societies are identified. Members belonging to a society must coordinate their actions with each other. No individual can do 'his /her own thing' without any concern for others.

### **2.6 Social Class**

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Social class can be defined as the classification of members of a society into distinct classes, so that a member of each class has approximately equal position in society with other members of the same class. Though all people in this world may be created equal, society gives different status to different people. Some people have a high status in society, while others are given a lower status. These statuses are referred to as social strata or classes. Social stratification is the ranking of people by the other members of a society into higher and lower positions. The status and respect given to the people in the society depends on this ranking.

#### **2.6.1 Characteristics of Social Class**

Social classes have the following characteristics.

##### **Social Classes are Multidimensional**

Social classes are based on various components, and parameters. They are not determined by a single parameter such as occupation and income. Certain parameters are more reliable than others. For instance, although money is often a misleading indicator of social class or position, in the US, it is largely

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associated with the idea of social class. Occupation is one of the best indicators of social class. In every society, some jobs are given higher status than others. Housing is another important variable that helps determine a person's social class.

### **Social Classes are Hierarchical**

Social class categories are ranked vertically ranging from higher status to lower status. Members of a particular social class may perceive the members of other social classes as either equal or as of higher or lower status. This aspect is very important for marketers. Consumers prefer to buy the product which they think is being used by their equals or higher classes. They usually avoid products that are perceived to be lower class products.

### **Social Classes are Restrictive**

Members of a social class interact with each other as their values, behavior, activities, and interests match. They interact less with members of other social classes because of differences in educational background, lifestyle, and income level. People also think that it is below their dignity to interact with persons of lower status. This kind of restricted behavior makes it difficult for marketers to communicate their message across different social classes.

### **Social Classes are Homogeneous**

People within a social class are homogeneous as they have similar interests, attitudes, and purchasing behavior patterns. They are exposed to similar media, and buy similar products and services. This homogeneity helps marketers in segmenting the market effectively.

### **Social Classes are Dynamic**

The social stratification system can be divided into open and closed systems. In an open system, people have the opportunity to move vertically in the society, i.e., they can move from a lower status to a higher one or vice-versa. In a closed system, the status of a person is determined by their birth. That is, status is inherited and social mobility is restricted. Changes in social status, however, take place over a long period of time.

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### **Check Your Progress-2**

Indicate your choice of the correct answer from the options given by circling it.

5. Which of the following statements is **not true** regarding society?
  - i. Society is composed of a group of people who share institutions which we classify as political, economic, religious, etc.
  - ii. Society has very precise territorial boundaries marked by language and religion, which are the important features by which societies are identified.

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- iii. Members belonging to a society may or may not coordinate their actions with each other.
    - a. Only i and ii
    - b. Only i and iii
    - c. Only ii and iii
    - d. Only iii and iv
  - 6. All the statements given below are true regarding social classes, **except**:
    - a. Social classes are multidimensional.
    - b. Social classes are heterogeneous.
    - c. Some people have a high status in society, while others are given a lower status.
    - d. Social classes are restrictive.
  - 7. The social stratification system can be divided into:
    - a. Open and closed system
    - b. Formal and informal system
    - c. Primary and secondary system
    - d. Economic and non-economic system
  - 8. In which of the following systems do people have the opportunity to move vertically in the society, i.e., they can move from a lower status to a higher one or vice-versa?
    - a. Formal system
    - b. Open system
    - c. Closed system
    - d. Informal system
- 

## 2.7 Group

A group can be defined as, “two or more individuals who share a set of norms, values or beliefs and have certain implicitly defined relationships to one another such that their behaviors are interdependent.” A group consists of two or more people who interact to accomplish either individual or mutual goals.

### 2.7.1 Group Properties

In order to understand the concept of group, one has to be aware of the concepts of status, norms, role, socialization, and power.

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### **Status**

Status is the achieved or recognized position of an individual in a group. This can be attained through aspects like education, income level, occupation, or family background. It is one's rank in the social system, as perceived by the other members of the society. Status goes with certain rights and duties associated with that position. Sometimes, few members who have similar status in the society may come together to form a group.

### **Norms**

Norms are the rules and standards of conduct set by a group. Group members are expected to abide by these norms. In informal groups, norms are generally unwritten, but are well understood.

### **Role**

The term 'role' is usually designated to the behavioral patterns associated with a particular status. Role is the dynamic aspect of status, and includes the attitude, values, and behavior ascribed by society to people having a particular status. The structure existing in the society decides what sort of role behavior is acceptable. The behavior expected of an individual depends on the position held by him/her, rather than on the individual himself.

For instance, generally all students are expected to attend classes and study. However, the levels to which these expectations are fulfilled vary dramatically. While some students come into the class early, take notes, and ask several questions, there are others who come late to class and never ask questions. All of us perform several roles. The roles may change over time, sometimes even within a day. A student may be playing the role of a son in the house, a part-time employee in a restaurant, and a basketball team player. His behavior in each role will be different.

Roles in groups are learned, but each individual does not learn in the same way. Society allows some variation in role performance. Role parameters represent the range of behavior acceptable within a given role. If the behavior varies too much, sanctions are imposed. Sanctions are punishments imposed on an individual for violating role parameters. That is, individuals are rewarded for conformity and punished for non-conformity. Role overload occurs when an individual tries to perform too many roles in the limited available time, energy, or money. Individuals who try to do this may also face role conflict, that is, two or more of their roles are incompatible with each other. For example, working women who are married often have to face conflict between their roles as a home-maker and as an employee.

A role stereotype is a shared visualization of the ideal performer of a given role. We share a common view about the behavioral characteristics of doctors, lawyers, and teachers. Managers can use these stereotypes in their promotional messages.

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### **Socialization**

Socialization is a process by which new members learn the values, norms, and expected behavior patterns of the group they are becoming a part of. Socialization is a process by which members of the groups learn the social skills and value to conform to the norms and roles required for integration into group or community. It is an act of adapting behavior to the norms of a culture or society. In short, it is a process of making social.

It is intense in childhood, but people go through the process whenever they meet new groups that impact their lives. Consumer socialization is a process by which individuals acquire the skills, knowledge, and attitudes required to function as consumers.

### **Power**

Power can be defined as a force that results in behavior that would not have occurred in the absence of the force. It also refers to the degree of personal choice a person enjoys or his/her influence over others. Various social powers may be operative in different social groups. Some of these are reward power, coercive power, legitimate power, expert power and referent power.

#### **Reward power**

It is based on the perception one has about another's ability to reward him/her. The strength of reward power increases as the one perceives the size of reward another can assess. Rewards may either be tangible (money, gifts) or intangible (recognition, praise). Social groups have a great deal of reward power, which they dispense to their members. This motivates members to exhibit the desired behavior. Marketers use reward power, directly (by providing quality products and services) or indirectly (by promising the reward of group acceptance through the use of a particular product), to influence consumers.

#### **Coercive power**

It is the power to influence behavior through punishment or by withholding rewards. Punishment may not be physical punishment, but subtle psychological sanction. Coercive power is used by marketers to show the unfortunate consequences that a consumer may face if he/she doesn't own the product or service (life insurance, deodorants, mouthwash, etc.), thus coercing them to buy the product or service.

#### **Legitimate power**

It stems from a member's perception that the group has the legitimate right to influence him/her. Some of these feelings are internalized by parents, teachers, and religious institutions. An individual accepts some sort of code, and the group he/she belongs to can assert its power to see that he/she abides by the code. Family is a small group in which we can see legitimate power operating. Each member performs some role that is legitimized by other members. Marketers use this power by appealing to consumer values. Words like 'should', 'ought to', are used to express such behavior.

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### **Expert power**

It results from the expertise gained in due course of time, either by an individual or a group. Consumers are always influenced by those whom they perceive having superior knowledge, better skills, and more experience. Many advertisements rely on expert opinion about the product. Information power, which is often related to expert power, comes from logic, reasoning, and importance of communication. Advertisements which use information power, explain why their product is good by providing evidence on aspects like price, quality, features, and performance.

### **Referent power**

It is based on a person's, a firm's, or a product's attractiveness or appeal. It flows from the feeling of belongingness of an individual to a group. As a result of the feeling, one develops a desire to gain closer association with the group. The individual's identity with the group can be established or maintained only if the individual behaves in the way a group does. The more this identification will be, the more will be its referent power.

Advertisers use referent power in promotions to encourage consumers to be like, or do the same thing as, the individual advertising the brand. Using celebrities in advertisements is especially popular. Marketers also use testimonials from 'ordinary' consumers to show that they experienced same problems and have found satisfaction with the recommended brand.

### **2.7.2 Classification of Groups**

Groups can be classified based on the dimensions of function, degree of personal involvement, and degree of organization.

#### **Function**

These groups are classified in terms of their functions such as students and workers. Each major group has subcategories that could generally be categorized into family, age, gender, education, and religion.

#### **Degree of Personal Involvement**

Based on the degree of personal involvement, we can identify two different groups -- primary and secondary. In the primary group, interpersonal relationships are based on frequent face-to-face interaction. These groups have shared norms and interlocking roles. Families and work groups are examples of such groups. Secondary groups are those in which the members have relatively impersonal and formalized relationships. This is a residual category that includes all groups that are not primary such as political parties and trade unions. Even in secondary groups, there may be face-to-face interaction. The distinction lies in the lack of intimacy or personal involvement.

#### **Degree of organization**

Groups range from unorganized to highly structured groups. Depending on where they fall in the range, groups are classified as formal and informal groups.

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Formal groups have definite structure such as they have president, vice-president, general manager, and secretary in an organization. These groups are typically secondary groups, and are developed to accomplish specific goals, whether economic, political, or social. Informal groups are typically primary groups. They have a relatively loose structure and lack clearly defined goals and objectives. These groups influence an individual's values and attitudes.

Primary groups greatly impact the customers, and therefore are important to marketers. It is from such groups that consumers develop their consumption patterns and media preferences. Hence, advertisers present their products within a primary group setting, such as among family members or friends. Secondary groups also influence consumers, and they are also used in advertising.

**Activity:** Health Foods Incorporated is a company providing health drinks, healthy snacks, and nutritious supplements to school and college going students. To market its products to the group, the company rolled out certain ads. The ads featured well-known nutritionists and doctors talking about the Company's products and comparing them with similar products from other companies. What kind of an advertising strategy did the company adopt? Explain the probable reasons for the company to use this strategy.

**Answer:**

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### Check Your Progress-3

Indicate your choice of the correct answer from the options given by circling it.

9. \_\_\_\_\_ can be defined as two or more individuals who share a set of norms values or beliefs and have certain implicitly defined relationships to one another such that their behaviors are interdependent.
  - a. Group
  - b. Role
  - c. Power
  - d. Status
10. Which among the following terms can be defined as the achieved or recognized position of an individual in a group?
  - a. Role
  - b. Status
  - c. Power
  - d. Norm
11. Norms can be defined as:
  - a. the behavioral patterns associated with a particular status.



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- b. the degree of personal choice a person enjoys or his/her influence over others
  - c. the rules and standards of conduct set by a group.
  - d. a process by which new members learn the values, norms, and expected behavior patterns of the group they are becoming a part of.
12. Identify the statements which are **false** regarding 'role'.
- i. It is the degree of personal choice a person enjoys.
  - ii. It is the dynamic aspect of status, and includes the attitude, values, and behavior ascribed by society to people having a particular status.
  - iii. It is usually designated to the behavioral patterns associated with a particular status.
- a. Only i
  - b. Only ii
  - c. Only iii
  - d. Only i and iii

13. Match the following terms with their respective definitions.

Term	Definition
i. Role parameter	p. A shared visualization of the ideal performer of a given role.
ii. Role overload	q. It represents the range of behavior acceptable within a given role.
iii. Role stereotype	r. It occurs when an individual tries to perform too many roles in the limited available time, energy, or money.

- a. i/q, ii/r, iii/p
  - b. i/r, ii/p, iii/q
  - c. i/q, ii/p, iii/p
14. Identify the statements that are **true** regarding socialization.
- i. It is the process by which new members learn the values, norms, and expected behavior patterns of the group they are becoming a part of.
  - ii. It is an ongoing process.

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- iii. It is intense in childhood, but people go through the process whenever they meet new groups that impact their lives.
  - a. Only i and ii
  - b. Only i and iii
  - c. Only ii and iii
  - d. i, ii, and iii
- 15. Which among the following terms can be defined as a force that results in behavior that would not have occurred in the absence of the force?
  - a. Group
  - b. Norm
  - c. Power
  - d. Role
- 16. Which of the following is referred to as the power to influence behavior through punishment or by withholding of rewards?
  - a. Coercive power
  - b. Legitimate power
  - c. Reward power
  - d. Expert power
- 17. 'Their power flows from the feeling of belongingness of an individual or group.' Which power is being referred here?
  - a. Legitimate power
  - b. Expert power
  - c. Referent power
  - d. Reward power
- 18. Which of the following statements is **false** regarding legitimate power?
  - a. The power flows from the feeling of belongingness of an individual or group.
  - b. It stems from a member's perception that the group has the legitimate right to influence him/her.
  - c. Some of these feelings are internalized by parents, teachers, and religious institutions.
  - d. An individual accepts some sort of code, and the group he/she belongs to can assert its power to see that he/she abides by the code.
- 19. Advertisements which use information power, explain why their product is good by providing evidence on aspects like price, quality, features, and performance. Information power is related to \_\_\_\_\_.
  - a. legitimate power
  - b. referent power

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- c. coercive power
  - d. expert power
20. Which of the following statements is **true** regarding the classification of groups based on the degree of organization?
- i. Groups range from unorganized to highly structured groups.
  - ii. Each major group has subcategories that could generally be categorized into family, age, gender, education, and religion.
  - iii. Formal groups have definite structure, while informal groups have relatively loose structure and lack clearly defined goals and objectives.
- a. Only i and ii
  - b. Only i and iii
  - c. Only ii and iii
  - d. i, ii, and iii
- 

### 2.8 Family

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The term ‘family’ has been defined by different authors in different ways. Given below are some of the well-known definitions of the term.

- A social unit living together.
- Two or more persons related by blood, marriage, or adoption who reside together.
- A household of people related by blood or marriage. More especially, we can define a family as husband and wife (or one parent), with or without never married children, living together in the same dwelling.

A household may contain more than two generations of people. A nuclear family is made up of husband and wife together with their children, born or adopted. A kinship group is an extension of the parent-child relationship through three or more generations, including grandparents, grandchildren, cousins, uncles, and aunts. Sib is a group of individuals unilaterally descended from a single (real or postulated) common ancestor. It is sometimes called a “consanguineous group”.

#### 2.8.1 Functions of Family

A family has the responsibility to ensure the economic wellbeing of its members, to provide emotional support, to establish suitable family lifestyles, and to ensure the socialization of members. These four functions are of relevance to business.

##### Economic Well-being

In an affluent country, family is no longer formed primarily for economic security. Giving some kind of financial support to the members is a basic family function. In the last few decades, division of responsibilities in the family for ensuring economic well-being has changed significantly. The traditional roles

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of husband as provider and wife as homemaker have changed with an increase in the number of working women. The role of children has also changed with more number of teenagers working part-time to earn their pocket money. They rarely support the family financially, while their education costs are met by the other family members.

### **Emotional Support**

Providing emotional support (love, affection, and intimacy) and encouragement to the members is an important function of the family that helps the members cope with personal and social problems. If the family does not provide this kind of support when it is required, individuals may end up taking the help of professional counselors or psychologists.

### **Suitable Family Lifestyle**

Establishing a suitable lifestyle is another important function of the family. Upbringing, experience, and the personal and jointly held goals of the spouses determine how much importance they give to education, career, reading, and television viewing; how frequently they dine out; and what recreational and entertainment activities they choose. Family lifestyle commitments that include the allocation of time influence the consumption pattern to a great extent.

### **Socialization of Children and Other Family Members**

Socialization of family members, especially young children, is an important family function. This process involves teaching children the basic values and modes of behavior that are consistent with the prevailing culture. These usually include moral and religious principles, interpersonal skills, dress and grooming standards, appropriate manners and speech, and the selection of suitable educational and occupational goals.

Socialization skills can be imparted. Children are socialized directly through instructions, and indirectly through observing the behavior of their parents and other siblings. Marketers usually target parents looking for assistance in the task of socializing pre-adolescent and post-adolescent children. Socialization of young children is important because it provides a foundation for their behavior in the future.

### **Consumer socialization of children**

Consumer socialization refers to the process by which an individual acquires the skills necessary to function in the marketplace as a consumer. It has two different components -- socialization directly related to consumption, and socialization indirectly related to consumption. An example of socialization directly related to consumption is the acquisition of skills and knowledge related to budgeting, pricing, and brand attitudes. An example of socialization indirectly related to consumption is the motivation that spurs a young man to purchase his first razor. The indirect component of consumer socialization is of great interest to marketers as it helps them to understand why people buy specific products.

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Consumer socialization of children is a process by which children acquire the skills, knowledge, and attitudes necessary to function in the marketplace as consumers. Studies have shown that children develop consumption skills by observing their parents who function as role models. Children and young adults learn the rational aspects of consumption from their parents while the mass media teaches them to give social meaning to products; schools teach the importance of economic wisdom and finally peers exercise varying social pressures. Children get opportunities to learn instore shopping skills through shared shopping experiences. Working mothers usually opt for 'coshopping' with their children. Coshopping is a means of spending time with one's children, and accomplishing an important task at the same time.

### 2.8.2 Family Life Cycle

The concept of the Family Life Cycle (FLC) facilitates the classification of family units into distinct segments. FLC analysis helps marketers to segment families in terms of a series of stages spanning the life course of a family unit. FLC studies demographic variables such as marital status, the size of family, the age of family members, the employment status of the members, and the disposable incomes of the members. The family-life-cycle concept is broadly categorized into two sections. The first section studies the traditional family-life-cycle. As the first failed to analyze important family living arrangement, the second emerged to focus on alternative stages, including the non-traditional family.

#### Traditional Nuclear Family Life Cycle

The traditional family life cycle has been divided into the following five different segments on the basis of various stages in the family.

- i. **Bachelorhood:** The major task during this period is to disconnect and reconnect with one's family on a different level while simultaneously establishing oneself as a person. During this stage, individuals strike out on their own taking full responsibility for their actions and choices. Meeting, dating, and mating are prominent concerns during this period.
- ii. **Honeymooners:** During this stage, newly married couples learn to adjust, adopt, or share space, meals, work, leisure, and other activities. This process takes time, energy, good will, and the ability to compromise. During this stage, couples opt for a pleasure seeking lifestyle.
- iii. **Parenthood:** Parenthood can be divided into two distinct parts. They are:
  - **Families with young children:** When a newborn enters a family, the family becomes temporarily unbalanced. Couples have to adjust the time they spend working outside the house, socializing with friends, and engaging in recreational activities. They also have to decide between activities, and between themselves who will take the responsibility of the child. A rebalancing and renegotiation occurs between husband and wife concerning their investment of energy, time,

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and focus. Couples at this stage are the best targets for companies that serve the baby market.

- **Families with adolescents:** Couples who take care of adolescents must take care of themselves, the relationships, their teenagers, and often their aging parents. This time can be turbulent if parents have difficulty setting limits and defining relationships. This stress is usually marked by increased number of arguments and disagreements between parents, and difference in terms due to an inconsistency between what the parents want for their children and what the children want for themselves.
- iv. **Post-parenthood (an older married couple with no children living at home):** As children leave home for college, careers, or marriage, parents experience an ideal time to rediscover each other and have fun together. Many women are likely to be attending to their own interests and thankful for the freedom to pursue them at last. For those women who have primarily defined themselves as mothers and invested heavily in their children, this time can be marked by sadness and depression.
- v. **Dissolution:** Couples in this stage are either in the final years of employment or in retirement. Finances are the major concern for this population. Health and loss of spouse are major concerns.

### Modern Family Life Cycle

In the last few decades, the structure of families has changed. They have become smaller in size. People have started postponing their marriages and divorce rates have risen. So, it has become necessary to include divorced single parents, and middle-aged married couples without children in the family lifecycle. The various stages in this modern cycle are given in below.

- **Bachelor I:** Age of head is between 18 and 34; single (never married, divorced, separated, or widowed); no dependent children
- **Young Couple:** Female head is aged between 18 and 34; couple (married or unmarried); no children
- **Full Nest I:** Female head is aged between 18 and 34; couple (married or unmarried); youngest child is under 6
- **Full Nest II:** Female head is aged between 18 and 34; couple (married or unmarried); youngest child is 6 or over
- **Single Parent I:** Age of head is between 18 and 34; single (never married, divorced, separated, or widowed); youngest child is under 6.
- **Single Parent II:** Age of head is between 18 and 34; single (never married, divorced, separated, and widowed); youngest child is 6 or over.
- **Bachelor II:** Age of head is between 35 and 64; single (never married, divorced, separated, or widowed); no dependent children.

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- **Childless Couple:** Female head is aged between 35 and 64; couple (married or unmarried); no dependent children.
- **Delayed Full Nest:** Female head is aged between 35 and 64; couple (married or unmarried); youngest child is under 6.
- **Full Nest III:** Female head is aged between 35 and 64; couple (married and unmarried); youngest child is 6 or over.
- **Single Parent III:** Age of head is between 35 and 64; youngest child is 6 or over.
- **Bachelor III:** Age of head is 65 or over; single (never married, divorced, separated, or widowed); no dependent children.
- **Older Couple (Empty Nest):** Female head is aged 65 or over; couple (married or unmarried); no dependent children.

**Activity:** Anvitha is a 32 year old woman working with Nike as a quality control manager. She has two kids -- one aged 8 and the other aged 6. She is the sole earner in the family. Anvitha belongs to which stage in the modern family life cycle? Name the other stages in the life cycle. Also, compare the modern family life cycle with the traditional one.

**Answer:**

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### Check Your Progress-4

Indicate your choice of the correct answer from the options given by circling it.

21. Which of the following statements are **false** regarding family?
- i. It is a social unit living together.
  - ii. It is a household of people who are related only by blood, and not by adoption or marriage.
  - iii. It contains only two generations of people comprising of father, mother, and children.
  - iv. It has to ensure the economic wellbeing of its members by providing emotional support, establishing suitable family lifestyles, and socializing members.

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- a. Only i and ii
  - b. Only i and iv
  - c. Only ii and iii
  - d. Only iii and iv
22. \_\_\_\_\_ can be defined as an extension of the parent-child relationship through three or more generations, including grandparents, grandchildren, cousins, uncle, and aunts.
- a. Sib
  - b. Kinship group
  - c. Nuclear group
  - d. Post parenthood
23. Which of the following are the functions of a family?
- i. Provide emotional support
  - ii. Ensure economic well-being
  - iii. Establish suitable lifestyles
  - iv. Socialize children and other family members
- a. Only i, ii, and iii
  - b. Only i, ii, and iv
  - c. Only ii, iii, and iv
  - d. i, ii, iii, and iv
24. Which of the following statements is not true, in terms of Socialization?
- a. It involves teaching children the basic values and modes of behavior that are consistent with the prevailing culture.
  - b. These skills cannot be imparted through instructions or observation.
  - c. It provides a foundation for the behavior of children in the future.
  - d. It usually includes moral and religious principles, interpersonal skills, dress and grooming standards, appropriate manners and speech, and the selection of suitable educational and occupational goals.
25. Which of the statements is **true** regarding consumer socialization of children?
- a. It refers to the process by which an individual acquires the skills necessary to function in the marketplace as a consumer.
  - b. An example of socialization indirectly related to consumption is the acquisition of skills and knowledge related to budgeting, pricing, and brand attitudes.



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- c. The direct component of consumer socialization is of great interest to marketers as it helps them to understand why people buy specific products.
  - d. All of the above
26. From the following, identify the statement that is **not true** regarding family life cycle analysis.
- a. It helps marketers to segment families in terms of a series of stages spanning the life course of a family unit.
  - b. It does not study aspects like the income, expenditure, or disposable income of family members.
  - c. It studies demographic variables such as marital status, the size of family, the age of family members, and the employment status of the members.
  - d. It facilitates the classification of family units into distinct segments.
27. The traditional family life cycle has been divided into five different segments on the basis of various stages in the family. All the segments given below are part of the traditional nuclear family life cycle, except:
- a. Bachelorhood
  - b. Families with adolescents
  - c. Dissolution
  - d. Single Parent I
28. Mr. Singh is 57 years old and is about to retire in another 3 years. He stays along with his wife. His children are married and well-settled. Mr. and Mrs. Singh are in which stage of the traditional family life cycle?
- a. Bachelorhood
  - b. Dissolution
  - c. Parenthood
  - d. Delayed full nest
29. Yogita is a 32 year old mother of two daughters, one aged 9 and the other aged 5. Her husband, an army officer, died two years back while on duty. Yogita had to take care of the kids by herself. Considering her husband's sacrifice to the country, the Indian army gave her a job at the Army Dental Hospital. Yogita is going through which stage in the modern family life cycle?
- a. Full Nest I
  - b. Empty Nest
  - c. Single Parent I
  - d. Single Parent III
-

## Block-1: Business Environment and Law

### 2.9 Summary

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- Demographics describe a population in terms of its size, structure, and distribution.
- Income, lifestyle, education, gender, social class, occupation, and age are demographic variables.
- Society is composed of a group of people who share institutions which we classify as political, economic, religious, etc.
- Social class can be defined as the classification of members of a society into a hierarchy of distinct classes, so that a member of each class has approximately equal position in society with other members of the same class.
- Social classes are multidimensional, restrictive, homogeneous, and dynamic.
- A group can be defined as two or more individuals who share a set of norms values or beliefs and have certain implicitly defined relationships to one another such that their behaviors are interdependent.
- Groups can be classified based on the dimensions of function, degree of personal involvement, and degree of organization.
- A family is a social unit living together. It comprises two or more persons related by blood, marriage, or adoption who reside together.
- A family ensures the economic wellbeing of its members, provides emotional support, establishes suitable family lifestyles, and socializes members.
- The concept of the family life cycle facilitates the classification of family units into distinct segments. Family life cycle analysis helps marketers to segment families in terms of a series of stages spanning the life course of a family unit.

### 2.10 Glossary

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- **Coercive power (classification of power):** The power to influence behavior through punishment or by withholding rewards.
- **Demographics:** Description of a population in terms of its size, structure, and distribution. The demographic variables are income, lifestyle, education, gender, social class, occupation, and age.
- **Distribution (in demographics):** Description of the location of individuals in terms of geographic region and rural, urban, or suburban location.
- **Expert power (classification of power):** The power that results from the expertise gained in due course of time, either by an individual or a group.

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- **Family:** A social unit living together. It comprises two or more persons related by blood, marriage, or adoption who reside together.
- **Group:** Two or more individuals who share a set of norms values or beliefs and have certain implicitly defined relationships to one another such that their behaviors are interdependent.
- **Legitimate power (classification of power):** The power that stems from a member's perception that the group has the legitimate right to influence him/her.
- **Lifestyle:** The pattern of living expressed by an individual through his/her activities, interests, and opinions.
- **Market segmentation:** Dividing the market into distinct subset of consumers with homogeneous needs or characteristics and selecting one or more segments to target them.
- **Norms:** The rules and standards of conduct set by a group. Group members are expected to abide by these norms.
- **Power:** A force that results in behavior that would not have occurred in the absence of the force. It also refers to the degree of personal choice a person enjoys or his/her influence over others.
- **Reward power (classification of power):** The power based on the perception one has about another's ability to reward him/her.
- **Role:** The dynamic aspect of status, and includes the attitude, values, and behavior ascribed by society to persons having a particular status.
- **Size (in demographics):** Number of individuals in a population.
- **Social class:** A hierarchical division of a society into relatively distinct and homogeneous groups whose members have similar attitudes, values, and lifestyles.
- **Social class:** The classification of members of a society into a hierarchy of distinct classes, so that a member of each class has approximately equal position in society with other members of the same class.
- **Socialization:** A process by which new members learn the values, norms, and expected behavior patterns of the group they are becoming a part of.
- **Society:** A group of people who share institutions which we classify as political, economic, religious, etc. People identify a particular society by determining what identifies themselves as members and generally by others as members.
- **Status:** The achieved or recognized position of an individual in a group. It is one's rank in the social system, as perceived by the other members of the society.
- **Structure (in demographics):** Description of the population in terms of age, income, education, and occupation among others.

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### **2.11 Self-Assessment Test**

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1. 'An understanding of the demographic environment is important for a business as it involves people for whose consumption goods and services are produced.' Explain this statement.
2. Demographic variables are used by marketers to segment a market. What are these variables? Describe in detail.
3. Though, people may be created equal, society gives different status to different people. Some people have a high status in society, while others are given a lower status. What is a social class? Explain its characteristics.
4. In order to understand the concept of group, one has to be aware of the concepts of status, norms, role, socialization, and power. Explain the concept of group in this regard.
5. Describe the following in detail.
  - Society
  - Classification of groups
  - Family and its functions

### **2.12 Suggested Readings / Reference Material**

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### 2.13 Answers to Check Your Progress Questions

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Following are the answers to the Check Your Progress questions given in the Unit.

1. (c) **Distribution of the population describes the location of individuals in terms of geographic region and rural, urban, or suburban location.**

Demographics describe a population in terms of its size, structure, and distribution. Size means the number of individuals in a population; structure describes the population in terms of age, income, education, and occupation among others; and distribution of the population describes the location of individuals in terms of geographic region and rural, urban, or suburban location.

2. (d) **i, ii, iii, and iv**

All the statements are true regarding the study of demographics in the environment. Demographics influence consumption behaviors directly and indirectly by influencing other attributes of individuals such as their personal values and decision styles (which in turn influence consumption).

3. (b) **Market segmentation**

Market segmentation aims at dividing the market into distinct subset of consumers with homogeneous needs or characteristics and selecting one or more segments to target them. Demographic variables like income, lifestyle, education, gender, social class, occupation, and age have been traditionally used by marketers to segment the market.

4. (a) **Social class**

A social class is a hierarchical division of a society into relatively distinct and homogeneous groups whose members have similar attitudes, values, and lifestyles. An individual's education, occupation,

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ownership of property, income level, and heritage (racial/ethnic background, parents' status) influence his/her social standing.

### **5. (c) Only ii and iii**

Society is composed of a group of people who share institutions which we classify as political, economic, religious, etc. Typically, it has territorial boundaries, but these may not be precise. Members belonging to a society must coordinate their actions with each other. No individual can do 'his/her own thing' with no concern for others.

### **6. (b) Social classes are heterogeneous.**

All the statements are true except statement (b). Social classes are multidimensional, homogeneous, and restrictive. People within a social class are homogeneous as they have similar interests, attitudes, and purchasing behavior patterns. They are exposed to similar media, and buy similar products and services.

This homogeneity helps marketers in segmenting the market effectively.

### **7. (a) Open and closed system**

The social stratification system can be divided into open and closed system. In an open system, people have the opportunity to move vertically in the society, i.e., they can move from a lower status to a higher one or vice-versa. In a closed system, the status of a person is determined by their birth. That is, status is inherited and social mobility is restricted.

### **8. (b) Open system**

The social stratification system can be divided into open and closed system. In an open system, people have the opportunity to move vertically in the society, i.e., they can move from a lower status to a higher one or vice-versa. In a closed system, the status of a person is determined by their birth. That is, status is inherited and social mobility is restricted.

### **9. (a) Group**

A group can be defined as two or more individuals who share a set of norms values or beliefs and have certain implicitly defined relationships to one another such that their behaviors are interdependent. It comprises two or more people who interact to accomplish either individual or mutual goals.

### **10. (b) Status**

Status is the achieved or recognized position of an individual in a group. It is one's rank in the social system, as perceived by the other members of the society.

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**11. (c) the rules and standards of conduct set by a group.**

Norms are the rules and standards of conduct set by a group. Group members are expected to abide by these norms. In informal groups, norms are generally unwritten, but are well understood.

**12. (a) Only i**

The term 'role' is usually designated to the behavioral patterns associated with a particular status. Role is the dynamic aspect of status, and includes the attitude, values, and behavior ascribed by society to people having a particular status. Power is the degree of personal choice a person enjoys or his/her influence over others.

**13. (b) i/q, ii/r, iii/p**

Role parameters represent the range of behavior acceptable within a given role. Role overload occurs when an individual tries to perform too many roles in the limited available time, energy, or money. A role stereotype is a shared visualization of the ideal performer of a given role.

**14. (d) i, ii, and iii**

Socialization is a process by which new members learn the values, norms, and expected behavior patterns of the group they are becoming a part of. Socialization is an ongoing process. It is intense in childhood, but people go through the process whenever they meet new groups that impact their lives.

**15. (c) Power**

Power can be defined as a force that results in behavior that would not have occurred in the absence of the force. It also refers to the degree of personal choice a person enjoys or his/her influence over others.

**16. (a) Coercive power**

Coercive power is the power to influence behavior through punishment or by withholding rewards. Punishment may not be physical punishment, but subtle psychological sanction.

**17. (c) Referent power**

Referent power is based on a person's, a firm's, or a product's attractiveness or appeal. It flows from the feeling of belongingness of an individual to a group. As a result of the feeling, one develops a desire to gain closer association with the group.

**18. (a) The power flows from the feeling of belongingness of an individual or group.**

Legitimate power stems from a member's perception that the group has the legitimate right to influence him/her. Referent power flows from the feeling of belongingness of an individual to a group.

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### **19. (d) expert power**

Expert power results from the expertise gained in due course of time, either by an individual or a group. Consumers are always influenced by those whom they perceive having superior knowledge, better skills, and more experience. Many advertisements rely on expert opinion about the product.

### **20. (b) Only i and iii**

Statement ii is false as it is related to the classification of groups based on function. In this, groups are classified in terms of their functions such as students and workers. Each major group has subcategories that could generally be categorized into family, age, gender, education, and religion.

### **21. (c) Only ii and iii**

Statements i and iv are true regarding family, while statements ii and iii are false. In a family, two or more persons related by blood, marriage, or adoption reside together. A household may contain more than two generations of people.

### **22. (b) Kinship group**

A kinship group is an extension of the parent-child relationship through three or more generations, including grandparents, grandchildren, cousins, uncles, and aunts. Sib is a group of individuals unilaterally descended from a single (real or postulated) common ancestor. A nuclear family is made up of husband and wife together with their children, born or adopted. Post parenthood is a stage in the traditional family cycle that comprises an older married couple with no children living at home.

### **23. (d) i, ii, iii, and iv**

A family has the responsibility of ensuring the economic wellbeing of its members by providing emotional support, establishing suitable family lifestyles, and socializing members.

### **24. (b) These skills cannot be imparted through instructions or observation.**

The process of socialization of family members, especially young children, is an important family function. It involves teaching children the basic values and modes of behavior that are consistent with the prevailing culture. Socialization skills can be imparted. Children are socialized directly through instructions, and indirectly through observing the behavior of their parents and other siblings.



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- 25. (a) It refers to the process by which an individual acquires the skills necessary to function in the marketplace as a consumer.**

Consumer socialization refers to the process by which an individual acquires the skills necessary to function in the marketplace as a consumer. It has two different components -- socialization directly related to consumption, and socialization indirectly related to consumption. An example of socialization directly related to consumption is the acquisition of skills and knowledge related to budgeting, pricing, and brand attitudes. An example of socialization indirectly related to consumption is the motivation that spurs a young man to purchase his first razor. The indirect component of consumer socialization is of great interest to marketers as it helps them to understand why people buy their products.

- 26. (b) It does not study aspects like the income, expenditure, or disposable income of family members.**

The concept of the Family Life Cycle (FLC) facilitates the classification of family units into distinct segments. FLC studies demographic variables such as marital status, the size of family, the age of family members, the employment status of the members, and the disposable incomes of the members.

- 27. (d) Single Parent I**

The traditional family life cycle has been divided into the following five different segments on the basis of various stages in the family. These are bachelorhood, honeymooners, parenthood, post parenthood, and dissolution. Single Parent I is a stage in the modern family life cycle.

- 28. (b) Dissolution**

Mr. and Mrs. Singh are going through dissolution, a stage in the traditional family life cycle in which the couples are either in the final years of employment or in retirement. Finances and health are the major concerns in this stage.

- 29. (c) Single Parent I**

Yogita is a single parent. She is 32 years old and her youngest child is 5 years old. Therefore, she belongs to the Single Parent I stage in the modern family life cycle.

## Unit 3

# Cultural Environment

### Structure

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- 3.1 Introduction
- 3.2 Objectives
- 3.3 Understanding Culture
- 3.4 Essence of Culture
- 3.5 Elements of Culture
- 3.6 Manifestation of Culture
- 3.7 Culture Change
- 3.8 Cultural Analysis
- 3.9 Cultural Adaptation
- 3.10 Cultural Sensitivity of Markets
- 3.11 Summary
- 3.12 Glossary
- 3.13 Self-Assessment Test
- 3.14 Suggested Readings / Reference Material
- 3.15 Answers to Check Your Progress Questions

### 3.1 Introduction

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In the previous unit, we discussed the importance of the demographic and the social environments in understanding the environment where the business operates. In this unit, we will discuss the cultural environment, an external environment factor.

In today's business environment, companies do business both within a country and across national boundaries, interacting with people, institutions, and organizations nurtured in different cultural environments. Different nations have striking and significant differences of attitude, belief, ritual, motivation, perception, morality, truth, superstition and an almost endless list of other cultural characteristics. Values that are important to one group of people may mean little to another. These cultural differences deeply affect market behavior. Today's organizations need to be as familiar with the cultural traits of the countries they want to do business with.

This unit will help you understand meaning and nature of culture and its essence. We will then move on to discuss the elements of culture and the manifestation of culture. We will also discuss aspects like culture change, cultural analysis, and cultural adaptation. Finally, we will discuss how the markets are sensitive to the various cultures.

### 3.2 Objectives

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By the end of this unit, you should be able to:

- Define culture, and explain the essence of culture.
- Identify the elements of culture.
- Recognize the influence of culture on consumption, thinking process, and communication processes.
- Explain the concepts of culture change, cultural analysis, and cultural adaptation.
- Determine the cultural sensitivity of markets.

### 3.3 Understanding Culture

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E. Adamson Hoebel defined culture as, “the integrated sum total of learned behavioral traits that are shared by members of a society.” Sir Edward Tylor<sup>1</sup> defined culture as, “that complex whole which includes knowledge, belief, art, morals, law, customs, and any other capabilities and habits acquired by individuals as members of society.” Other definitions of culture are given below.

- Culture is a total pattern of behavior that is consistent and compatible in its components. It is not a collection of integrated random behaviors, but behaviors that are internally related and integrated.
- Culture is a learned behavior, it is not biologically transmitted. It depends on environment, not heredity. Thus it can be called the man-made part of our environment.
- Culture is behavior that is shared by a group of people, a society. It can be considered as the distinctive way of life of people.

Culture thus includes all learned behavior and values that are transmitted to an individual living within a society, through shared experiences.

### 3.4 Essence of Culture

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Different people have varied views on culture. Many regard it as something a country, a region, or a firm has, or as something that you can see, hear, touch, smell, or taste. This approach to culture identifies the ceremonies, clothing, historical landmarks, art, and food as examples of a country’s culture. Irrespective of the various views, it is a commonly accepted fact that culture develops through recurrent social relationships that form patterns that are eventually internalized by members of the entire group.

Three vital characteristics are integral to the definition of culture.

1. **It is learned:** It is acquired by people over time through their membership in a group that transmits culture from generation to generation.
2. **It is interrelated:** One part of the culture is deeply connected with another part such as religion and marriage, and business and social status.
3. **It is shared:** The tenets of a culture extend to other members of the group.

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<sup>1</sup> (Sir Edward Burnett Tylor was an English anthropologist. Tylor is representative of cultural evolutionism)

Culture as a concept encompasses every part of a person's life. It meets virtually all human needs, both physical and psychological. Its evolution is not complete. Through constant embellishment and adaptation, culture continues to evolve, partly in response to environment needs and partly through the influence of outside forces.

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**Check Your Progress-1**

Indicate your choice of the correct answer from the options given by circling it.

1. \_\_\_\_\_ can be defined as the integrated sum total of learned behavioral traits that are shared by members of a society.
    - a. Ethics
    - b. Culture
    - c. Business
    - d. Politics
  2. Which of the following statement is not true with relation to culture?
    - i. It is the integrated sum total of learned behavioral traits that are shared by members of a society.
    - ii. It is a collection of integrated random behaviors which are not related in any way.
    - iii. It is a learned behavior and it is biologically transmitted.
    - iv. It can be considered as the distinctive way of life of people, which is dependent on the environment.
    - a. Only i and ii
    - b. Only i and iv
    - c. Only ii and iii
    - d. Only iii and iv
  3. Which of the following characteristics is not related to culture?
    - a. It is acquired by people over time through their membership in a group that transmits culture from generation to generation.
    - b. Cultures are rarely connected with each other as each culture is very different from others.
    - c. Culture can be shared, i.e., the tenets of a culture can extend to other members of the group.
    - d. Culture develops through recurrent social relationships that form patterns that are eventually internalized by members of the entire group.
- 

**3.5 Elements of Culture**

Culture can be understood by examining the cultural elements within a country. Given below are four cultural elements that are vital to any country.

**3.5.1 Language**

Language differentiates human beings from animals. Human beings speak in so many languages that it becomes a part of the cultural environment of the region to which they belong. Language is used to communicate and to interpret the environment. There are two facets of language which have a bearing on business organizations. These are -- the use of language as communication across, and often within, national boundaries, and the huge diversity of languages across, and often within, national boundaries.

Most languages do not literally translate from one to another. Added to this, it is extremely difficult to understand the symbolic and physical aspects of the communication of different cultures. The language used for communication has two parts -- the spoken part and the silent part. Communication through vocal sounds or written symbols forms the spoken part, while silent language refers to the numerous non-verbal communication mechanisms such as gestures, grimaces, body language, eye contact, and conversation distance that people use to get a message.

Different gestures convey different meanings across cultures. Thus managers should familiarize themselves with the various aspects of foreign cultures. Language is often described as the mirror of a culture. The diversity of languages across the globe poses a serious problem for multinationals. In countries such as India, there are many languages. The problem is further aggravated when the meanings and expressions vary a great deal between countries that share the same language.

**3.5.2 Aesthetics**

Aesthetics includes aspects like art, drama, color, music, folklore, and architecture present in a society. This aspect usually captures the ideas and expressions that are inherent in a culture. For example, colors carry different meanings across the globe. Aesthetics could mean a lot to a business manager designing a product to suit the local cultural setup.

**3.5.3 Religion**

Managers should understand and appreciate buying motives, customs, practices, and religious beliefs of people. According to Terpstra and David, religion refers to a community's set of beliefs that relate to a reality that cannot be verified empirically. These beliefs usually involve reflection about after-life, but not always. An MNC has to adapt itself to the local religious taboos and sentiments. The location and design of stores and office buildings are also influenced by religious beliefs.

**3.5.4 Education**

Education can be considered as a vehicle to channel culture from one generation to another. There are two facets of education that impact multinationals -- the level and quality of education, and the level of education in comparison with other countries. In most developed countries, education up to a certain age is compulsory. The illiteracy rate is a powerful tool for assessing the education level of a country. In countries having a very low to moderate literacy rate, managers have to be careful in matters pertaining to product labeling, print ads, and survey research. Even simple labels can be misunderstood in such countries.

Companies are also concerned about the quality of education in the country. They need to know whether the education level of a country meets their business needs and whether the labor force within a country possesses the necessary skills to make the transition from labor-intensive to capital-intensive industries. Even within countries having similar levels of economic development, there are huge differences in the blend of skills the labor forces possesses. Shortage in certain fields might force the companies to employ expatriates or bid against one another for the scarce talent available.

A fine example of increase in stock price of Microsoft with cultural transformation introduced by Nadella can be seen from the exhibit hereunder.

**Exhibit No 3.1**  
**Cultural Transformation – A Secret Sauce for Microsoft’s Stock Rise**

In 2020, the second quarter’s report of Microsoft showed rise of shares by 4%. Both earnings and revenues hiked. Performance exceeded the expectations of analysts. Microsoft’s EPS (Earnings-per-Share) exceeded 19 cents above expectations, revenues soared by 14%, and operating margin also raised by 2%. Though improvement in many factors like marketing and sales skills attributed for this success, cultural transformation was said to lay the basis for improvement, by raising the energies of talented people involved in those jobs.

While on the way to success, issues like new markets, business models, new products/services and anticipation to grow while continuing to perform well were some of the challenges Microsoft faced. To overcome these challenges, Nadella found a unique way, i.e. to instil new culture associated with growth mindset (Nadella defined growth mindset as "take nothing for granted and always be willing to check your assumptions as new data comes in"). To do so, Nadella felt that employees need to interact with the decision makers and also technical people to understand and lead the advanced products. He arranged for the necessary training.

The new culture, emphasized on learning and failing. It created excitement in employees as it allowed them to move out of their comfort zone to seize new opportunities. The new mindset lead to sales enhancement and provided opportunities to interact with new groups of customers.

*Source: <https://www.forbes.com/sites/petercohan/2020/01/30/culture-is-the-most-surprising-reason-microsoft-stock-will-keep-rising/?sh=682a85e11b23>*

**Activity:** The cultures in India, US, and UK differ in many ways. Take at least two cultural elements and explain the differences between these three cultures.

**Answer:**

### 3.6 Manifestation of Culture

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The diffusion theory of innovation refers to an acceptance of a product or idea by consumers over time, linked to a given social structure and a given system of values or culture. The diffusion process varies from culture to culture. While some cultures are very conservative, others demand innovativeness from the employees in every aspect of their business.

Culture not only affects the diffusion process in general, but also exerts a great deal of influence on the adoption of a product in particular. A product that is suitable for one culture may be totally inappropriate elsewhere. Therefore, marketers should avoid using a global standardized campaign to introduce new products in foreign markets. The innovators, who are usually the opinion leaders, prompt the adoption of a product.

Hence, international marketers should identify them in the given market.

#### 3.6.1 Influence of Culture on Consumption

Culture refers to the set of values, ideas, and attitudes that are accepted by a homogeneous group of people and transmitted to the next generation. The priority of needs, consumption patterns, and consumption habits and lifestyles are all dictated by culture. Culture influences what is to be purchased; it also affects what should not be purchased. Understanding the influence of culture is very important for conducting business effectively in various countries of the world. Because of the enduring aspect of culture, it is easier and profitable for marketers to make products consistent with the culture in which products are marketed than to try to change the culture to fit the product.

#### 3.6.2 Influence of Culture on Thinking Process

Culture affects the thinking processes of individuals, groups, and organizations due to the Self-Reference Criteria (SRC) that binds an individual to his/her cultural assumptions. It becomes important for the manager/researcher to make objective evaluations about such assumptions. Managers have to examine the applicability of these initial assumptions in terms of another culture. This makes them think in international terms and not in terms of his/her native culture. An awareness of the influence of culture on thinking processes is valuable as it helps a manager prevent a transfer of personal cultural norms on a wholesale basis to an overseas market. This awareness should make a manager more consumer-oriented, and the marketing strategy developed will more likely reflect true market needs.

#### 3.6.3 Influence of Culture on Communication Processes

Edward T. Hall, an anthropologist made a vital distinction between high and low-context cultures and how it impacted communication. A high-context culture uses high-context communication, i.e., information that is either in the physical context or internalized in the person, with little being communicated in the explicit words or message. The context of communication is high as it includes a great deal of additional information such as message sender's values, positions, background, and associations in society. A low context culture employs low-context communication, in which most information is contained in explicit codes, such as words. Unless global leaders are aware of the subtle

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differences, communication misunderstandings might occur between low- and high-context communicators.

Hall also distinguished between monochronic and polychronic cultures. Some cultures handle information in a direct, linear fashion and are thus monochronic in nature. Other cultures are relatively polychronic as people work on several fronts simultaneously instead of pursuing a single task. The cultural context and the manner in which information is processed can be combined to describe the communication process of a particular country.

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### **Check Your Progress-2**

Indicate your choice of the correct answer from the options given by circling it.

4. Which of the following statements is **not** true regarding language, as an element of culture?
  - a. It is used to communicate and to interpret the environment.
  - b. It is described as a mirror of culture.
  - c. Most languages do not literally translate from one to another.
  - d. The language used in communication has only the spoken part, which involves communication through vocal sounds and/or written symbols.
5. Which among the following is not a form of communication used in silent language?
  - a. Gestures
  - b. Body language
  - c. Written symbols
  - d. Eye contact
6. Which of the following elements of culture usually captures the ideas and expressions that are inherent in a culture, and includes aspects like art, drama, color, music, and architecture?
  - a. Language
  - b. Religion
  - c. Education
  - d. Aesthetics
7. \_\_\_\_\_ is an element of culture that refers to a community's set of beliefs that relate to a reality that cannot be verified empirically.
  - a. Language
  - b. Religion
  - c. Education
  - d. Aesthetics
8. Which of the following facets of education (as an element of culture) has a vital bearing on a multinational business organization?
  - i. Blending of skills of the labor in the country.
  - ii. The level and quality of education.
  - iii. The level of education in comparison with other countries.



- a. Only i and ii
  - b. Only i and iii
  - c. Only ii and iii
  - d. i, ii, and iii
9. Which type of culture handles information in a direct, linear fashion, according to Edward Halls' theory?
- a. Polychronic
  - b. Monochronic
  - c. High-context
  - d. Both (a) and (b)
10. The \_\_\_\_\_ refers to an acceptance of a product or idea by consumers over time, linked to a given social structure and a given system of values or culture.
- a. self-reference criterion
  - b. cultural adaptation
  - c. cross-cultural analysis
  - d. diffusion theory of innovation
11. Which of the following statements is not a high-context culture?
- a. Information used is in the physical context
  - b. Information contained is mostly in explicit codes, such as words
  - c. Information used is internalized in the person, with little being communicated in the explicit words or messages
  - d. Includes a great deal of additional information such as message sender's values, positions, background, and associations in society
- 

### 3.7 Culture Change

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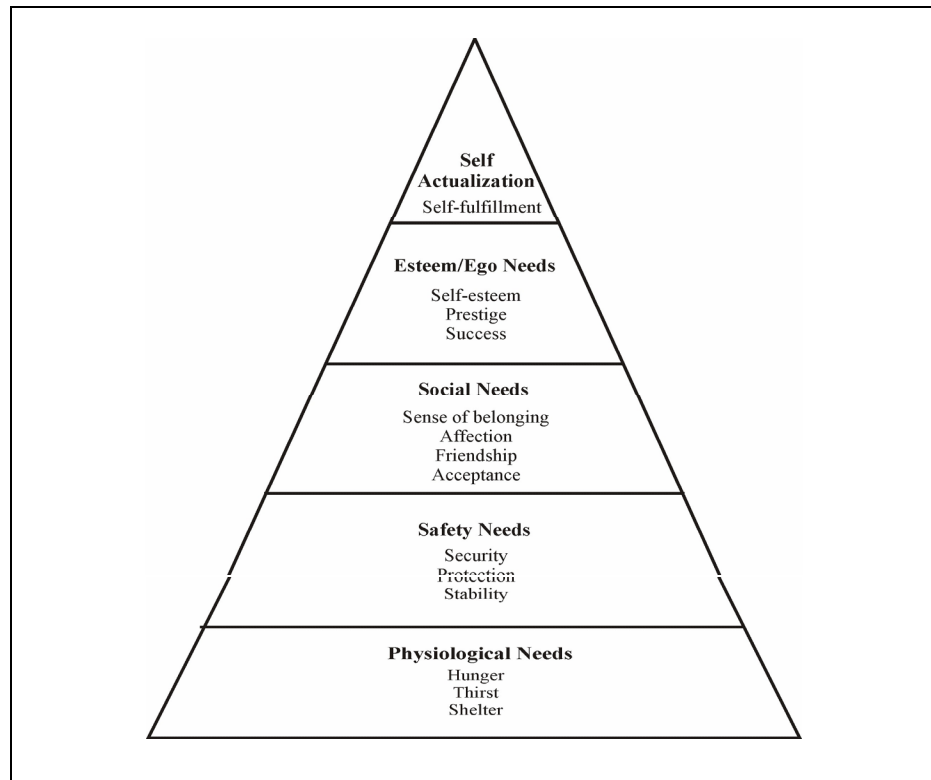
Companies should be aware of culture change. This characteristic of culture brings in a variety of possibilities. Products and services, which might not have been accepted at one point of time due to a particular culture, may become acceptable at a later time due to a change in the culture.

#### 3.7.1 Basics of Cultural Change

Many theories have been propounded on the basis on which cultural transition takes place. One such proposition is based on Maslow's hierarchy of needs theory. Refer to figure 3.1 for the Maslow's Hierarchy of Needs. In this theory, Maslow ranked five human needs in ascending order. Starting with the lowest, these needs are -- physiological needs (food, water, shelter); safety needs (protection, security, stability); social need (affection, friendship, acceptance); ego needs (prestige, success, self-esteem); and finally the need for self-actualization (self-fulfillment). As a country moves from a subsistence level economy, where the major goal has been the basic fulfillment of physiological needs, to a stage where basic needs are achievable easily, new needs take precedence. Thus, when an economy satisfies one level of needs, it

automatically gives rise to new needs, whose satisfaction requires cultural change.

**Figure 3.1: Maslow's Hierarchy of Needs**



Another proposition, based on Hall's classification of culture, examines the formal, informal, and technical aspects of cultural change. According to Hall's classification, the formal aspects are the core cultural aspects of an economy. These core aspects are very deeply rooted and are totally resistant to change. They are considered absolute rights and wrongs in a society. But informal aspects refer to traits that the members of the society learn over time. These are also common norms that everyone is supposed to be aware of. If an informal aspect is not adhered to, an expression of disapproval or concern is shown. Technical aspects are transmitted in the form of instruction and have valid reasons underlying them. As there is little emotional bondage to this aspect, it is easily prone to change. All the three cultural aspects vary from country to country.

### **3.7.2 MNCs as Agents of Change**

In today's globalized era, MNCs contribute considerably to industrialization in various economies. As a result, MNCs are effective in rapidly transferring features of one society to another, perhaps a very different society. They are uniquely capable of forcing cultural change. MNCs transmit their home country values in two different ways:

Through the vast network of affiliates, which introduces, demonstrates, and disseminates new behaviors while increasing and shaping the manufacturing sector of host countries, and through the business services structure, including advertising and business education.

**Activity:** According to the Maslow's hierarchy of needs theory, suggest the appropriate level for the following needs.

- At the New Year's party, Jonathan drove in a brand new hybrid car, imported from the US.
- Having gained enough experience working in the cities, Vaishnavi, a doctor, now wants to work in the villages to help the people over there.
- As soon as he shifted to a new house, Karthik joined the local sports and cultural clubs.

**Answer:**

### 3.8 Culture Analysis

In order to understand the cultural environment in the international business scenario, it is vital to analyze the various cultural setups in different countries. Cultural analysis can be based upon any of these three approaches.

- **Ethnocentrism approach:** Companies following this approach adopt a strategy which is more appropriate to the domestic market. They assume that what is good at home would also work the same way in foreign markets.
- **Assimilation approach:** This approach is similar to the ethnocentrism approach. Most companies consider that the US market is a cultural melting pot. They assume that the cultural traits demonstrated in the US market should work everywhere in the world. They believe that if the product or the service clicks in the US market, the same will click in any other part of the world.
- **Primacy of host country approach:** Companies following this approach consider the market composition and base decisions on the cultural traits of the host country. This approach is based on the assumption that the home country's cultural traits are inappropriate for successful operation in markets outside the home country.

The Hall's map of culture teaches us how to understand the different aspects of foreign culture.

#### 3.8.1 Hall's Map of Culture

Hall has devised a two-dimensional matrix containing different human activities, which he calls primary message systems. Ten activities fall under this category. These are --

- **Interaction:** Interaction with the environment through various modes like speech and writing.
- **Association:** Structure and organization of the society and its various components
- **Subsistence:** Activities through which the society satisfies the basic needs of people such as food and water, and the attitude toward such needs.

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- **Bisexuality:** Differences between the roles and functions of men and women.
- **Territoriality:** Ownership, use, and protection of land territory.
- **Temporality:** Division and allocation of time and its use for various activities.
- **Learning:** Pattern of transmitting knowledge.
- **Play:** Process of enjoying through relaxation and recreation.
- **Defense:** Protection against natural and human forces in the environment
- **Exploitation:** Using skills and technology to turn natural resources to people's needs.

According to him, a person interested in the cultural analysis of a particular region need not necessarily study all the ten aspects, but can study any one of them and grasp adequate understanding of the culture. Based on Hall's framework, Robock and Simmond have analyzed the play activities of a toys and games company. The analysis showed that perspectives of play vary from one culture to another. Hall's framework created 18 categories of questions in this case. Some of the questions are -- How do people interact during play as regards competitiveness, instigation, or leadership? (Interaction/Play) What games are played involving acting, role playing, or other aspects of real-world interaction? (Play/Interaction) Who organizes play and how do the organization patterns differ? (Association/Play), etc.

Thus through Hall's map of culture, one can understand the overall nature of a culture by studying one or two primary message systems. Such an analysis works very well in the context of international business because only a particular element of culture related to an international business decision needs to be analyzed.

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### Check Your Progress-3

Indicate your choice of the correct answer from the options given by circling it.

12. Which of the following is a required approach to a company to understand the market composition and decision making about host country cultural habits?
  - a. Cross-cultural
  - b. Assimilation
  - c. Primacy of host country
  - d. Self-reference criteria
13. Which of the following philosophies of approach does work in domestic markets and also in foreign markets
  - a. Assimilation approach
  - b. Ethnocentrism approach
  - c. Primacy of host country approach
  - d. None of the above

14. Which of the following is the proper sequence of needs in Maslow's hierarchy beginning from low to high?
- Physiological – Social – Security – Esteem – Self-actualization
  - Physiological – Security – Esteem – Social – Self-actualization
  - Physiological – Security – Social – Esteem – Self-actualization
  - Physiological – Social – Esteem – Security – Self-actualization
15. The major goal of a subsistence level economy is to meet the \_\_\_\_\_ needs of its people.
- social
  - esteem
  - security
  - physiological
16. Many theories have been propounded on the basis on which cultural transition takes place. One of these propositions is based on Edward Hall's classification of culture that examines all the following aspects of cultural change, **except** the \_\_\_\_\_ aspects.
- formal
  - security
  - informal
  - technical
17. Match the following aspects of cultural change proposed by Hall with their respective description.

Aspect	Description
i. Formal	p. These are transmitted in the form of instruction and have valid reasons underlying them.
ii. Informal	q. These are absolute rights and wrongs in the society.
iii. Technical	r. These are traits that members of the society learn over time.

- i/p, ii/q, iii/r
  - i/r, ii/p, iii/q
  - i/q, ii/r, iii/p
  - i/r, ii/q, iii/p
18. Which one of the following statement is not true relating to formal aspects of cultural changes according to the Hall's classification of culture?
- These are traits that the members learn over time.
  - They are considered absolute rights and wrongs in a society.
  - These are easily prone to change as there is little emotional bondage.
  - These core aspects are very deeply rooted and are totally resistant to change.
- Only i and ii

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- b. Only i and iii
  - c. Only ii and iv
  - d. Only iii and iv
19. Match the following human activities defined according to Hall with their respective descriptions.

Activity	Description
i. Subsistence	p. Division and allocation of time and its use for various activities
ii. Exploitation	q. Perspectives of activities of individuals and groups that deal with livelihood and living
iii. Temporality	r. Using skills and technology to turn natural resources to people's needs.
iv. Defense	s. Structure and organization of the society and its various components
v. Association	t. Protection against natural and human forces in the environment

- a. i/r, ii/s, iii/q, iv/p, v/t
- b. i/q, ii/r, iii/p, iv/t, v/s
- c. i/p, ii/t, iii/r, iv/s, v/q
- d. i/t, ii/q, iii/s, iv/r, v/p

**3.9 Cultural Adaptation**

Cultural adaptation refers to business decision making appropriate to the cultural traits of a society. It involves adapting one's decisions to the local cultural sentiments of the society and ensuring that the native customs, traditions, and taboos offer no constraints to their implementation.

The concept of cultural adaptation is difficult to practice. One major constraint in the process is the tendency to use the Self-Reference Criteria (SRC), which means, whenever people are faced with unique situations, their own values take precedence for their understanding of the circumstances. Cultural analysis of global markets is vital, whether a firm is pursuing a business locally or globally. Companies should be capable of conducting cross-cultural analysis. Such a capability will help companies position themselves in the best competitive place in the marketplace.

**3.9.1 Cross-cultural Analysis**

Cross-cultural analysis is the symbolic comparison of similarities and differences in the material and behavioral aspects of different cultures. It is used by managers to understand the different market segments within and across national boundaries. It helps in determining whether a marketing program can be used in more than one foreign market or must be modified to suit local conditions. This analysis uses methods and approaches used in social sciences

such as anthropology, linguistics, and sociology, and other standard marketing research techniques like multi-attribute and psychographic techniques.

### **3.9.2 Misinterpreting Cross-Cultural Assessments**

While conducting cross-cultural assessments, one serious issue confronting business decisions is cultural bias. Managers should be aware of the influence of their own culture on the interpretation of given events, behaviors, and information. While our past experiences and the way we interpret them are culturally defined, it is still possible to be aware of the influences culture has had in our lives, on our behavior, and on the decisions we make.

### **3.9.3 Sources of Cultural Misinterpretation**

According to Adler, there are three sources of cross-cultural misinterpretation - - subconscious cultural blinders, lack of cultural self-awareness, and projected similarity and parochialism.

#### **Subconscious Cultural Blinders**

These refer to the tendency to subconsciously draw assumptions about events, people, and behavior. It is important to consider this type of misinterpretation while developing advertising material, whether visual or verbal, for example.

#### **Lack of Cultural Self-awareness**

These refer to the awareness of one's own cultural characteristics. Usually, we tend to interpret the actions of others in terms of our own cultural framework. Misunderstandings can arise if we fail to see how others see us, and lack understanding as to how our culture influences our behavior and decisions.

#### **Projected Similarity and Parochialism**

It refers to our tendency to assume that people from other cultures (or situations in other cultures) are similar to people belonging to our own culture.

### **3.9.4 Self-Reference Criteria**

Self-Reference Criteria (SRC) is an unconscious tendency to refer to one's own cultural values when evaluating situations in other cultural environments. According to Lee, it is the root cause of most international business problems. In order to remove errors in judgment or interpretation, a conscious effort has to be made by the managers. Lee proposed four steps for identifying and correcting SRC.

- i. Define the business problem or goal in terms of your own cultural traits, habits, or norms.
- ii. Define the business problem or goal in terms of the foreign cultural traits, habits, or norms. Make no value judgments.
- iii. Isolate the SRC influence in the problem, and examine it carefully to see how it complicates the problem.
- iv. Redefine the problem without the SRC influence, and solve for the optimum business goal situation.

To use this framework to one's advantage, one should have an intimate knowledge of other cultures as well as one's own culture. This cross-cultural

analysis of markets requires cultural empathy or an ability to understand the inner logical buyer behavior in other cultures, and an ability to be non-judgmental about the values underlying buyer behavior in other cultures. The former goal is achievable only as a result of exposure to other cultures, sensitivity training, and a conscious effort to see the world as others see it. The latter goal is achievable after a conscious effort is made to understand one's own culture and to overcome the natural tendency to make judgments based on this culture.

MNC's have to understand the cultural issues in the host countries and fine tune their business accordingly failing which they may suffer immensely.

**Exhibit 3.2**

**The Challenges When Creating Across Cultures**

Diversity in an organization has many positive effects as reported in research conducted by University of Pennsylvania, MIT , HEC Paris and Stanford also conducted similar exercise and the findings are more or less same.

Some benefits

- Diversified cultural background leads to increase in profits of an organization.
- Vast experience of employees adds to the knowledge pool at the workplace.
- Better performance and improved bottom line of the group
- There is no creative nationality but there exists strong cultural values. These values help the organization to realize latent creativity

Challenges: It cannot be achieved easily. There is a substantial cost involved.

- It is a tough job to coordinate with diverse team compared to a homogeneous team.
- Large organizations have to put in place a mechanism to deal with the situation.
- To tap the diversity benefits of the employees, it is crucial that there should be high degree of global fluency to see and understand the perspectives beyond our own.
- Organizations have to understand the cultural bundles (Cultural aspects of creativity) of teams, both in terms of the nationalities and cultures within them.

Only then will the companies reap the dividends that the diverse teams can provide.

Source: <https://www.forbes.com/sites/adigaskell/2020/10/20/the-challenges-when-creating-across-cultures/?sh=78b9d9cf13de> Dated 20.10.2020



**Activity:** Chips International is a US-based potato chips making company. The company was well-known for its good quality, crispy, and flavored chips. The top management of the company decided to foray into India and Japan. The company entered into these markets in 2020. The company felt that using the same flavors used in the US would attract the Indian and the Japanese consumers, and therefore, did not make any changes to the products. What do you call this approach of cultural analysis by the company? How is it different from the other approaches of cultural analysis?

**Answer:**

### 3.10 Cultural Sensitivity of Markets

Markets can be broadly classified into consumer markets and industrial markets. Consumer markets can be further classified into durable goods market and nondurable goods market. Durable goods can be further divided into technological products and non-technological products.

#### 3.10.1 Industrial Markets

Industrial markets consist of industrial buyers. These buyers are generally interested in solving problems that are related to reducing costs, increasing production and administrative efficiency, producing a particular type of product, or achieving a combination of these goals. As most industrial buyers tend to emphasize economic goals, cultural and social considerations play a relatively less significant role in a purchase decision. In terms of a global perspective, there are differences that need to be considered when selecting the products to be marketed and the marketing program to be used. Other variables that might come into the picture are – government regulations, the size and sophistication of the potential buyer's operations, and the context within which the product or service is to be used. All these variables have an impact on the marketing effort of the company.

#### 3.10.2 Consumer Markets

Consumer markets comprise individual buyers who are interested in satisfying a person's need or want. These are more susceptible to cultural and social forces than industrial markets; the purchase of non-durable products such as clothing, food, and cosmetics is driven by numerous socio-cultural factors. But these factors have little effect on the purchase of durable goods such as television sets, radios, and small and large household appliances.

There are exceptions, however, that make the job of an international business manager more interesting and challenging. The purchase of refrigerators, for example, is sensitive to both spatial and social factors such as room size and shopping habits. Europeans tend to live in smaller rooms and hence purchase smaller refrigerators in contrast to Americans. Not only this, they also shop for food more frequently and in smaller amounts than most Americans do. Such

differences occur due to the social functions of meetings friends, non-ownership of automobiles, and inadequate parking facilities. Mexicans, on the other hand, purchase large refrigerators as status symbols and to meet the needs of their large families. It is important for managers to understand the influence of social and cultural factors on buyer behavior.

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**Check Your Progress-4**

Indicate your choice of the correct answer from the options given by circling it.

20. Jiten is a quality control specialist working at AG Motors. He was sent to Japan to attend a training program at the company's headquarters. Jiten had never been to Japan. He had several views about the country and its people. He thought that the food over there was weird and expensive, there would be Japanese signboards everywhere, and people did not know how to speak English. What is the tendency to assume certain things known as?
  - a. Conscious cultural blinders
  - b. Subconscious cultural blinders
  - c. Parochialism
  - d. Self-reference criteria
21. Which of the following refers to an act of making decisions based on the cultural traits of the society?
  - a. Cross-cultural analysis
  - b. Cultural adaptation
  - c. Self-reference criteria
  - d. None of the above
22. What is the tendency that assumes that people from other cultures (or situations in other cultures) are similar to people belonging to our own culture?
  - a. Parochialism
  - b. Comparative similarity
  - c. Maslow's hierarchy of needs
  - d. None of the above
23. What is the unconscious tendency to refer to one's own cultural values when evaluating situation in other cultural environments known as?
  - a. Parochialism
  - b. Cultural adaptation
  - c. Self-reference criteria
  - d. Subconscious cultural blinders
24. What do you call a systematic comparison of similarities and differences in the material and behavioral aspects of different cultures?
  - a. Parochialism
  - b. Cross-cultural analysis
  - c. Hall's map of culture
  - d. Maslow's hierarchy of needs

25. Which of the following statement is true regarding cross-cultural analysis?
- i. It is used by managers to understand the different market segments within and across national boundaries.
  - ii. It helps in determining whether the marketing program can be used in more than one foreign market or must be modified to suit local conditions.
  - iii. It binds an entity (individuals, groups, and organizations) to its cultural assumptions, thus affecting the thinking process of the entity.
  - iv. It gives rise to the tendency to assume that people from other cultures (or situations in other cultures) are similar to people belonging to one's own culture.
- a. Only i and ii
  - b. Only i and iv
  - c. Only ii, iii, and iv
  - d. Only iii and iv
26. Which of the following is not a source of cross-cultural misinterpretation as given by Adler?
- a. Subconscious cultural blinders
  - b. Lack of cultural self-awareness
  - c. Projected similarity
  - d. Needs' hierarchy
27. Which of the following statements is not true regarding cultural adaptation?
- a. It involves business decision making appropriate to the cultural traits of the society.
  - b. The use of self-reference criteria helps in the process of cultural adaptation.
  - c. It is very difficult to practice.
  - d. It involves adapting one's decisions to the local cultural sentiments of a society and ensuring that the native customs, traditions, and taboos offer no constraints to their implementation.
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### 3.11 Summary

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- Culture refers to the set of values, ideas, and attitudes that are accepted by a homogeneous group of people and transmitted to the next generation.
- Three vital characteristics of culture are -- it is learned, it is interrelated, and it is shared.
- The elements of culture are language, aesthetics, religion, and education.
- Culture influences consumption, thinking processes, and communication processes.

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- Many theories have come up on the basis on which cultural transition takes place. One theory has used the Maslow's hierarchy of needs theory as the basis. Another theory is based on Hall's classification of culture. MNCs also act as agents of change.
- Cultural analysis can be based upon any of these three approaches -- ethnocentrism approach, assimilation approach, and primacy of host country approach.
- Cultural adaptation refers to business decision making appropriate to the cultural traits of a society.
- As most industrial buyers tend to emphasize economic goals, cultural and social considerations play a relatively less significant role in purchase decisions. Consumer markets are more susceptible to cultural and social forces than industrial markets.

### 3.12 Glossary

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- **Cross-cultural analysis:** It is the symbolic comparison of similarities and differences in the material and behavioral aspects of different cultures.
- **Cultural adaptation:** It refers to business decision making appropriate to the cultural traits of the society.
- **Culture:** The set of values, ideas, and attitudes that are accepted by a homogeneous group of people and transmitted to the next generation.
- **Diffusion theory of innovation:** An acceptance of a product or idea by consumers over time, linked to a given social structure and a given system of values or culture.
- **Maslow's Hierarchy of Needs theory:** In this theory, Maslow ranked five human needs in increasing order. Starting with the lowest, these needs are -- physiological needs (food, water, shelter); safety needs (protection, security, stability); social need (affection, friendship, acceptance); ego needs (prestige, success, self-esteem); and finally the need for self-actualization (self-fulfillment).
- **Monochronic and polychronic cultures:** Monochronic cultures handle information in a direct, linear fashion. People belonging to polychronic cultures work on several fronts simultaneously instead of pursuing a single task.
- **Self-reference Criteria (SRC):** An unconscious tendency to refer to ones own cultural values when evaluating situations in other cultural environments.
- **Subconscious cultural blinders (source of cultural misinterpretation):** These refer to the tendency to subconsciously draw assumptions about events, people, and behavior.

### 3.13 Self-Assessment Test

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1. Organizations need to be familiar with the cultural traits of the countries they want to do business with. Define culture. Explain its characteristics.
2. Culture can be understood by examining the cultural elements within the country. What are these elements?

3. Culture not only affects the diffusion process in general, but also exerts a great deal of influence on other aspects. Explain this statement.
4. Companies should be aware of culture change as it brings in a variety of possibilities. What factors contribute to changes in culture?
5. To understand the cultural environment in the international business scenario, it is vital to analyze the cultural setups in different countries. How can one analyze the cultures of different countries?
6. Organizations should ensure that their decisions adapt to the cultural sentiments of the societies in which they are operating. Explain the importance of cross-cultural analysis. What are the major constraints in the process?
7. Culture affects purchase decisions in the consumer and industrial markets. Explain this statement.

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### **3.15 Answers to Check Your Progress Questions**

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Following are the answers to the Check Your Progress questions given in the Unit.

**1. (b) Culture**

E. Adamson Hoebel defined culture as, “the integrated sum total of learned behavioral traits that are shared by members of a society.”

**2. (c) Only ii and iii**

Culture is not a collection of integrated random behaviors, but behaviors that are internally related and integrated. It is a learned behavior, and it is not biologically transmitted. It depends on the environment, and not heredity.

**3. (b) Cultures are rarely connected with each other as each culture is very different from other.**

All the statements are true about the characteristics of culture, except (b). Culture is interrelated. One part of the culture is deeply connected with another part such as religion and marriage, and business and social status.

**4. (d) The language used in communication has only the spoken part, which involves communication through vocal sounds and/or written symbols.**

All the statements are true regarding language, except statement (d). The languages used for communication has two parts -- the spoken part and the silent part. Communication through vocal sounds or written symbols forms the spoken part, while silent language refers to the numerous non-verbal communication mechanisms such as gestures, grimaces, body language, eye contact, and conversation distance that people use to get a message.

**5. (c) Written symbols**

The languages used for communication has two parts -- the spoken part and the silent part. Communication through vocal sounds or written symbols forms the spoken part.

**6. (d) Aesthetics**

Aesthetics includes aspects like art, drama, color, music, folklore, and architecture present in a society. This aspect usually captures the ideas and expressions that are inherent in a culture.

**7. (b) Religion**

Language, aesthetics, religion, and education are the elements of a culture. Terpstra and David defined religion as a community's set of beliefs that relate to a reality that cannot be verified empirically.

**8. (d) i, ii, and iii**

Education can be considered as a vehicle to channel culture from one generation to another. There are two facets of education that impact multinationals -- the level and quality of education, and the level of education in comparison with other countries.

**9. (b) Monochronic**

Edward Hall, an anthropologist, identified cultures to be monochronic or polychronic. Some cultures handle information in a direct, linear fashion and are thus monochronic in nature. Other cultures are relatively polychronic as people work on several fronts simultaneously instead of pursuing a single task.

**10. (d) Diffusion theory of innovation**

The diffusion theory of innovation refers to an acceptance of a product or idea by consumers over time, linked to a given social structure and a given system of values or culture. The diffusion process varies from culture to culture. While some cultures are very conservative, others demand innovativeness from the employees in every aspect of their business.

**11. (b) Information contained is mostly in explicit codes, such as words**

A high-context culture uses high-context communication, i.e., information that is either in the physical context or internalized in the person, with little being communicated in the explicit words or message. A low context culture employs low-context communication, in which most information is contained in explicit codes, such as words.

**12. (c) Primacy of host country**

Companies following the primacy of host country approach consider the market composition and base decisions on the cultural traits of the host country. This approach is based on the assumption that the home country's cultural traits are inappropriate for successful operation in markets outside the home country.

**13. (b) Ethnocentrism approach**

Companies following the ethnocentrism approach adopt a strategy which is more appropriate to the domestic market. They assume that what is good at home would also work the same way in foreign markets.

**14. (c) Physiological – Security – Social – Esteem – Self-actualization**

Maslow in his theory of hierarchy of needs ranked five human needs in increasing order. Starting with the lowest, these needs are -- physiological needs (food, water, shelter); safety needs (protection, security, stability); social needs (affection, friendship, acceptance); ego needs (prestige, success, self-esteem); and the need for self-actualization (self-fulfillment).

**15. (d) physiological**

A subsistence level economy's major goal is to fulfill the basic physiological needs of its people. As it grows by achieving its basic needs, new needs take precedence.

**16. (b) Security**

The Hall's classification of culture examines the formal, informal, and technical aspects of cultural change.

**17. (c) i/q, ii/r, iii/p**

The formal aspects are the core cultural aspects of an economy. They are considered absolute right and wrongs in a society. Informal aspects refer to traits that the members of the society learn over time. These are also common norms that everyone is supposed to be aware of. Technical aspects are transmitted in the form of instruction and have valid reasons underlying them. As there is little emotional bondage to this aspect, it is easily prone to change.

**18. (b) Only i and iii**

Statements ii and iv are true regarding the formal aspects of cultural change based on the Hall's classification of culture. Statements i and iii are false. Statement i refers to informal aspects, while statement iii refers to technical aspects.

**19. (b) i/q, ii/r, iii/p, iv/t, v/s**

Hall has devised a two-dimensional matrix containing 10 different human activities, which he calls primary message systems. The other five activities are -- learning (pattern of transmitting knowledge); play (process of enjoying through relaxation and recreation); interaction (interaction with the environment through various modes like speech and writing); bisexuality (differences between the roles and functions of men and women), and territoriality (ownership, use, and protection of land territory).

**20. (b) Subconscious cultural blinders**

Subconscious cultural blinders refer to the tendency to subconsciously draw assumptions about events, people, and behavior. It is important to consider this type of misinterpretation while developing advertising material, whether visual or verbal. In the given situation, Jiten has certain misconceptions about Japan and its people. These are in reality not true.

**21. (b) Cultural adaptation**

Cultural adaptation refers to business decision making appropriate to the cultural traits of the society. It involves adapting one's decisions to the local cultural sentiments of the society and to ensure that the native customs, traditions, and taboos offer no constraints to their implementation.



**22. (a) Parochialism**

Projected similarity or parochialism refers to the tendency to assume that people from other cultures (or situations in other cultures) are similar to people belonging to one's own culture.

**23. (c) Self-reference criteria**

Self-Reference Criteria (SRC) refers to an unconscious tendency to refer to one's own cultural values when evaluating situations in other cultural environments. Culture affects the thinking processes of individuals, groups, and organizations due to the Self-Reference Criteria (SRC) that binds an individual to his/her cultural assumptions.

**24. (b) Cross-cultural analysis**

Cross-cultural analysis is the symbolic comparison of similarities and differences in the material and behavioral aspects of different cultures. It is used by managers to understand the different market segments within and across national boundaries.

**25. (a) Only i and ii**

Statements i and ii are true, while statements iii and iv are false. Statement iii refers to self-reference criteria, while statement iv refers to projected similarity and parochialism.

**26. (d) Needs' hierarchy**

According to Adler, there are three sources of cross-cultural misinterpretation -- subconscious cultural blinders, lack of cultural self-awareness, and projected similarity and parochialism. The hierarchy of needs theory was proposed by Maslow. It is one of the theories on the basis of which cultural transition takes place. One such proposition is based on Maslow's hierarchy of needs theory.

**27. (b) The use of self-reference criteria helps in the process of cultural adaptation.**

All the statements given above are true regarding cultural adaptation, except statement (b). The concept of cultural adaptation is difficult to practice. One major constraint in the process is the tendency to use the Self-Reference Criteria (SRC), which means, whenever people are faced with unique situations, their own values take precedence for their understanding of the circumstances.

## Unit 4

### Political Environment

#### Structure

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- 4.1 Introduction
- 4.2 Objectives
- 4.3 Types of Government
- 4.4 Multiplicity of Political Environments
- 4.5 Factors Contributing to Political Instability
- 4.6 Political Risk
- 4.7 Interface of Politics with Business
- 4.8 Impact of International Political Environment on Domestic Business
- 4.9 Summary
- 4.10 Glossary
- 4.11 Self-Assessment Test
- 4.12 Suggested Readings / Reference Material
- 4.13 Answers to Check Your Progress Questions

#### 4.1 Introduction

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In the previous unit, we discussed the cultural environment of business. In this unit, we will cover the political environment of business. The term political environment includes diverse happenings such as civil difficulties, acts of terrorism against businesses, and conflicts between countries in a particular region, which may be onetime occurrences like the war between India and China or perennial problems like the enmity between Israel and its Arab neighbors.

The political environment forms one of the most important facets of the business environment for any business today, since business is influenced by the political happenings within the country and internationally. A significantly rich foreign market may not warrant entry if the political environment is characterized by instability and uncertainty. Therefore, today's organizations rely on a thorough review of the political environment before committing themselves to a new market in a foreign country. The political environment of a country does not remain static; political changes and upheavals may occur at any point of time after an international marketer has made a commitment and has established his/her business.

Political stability has been found to be one of the most crucial variables that companies consider when planning overseas ventures. Unstable political activity subjects foreign businesses to risks such as violence, expropriation, restriction of operations, and restrictions on repatriation of capital and remittances of profits.

This unit will discuss the types of governments, the multiplicity of political environment, and the factors contributing to political instability. We will then move on to discuss political risk and the political risk considerations in emerging markets. Finally, we will discuss the interface of politics with business, and the impact of the international political environment on domestic business.

## **4.2 Objectives**

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By the end of this unit, you should be able to:

- Classify the various types of governments
- Recognize the multiplicity of political environments
- Identify the factors contributing to political instability
- Define political risk
- Assess the political risk considerations in emerging markets
- Explain the interface of politics with business
- Recognize the impact of the international political environment on domestic business

## **4.3 Types of Government**

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Governments are generally classified on the basis of political systems or economic systems. Refer to Figure 4.1 for the classification of governments.

### **4.3.1 Political Systems**

Knowledge of the different forms of government can help one evaluate political climates. The different forms of government can be classified as either parliamentary (open) or absolutist (closed). Parliamentary governments consult citizens from time to time to learn their opinions and preferences. The policies of such governments reflect the desires of the majority of members of the society. Absolutist governments include monarchies and dictatorships, where the ruling regime dictates government policies without considering the needs or opinions of the citizens. These are found in newly formed nations or those undergoing some kind of political transition. Such governments are relatively rare now.

The political systems of different countries do not fall neatly into one of these two categories. The UK is a good example of a constitutional hereditary monarchy; despite the monarch, the government is classified as parliamentary. Some monarchies and dictatorships have parliamentary elections. The former Soviet Union for example was not classified as parliamentary voting, because the ruling party never allowed an alternative on the ballot.

One of the important forms of political systems is the democracy.

### **Democracy**

Democracy is a political system in which the supreme power is vested in the hands of the people. It is thus a political system with institutions which allows the citizens to express their political preferences. It ensures security to citizens by allowing them to participate in decision-making. It is widely prevalent in most countries of the world. The culmination of World War I led to the birth of many democracies. But many countries of Europe, Latin America and Asia

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such as Germany, Spain, Italy, Cuba, Japan etc., shifted back to autocratic rules. It is after World War II that the number of democracies started growing. Democratic governments are prevalent in several countries like India, USA, Canada, UK etc.

### ***Types of Democracies:***

There are two types of democracies –

**1. *Direct or Pure Democracies*** – In this form of democracy, citizens get the opportunity to participate in the decision-making process, without any intermediary. For example, Switzerland follows a direct democracy. Direct democracy in Switzerland allows its electorate to express their opinion on decisions taken by Federal Parliament and to propose amendments to Federal Constitution. On an average, the Swiss electorate are called on at least four times a year to exercise this right. In addition, Swiss electorate can voice their opinion through three instruments of direct democracy, which are (forms of referendums) –

- **Mandatory Referendum** – Constitutional amendments approved by Parliament are subject to this form of referendum
- **Optional Referendum** – Used for voicing opinion on any bill approved by Federal Assembly
- **Popular Initiative** – Gives right to citizens to propose any amendment or addition to Constitution.

**2. *Representative Democracies*** – The pure form of democracy may not be workable owing to the complexities involved especially in large countries. As such most democracies are representative democracies. In these democracies, citizens participate in decision-making, through their elected representatives.

Based on the allocation of power and authority to the representatives, democracies are also classified as Presidential and Parliamentary form of democracies.

- ***Presidential Form of Democracy*** – Under this form of democratic government, the President (Head of the Government) of the State, is directly/indirectly elected by citizens of the State. All powers are vested in the hands of the executive head, the President. In this system, all three branches – the executive, legislature and the judiciary are constitutionally independent and no branch can dismiss or dissolve any other. However, each branch of the government checks on the other two so that a system of checks and balances exist.

Presidential form of governments can be full presidential systems and semi-presidential systems. In full presidential systems, the President is the Head of the State and Government. For example, USA, Congo, Brazil and Argentina have this form of government. Under semi-presidential systems, there is a President and a Prime Minister with President having executive authority. Examples of this form of system are: Egypt, France etc.

➤ ***The American Form of Presidential Government:***

The United States of America, the largest economy in the world with a GDP of US\$ 21,482.41 billion in 2019 functions through the Presidential form of government.

The US Government functions through its three branches – the legislature, executive and judiciary. The legislature, referred to as, the Congress, is comprised the House of Representatives and the Senate. The legislature makes laws. The executive comprises the President, Vice President, Cabinet and most federal agencies. The executive enforces the laws. The judiciary consisting of Supreme Court and other Courts evaluates the enforcement of laws.

- ***Parliamentary Form of Democracy*** – Under this form of democratic government, the legislature consisting of elected representatives of the citizens enjoys considerable power. The elected legislature chooses the Head of the Government, who functions in the capacity of the Prime Minister. The Head of the State (President) is different from the Head of the Government (Prime Minister) and both have varying degrees of power. Parliamentary form of government exists in India, Hungary, and Bangladesh etc.

➤ ***People's Republic of China (PRC):***

The People's Republic of China is the world's most populated country and 2nd largest economy in the world with a GDP of US\$ 14,172.20 billion in the year 2019. China's Constitution states that the PRC is a socialist state under the people's democratic dictatorship led by the working class and based on the alliance of the workers and peasants. The state organs apply the principle of democratic centralism. The primary organs of power are: the National People's Congress (China's Parliament), the President and the State Council. The NPC is made up of nearly 3,000 delegates elected by China's provinces, autonomous regions, municipalities and the armed forces. The President is Head of State, elected by the National People's Congress. The State council consists of Premier, four Vice Premiers, five State Councilors, the Secretary General and ministers and other Cabinet level department heads.

**Classification of Political Systems on the Basis of Number of Parties:**

Governments can also be classified on the basis of the number of political parties that are represented in it, as two-party, multiparty, single-party, and one party dominant systems.

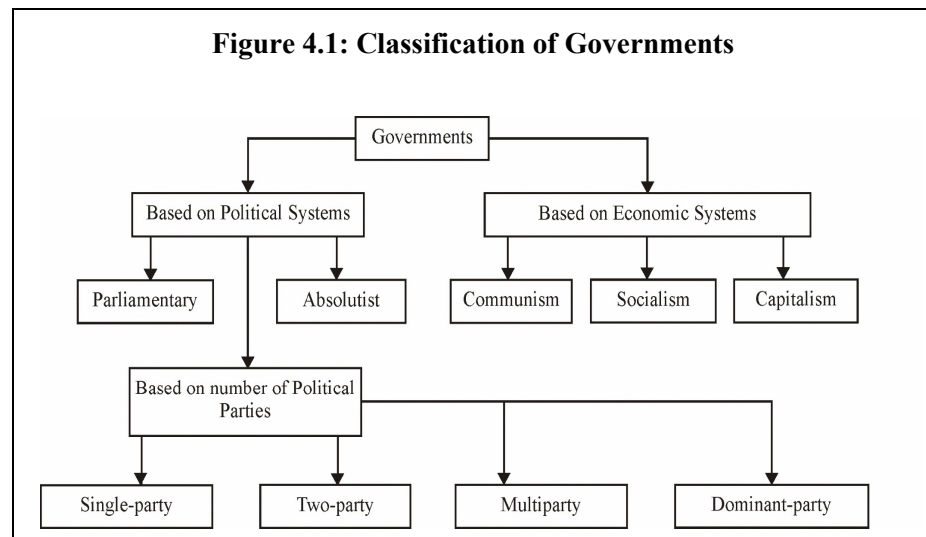
**Two-party system:** In this, there are typically two strong parties that take turns controlling the government, though there may be several other parties. The two parties are generally governed by different philosophies, which results in a change in the government policy when one party succeeds the other. The UK, Japan, and Sri Lanka have a two-party system of government.

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**Multiparty system:** In this form of government, there are some large parties, but these are unable to form the government because they fall short of the required majority. In such cases, the government is formed through coalitions between the various parties, each one of which wants to protect its own interests. The longevity of the coalition depends largely on the cooperation of the party partners. A change in a few votes may bring down the coalition government. If the government does not survive a vote of no confidence (i.e., does not have the support of the majority of the representatives), the government is disbanded and a new election is called. India, Germany, France, and Israel have a multiparty system of government.

**Single-party system:** In this system, only one political party is legally allowed to form the government. Opposition to the ruling party in any form is banned by law. Countries like Cuba and Vietnam have single-party systems.

**Dominant-party system (or one party dominant system):** In this, only one political party can become the ruling government. This is because the party is so strong that it becomes dominant within the political structure of the country. The other parties are allowed to operate freely, but are weak or ineffective to challenge the power of the dominant party. In Britain, the Conservative party was the dominant party for a period of 18 years (1979-1997) under the leadership of Margaret Thatcher and John Major. Countries like Egypt, Malaysia, Singapore, and Zimbabwe have a dominant-party system of government.



Source: ICMR.

### 4.3.2 Economic Systems

This system of classification is concerned with business ownership -- whether businesses are privately owned, or government owned, or whether there is a combination of private and government ownership. The economic system can be further subdivided into three types – communism, socialism, and capitalism. Based on the government's control over business activity, the various economic systems can be placed along a continuum, with communism at one extreme and capitalism at the other. The transition from communism to capitalism is accompanied by a decrease in government interference and lower control over

the factors of production. No nation operates under pure communism or pure capitalism. Most countries find it necessary to make some compromise between the two extremes.

The communist philosophy holds that all resources should be owned and shared by all people (i.e., not for profit seeking enterprises) for the benefit of society. The degree of government control that occurs under socialism is somewhat less than under communism. A socialist government owns and operates the basic, major industries, but allows private ownership of small businesses. The degree of control exercised by a socialist government can vary. The philosophy of capitalism provides for a freemarket system that allows business competition and freedom of choice for both consumers and companies. It is a market-oriented system in which individuals, motivated by private gains, are allowed to produce goods or services for public consumption under competitive conditions. The results include diverse products, product quality, efficiency, and relatively lower product prices.

**Activity:** Identify the types of governments in the following countries both in terms of the political systems as well as in terms of the economic systems.

- a. India
- b. People's Republic of China
- c. United States of America
- d. United Kingdom

**Answer:**

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### **Check Your Progress - 1**

Indicate your choice of the correct answer from the options given by circling it.

1. The single-party system of government is classified based on \_\_\_\_\_ form of government classification.
  - a. Political system
  - b. Economic system
  - c. Parliamentary system
  - d. All the above
2. Identify the types of political systems, where only one political party is legally allowed to form the government, and opposition to the ruling party in any form is banned by law.
  - a. Two-party system
  - b. Multiparty system
  - c. Single-party system
  - d. Dominant-party system

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3. Which of the following statement is not true regarding the dominant party political systems?
  - a. Only one political party can become the ruling government.
  - b. Opposition to the ruling party in any form by the other parties is banned by law.
  - c. The ruling party is very strong that it becomes dominant within the political structure of the country.
  - d. There are other parties, which are allowed to operate freely, but are weak or ineffective to challenge the power of the dominant party.
4. What form of government includes monarchies and dictatorships, where the ruling regime dictates government policies without considering needs or opinions of the citizens?
  - a. Single-party
  - b. Absolutist
  - c. Communist
  - d. Capitalist
5. The \_\_\_\_\_ government philosophy holds that all resources should be owned and shared by all people for the benefit of society.
  - a. Absolutist
  - b. Capitalist
  - c. Socialist
  - d. Communist
6. What form of government consults citizens from time to time for the purpose of learning their opinions and preference?
  - a. Capitalist
  - b. Communist
  - c. Socialist
  - d. Parliamentary
7. Which of the following is a socialist form of government?
  - a. The government form that owns and operates the basic, major industries but allows private ownership of small business.
  - b. The degree of government control that occurs under communism is comparatively less than the same under socialism.
  - c. The resources are owned and shared by all people (i.e., not for profit seeking enterprises) for the benefit of society.
  - d. In this, the individuals, motivated by private gains, are allowed to produce goods or services for public consumption under competitive conditions.
8. Which government philosophy provides for a free market system that allows business competition and freedom of choice for both consumers and companies?
  - a. Parliamentary



- b. Communist
- c. Absolutist
- d. Capitalist

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#### 4.4 Multiplicity of Political Environments

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Today, businesses have to face a complex political environment, mainly because they have to cope with the political situation in more than one nation. This complexity has forced MNCs to consider the political environment from different angles like foreign politics, domestic politics, and international politics.

##### 4.4.1 Foreign Politics

Foreign politics refers to the politics that are associated with the host country. The association in this form of politics might range from being favorable and friendly to being hostile and dangerous. The political and economic circumstances in the host country will determine the kind of political climate a company may face when doing business in that country.

A government supports or discourages foreign investment, considering the balance of payments (BOP), economic development, and political realities. The host government may view imports negatively because they adversely affect the host country's balance of payments. This is generally true in the case of import of luxury and nonessential products, especially when those items can be or are already produced locally. The government may also favor policies that improve the country's exports and encourage investment in industries that stimulate employment. Similarly, foreign ownership of vital or sensitive businesses may be prohibited considering national interests.

The host country may be for or against foreign firms. To win foreign capital and new technology, the host country may promise cooperation, and provide various tax and financial incentives. On the other hand, it may criticize the foreign firms for making excessive profits and draining the nation of its wealth. Further, it may also restrict the repatriation of profits to corporate headquarters abroad.

##### 4.4.2 Domestic Politics

Domestic politics refers to the politics that exist in the company's home country, also known as the parent or source country. These politics are usually thought as causing minimal problems. This is not true. Apart from dealing with political problems overseas, companies should pay close attention to political developments at home.

Labor and political organizations criticize a local company's international activities by accusing it of exporting capital and jobs. At times, this opposition is based on moral principles. The government, instead of providing support, can become a hindrance in international trade. For instance, it may impose regulations that interfere with the free flow of trade. This action may be motivated more by political considerations rather than by sound economic reasoning. Also, when national interests are at stake, a government may use certain companies as instruments to achieve its political goals.

#### **4.4.3 International Politics**

International politics refers to the interaction of the overall political environment factors of two or more countries. The environment becomes highly complex when the interest of the company, host country, and the home country do not coincide. And, sometimes, the problems cannot be solved.

The example of impact of business due to political change in Myanmar is discussed in the exhibit 4.1 hereunder.

##### **Exhibit 4.1**

##### **Myanmar coup: Beer giant Kirin pulls out of partnership**

The coup in Myanmar by the military Junta has created political upheaval and has impacted the operations of MNCs in that country. Companies from Japan to Thailand are eager to leave the troubled country due to widening business fallout and uncertain future. Companies which manufacture Beer to Gamming firms such as Kirin and Razer Inc., who have invested in Myanmar are closing their shops and all due to the adverse political situation and the impact of a military coup. Further many multinationals have delayed further investment plans in Myanmar.

The story is about Japanese Beer giant Kirin which has set up a joint venture with Myanmar Economic Holdings controlled by the Military Junta. Further the company is an equal partner with investments in equity of over 50 % in Myanmar Brewery and Mandalay Brewery and the balance equity is held by Myanmar Economic Holdings (MEH). The company has finally taken a call and is leaving the partnership with MEH once for all due to political turmoil.

Kirin is one of the world's biggest brewing companies. The company owns top brands such as Kirin and Toohey's. The company has major investment in San Miguel and a number of breweries in the UK and US.

The company entered into partnership with MEH in 2015 after the democratic election at Myanmar took place.

The action of the Junta is likely to have major economic upheaval in Myanmar. An investigation by the UN agency has brought out certain information that has led to the culmination of companies leaving Myanmar. The UN agency has clearly stated that MEH has strong links to its military and has a significant portfolio across many industries including banking, tourism, real estate, transportation, gems and metals.

Human rights group Justice for Myanmar are of the firm view that the funds generated through Kirin's joint venture is used to fund the military's ongoing war crimes against humanity. Other companies are also under pressure from Human rights group justice for Myanmar to leave the country, especially foreign oil and gas companies.

*Source: <https://www.bbc.com/news/business-55944643>, Dated 5th February 2021*

#### **4.5 Factors Contributing to Political Instability**

It is vital to identify and evaluate the relevant factors contributing to political instability in order to assess a company's potential political environment. The potential sources of political complications include social unrest, the attitudes of nationals, and the policies of the host government.

#### 4.5.1 Social Unrest

Social disorder is caused by underlying conditions as economic hardship, internal discord and revolt, and ideological, religious, racial, and cultural differences. These cause social unrest, adversely affecting the companies which get involved in the process.

#### 4.5.2 Attitude of Nationals

The government and the attitudes of the citizens of the host country should be investigated to assess how hospitable they can be to foreign enterprises and citizens. Citizens of the host country are often concerned about the intentions of the foreign enterprises and citizens with regard to exploitation and colonialism. These concerns are often linked to the foreign government's actions in the past that may be seen as being improper. Such inherent hostility will lead to major problems because of their relative permanence. The governments may change, but citizen's hostility may remain the same.

#### 4.5.3 Policies of the Host Government

The host government's attitude toward foreigners may be short lived. This attitude may change with time or change in leadership, and this change could be either for better or worse. Government policy formulation can affect business operations in two ways -- internally and externally. The effect is internal when the policy regulates the firm's operations within the home country. It is external when the policy regulates the firm's activities in another country. The external government policy does not affect those firms doing business only in one country, but such a policy can create complex problems for firms doing business in countries that are in conflict with each other.

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#### **Check Your Progress 2**

Indicate your choice of the correct answer from the options given by circling it.

9. Identify the factor(s) which can contribute to political instability in a country where a foreign company is operating.
  - i. Social unrest
  - ii. Policies of the host government
  - iii. Attitudes of the nationals
  - a. Only i
  - b. Only i and ii
  - c. Only ii and iii
  - d. i, ii, and iii
10. Which of the following statements is **true** regarding domestic politics?
  - a. It refers to the politics that exist in the company's home country.
  - b. These politics do not cause any trouble to the local companies.
  - c. Governments of home countries always lend complete support to local companies.
  - d. Governments of home countries never use local companies to achieve their political goals.

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11. Which of the following parties are involved or get affected due to international politics?
    - a. Company
    - b. Host country governments
    - c. Home country governments
    - d. All of the above
- 

### **4.6 Political Risk**

Political risk refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government. It also includes any action by the government that differentiates between foreign and domestic firms. Political risk is distinct from terrorism and credit risks arising from international operations. However, risk that arises due to restrictions on currency convertibility is classified as political risk.

#### **4.6.1 Elements of Political Risk**

Political risk may arise due to one or more of the following elements. Firms should look for ways to manage their political risk.

##### **Confiscation, Expropriation and Nationalization**

These are the most severe government actions against foreign firms. Confiscation occurs when a government takes ownership of a property without providing compensation. Expropriation is similar to confiscation but differs with regard to compensation. In expropriation, there will be some compensation, though not necessarily adequate. Usually a company whose property is being expropriated agrees to sell its operations not because it has a choice, but because of some coercion. This sale is made to the government or a nominee of the government, by order. Under nationalization, an entire industry within a country is transferred from private ownership to public, with no discrimination as to foreign or local ownership. When firms are nationalized, the compensation provided by the government does not adequately reflect the going-concern value of the firm. After a property has been confiscated or expropriated, it can either be nationalized or domesticated.

##### **Contract Repudiation and Frustration**

Firms engaged in building infrastructure projects (turnkey facilities) and those which are in joint ventures with a government sometimes enter into disputes with the host country government, often on matters of payment. The government may repudiate a contract because of financial reasons; real or imagined non-performance; or failure to fulfill the contract due to conditions beyond the firm's control. Most times, payment will be made up to the point of the dispute.

##### **Unfair Regulatory Environment**

Foreign firms are discriminated against in many ways such as discriminatory capital requirements; differing tax structures; and limitations on access to necessary materials, components, or distribution systems. An advantage for foreign firms in recent years has been the right to bid on host government

contracts. However this again can be a reason for discomfort for the firm within the host country.

### **Restrictions on Currency Convertibility**

Currency convertibility has grown with a growth in the world trade. Some governments believe that convertibility regulation and the rate at which currency is converted are important economic tools. In order to preserve foreign exchange reserves, some governments either do not allow foreign firms to repatriate profits to their home countries or force them to convert currency at rates less than the market rate.

### **War risk**

A foreign firm's assets are potentially at risk at the advent of war, either civil or against another country. War refers to hostile contention by means of armed forces carried out between nations or factions. It includes civil war and armed insurrection. The question here is, when does civil commotion become civil war? In most countries, unions are political parties, or at least they are politically active in some way or the other. Though violent strikes may occur, injuries and damages that result from them are generally not thought of as political risk. The term insurrection, commonly referred to an uprising, may also refer to any resistance to the lawful authority of the state.

### **4.6.2 Analysis of Political or Country Risk**

Various methods have evolved to measure, analyze, and predict potential political risks. Simon provides a good overview of the political risk assessment in terms of definition, approach, database, and variables. He classified the variables for assessing political risk along several dimensions -- societal-related, government related, external or internal, based on the origin of risk, based on whether they are macro or micro, or based on whether government actions are directed at all foreign firms or only selected industries in the host country.

The level of economic development and the type of political systems can be used as additional variables for assessing political risks. According to the level of economic development, countries may be either industrialized or developing, having either open or closed political systems. A society is termed as open when people voice their approval or discontent in the form of voting, protests, or boycotts. In closed societies, the government does not encourage these forms of expression publicly, and the repression of the people can lead to violent encounters.

Douglas and Craig proposed another model which comprises four distinct, vital dimensions for the assessment of political risk. These dimensions could be objectively measured, and had some indicators or variables associated with each of them. They are domestic stability (riots, purges, assassinations); foreign conflict (diplomatic expulsions, military violence); political climate (size of the country's communist party, number of socialist seats in the legislature); and economic climate (gross national product, inflation, external debt levels, and frustration levels).

Small and medium-sized firms might not be in a position to do a country-risk analysis due to factors such as cost, and lack of expertise and resources required. However, there are ways to do so. One way is to interview people who have

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some knowledge or experience with the countries of interest including business persons, bankers, and government officials. Another alternative is to subscribe to reports prepared by an organization that has studied the country's risks. However, this form of risk analysis is not entirely reliable.

Another relatively simple method for evaluating political risk is based on the LIBOR (London Interbank Offer Rate). The LIBOR rate is the interest rate charged between banks and is relatively risk free. Non-bank borrowers have to pay a premium over LIBOR, where the premium (i.e., the spread between the loan rate and LIBOR) indicates the extent of risk involved. A borrower has to pay a high premium, if he/she is from a country with a high risk of default. Thus, the premium is a good indicator of risk as it reflects a lender's assessment of the country in terms of debt levels and payment records, after adjusting for volume and maturity.

**Activity:** Delta Limited is a Finland-based furniture manufacturing company, well known for its innovatively designed and good quality furniture. The company forayed into Asia by setting up an outlet in an Asian country. The company's products were unique, which attracted the country's consumers. The company started earning profits. It also expanded its presence by setting up several outlets in the other provinces of the country. In 2020, the country's government ordered the company to sell off its local operations, and quit the country. The company negotiated with the government several times regarding the issue, but failed. Ultimately, the company sold off its operations to a local manufacturer for a very low price. What kind of a political risk brought the company to this situation?

**Answer:**

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### Check Your Progress - 3

Indicate your choice of the correct answer from the options given by circling it.

12. Which of the following statements best defines political risk?
  - a. Official seizure of foreign property by a host country whose intention is to use the seized property in the public interest.
  - b. It refers to any government action that diminishes the value of a firm's operations with the political boundaries or influence of that government.
  - c. A process by which controls and restrictions placed on the foreign firms to gradually reduce the control of the owners.
  - d. Any resistance to the lawful authority of the state.
13. Which of the following is not an element of political risk?
  - a. War risk
  - b. Contract repudiation
  - c. Fair regulatory environment
  - d. Restrictions on currency convertibility

14. When government takes ownership of a firm's property without providing compensation, it results in \_\_\_\_\_.
  - a. Confiscation
  - b. Expropriation
  - c. Domestication
  - d. Cancellation
15. In which of the following processes is an entire industry within a country transferred from private to public ownership, with no discrimination as to foreign or local ownership?
  - a. Nationalization
  - b. Unforeseen takeover
  - c. Domestication
  - d. Expropriation
16. Which of the following is not a feature of an open political system?
  - a. Protests
  - b. Voting
  - c. Boycotts
  - d. Repression
17. All the statements given below were true regarding LIBOR (London Interbank Offer Rate), **except**:
  - a. It is a simple method for evaluating political risk.
  - b. It is the interest rate charged between banks.
  - c. A borrower pays a low premium over the LIBOR, if he/she is from a country with a high risk of default.
  - d. The premium in LIBOR is a good indicator of risk as it reflects a lender's assessment of the country in terms of debt levels and payment records, after adjusting for volume and maturity.

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#### 4.6.3 The Management of Political Risk

There are two important stages in the management of political risk -- identification and measurement.

##### Identification

As political risk results from potential governmental action that reduces the firm's value, the risk manager should familiarize himself/herself with the host-country's government. The study, with respect to the host government, should include its history, how it came to power, how power was transferred, who are the participants in the political process (are large groups disenfranchised?), and the organization of the political structure (what are the powerful ministries or agencies? who are the influential political leaders?).

A major portion of this analysis is available through a variety of media including the Internet. The risk manager should be careful about the fact that political analysts can and do disagree. The risk manager should go in for internal analysis after gathering as much publicly available information as possible. There are

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three sources from which the risk manager should gather information before conducting an internal analysis -- international managers located at headquarters; field managers on assignment in foreign affiliates; and information specialists assigned to monitor political activity from the firm's headquarters.

A major source of concern is the information regarding political subdivisions within the country, such as the provincial, state, or city governments. These smaller entities may also offer economic inducements or tax incentives which, if withdrawn, could have significant financial consequences.

### **Measurement**

Many organizations, private as well as government, offer political risk assessment in various forms. In developed economies, political polling, market research, and attitude surveys are used to examine the preferences and feelings of consumers toward political parties. But developing countries are relatively less open to analysis. In these countries, information is not only scarce but also confusing as economies undergo rapid political and economic changes.

Embassies of most countries regularly file reports with their state departments or other national agencies or ministers. Also, most governments maintain a "Country Desk" within their state department or other agency or ministry, wherein country-specific information is available to national firms and citizens.

A company should not only collect information from various sources, but it should also assess the impact of political risk with respect to a particular company or industry, as events which matter very little to one company may mean the very existence to another.

The most difficult task in political risk analysis is predicting the timing of events. It may be relatively easy to predict that a particular disenfranchised group will attempt to seize power in the future, but the means and the time of the seizure may not be known even to the group itself.

### **4.6.4 Measures to Minimize Political Risk**

Political risk cannot be eliminated, but it can be minimized. Given below are some of the measures that a company can take to discourage a host country from taking control of its assets.

#### **Stimulating the local economy**

This is a defensive investment strategy in which a company links its business activities to the host country's national economic interests. There are a number of different ways in which the local economy can be stimulated. One strategy might be the purchase of local products and raw materials by the company for its production and operations. By assisting the local firms, the company can develop local allies who can provide valuable political contacts in time of need.

Sometimes local sourcing is compulsory. Some governments may require products to contain locally manufactured components because local content improves the economy in two ways -- it stimulates demand for domestic components and it obviates the need for a foreign exchange transaction. The company can also assist the host country by being export-oriented.



### **Employment of Nationals**

Companies try to minimize their political risk by hiring local workers into their workforce. Automation is not encouraged in some countries (where there is cheap labor and high unemployment) as it leads to job losses or job elimination. In such countries, opting for automation would be a serious mistake.

### **Sharing Ownership**

Firms can tackle political risk by sharing ownership with others, especially local companies. This can be done by converting from a private to a local company, and by converting from a foreign company to a local one. Another common technique for sharing ownership is to enter into a joint venture, a loss in control is compensated by some benefits. Joint ventures in international business not only help in reducing exposure, but also make it difficult for the host government to takeover without offending a number of nations all at once. Alternatively, firms can also opt for domestication. That is, the foreign companies can reduce their holdings in the local companies if the host government places any such restrictions.

### **Being Civic Minded**

A company, apart from doing business in a foreign country, should strive to be a good corporate citizen. This can be done by making small investments in civic projects. This may prove to be costly initially, but can help the company earn goodwill in the long run. MNCs can help in building schools, hospitals, roads, and water systems as these projects benefit the host country as well as the company.

### **Political Neutrality**

Companies should primarily focus on economic development. They should keep a low profile and avoid political disputes among local groups or between countries.

### **Behind-the-scenes Lobbying**

Political risk can be managed in a civilized manner through lobbying. At times, lobbying quietly behind the scenes could become necessary. Lobbying is not necessarily carried out in the home country alone; such kind of activity can also be done in the host country, either by the concerned company or by the government. However, it should be conducted in such a way that it attracts the least political clamor.

### **Observation of Political Mood and Reduction of Exposure**

Companies can reduce their exposure to political risk by making right decisions at the right time. They should always watch for changes in political situation, and keep a contingency plan ready for when the political situation turns hostile.

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### **Check Your Progress - 4**

Indicate your choice of the correct answer from the options given by circling it.

18. Which of the following is a measure used by firms to minimize political risk in which the company would primarily focus on economic

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- development and avoid political disputes among local groups or between countries?
- Sharing ownership
  - Being civic minded
  - Political neutrality
  - Simulation of the local economy
19. Which of the following measures does not help a foreign firm to discourage a host country from taking control of its assets?
- By lobbying
  - By sharing ownership
  - By being politically neutral
  - By employing people only from its home country
20. Which of the following is the source of information that the risk managers can use to conduct an internal analysis?
- International managers located at the company headquarters
  - Field managers on assignment in foreign affiliates
  - Information specialists assigned to monitor political activity from the firm's headquarters
- Only i and ii
  - Only i and iii
  - Only ii and iii
  - i, ii, and iii

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### 4.7 Interface of Politics with Business

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Though overseas markets may offer substantial opportunities for business, these opportunities are coupled with risks of intervention by the host governments. Today nations consist of different groups, each of which seeks to maximize their individual interests. In countries where foreign investments play a significant role in shaping the economy, the goals of special interest groups frequently necessitate interference in the operation of foreign firms. Political intervention can be defined as a decision on the part of the host country government that may force a change in the operations, policies, and strategies of a foreign firm. This intervention may range from some sort of control to complete takeover or annexation of the foreign enterprise. There are different forms of intervention like expropriation, domestication, exchange control, import restrictions, market control, tax control, price control, and labor problems.

#### 4.7.1 Expropriation

Eiteman and Storehill defined expropriation as, “official seizure of foreign property by a host country whose intention is to use the seized property in the public interest. Expropriation is recognized by international law as the right of sovereign states, provided the expropriated firms are given prompt compensation, at fair market value, in convertible currencies.”

Other terms used interchangeably with expropriation are nationalization and socialization. Nationalization refers to a transfer of the entire industry or assets

within that country from private to public ownership, with no discrimination as to foreign or local ownership. After nationalization, the property is controlled or owned by the government and the nationals of the host country. Socialization is similar to nationalization. Here the property that has been taken over or transferred is kept with the government. That is, private ownership, either foreign or local, is completely excluded. Nationalization is also referred to as socialization, when used with reference to socialist or communist programs designed to put an end to private ownership of property. Expropriation without compensation is called confiscation. Expropriation patterns might vary according to the industry, geographic region, and type of ownership, technology, degree of vertical integration, asset size, and politico-economic situation.

#### **4.7.2 Domestication**

Domestication is a process by which controls and restrictions placed on the foreign firms gradually reduce the control of the owners. Domestication may lead ultimately to expropriation. This process offers a compromise to both parties. That is, the multinational company continues to operate in the country, while the host government is able to maintain control on the foreign firms through different restrictions and regulations.

Domestication includes gradual transfer of ownership to nationals; promotion of a large number of nationals to higher levels of management; greater decision-making power accorded to nationals; more products produced locally rather than imported for assembly; and specific export regulations designed to dictate participation in world markets.

#### **4.7.3 Other forms of intervention**

Apart from expropriations and domestication, there are other means of government intervention in foreign enterprises.

##### **Exchange Control**

Foreign exchange regulations are imposed by countries facing difficulties regarding their balance of payments. These exchange control regulations are intended to encourage domestic industry. As a result of exchange control, foreign businesses -- cannot return profit and capital to the parent company from the host country at will, and cannot freely import raw materials, spare parts, and machinery for operating purposes.

The exchange control regulations in most developing countries are meant to protect and regulate their hard currency balances. This in turn can lead to restrictions on the import of some consumer goods (for example, cars, appliances, clothing, perfumes). Not only the developing countries, but even the developed countries sometimes resort to exchange control.

##### **Import Restrictions**

Import restrictions are usually imposed to support the domestic industry. Generally governments impose import restrictions for an entire industry, and not a particular company. When a country wants to encourage domestic industry as a matter of industrial policy, import restrictions are adopted even if it is realized that the local product will be inferior, at least initially. From the point

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of view of the government, import restrictions may be reasonable; but they jeopardize the function of foreign business.

### **Market Control**

Governments of certain countries impose restrictions on foreign firms to prevent them from competing in certain specified markets.

### **Tax Control**

Government may impose certain excessive and unconventional taxes on foreign firms for the following reasons --

- An unconventional tax burden on foreign firms indicates that they are not wanted there any longer.
- When a country is in a dire need of revenue inflows, it is quite possible that foreign firms will become the target of attack, as it is more economical, convenient, and politically prudent to do so.
- If the government comes to know that the foreign firm has abused differences in international taxation to deprive the host country of its due revenues, retaliatory taxes can be imposed.

### **Price Control**

Price control is usually taken up in public interest when the country faces with economic difficulties. Many countries have resorted to price controls to improve their economies. For example, a government might set an official price on essential products such as drugs, heating oil, sugar, and cereals. When applied randomly, price control brings its own set of problems. It also hampers the working of the foreign firm if the firm has been singled out by such regulations that are not based on a sound economic rationale.

### **Labor Restrictions**

In many countries, labor unions are so strong that they may be able to negotiate terms with the government to pass very restrictive laws that support labor at a heavy cost to business. Their demands and the laws supporting them can pose major problems for foreign enterprises. In such situations, the foreign firms may have no choice but to leave.

## **4.8 Impact of International Political Environment on Domestic Business**

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A company originating in the US will continue to be known as a US company even though it derives a major portion of its revenues from operations outside the country. The relationship between the host country and home country's government will also affect the MNC, either directly or indirectly. Questions such as -- Do the governments agree on issues debated by international agencies? Are there any points of discord between the host country and the home country? Is there reason to believe that relations between them will improve or deteriorate in the future? -- should be addressed before commencing operations in an unknown foreign market.

**Activity:** ABP International (ABP) is a UK-based drug manufacturing company. The company set up a manufacturing facility in Brazil in 2018. It employed the local people in the manufacturing unit. It also entered into partnership with local.

Brazilian manufacturers to fulfill its raw material requirements. In late 2020, ABP joined with Aliança da Terra, an NGO in Brazil that supports environmentally responsible land management in the Amazon rainforest, and Instituto Jacques Walter, an NPO that aims to preserve and recoup Atlantic Forest in Espirito Santo, Brazil. In what way can these initiatives help the company in the host country?

**Answer:**

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### **Check Your Progress - 5**

Indicate your choice of the correct answer from the options given by circling it.

21. Which of the following process are used by the government in which controls and restrictions placed on the foreign firms gradually reduce the control of the owners?
  - a. Nationalization
  - b. Socialization
  - c. Domestication
  - d. All of the above
22. In which of the following forms of intervention does the government impose restrictions on foreign firms to prevent them from competing in certain specified markets?
  - a. Import restrictions
  - b. Market control
  - c. Exchange control
  - d. None of the above
23. \_\_\_\_\_ refers to official seizure of foreign property by a host country whose intention is to use the seized property in public interest, in which the foreign firms are given some compensation.
  - a. Confiscation
  - b. Nationalization
  - c. Expropriation
  - d. Socialization

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24. Which of the following statements is not true regarding the import restrictions?
- These are usually imposed to support the domestic industry.
  - Governments generally, impose import restrictions on a particular company in an industry, and not for the entire industry.
  - These restrictions may restrict the functioning of the foreign businesses.
  - When a country wants to encourage domestic industry as a matter of industrial policy, import restrictions may be adopted even if it is known that the local product will be inferior, at least initially.
25. Under which of the following circumstances do governments impose excessive and unconventional taxes on foreign firms?
- When the foreign firms are not wanted in a country any longer
  - When a country is in a dire need of revenue inflows
  - When the government comes to know that the foreign firm has abused differences in international taxation to deprive the host country of its due revenues.
- Only i and ii
  - Only i and iii
  - Only ii and iii
  - i, ii, and iii

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### 4.9 Summary

- The political environment forms one of the most important facets of the business environment for any business today, since business is influenced by the political happenings within a country, and internationally.
- Governments can be classified according to their political systems or their economic systems. They can also be classified on the basis of the number of political parties present -- two-party, multiparty, single-party, and dominated one-party.
- The economic system of classification is concerned with business ownership -- whether businesses are privately owned, or government owned, or whether there is a combination of private and government ownership. The economic system can be further subdivided into three types -- communism, socialism, and capitalism.
- MNCs should consider the political environment from different angles -- foreign politics, domestic politics, and international politics.
- Political risk refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government. It also includes any action by the government that differentiates between foreign and domestic firms.
- The elements of political risk include confiscation, expropriation, and nationalization; contract repudiation and frustration; unfair regulatory environment; currency inconvertibility; and war risk.

- Simon, Douglas, and Craig have proposed various methods to measure, analyze, and predict potential political risks. The LIBOR rate can also be used to assess political risk.
- There are two important stages in the management of political risk -- identification and measurement.
- Foreign companies can take certain measures to discourage a host country from taking control of the assets. These are -- by stimulating local economy, employing nationals, sharing ownership, by being civic minded, by being politically neutral, by lobbying, and by observing political situations.
- Political intervention can be defined as a decision on the part of the host country government that may force a change in the operations, policies, and strategies of a foreign firm.
- There are different forms of political intervention like expropriation, domestication, exchange control, import restrictions, market control, tax control, price control, and labor problems.
- The relationship between host country and home country's governments will affect MNCs, either directly or indirectly. Questions like -- whether the governments agree on issues debated by international agencies and are there any points of discord between the host country and the home country should be addressed before commencing operations in a foreign market.

#### 4.10 Glossary

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- **Absolutist governments (closed) (sub-type of political system):** These include monarchies and dictatorships, where the ruling regime dictates government policies without considering citizens' needs or opinions.
- **Capitalist philosophy (sub-type of economic system):** Under this, a free-market system is provided that allows business competition and freedom of choice for both consumers and companies.
- **Communist philosophy (sub-type of economic system):** Under this, all resources should be owned and shared by all people for the benefit of society (i.e., not for profit seeking enterprises).
- **Confiscation:** It occurs when a government takes ownership of a property without providing compensation. Expropriation without compensation is called confiscation.
- **Domestic politics:** Politics that exist in the company's home country, also known as the parent or source country.
- **Domestication:** It is a process by which controls and restrictions placed on the foreign firms gradually reduce the control of the owners. Domestication may lead ultimately to expropriation.
- **Dominant-party system (sub-type of political system):** In this, only one political party can become the ruling government. This is because the party is so strong that it becomes dominant within the political structure of the country. The other parties are allowed to operate freely, but are weak or ineffective to challenge the power of the dominant party.
- **Expropriation:** Official seizure of foreign property by a host country whose intention is to use the seized property in the public interest. In

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expropriation, there will be some compensation, though not necessarily adequate.

- **Foreign politics:** Politics that are associated with the local or host country. The association in this form of politics might range from being favorable and friendly to being hostile and dangerous.
- **International politics:** It refers to the interaction of the overall political environment factors of two or more countries. The environment becomes highly complex when the interest of the company, host country, and the home country do not coincide.
- **Multiparty system (sub-type of political system):** In this, there are some large parties, but these are unable to form the government because they fall short of the required majority. The government is formed through coalitions between the various parties, each one of which wants to protect its own interests.
- **Nationalization:** It refers to a transfer of the entire industry within that country from private to public ownership, with no discrimination as to foreign or local ownership.
- **Parliamentary government (open) (sub-type of political system):** These governments consult citizens from time to time for the purpose of learning of their opinions and preferences. The policies of such governments reflect the desires of the majority of members of the society.
- **Single-party system (sub-type of political system):** In this system, only one political party is legally allowed to form the government. Opposition to the ruling party in any form is banned by law.
- **Socialist philosophy (sub-type of economic system):** Under this, the government owns and operates the basic, major industries, but allows private ownership of small businesses.
- **Socialization:** In this, the property that has been taken over or transferred is kept with the government. That is, private ownership, either foreign or local, is completely excluded.
- **Two-party system (sub-type of political system):** In this, there are typically two strong parties that take turns controlling the government, though there may be several other parties. The two parties are generally governed by different philosophies, which results in a change in the government policy when one party succeeds the other.

### 4.11 Self-Assessment Test

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1. Knowledge of the different forms of government can help one appraise the political climate in any country. What are the different types and sub-types of governments?
2. Businesses have to face a complex political environment as they have to cope with the political situation of more than one nation. Discuss the impact of the international political environment on domestic business. How should the multinationals look at the complexities in the political environment?
3. Various factors contribute to political instability. Explain these factors in detail.



4. Political risk refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government. It may arise due to one or a combination of certain elements. Describe these elements in detail.
5. Describe the ways in which the political risk can be analyzed. Explain the stages involved in the management of political risk. What are measures that a foreign company can take to discourage a host country from taking control of its assets?
6. Overseas markets offer substantial opportunities and at the same time are coupled with risks of intervention by the host government. Identify the various forms of political interventions.

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#### **4.13 Answers to Check Your Progress Questions**

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Following are the answers to the Check Your Progress questions given in the Unit.

**1. (a) Political system**

According to the political system, governments are classified on the basis of the number of political parties that are represented in it -- two-party, multi-party, single-party, and dominated one-party. In a single-party system, only one political party is legally allowed to form the government. Opposition to the ruling party in any form is banned by law.

**2. (c) Single-party system**

In a single-party political system, only one political party is legally allowed to form the government. Opposition to the ruling party in any form is banned by law. Countries like Cuba and Vietnam have single-party systems.

**3. (b) Opposition to the ruling party in any form by the other parties is banned by law.**

All statements are true regarding dominant-party system, except statement 'b'. In a single-party political system, opposition to the ruling party in any form is banned by law.

**4. (b) Absolutist**

Absolutist governments include monarchies and dictatorships, where the ruling regime dictates government policies without considering needs or opinions of the citizens. These are found in newly formed nations or those undergoing some kind of political transition. Such governments are relatively rare now.

**5. (d) Communist**

The economic system can be further subdivided into three types -- communism, socialism, and capitalism. The communist philosophy holds that all resources should be owned and shared by all people (i.e., not for profit seeking enterprises) for the benefit of society.

**6. (d) Parliamentary**

Governments can be classified as either parliamentary or absolutist. Parliamentary governments consult citizens from time to time for the purpose of learning their opinions and preferences. The policies of such governments reflect the desires of the majority of members of the society.

7. (a) **The government form of government owns and operates the basic, major industries but allows private ownership of small business.**

A socialist government owns and operates the basic, major industries, but allows private ownership of small businesses. The degree of government control that occurs under socialism is comparatively less than the same under communism.

8. (d) **Capitalist**

The economic system can be further subdivided into three types – communism, socialism, and capitalism. The philosophy of capitalism provides for a free-market system that allows business competition and freedom of choice for both consumers and companies. It is a market-oriented system in which individuals, motivated by private gains, are allowed to produce goods or services for public consumption under competitive conditions.

9. (d) **i, ii, and iii**

To assess a company's political environment, it is vital to identify and evaluate the relevant factors contributing to political instability in order to assess a company's potential political environment. Potential sources of political complication include social unrest, the attitudes of nationals, and the policies of the host government.

10. (a) **It refers to the politics that exist in the company's home country.**

Domestic politics refers to the politics that exist in the company's home country. These politics are usually thought as causing minimal problems, which is not true. Labor and political organizations criticize a local company's international activities by accusing it of exporting capital and jobs. The government, instead of providing support, can become a hindrance in international trade. Also, when national interests are at stake, a government may use certain companies as an instrument to achieve its political goals.

11. (d) **All of the above**

International politics refers to the interaction of the overall political environment factors of two or more countries. The environment becomes highly complex when the interest of the company, host country, and the home country do not coincide. And, sometimes, the problems cannot be solved.

12. (b) **It refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government.**

Political risk refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government. It also includes any action by the government that differentiates between foreign and domestic firms.

13. (c) **Fair regulatory environment**

Political risk refers to any government action that diminishes the value of a firm's operations within the political boundaries or influence of that government. The elements of political risk include confiscation,

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expropriation, and nationalization; contract repudiation and frustration; unfair regulatory environment; currency inconvertibility; and war risk.

### **14. (a) Confiscation**

Confiscation is an element of political risk. In this, the host government takes ownership of a property of the foreign company without providing any compensation. After a property has been confiscated, it can either be nationalized or domesticated.

### **15. (a) Nationalization**

Nationalization is one of the elements of political risk. It refers to a transfer of the entire industry within that country from private to public ownership, with no discrimination as to foreign or local ownership.

### **16. (d) Repression**

A society is termed as open when people voice their approval or discontent in the form of voting, protests, and boycotts. In closed societies, the government does not encourage these forms of expression publicly, and the repression of the people can lead to violent encounters.

### **17. (c) A borrower pays a low premium over the LIBOR, if he/she is from a country with a high risk of default.**

All the statements are true regarding LIBOR, except statement (c). LIBOR is the interest rate charged between banks and is relatively risk free. A borrower has to pay a high premium, if he/she is from a country with a high risk of default.

### **18. (c) Political neutrality**

Political neutrality is a measure used by firms to minimize political risk. In this, the foreign company should primarily focus on economic development. They should keep low profile and avoid political disputes among local groups or between companies.

### **19. (d) By employing people only from its home country**

In order to discourage a host country from taking control of its assets, a foreign firm can take up the following measures -- stimulation of the local economy, employment of nationals, sharing ownership, being civic minded, political neutrality, behind-the-scenes lobby, and observation of political mood and reduction of exposure.

### **20. (d) i, ii, and iii**

The risk manager should go in for internal analysis after gathering as much publicly available information as possible. There are three sources from which the risk manager should gather information before conducting an internal analysis -- international managers located at headquarters; field managers on assignment in foreign affiliates; and information specialists assigned to monitor political activity from the firm's headquarters.

### **21. (c) Domestication**

Domestication is a process by which controls and restrictions placed on the foreign firms gradually reduce the control of the owners. This process allows the multinational to continue to operate in the country.

Also, the host government is allowed to maintain control on the foreign firms through various restrictions and regulations.

**22. (b) Market control**

Market control is a form of political intervention in which the host government may force a change in the operations, policies, and strategies of a foreign firm. In market control, governments of certain countries impose restrictions on foreign firms to prevent them from competing in certain specified markets.

**23. (c) Expropriation**

Expropriation is a form of political intervention. Eiteman and Storehill defined expropriation as, “official seizure of foreign property by a host country whose intention is to use the seized property in the public interest. Expropriation is recognized by international law as the right of sovereign states, provided the expropriated firms are given prompt compensation, at fair market value, in convertible currencies.”

**24. (b) Governments generally, impose import restrictions on a particular company in an industry, and not for the entire industry.**

All the statements are true regarding import restrictions, except statement (b). Governments impose import restrictions for the entire industry, and not a particular company.

**25. (d) i, ii, and iii**

Government may impose certain excessive and unconventional taxes on foreign firms for the following reasons -- an unconventional tax burden on foreign firms indicates that they are not wanted there any longer; when a country is in a dire need of revenue inflows, it is quite possible that foreign firms will become the target of attack, as it is more economical, convenient, and politically prudent to do so; and if the government comes to know that the foreign firm has abused differences in international taxation to deprive the host country of its due revenues, retaliatory taxes can be imposed.

# Business Environment and Law

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