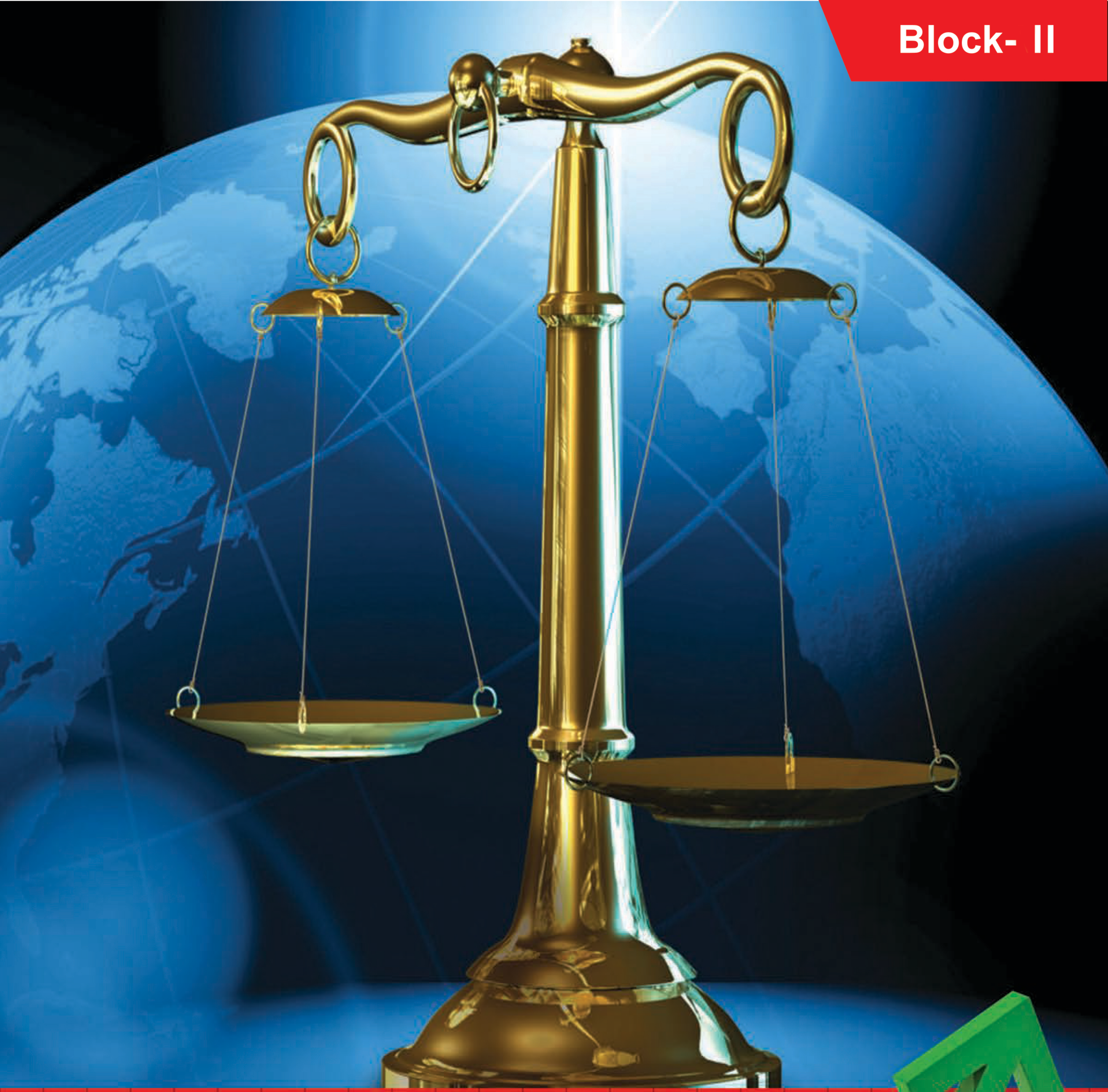
Block- II



Business Environment & Law

The Economic and Technological Environment of Business

Block

2

THE ECONOMIC AND TECHNOLOGICAL ENVIRONMENT OF BUSINESS

UNIT 5

Economic Environment **1-18**

UNIT 6

Financial Environment **19-40**

UNIT 7

Trade Environment **41-64**

UNIT 8

Technological Environment **65-74**

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BLOCK II: THE ECONOMIC AND TECHNOLOGICAL ENVIRONMENT OF BUSINESS

The second block deals with the concepts of economics and technological environment of business. The block contains four units. The first unit focuses on the economic environment and the impact of economic factors on business. The second unit discusses the financial environment and its affect on the business. The third unit discusses the significance of trade environment to business. The fourth unit examines the technological environment and the growing importance of technology in making business decisions.

Unit 5 gives an overview of the world economy. The unit focuses on the classification of economies. It discusses various consumption patterns. The unit also focuses on the significance of balance of payments. It then discusses national control of international transfers and gives an overview of the Indian economy. The unit explains how economic indicators are used to measure the overall economic activity.

Unit 6 deals with the concepts of money supply and gross domestic product. The unit explains the functions of the financial system. It examines key financial markets such as the capital market and the money market and also focuses on the development of these markets. The unit explains the significance of financial institution to the economic well-being and future growth of a market-oriented economy. The unit also discusses kinds of financial intermediaries and financial products.

Unit 7 helps in making one understand the significance of liberalization and globalization of markets. The unit gives an overview of globalization in the Indian industry. The unit then discusses the import policy and the export policy. It also explains the objectives of the EXIM Policies. The unit explains the basic issues in international licensing and international franchising. It focuses on the kinds of middlemen – mercantile agents and merchant middlemen. The unit also explains the issues in the global economic environment.

Unit 8 deals with the forces affecting technology which result in the creation of new products, markets, and marketing opportunities. The unit examines the definitions of technology and technology transfer. It then discusses the factors to be considered while selecting a technology. The unit also explains the new risks introduced by technology and environmental liability and the costs of technological advances.

Unit 5

Economic Environment

Structure

5.1 Introduction
5.2 Objectives
5.3 The World Economy – An Overview
5.4 Classification of Economies
5.5 Consumption Patterns
5.6 Balance of Payments
5.7 Economic Indicators
5.8 Summary
5.9 Glossary
5.10 Self-Assessment Test
5.11 Suggested Readings / Reference Material
5.12 Answers to Check Your Progress Questions

5.1 Introduction

In the previous unit we discussed on various issues related to political environment. 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 are 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. Political risk is one of the important aspects the multinational corporations have to consider in their expansion plans. The two important stages in the management of political risk -- identification and measurement were discussed. The relationship between host country and home country's governments will affect MNCs, either directly or indirectly.

This unit provides an introduction to the economic environment. Economic environment refers to all those economic factors which have a bearing on the functioning of a business. Business is dependent on the economic environment for procuring the required inputs and for selling the finished goods. To be able to reach sound business decisions in a dynamic economy, managers need to have a clear understanding of economic interrelationships and their impact on business.

This unit provides an overview of world economy and the classification of economies. The unit then discusses the consumption patterns, balance of payments, and national control of international transfers. The unit also gives an overview of the Indian economy and explains key economic indicators.

5.2 Objectives

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

- Describe the world economy.
- Classify the economies.
- Identify various consumption patterns.
- Explain balance of payments.
- State the reasons for controlling international transfers.
- Describe the Indian economy.
- Identify several economic indicators.

5.3 The World Economy – An Overview

The world economy has undergone revolutionary changes during the past few decades, the most significant change being that of the emergence of global markets and global competitors resulting from liberalization, privatization and globalization. Many remarkable changes took place. The first change is the increased volume in capital movements. The capital movements far exceed the volume of trade finance. In the past, when a country ran a deficit on its trade accounts, its currency would depreciate. Today, it is capital movements and trade that determine currency value. The second change is that although employment in manufacturing is steady, the production is continuously growing. Another change is the emergence of the world economy as a dominant economic unit. There is great competition and every player provides something different and thus wins. The changes in the global competition are bringing countries into more direct confrontation with their main economic rivals which was not the case in the past.

The changes in the world economy in the past few years have been dramatic. A remarkable change in the world economy is slowdown in economic growth mostly in developed countries. The emerging markets, led by India, China, Brazil, and Russia grew at a rate of 7% to 10% for years. North America and Europe were characterized by consistent growth due to boom in property and stock markets. [1]The Gross Domestic Product (GDP) in the United States was worth 20936.60 billion US dollars in 2020, according to official data from the World Bank. The GDP value of the United States represents 18.55 percent of the world economy. In the year 2016 the GDP was USD 18745.08 billion. The GDP of [2]European Union in the year 2020 was USD 15,569.21 billion where as in the year 2015 the GDP was USD 15263 billion.

[1]Source : https://tradingeconomics.com/united-states/gdp

[2] Source : https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?locations=EU

Investment had brought about economic development in the Middle East and Africa. Japan also recovered from its 'lost decade' of deflation. However the growing world economy was hit by a slowdown in the US economy. The slowdown was largely driven by financial turmoil, rising commodity prices, and a downturn in the housing market in early 2008 due to financial crisis hit the US markets due to subprime lending. According to the [3]World Bank world GDP growth fell from 4.2 in 2007 to 1.86 in 2008. In dollar terms world GDP recorded USD 60.704 trillion to 81.913 trillion.

Year	US$ Trillion	% growth	Year	US$ Trillion	% growth
2006	60.704		2014	73.884	2.88
2007	63.326	4.32	2015	76.04	2.92
2008	64.504	1.86	2016	78.022	2.61
2009	63.429	-1.67	2017	80.582	3.28
2010	66.163	4.31	2018	83.027	3.03
2011	68.231	3.13	2019	84.966	2.34
2012	69.951	2.52	2020	81.913	-3.59
2013	71.819	2.67			

During 2007-09 the global financial markets went through a subprime mortgage crisis and the failure of investment banks like Lehman Brothers, Bear Sterns, and other mortgage companies caused negative growth. Similarly in 2020, the impact of pandemic Covid 19 and consequential lockdown of industries /economies and travel restrictions / production curbs resulted in negative growth in global GDP figures. The easing of travel and lifting of lockdown across the countries brought the world economy on track again in the 2nd half of 2021 and recovery has started.

5.4 Classification of Economies

The economies of the world can be classified on the basis of:

1. Ownership of the means of production
2. Level of development reached

5.4.1 Ownership of the Means of Production

The economic system of any country is an empirical hypothesis of its economic environment. There are basically three types of economic systems based on the

[3]Source: https://data.worldbank.org/indicator/NY.GDP.MKTP.KD

ownership of the means of production. They are capitalist, socialist, and mixed. economies.

Capitalist Economy

Capitalist economy is a system in which all the means of production (land, labor, and machinery) are owned and controlled by private individuals. All the economic activities are steered by self-interest. The economic problems are solved by price mechanism and there is a very limited role for the government. The capitalist economy also helps the consumers to cut down the consumption if the price is high. All economic activities are regulated through price. The price is fixed by the interaction of demand and supply principles.

Socialist Economy

Socialist economy is a system in which all the means of production are owned by the whole community and all economic decisions related to production, exchange, and distribution are taken by the state.

Mixed Economy

In a mixed economy, there are three sectors:

- Public sector (all firms and business houses are owned by the government).
- Private Sector (all firms and business houses are owned by private individuals).
- Joint Sector (has both public and private enterprises).

India is a good example of mixed economy. In India, while the government owns some of the most important industries, some are owned by private individuals.

5.4.2 Level of Development Reached

On the basis of the level of development reached, countries can be classified as developed, underdeveloped, or developing economies.

Developed Economies

A developed economy is one, which has reached a very high stage of development. The per capita income and standard of living of the people is very high in such countries.

Underdeveloped Economies

According to the United Nations, "Countries in which per capita real income is low when compared with the per capita real income of the United States of America, Canada, Australia, and Western Europe."

Developing Economies

[4]The World Bank assigns the world's economies to four income groups—low, lower-middle, upper-middle, and high-income countries.

According to the World Bank, low income and middle income countries are termed as developing economies.

The classifications are updated each year by World Bank on July 1 and are based on GNI per capita in current USD (using the Atlas method exchange rates) of the previous year ..To keep the income classification thresholds fixed in real terms, they are adjusted annually for inflation.

Group	**July 1, 2021 (new)**	**July 1, 2020 (old) figures in US$**
Low income		
Lower-middle income	1,046 – 4,095	1,035 – 4,045
Upper-middle income	4,096 -12,695	4,046 -12,535
High income	> 12,695	> 12,535

The International Monetary Fund (IMF) has defined a developing country as follows: "Low-and middle-income countries in which most people have a lower standard of living with access to fewer goods and services than do most people in high-income countries."

The term 'developing economies' indicates that even though, some countries are underdeveloped, the process of development has been initiated.

Some of the physical characteristics of underdeveloped and developing countries include low living standards, low levels of productivity, high population growth rate, large scale unemployment and underemployment, and market imperfections.

The Exhibit 5.1 briefly discusses on the contemporary scenario (2021) of Brazil.

Exhibit 5.1: Brazil – An Overview of a Developing Country

Brazil is the world's fifth largest country. With an estimated population above 211 million, it is one of the world's most populous countries, after China, India, the United States, Indonesia and Pakistan. The official language of Brazil is Portuguese, and the currency is the real (BRL).

According to IMF country focus report released on 23rd September 2021 Brazil's economy has returned to pre-pandemic levels, supported by booming terms of trade and robust private sector credit growth, and one of the biggest stimulus packages in emerging markets–nearly 4 percent of GDP in emergency cash transfers alone in 2020.

Contd. .....

[4] *https://blogs.worldbank.org/opendata/new-world-bank-country-classifications-income-level-2021-2022*

The Gross Domestic Product (GDP) in Brazil was worth 1444.73 billion US dollars in 2020, according to official data from the World Bank. The GDP value of Brazil represents 1.28 percent of the world economy. Brazil has a diversified economy with strong companies in the agricultural, commodities, industrial, and service sectors; it has one of the biggest middle classes.

The COVID-19 pandemic exposed Brazil to an unprecedented health and economic challenge. To contain the pandemic, Brazil implemented social measures to slow the spread of the virus and contain its impact on the health system capacity, which is uneven across the country.

COVID-19 hit as Brazil was still recovering from its 2014-16 recession. Economic recovery remained weak and fiscal policy space limited since the peak of the recession in 2015-2016, with GDP growth below 2 percent in the following years.

To protect the most vulnerable people during Covid 19 pandemic in 2020, the Government put forward a large, timely, and targeted and time bound fiscal package focused on social assistance. The cost of this package was estimated at BRL 815.5 billion (US$156.8 billion), or 11.4 percent of GDP in 2020. The large fiscal stimulus limited the annual contraction in 2020 to 4.1 percent. Recovery momentum is expected to propel growth to 3.0 percent in 2021 but this is subject to large uncertainty, particularly on the impact of the new wave of the pandemic and the pace of vaccination.

The COVID-19 pandemic is also jeopardizing years of progress in poverty reduction and human capital accumulation. While the poverty rate temporarily fell to 21 percent in 2020 (from 29 percent in 2019) because of generous social emergency transfers (Auxilio Emergencial) to 66 million individuals and the expansion of the Bolsa Familia Conditional Cash Transfer (CCT) program.

Brazil is among the LCR countries that suffered the longest spell of public schools' closures to date, which is expected to raise learning poverty from 48 to 70 percent and to disproportionately affect the poor (remote learning benefited less than 50 percent of students in less developed regions, vs. 92 percent in richer parts of the country). As a result, the impact of COVID-19 is expected to reverse a decade-long of steady improvement in the Human Capital Index (which had increased from 0.52 to 0.58 between 2007 and 2019) and calls for strong remedial acceleration policies.

Sources: https://www.worldbank.org/en/country/brazil/overview#1
https://tradingeconomics.com/brazil/gdp
https://taxsummaries.pwc.com/brazil
https://www.imf.org/en/News/Articles/2021/09/22/na092221-brazil-sustaining-a-strong-recovery

Activity: Name at least three countries each classified on the basis of ownership of production reached and the level of development reached.

Answer:

____

____

____

____

<u>Check Your Progress - 1</u>

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

1. In which of the following economies, the state ownership of all the means of production is an important feature?
   a. Legal environment
   b. Trade environment
   c. Economic environment
   d. Social environment
2. Which of the following is the economic systems in which all the means of production are owned by private individuals?
   a. Socialist economy
   b. Capitalist economy
   c. Mixed economy
   d. Developed economy
3. In which of the following economies, the state ownership of all the means of production is an important feature?
   a. Capitalist economy
   b. Developing economy
   c. Underdeveloped economy
   d. Socialist economy
4. Which of the following is a notable feature of a developed economy?
   a. High population growth rate
   b. Large but neglected agricultural sector
   c. High per capita income and high standard of living
   d. Large-scale unemployment and underemployment

5. India is a good example of ……….
   a. Socialist economy
   b. Mixed economy
   c. Capitalist economy
   d. Communist economy
6. In which of the following economies, the ownership and control vest mostly in private hands?
   a. Mixed economy
   b. Capitalistic economy
   c. Socialistic economy
   d. None of the above
7. Which of the following is a characteristic of mixed economy?
   a. The state regulates economic activity and the operations of business and industries
   b. Production and consumption is determined by the state
   c. There exist all different types of economies in the different parts of the country
   d. Private enterprises co-exist with government enterprise

5.5 Consumption Patterns

Let us look into the consumption patterns and the theories behind them to have a focused attention on the economic development of a country.

5.5.1 Engel's Law

Every marketer is aware of the relationship between income level and consumption patterns and, therefore, frequently uses income segmentation in defining a market. The nature of income elasticity (the relationship between demand changes and changes in income) for food was first observed and formulated by the nineteenth century Prussian statistician, Ernst Engel.

According to Engel's Law, "With rising incomes, the share of expenditures for food and, by extension, other products share declines. The resulting shift in expenditures affects demand patterns and employment structures. The poor families will spend a larger share of their total expenditures on food than wealthier families."

5.5.2 Product Saturation Levels

In general, product saturation levels increase as national income per capita increases. However, in markets where income is sufficient to enable consumers to buy a particular product, other factors must be considered.

5.6 Balance of Payments

The currency price of any country is dependent on the quantity supplied in relation to the quantity demanded especially when exchange rates are settled in an unregulated market. Any factor that increases the demand for the currency would result in an increase in the currency's foreign exchange value i.e. appreciates the currency. Similarly, any factor that increases the supply of the currency would result in a decrease in the foreign exchange value of the currency i.e. depreciates the currency.

The balance of payment account is a systematic record of transactions of a country involving claims on and liabilities to the rest of the world. According to the Reserve Bank of India, "The balance of payments of a country is a systematic record of all economic transactions between the 'residents' of a country and the rest of the world. It presents a classified record of all receipts on account of goods exported, services rendered and capital received by 'residents' and payments made by them on account of goods imported and services rendered from the capital transferred to 'non-residents' or 'foreigners'." The balance of payments account can be divided into current and capital accounts.

The **current account** of the balance of payments is a record of the value of trade in goods and services and of transfers between a country and the rest of the world. Service transactions include travel and transportation, income and payments on foreign investments. Transfer payments relate to gifts, pensions, private remittance, and charitable donations received from foreign individuals.

A deficit on the current account means that more goods and services have been imported into the country than have been sold abroad. A surplus in the current account means more goods and services have been exported than imported.

Capital account may be defined as "a record of investment and payment flows between a country and the rest of the world."

The capital account of a country consists of its transactions in financial assets in the form of short-term/long term lending and borrowing, and private and official investments.

In the capital account, borrowing from foreign countries and direct investments from foreign countries represent capital inflows or credits (as these are receipts from foreigners). The direct investments and lending to foreign countries represents debits or capital outflows (as they are payments to foreigners). There are two types of transactions in the capital account – private and government. Private transactions include all types of investment i.e. portfolio investment, direct investment, and short-term investment. Portfolio investment refers to investments in financial instruments that have a maturity period of more than one year. These investments are mainly made in long-term securities such as equities (less than 10% ownership) and bonds. These investments are of a passive nature with no active role by the investor. Direct investment involves purchase of common stock of 10% or more of the voting stock of a company. Wholly owned subsidiaries, foreign branches, and joint ventures are also direct investments. Short-term investments include financial assets such as bills, deposits, and currency. Government investments consist of loans to and from foreign official agencies.

5.6.1 Disequilibrium in Balance of Payments

If the total receipts from foreigners on the credit side exceed the total payments to foreigners on the debit side, the balance of payments is said to be favorable. If the total payment to foreigners exceeds the total receipts from foreigners, the balance of payment is unfavorable.

Causes of Disequilibrium

There are many factors that may cause a deficit or surplus in a country's balance of payments. The various causes of disequilibrium are discussed below:

- A temporary disequilibrium may be caused by random variations in trade, the efforts of the weather on agricultural production, seasonal fluctuations, etc.
- Technological changes in the methods of production may affect the country's ability to compete in home or foreign markets.
- A country's balance of payments also depends on its state of economic development.
- There may be chronic or fundamental disequilibrium due to changes in consumer tastes within the country or abroad, which affect the country's imports or exports.
- Another cause is the change in the country's national income. If a country's national income increases, it may lead to an increase in imports, thereby creating a deficit in its balance of payments.
- Inflation is another cause of disequilibrium in the balance of payments. If there is inflation in the country, exports fall. At the same time imports increase and this results in adverse balance of payments.

Example: US Current Account Deficit: Repercussions on Global Economy

The current account is a measure of trade. It covers goods, services and investment flows. Lower trade deficit indicates that the US companies are producing more to meet domestic and overseas demand.

It also indicates that the country's economy is less dependent on domestic demand and relays on exports and investments which likely lead the US economy to more balanced structure. If this trend continues in the US, it will put pressure on countries such as China and Germany. They have to take their own measures to adjust their economies.

The U.S. current account deficit, which reflects the combined balances on trade in goods and services and income flows between U.S. residents and residents of other countries, widened by $167.0 billion, or 34.8 percent, to $647.2 billion in 2020. The widening mostly reflected reduced surpluses on primary income and on services and an expanded deficit on goods. The 2020 deficit was 3.1 percent of current dollar gross domestic product, up from 2.2 percent in 2019.

Contd. .....

The U.S. current account deficit, which reflects the combined balances on trade in goods and services and income flows between U.S. residents and residents of other countries, widened by $7.6 billion, or 4.2 percent, to $188.5 billion in the fourth quarter of 2020, according to statistics released by the U.S. Bureau of Economic Analysis. The revised third quarter deficit was $180.9 billion.

The fourth quarter (2020 October to December quarter) deficit was 3.5 percent of current dollar gross domestic product (GDP), up from 3.4 percent in the third quarter.

The $7.6 billion widening of the current account deficit in the fourth quarter primarily reflected an expanded deficit on goods and a reduced surplus on services that were partly offset by a reduced deficit on secondary income.

Exports of goods and services to, and income received from, foreign residents increased $40.8 billion, to $840.0 billion, in the fourth quarter. Imports of goods and services from, and income paid to, foreign residents increased $48.3 billion, to $1.03 trillion.

Source: https://www.bea.gov/news/2021/us-international-transactions-fourth-quarter-and-year-2020

5.7 National Control of International Transfers

The Nation/States of the world exercise control over a wide range of international transfers. The items transferred comprise not only goods and services but also technology, people, money, and rights. There are several reasons for controlling international transfers. The primary reason is to accomplish economic goals. Earlier, controls over international transfers were guided by a revenue motive. Today, with the exception of low-income countries, the revenue motive is not an important factor guiding national policy in this area. The protection of local industry and fostering the development of local enterprise are more common motives today. The three motives work together. By increasing tariffs and duties on transfer of goods, a country can increase national revenues and at the same time provide protection for local industries and local enterprises.

Employment is another major economic goal that influences international transfers. When the free play of economic forces results in heavy competitive pressure, it leads to domestic unemployment.

Economic and political goals and different value systems are other prime reasons for controls on international transfers.

Every country is free to protect its domestic producers by imposing controls on transfer. This protection, however, proves to be quite expensive. There are two costs to consider in this relation. The first is the cost to consumers – business buyers as well as house-hold buyers. Any curtailment of the access to markets of international producers raises the price and cost to customers and lowers their standard of living (if they are individuals), or their competitiveness (by increasing input costs) if they are companies. The second cost arises because when companies are protected from competition, they may be less motivated to innovate, create, and sustain world-class competitive advantage. On the other hand, when companies compete with domestic or international rivals, they improve their performance and chalk out plans to serve the market better than others.

Check Your Progress - 2

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

8. The nature of income elasticity (the relationship between demand changes and changes in income) for food was first observed and formulated by:
   a. Ernst Engel
   b. Levine
   c. Fischer
   d. Keynes
9. Which of the following is a record of investment and payment flows between a country and the rest of the world?
   a. Capital account
   b. Current account
   c. Reserve account
   d. Receipts account
10. In which of the following account of the balance of payments implies that more goods and services have been imported into the country than have been sold abroad?
    a. Capital account
    b. Current account
    c. Reserve account
    d. Receipts account
11. International transfers are controlled in order to:
    a. Accomplish economic goals
    b. Protect local industry
    c. Foster the development of local enterprise
    a. All of the above.

5.8 The Indian Economy – An Overview

India is one of the fastest growing economies in the world. The economic stagnation which characterized the Indian economy has given way to increased economic activity. A new spirit of economic freedom is now thriving in the country, bringing sweeping changes in its wake. A series of ambitious economic reforms, aimed at deregulating the country and stimulating foreign investment, moved India firmly into the front ranks of the rapidly growing Asia Pacific region and unleashed the latent strengths of a complex and rapidly changing nation. Moreover, skilled managerial and technical manpower give India a distinct cutting edge in global competition.

In brief, the strengths of the Indian economy include abundance of natural resources, large domestic agricultural and industrial production base, vast pool of skilled manpower, well-developed distribution networks and established free market infrastructure, large and growing consumer market, and deeply rooted industrial-entrepreneurial culture.

[5]India's real gross domestic product (GDP) at current prices stood at Rs. 135.13 lakh crore (US$ 1.82 trillion) in FY21, as per the provisional estimates of annual national income for 2020-21.

India is the fourth-largest unicorn base in the world with over 21 unicorns collectively valued at US$ 73.2 billion, as per the Hurun Global Unicorn List. By 2025, India is expected to have 100 unicorns by 2025 and will create 1.1 million direct jobs according to the Nasscom-Zinnov report 'Indian Tech Start-up'.

India needs to increase its rate of employment growth and create 90 million non-farm jobs between 2023 and 2030's, for productivity and economic growth according to McKinsey Global Institute. Net employment rate needs to grow by 1.5% per year from 2023 to 2030 to achieve 8-8.5% GDP growth between 2023 and 2030.

According to data from the RBI, as of the week ended on June 04, 2021, the foreign exchange reserves in India reached US$ 605 billion.

As per the Reserve Bank of India's (RBI) estimates, India's real GDP growth is projected at 9.5% in FY22; this includes 18.5% increase in the first quarter of FY22; 7.9% growth in the second quarter of FY22; 7.2% rise in the third quarter of FY22 and 6.6% growth in the fourth quarter of FY22.

India is expected to be the third largest consumer economy as its consumption may triple to US$ 4 trillion by 2025, owing to shift in consumer behaviour and expenditure pattern, according to a Boston Consulting Group (BCG) report. It is estimated to surpass USA to become the second largest economy in terms of purchasing power parity (PPP) by 2040 as per a report by PricewaterhouseCoopers.

[6]According to the Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflow in India stood at US$ 529.63 billion between April 2000 and March 2021, indicating that the government's efforts to improve ease of doing business and relaxing FDI norms have yield results.

FDI equity inflow in India stood at US$ 59.64 billion between April 2020 and March 2021. Data for 2020-21 indicates that the computer software and hardware sector attracted the highest FDI equity inflow of US$ 26.15 billion, followed by construction (infrastructure) activities (US$ 7.88 billion), services sector (US$ 5.06 billion) and trading (US$ 2.61 billion).

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[5] https://www.ibef.org/economy/indian-economy-overview taken on 30th September 2021

[6] https://dpiit.gov.in/sites/default/files/FDI_Factsheet_March%2C21.pdf

Between April 2020 and March 2021), India received the highest FDI equity inflow from Singapore (US$ 17.42 billion), followed by the US (US$ 13.82 billion), Mauritius (US$ 5.64 billion), the UAE (US$ 4.20 billion), Cayman Islands (US$ 2.80 billion), the Netherlands (US$ 2.79 billion) and the UK (US$ 2.04 billion).

India is expected to attract foreign direct investments (FDI) of US$ 120-160 billion per year by 2025, according to CII and EY report. Over the past 10 years, the country witnessed a 6.8% rise in GDP with FDI increasing to GDP at 1.8%.

2020-21 (form April, 2020 to September, 2020) the cumulative FDI inflows into India amounted to Rs.224, 613 crores (in US$ 30 billion)

The cumulative FDI inflows in equity mode from April 2000 to March 2021 was Rs.3174480 crores.

5.8.1 Manufacturing Sector

According to a report by Mckinsey and Company, India's manufacturing sector could touch US$ 1 trillion by 2025. There is potential for the sector to account for 25-30 per cent of the country's GDP and create up to 90 million domestic jobs, by 2025.

5.8.2 Service Sector

[7]The services sector accounts for over 54% of India's GVA and nearly four-fifths of total FDI inflow into India. Services sector accounts for 48% of total exports, outperforming goods exports in the recent years. Years. The services sector accounts for over 54% of India's GVA and nearly four-fifths of total FDI inflow into India. The growth in the services sector can be attributed mostly to the emergence of the Indian Information Technology (IT) and IT enabled Services (ITeS) sectors as well as e-commerce. The services sector in India comprises a wide range of activities such as transportation, logistics, financial, business process outsourcing services, healthcare, trading, and consultancies, among many others.

5.8.3 Agriculture

The Indian agriculture sector accounts for 18 per cent of India's gross domestic product (GDP) and employs just a little less than 50 per cent of the country's workforce. India is presently the world's largest producer of pulses and the second largest producer of rice and wheat. The country is also the largest producer, consumer and exporter of spices and spice products in the world and overall in farm and agriculture outputs, it is ranked second.

The Department of Agriculture and Cooperation under the Ministry of Agriculture is the nodal organisation responsible for the development of the agriculture sector in India

[8]The share of Agriculture and Allied Sectors in Gross Value Added (GVA) of the country at current prices is 17.8% for the year 2019-20 (CSO-Provisional

[7] https://www.ibef.org/economy/economic-survey-2020-21

[8] https://www.ibef.org/economy/economic-survey-2020-21

Estimates of National Income, May 29, 2020). Total food grain production in the country in the agriculture year 2019-20 (as per Fourth Advance Estimates), is 11.44 million tonnes more than 2018-19.

The actual agricultural credit flow was Rs. 13, 92,469.81 crore (US$ 190.82 billion) against the target of Rs. 13, 50,000 crore (US$ 185.00 billion) in 2019-20. The target for 2020-21 was Rs. 15, 00,000 crore (US$ 205.56 billion) and a sum of Rs. 9, 73,517.80 crore (US$ 133.41 billion) was disbursed until November 30, 2020.

5.9 Economic Indicators

The economy of any country operates in recurring phases of rising and falling activity, which are referred to as business cycles. Economic indicators are used to measure overall economic activity, for classifying it as either rising (expansion) or falling (recession), as well as for determining the cyclical turning points of these expansions and recessions. Though the level of economic activity or absolute volume have some significance, movements from one period to another is important in order to keep a track of the economy. The analysis of most of the economic indicators is related to the cyclical fluctuations occurring between growth and expansion and decline and recession. The indicators frequently indicate change in terms of index numbers or percent, thus making relative comparisons easier over long periods of time.

5.9.1 Types of Indicators

While there are several types of economic indicators, the most important of them are briefly discussed below.

Inflation and Index Numbers

Inflation is the average rate of increase in prices. Inflation affects the purchasing power of people's income and wealth (personal income and saving), and the government's ability to manage the economy through fiscal and monetary policies (government budgets and debt, money supply, interest rates). The tendency to channel funds into different types of investment and the ability to compete in world markets (balance of payments, value of currency) are also influenced by the inflation rate. A low rate of inflation is a basic goal of economic policy because it protects purchasing power, helps in designing fiscal and monetary policies to promote economic growth and encourages investment in the production of goods and services.

Economic data represents various transactions between buyers and sellers in consumer, industrial, and financial markets involving both private properties and governments. In order to analyze this vast amount of data, the transactions are summarized into groups and overall totals. This summarizing of data is usually done using index numbers, which are a convenient way of quickly assessing the direction and level of changes in economic activity. Index numbers are typically associated with indicators of industrial production and prices, although they are also used for many other economic activities. The different types of index numbers generally used are:

- Consumer price index (it gauges the overall rate of price change for a fixed number of goods and services bought by households)
- Import and export price indexes (they measure price changes in agricultural, and manufactured products for goods bought from and sold to countries abroad)
- Industrial production index (it measures the change in output in manufacturing mining, and other industries)
- Producer price index (it tracks the rate of price change of domestically produced goods in the manufacturing, mining, and other industries)

Gross National Product and Gross Domestic Product

Gross National Product (GNP) refers to "the total value of final goods and services produced in a country, plus income received from other countries minus payments made to other countries." A related measure of the economy's total output product is Gross Domestic Product (GDP). GDP is the total monetary value of all the goods and services produced in a country in one financial year. There is a technical difference between GNP and GDP. GNP includes goods and services produced outside a nation's boundaries by the nation's citizens and firms, but GDP excludes them. GNP excludes goods and services produced within a nation's boundaries by foreign citizens and firms, but GDP includes them.

GDP and GNP are commonly used measures of national income, and are the indicators of growth and economic output. An economy is usually considered to be prosperous if the GDP and GNP, calculated on a per capita basis, are high.

Interest Rates

Interest represents the cost of borrowing money. An interest rate is the annualized percentage that interest is of the principal of the loan. The level of interest rates for different loans reflects the length and the risk of the loan. Interest rates have a significant impact on borrowing and spending decisions. Generally business, household, and government borrowing are stimulated when interest rates are perceived as low.

Unemployment

Unemployment figures indicate the number of persons without jobs and self employment. Thus, unemployment manifests itself in the form of excess supply of labor over the demand for labor. The unemployment rate refers to the percentage of labor force unemployed at any given date. The unemployment rate is a prime indicator of the extent to which the economy offers employment to job seekers.

Income Distribution

Income distribution implies the proportion of total household money income as received by households in low, middle, and high-income groups. Income distribution focuses on differences in the economic well-being of different groups in the population. Economic growth is hindered when purchasing power and profit-motivated incentives are not broadly based. A large disparity in income results in increasing discord and despair, among the population. Measures of poverty are related to the distribution of income.

Foreign Exchange Reserves

Foreign exchange reserves have a strong bearing on the process of economic growth of an economy. Gold, statutory depository receipts and foreign currency assets of the central bank of a country constitute a country's foreign exchange reserves. The fluctuations in foreign exchange reserves emanate from the movements in the external sector of the economy. In fact, improvement or deterioration in the country's balance of payment, capital inflow and capital outflow determine the size of the foreign exchange reserves. Thus, the position of the foreign exchange reserves shows the state of the country's balance of payments.

Infrastructure

Infrastructure is also one of the economic indicators of a country because the economic development of a country has to be accompanied by the development in infrastructure. The better the infrastructural facilities in a country, the better is the scope for economic development.

The infrastructure facilities of a country can be divided into soft and hard skills.

Soft skills include education and human skills. Education skills are significant since the literacy rate of a country plays an important role in economic development. Human skills are important since people equipped with better skills and knowledge can help increase the output.

Hard skills include transport and Information and Communication Technologies (ICT). An efficient and well developed system of transport and ICT is vital to the success of economic development planning, which lays stress on rapid industrialization.

Transport

Transport is an integral part of commercial activities, and is intended to help the free flow of exchange of commodities. Transport includes rail, road, sea, and air transport.

Rail

Railways are of great importance in the economy of any country. A good network of railways facilitates free flow of commodities.

Road

Roads constitute a significant element in the transportation infrastructure. Road transport is quicker, more convenient and more flexible. It is particularly good for short distance movement of goods.

Sea

Inland water transport, comprising canals, rivers, etc, hold out a potential for a nation's transport sector. Sea transport is important as it gives access to most parts of the world.

Air

Air transport also has a significant role to play in economic development. It saves time and is best suited for long distance travel.

Information and communication technologies

The telecommunication system of a country can also play an important role in its economic development. For instance, in India, telecommunication not only offers the benefits of communication to people but also improves global competitiveness of the economy and attracts foreign direct investment. With the advent of the Internet, the efficiency in the process of communication has increased significantly. Businesses have also benefited through the use of the Internet. The Internet has also had an impact on customers, who have become more demanding as they now have more information about new products and services. The consumer demand had led to the development of information and communication technologies (ICTs). ICTs cover all technical aspects for information processing and communication.

Activity: Take an example of any country and analyze its economic indicators for the period 2020-21.

Answer:

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Check Your Progress - 3

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

12. The total value of final goods and services produced in a country, plus income received from other countries minus payments made to other countries is generally termed as

    a. Gross domestic product
    b. Gross national product
    c. National income
    d. Net income

13. The economy of any country operates in recurring phases of rising and falling activity. This is commonly referred to as:

    a. Trade cycles
    b. Business cycles
    c. Production cycles
    d. Economic cycles

14. What is the rise in the general level of prices known as?
    a. Recession
    b. Deflation
    c. Inflation
    d. Stagflation
15. Which of the following are the broadest indicators of growth and economic output?
    a. Gross domestic product
    b. Gross national product
    c. Both a and b
    d. None of the above

5.10 Summary

- The economies of the world can be classified on the basis of ownership of the means of production and level of development reached.
- Based on the ownership of the means of production, economic systems are classified as capitalist, socialist, and mixed. Based on the level of development reached, countries are classified as developed economies, underdeveloped economies, and developing economies.
- Consumption patterns could be described on the basis of Engel's law and product saturation levels. According to Engel's Law, "With rising incomes, the share of expenditures for food (and, by extension, other) products declines. The resulting shift in expenditures affects demand patterns and employment structures. The poorer families will spend a larger share of their total expenditures on food than wealthier families."
- A record of the factors influencing the supply of and demand for a country's currency is maintained in the balance of payments account. The balance of payments account can be divided into current and capital account.
- National control of international transfers is done to accomplish economic goals,. Earlier, controls over international transfers were guided by a revenue motive. Today, with the exception of low-income countries, the revenue motive is not an important factor guiding national policy in this area.
- India is one of the fastest growing economies in the world due to development in agriculture, industrial, and service sectors.
- The different economic indicators that are used to measure overall economic activity in the country such as inflation and index numbers, GDP and national income, interest rates, unemployment, income distribution, foreign exchange reserves, and infrastructure.

5.11 Glossary

- **Balance of Payment Account**: "A balance of payment account is a systematic record of transactions of a country involving claims on and liabilities to the rest of the world."
- **Capital Account**: Capital account is that portion of a country's national accounting system that records international transactions involving the purchase or sale of financial or physically durable assets, such as money, securities, dividends, factories, government debt, and land.
- **Capitalist economy**: Capitalist economy is a system in which all the means of production (land, labor, capital and machinery) are owned and controlled by private individuals.
- **Current Account**: Balance of payments account that records exports and imports of goods, exports and imports of services, investment income, and gifts.
- **Developed Economy**: A developed economy is one, which has reached a very high stage of development. The per capita income and standard of living of the people is very high in such countries.
- **Developing Countries**: Countries characterized as having a relatively low per capita GDP and comparatively low levels of output, living standards, and technology.
- **Gross Domestic Product**: The gross domestic product (GDP) is the total monetary value of all the goods and services produced in a country in one financial year.
- **Gross National Product**: Gross National Product (GNP) refers to the total value of final goods and services produced in a country, plus income received from other countries minus payments made to other countries.
- **Mixed economy**: A mixed economy consists of three sectors: public sector (all firms and business houses are owned by the government), private sector (all firms and business houses are owned by private individuals), and joint sector (has both public and private enterprises).
- **Socialist economy**: Socialist economy is a system in which all the means of production are owned by the whole community and all economic decisions related to production, exchange, and distribution are taken by the state.

5.12 Self-Assessment Test

1. The world economy has undergone revolutionary changes during the past decades. Briefly give an overview of the world economy.
2. Classify the economies on the basis of ownership of means of production and the level of development reached. Briefly explain.
3. Describe in brief the consumption patterns and the theories supporting it.

4. Define balance of payments. Explain the causes for disequilibrium in balance of payments.
5. Explain the concept of national control on international transfers.
6. Give a brief overview of the Indian economy.
7. Economic indicators are used to measure overall economic activity, for classifying it as either rising (expansion) or falling (recession), as well as for determining the cyclical turning points of these expansions and recessions. Describe briefly the types of economic indicators.

5.13 Suggested Readings / Reference Material

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5.14 Answers to Check Your Progress Questions

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

1. (c) Economic environment

Economic environment refers to all those economic factors which have a bearing on the functioning of a business. Hence, the dependence of business on the economic environment is total; as it is rightly said, a business is one unit of the total economy.

2. (b) Capitalist economy

Capitalist economy is a system in which all the means of production (land, labor, capital and machinery) are owned by private individuals. All the economic activities are steered by self-interest. Economic problems are solved by price mechanism and there is a very limited role for the government.

3. (d) Socialist economy

Socialist economy is a system in which all the means of production are owned by the whole community and all economic decisions related to production, exchange, and distribution are taken by the state.

4. (c) High per capita income and high standard of living

A developed economy is one, which has reached a very high stage of development. The per capita income and standard of living of the people is very high in such countries.

5. (b) High per capita income and high standard of living

India is a good example of mixed economy. In India, while the government owns some of the most important industries, some are owned by private individuals.

6. (a) Capitalistic economy

Capitalist economy is a system in which all the means of production (land, labor, and machinery) are owned and controlled by private individuals.

7. (d) Private enterprises co-exist with government enterprise

In a mixed economy, private enterprises co-exist with government enterprise.

8. (a) Ernst Engel

The nature of income elasticity (the relationship between demand changes and changes in income) for food was first observed and formulated by the nineteenth century Prussian statistician, Ernst Engel. According to Engel's Law, "With rising incomes, the share of expenditures for food (and, by extension, other) products declines. The resulting shift in expenditures affects demand patterns and employment structures. The poorer families will spend a larger share of their total expenditures on food than wealthier families."

9. (a) Capital account

Capital account may be defined as a record of investment and payment flows between a country and the rest of the world. The capital account of a country consists of its transactions in financial assets in the form of short-term/long term lending and borrowing, and private and official investments.

10. (b) Current account

The current account of the balance of payments is a record of the value of trade in goods and services and of transfers between a country and the rest of the world. A deficit on the current account means that more goods and services have been imported into the country than have been sold abroad.

11. (d) All of the above

International transfers are controlled in order to accomplish economic goals. Earlier, controls over international transfers were guided by a revenue motive. Today, with the exception of low-income countries, the revenue motive is not an important factor guiding national policy in this area.

12. (b) Gross national product

Gross national product refers to the total value of final goods and services produced in a country, plus income received from other countries minus payments made to other countries.

13. (b) Business cycles

The economy of any country operates in recurring phases of rising and falling activity, which are referred to as business cycles. Economic indicators are used to measure overall economic activity, for classifying it as either rising (expansion) or falling (recession), as well as for determining the cyclical turning points of these expansions and recessions.

14. (c) Inflation

The rise in the general level of prices is known as inflation. Inflation affects the purchasing power of people's income and wealth (personal income and saving), and the government's ability to manage the economy through fiscal and monetary policies (government budgets and debt, money supply, interest rates).

15. (c) Both a and b

Gross Domestic Product and Gross National Product are indicators of growth and economic output.

Unit 6

Financial Environment

Structure

6.1 Introduction
6.2 Objectives
6.3 Monetization of Economy
6.4 Financial Systems
6.5 Financial Markets
6.6 Development of Financial Markets
6.7 The Nature and Role of Financial Institutions in the Economy
6.8 Summary
6.9 Glossary
6.10 Self-Assessment Test
6.11 Suggested Readings/Reference Material
6.12 Answers to Check Your Progress Questions

6.1 Introduction

In the previous unit, the economic environment and its significance to business were discussed. In this unit, the financial environment is discussed.

The financial environment is changing constantly worldwide due to the development of new financial products and changes in economic indicators and deployment such as balance of payment, inflation, foreign exchange reserves, etc. Every business is affected by financial environment.

As businesses are affected by the financial environment (financial markets, financial institutions, financial products, etc.) prevailing in that country, it becomes necessary to understand what types of markets exist in that country, what products are available in each market etc.

This unit discusses the monetization of economy and the functions of a financial system. The unit then discusses financial markets and its development. The unit also discusses the nature and role of financial institutions in the economy.

6.2 Objectives

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

- Explain monetization of economy.
- Describe financial systems and its functions.
- Define financial markets.
- Describe the development of financial markets.
- Determine the nature and role of financial institutions in the economy.

6.3 Monetization of Economy

Monetization of economy refers to the extent to which money is used for entertaining economic transactions. Monetization can be measured as Broad Money (M_3) divided by Gross Domestic Product. The formula shows the percentage of economy that is monetized.

6.3.1 Money Supply

Money is sometimes defined as anything generally acceptable as a medium of exchange. However, the means of transferring bank deposits from one person to another (i.e. cheques) are not money. A cheque is simply an instruction to a bank to transfer money from one account to another. A cheque that cannot be honored against a bank deposits is worthless.

The Measures of Monetary Aggregates

According to a definition given by RBI in July 1935, money supply is the sum of currency with the public and demand deposits with the banking system. This is known as 'narrow money' and is represented as M1. The concept of 'broad money', also referred to as Aggregate Monetary Resources, equivalent to the sum of M1 and the time deposits with the commercial banks, was first introduced in the financial year 1964-65. On acceptance of the Report of the Second Working Group in March 1970, a series of new aggregates, given below, came into effect.

M_1 = Currency with the public* + Demand Deposits with the Banking System + Other Deposits with the RBI

M_2 = M_1 + Post Office Savings and Bank Deposits

M_3 = M_1 + Time Deposits with the Banking System

M_4 = M_3 + Total Post Office Deposits (Excluding National Savings Certificates)

* Currency in circulation = Currency with the public + Currency with the commercial banks.

Of the four concepts of money supply, RBI emphasizes two concepts viz., Narrow Money (M_1) and Broad Money (M_3). These concepts are used extensively not only by the monetary authorities but also by academicians. Narrow money excludes time deposits based on the argument that they are income earning assets and therefore not liquid. On the contrary, broad money includes time deposits following the argument that, as time deposits are income earning assets and people have acquired them by converting cash into time deposits for earning future interest income, some amount of liquidity is present in time deposits.

The M_2 and M_4 measures of money supply include post office savings account and other deposits with the post offices. As these are also considered to be liquid assets, they should form a part of the aggregate monetary resources of the public.

6.3.2 Gross Domestic Product

The Gross Domestic Product is the total monetary value of all the goods and services produced in a country in one financial year. GDP equals the total monetary value of the consumption goods, investment goods, government purchases, exports, and services produced inside the country in one year. The GDP can be used as a measure of production and output.

Measuring the GDP

There are several methods for measuring the GDP. It is measured either as the flow of products or as the sum of earnings method. These two methods of measuring GDP are totally independent of each other.

The GDP takes into account only those goods that are produced in the current fiscal year and does not take into account the goods and services that are produced in the previous years but are consumed now. In addition, GDP only takes into account those goods and services that are produced domestically, within the borders of a country.

For example, the goods produced by Indian citizens and companies in the Gulf countries are not included in the GDP of India. But GDP does take into account the goods and services produced by foreign citizens and companies in India.

Now let us take a bird's eye view of the **dos and don'ts** of measuring the GDP. According to convention, the goods and services produced by a country are measured in terms of the proportional weightages assigned to them, in relation to the prices the goods and services carry. Also, while measuring the GDP, sufficient care has to be taken to avoid ***double counting.***

Consider buying a sports car, where the car tyres are part of car's standard equipment. Assume the car's tyres are worth Rs 20,000 and the overall worth of the sports car is Rs 20, 00,000. It would be a fatal mistake to separately count the tyres for Rs 20,000 as only the final goods and services are considered for measuring the GDP. Here the sports car's overall price includes the price of the tyres, and hence calculating the tyres separately for GDP along with overall car price in the GDP would give a wrong estimate of the GDP and would lead to double counting in the process of measuring the GDP. But if the car's tyres were sold separately, then it automatically becomes the final goods. To get the exact difference between intermediate and final goods, let us understand that the intermediate goods are those goods that require further processing in the value chain before they become final goods to be sold to the consumers. Intermediate goods are hence part and parcel of final goods. Final goods are those goods that are ready for consumption, are part of finished goods inventory, and require no further processing in the value chain. Only final goods are considered for measuring the GDP.

Other methods used for measuring GDP include expenditure or flow of funds approach and income or flow of income approach. The first method is expenditure or flow of funds approach. In this method, GDP equals gross private domestic investment, sum of personal consumption expenditure, net exports, and government purchase of goods and services.

The second method is the income or flow of income approach. In this method, the income of all the production factors is summed with employee compensation, rents, proprietor's income, interest, dividends, corporate income taxes, undistributed corporate profits, and depreciation and indirect business taxes. Both the methods should result in identical or near identical, GDP calculations.

6.4 Financial Systems

A financial system operates as an intermediary that facilitates the flow of funds from areas where funds are in surplus to areas where funds are in deficit. It is composed of several institutions, money managers, markets, analysts, claims and liabilities, regulations and law, practices, and transactions.

The financial system helps determine both the cost and the volume of credit. This system can affect an increase in the cost of funds, thus adversely affecting the consumption, production, employment, and growth of the economy. On the other hand, it could lower the cost of credit and have a positive affect and enhance all the factors. Clearly, a financial system has an impact on the basic existence of an economy and its citizens.

6.4.1 The Functions of a Financial System

The Savings Function

The savings that are again invested in the production function result in production of better goods and services and an increase in society's living standards. When savings decline, however, the growth of investment and living standard begins to fall.

Liquidity Function

Money in the form of deposits offers the least risk of all financial instruments. But its value is mostly eroded by inflation. That is why one always prefers to store funds in financial instruments like stocks, bonds, debentures, etc. However, in such investments (1) a greater level of risk is involved, (2) and the degree of liquidity (i.e. conversion of the claims into money) is less. The financial markets provide the investor with the opportunity to liquidate the investments.

Payment Function

The financial system provides an expedient payment mode for goods and services. The cheque system, credit card systems, etc. are some of the easiest methods of payment in the economy; they also drastically reduce the cost and time of transactions.

Risk Function

The financial markets provide protection against life, health, and income risks. They offer health, life, and property insurance policies.

Policy Function

Modern day economies require huge sums of money for investment in capital assets (land, equipment, factory, etc.), which are then used for providing goods and services. The funds required are so huge that it is not possible for a single government/firm to meet the requirement. By selling financial claims like stocks, bonds etc., the required funds can be quickly raised from a variety of investors. The business firm/government issuing such a financial claim then hopes to return the borrowed funds from expected future inflows. Indeed, we see that the financial markets within the financial system have made possible the exchange of current income for future income and transformation of savings into investments, so that production and income grow.

6.5 Financial Markets

A financial market is a market where financial assets are either created or transferred. Financial assets represent a claim to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend.

Financial markets are sometime classified as primary and secondary markets. But, more often, financial markets are classified as money markets and capital markets. The money market deals with all transactions in short-term instruments (with a period of maturity of one year or less, like treasury bills, bills of exchange, etc.), whereas the capital market deals with transactions related to long-term instruments (with a period of maturity of above one year, like corporate debentures, government bonds, etc.) and stocks (equity and preferences shares).

6.5.1 Money Market

A money market offers resources for working capital needs. In a money market, savings are channeled into short-term productive instruments like treasury bills market, call money markets, certificate of deposits, and markets for commercial paper.

6.5.2 Capital Market

The capital market offers resources to support medium and large-scale industries. The capital market deals in long-term sources of funds (with more than 1 year maturity).

Check Your Progress –1

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

1. Which of the following method(s) is/are used in measuring GDP?
   a. Product flow approach
   b. Sum of earnings approach
   c. Spending approach
   d. All of the above
2. Which of the following is not the function of a financial system?
   a. Consumption function
   b. Liquidity function

   c. Risk function
   d. Policy function

3. Which of these represent a claim to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend?
   a. Financial market
   b. Financial asset
   c. Money market
   d. Capital market

4. Which of the following is/are characteristic(s) of the money market?
   a. Offers resources for working capital needs
   b. Only highly illiquid and long term instruments are dealt in the money market.
   c. The instruments dealt in the money market constitute high risk.
   d. All of the above

5. Which of the following markets deal with transactions related to long-term instruments and stocks?
   a. Money market
   b. Financial market
   c. Capital market
   d. All of the above

6.6 Development of Financial Markets

In a rudimentary economy, there are no financial markets. In such an economy, each person has to be financially self-sufficient. Every opportunity to invest is dependent upon the individual's ability to save. Likewise, the desire to save is constrained by the individual's opportunities to invest. Individuals who want to invest more than they can possibly save are forced to cut back on their investment. And those who want to save more than their opportunities allow are forced to cut back on savings. As a result, very little of either gets done. Financial markets make it possible for acts of saving and investment to be separated: these markets make it possible for some members of the society to save, while others may assume responsibility for real investment operations. The separation of the acts of saving and investment serves to increase both savings and investment, and hence the wealth and growth of the economy. Individuals who want to save but not invest can do so by lending in financial markets. Others who want to invest but not save can do so by borrowing in financial markets.

The different individual decisions of participants in the market must be balanced. The balancing process is facilitated through the movement of interest rates toward equilibrium. The interest-rate price of lending and borrowing transactions adjusts rapidly so that those who want to borrow can find willing lenders and vice versa.

The development of markets to bring those who want to save and lend together with those who want to borrow and invest is an important step toward financial development. However, direct face-to-face dealing between ultimate net savers and ultimate net investors is often not practical. "Securities brokers" are needed when face-to-face transacting is too costly. "Financial intermediaries" are needed to resolve differences between the needs of savers and the needs of those who invest. Even if savers-lenders and borrowers-investors can agree on an interest rate, they will conclude their transaction only if they can further agree on all other terms such as maturity, collateral, method of redemption, etc. Such agreement can be exceedingly difficult. Most savers prefer to keep their savings liquid by lending short-term. Investment, on the other hand, is usually long-term; it is usually financed through long-term borrowing. Obviously, a single market connecting such lenders with such borrowers cannot work to mutual advantage. This, then, suggests the development of differentiated markets – one for short-term lending and one for long-term borrowing. This problem is solved by the development of different types of financial intermediaries.

The presence of various financial intermediaries in an economy indicates that the economy is in an advanced stage of financial development.

Financial markets can be classified as "negotiated" and "open" financial markets. An open market is one in which the unit of transactions is well known and does not need to be negotiated every time a transaction is carried out. Open market securities can be offered for bidding by many buyers. When the unit of transaction is very similar, even if not identical, an open market readily develops. High-grade corporate bonds are not all alike, but an open market in corporate bonds in general can be said to exist.

Negotiated markets, by contrast, include all the transactions that take place between a single lender and a single borrower, or among a small number of parties. Between them the terms of a loan are personally bargained. These terms include the interest rate.

6.7 The Nature and Role of Financial Institutions in the Economy

Financial institutions are vital to the economic well-being and future growth of a market-oriented economy. In most industrialized economies today, the liabilities of financial institutions are the principal means for making payments for goods and services, and their loans are the chief source of credit for all economic units in society-business, households, and governments.

6.7.1 The Nature of Financial Institutions

A financial institution is a business firm whose principal assets are financial assets or claims – stocks, bonds, and loans. They make loans to customers or purchase investment in the financial marketplace.

Financial institutions can be divided into two groups – financial intermediaries and other financial institutions. Financial intermediaries acquire the IOUs issued by borrowers-primary securities-and at the same time sell their own IOUs – secondary securities – to savers.

The major types of financial intermediaries in market-oriented economies include commercial banks, credit unions, saving banks, savings and loans associations, money market funds, insurance companies, investment companies (mutual funds), finance companies, pension funds, real estate investment trusts, and leasing companies.

6.7.2 Financial Institutions and the Financial System

Financial intermediaries and other financial institutions are part of a vast financial system that serves the public. The basic function of the financial system it to transfer funds that can be loaned from lenders to borrowers.

Savings-surplus units are those households businesses and units of government whose current income receipts exceed their current expenditures, giving them extra funds to lend to other units in the financial system.

Savings-deficit units on the other hand are those businesses, households and governments whose current expenditures for consumption and investment exceed their current income receipts.

6.7.3 Financial Intermediation

The term 'Financial Intermediation' primarily means facilitating the supply of funds to the buyer of funds from the seller of funds. That is, a financial intermediary is one who facilitates the flow of funds from a person who has excess funds to the person who needs it.

6.7.4 Kinds of Financial Intermediation

Financial Intermediaries actually perform various kinds of intermediation. They are:

Denomination intermediation occurs when small amounts of savings from individuals and others are collected and pooled so as to give loans to others.

Default-risk intermediation occurs when financial intermediaries offer loans to risky borrowers and at the same time issue safe liquid securities. Generally, the borrower from a financial intermediary is perceived to be more risky than the financial intermediary itself.

Maturity intermediation refers to the borrowing of relatively short-term funds from savers (who often cannot commit their funds over long periods) and making long-term loans to borrowers who require a long-term commitment to funds.

Liquidity intermediation refers to accessing of indirect financial claims while accepting illiquid direct claims from investors. This entails high transaction costs and considerable risk of loss if the claims were converted into cash.

Information intermediation refers to the process where the financial intermediaries alternate their skill in assembling and processing information from the financial market place for the saver, who has neither the expertise nor the time to stay ahead of market developments.

Activity: PR Brokerage Services (PRBS) is a brokerage firm based in New Delhi. It wanted to expand its services to other cities. For this purpose, it decided to take loans. As the nature of the business is highly risky, most banks did not accept the company's proposal. The company then approached ICBI,

a company involved in the business of financial intermediation. ICBI issues safe liquid securities to high risk-involved businesses like PRBS. Identify the kind of intermediation that ICBI can provide to PRBS, and describe it. Name the other kinds of financial intermediation.

Answer:

6.7.4.1 Mutual Funds

Mutual funds mobilize funds from various categories of investors and channel them into productive investments. Apart from UTI, mutual funds sponsored by various banks subsidiaries, insurance organizations, private sector financial institutions, Development Finance Institutions and Foreign Institutional Investors have come up. These mutual funds operate within the framework of SEBI regulations which prescribe the mechanism for setting up of a mutual fund, procedure of registration, its constitution and the duties, functions and responsibilities of the various parties involved.

Kinds of mutual funds

Mutual funds differ from each other in a variety of ways: their term, their investment objectives, the type of investors, management style and load. The various types of the mutual funds are as below;-:

Classification based on term of the fund

The basic difference between two mutual funds can be their term structure. A mutual fund may either be open-ended or close-ended. An open-ended fund remains open for unlimited duration for issue and redemption of its shares. A close-ended fund can issue shares only at the commencement of the duration. The shares could neither be redeemed nor issued till the end of the fixed investment duration.

Classification based on investment objectives

Mutual funds are formed with different investment objectives. A fund whose objective is to generate capital gains rather than current income for the investors is referred to as a growth fund. These funds generally invest in stocks. A fund which aims to generate current income is called an income fund. These funds may invest either in shares expected to distribute dividends, or in debt instruments, or in a combination of both.

Balanced funds are those which aim to generate both current income and capital gains. The aim of liquid funds is to invest in extremely liquid securities.

Specialized funds invest in particular industries, sectors or markets. Funds that invest solely in foreign markets are referred to as international funds (also called offshore funds), while those investing both in domestic markets and international markets are referred to as global funds.

Internationally, there is a category of funds that invests in a portfolio of other mutual funds. Such funds are called multi-funds.

Activity: Celia, a software engineer, invested in a mutual fund consisting of a portfolio of Indian software companies. What kind of mutual fund investment did Celia take up? Name the other classes of mutual fund investments.

Answer:

Classification based on types of investors

Some categories of funds differ from other funds because of their investor profile. An example of such funds is pension funds. These funds manage the pension money of their clients.

Classification based on management style

Funds can also be classified on the basis of the way the funds are managed. The corpus of the fund is managed either actively or passively. Active management of funds involves gathering of security specific information, analyzing it, and selecting those securities that are most expected to fulfill the investment objectives. This process entails a heavy cost that is charged to the scheme. Funds that manage their corpus actively are called managed funds. On the other hand, passive management of funds involves the selection of a market index. After an index has been selected, the securities that form a part of the index are bought in the proportion in which they are represented in the index. No further transaction is carried out and these securities are held till a need to liquidate the corpus arises. If a part of the corpus is required to be liquidated for redemption purposes, it is liquidated in the same proportion in which the securities are held.

Classification on the basis of load

A fund incurs two types of costs – marketing costs and operating costs. While the operating costs of the scheme are charged to the scheme's earnings, the marketing costs may not be so charged. On the basis of the marketing costs charged to the scheme, funds can be classified into load funds and no-load funds. Load funds charge the marketing costs to the scheme, while the no-load funds do not. The no-load funds recover the costs of marketing as part of management costs.

Load funds are of two types – front load and back load. In a front load fund, the load is charged at the time the investors invest in the fund. In the case of back load fund, investors are required to pay the load charges while exiting from the fund.

Example: Other Classifications of Mutual Funds

Mutual funds are also classified on the basis of a specific purpose and are targeted at specific customer groups. They are discussed below:

Tax savings schemes

There are various tax savings schemes in India and one such popular scheme is the Equity Linked Savings Scheme (ELSS), which is a generic mutual fund product.

Most mutual fund companies offer ELS schemes under their respective brands. Under an ELSS, investments up to a maximum of Rs.100, 000 are deductible from the investor's taxable income, under section 80C of the Income Tax Act. Funds collected under this scheme are invested in equity markets. ELSS funds have a minimum lock-in period of three years, and the risks associated with them are high as they are invested in equities.

These fund products are marketed to those investors who are ready to take a high risk and are not worried about immediate liquidity. Tata Tax-Saving Fund is an equity-linked, tax saving fund with a minimum investment of Rs.500 and further investment in multiples of Rs.500.

Index funds

Under index funds, investments are made on the stocks that are present in standard indices like the Bombay Stock Exchange, Sensex and S&P CNX Nifty (Nifty). When such investments are made, the returns from the portfolio behave in the same manner as that of the corresponding indices. For example, the UTI Nifty Fund, launched in 2000, is based on the S&P CNX Nifty index. The capital pooled from this fund is invested in all the fifty stocks present in the Nifty. So, the performance of this fund almost mirrors the performance of Nifty. In other words, if Nifty gains, the fund also gains and vice versa.

Theme-based funds

Theme-based funds are based on thematic ideas such as leadership, lifestyle, or industry/sector. Theme-based funds have all the associated characteristics of equity funds. According to paisabazar.com the best thematic mutual funds to invest in 2021 were ABSL MNC Fund, SBI Magnum Global Fund SBI Magnum Equity ESG Fund UTI Dividend Yield ICICI Prudential India Opportunities Fund.

Industry specific funds, also called sectoral funds, are based on the theme of an industry/sector. They are special purpose funds meant for investing only in specific industries. The same will be stated in the offer documents specifying the industry in which they may be invested. For example,

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industries like IT, pharmaceuticals, textiles, etc. have attracted investments through such funds. Sectoral funds under SBI Mutual Fund, for instance, include the FMCG Fund, the Emerging Businesses Fund, the IT Sector Fund, and the Pharmaceuticals Fund.

Compiled from various sources.

Advantages of mutual funds

Diversified investment improves the risk-return profile of the portfolio. The transactions of a mutual fund are usually very large. The large volumes of transactions attract lower brokerage commissions and other costs in contrast to the smaller volumes of the transactions done by individual investors. Mutual funds offer several schemes to cater to the needs of the investors. Thus the investors have the option to choose between regular schemes and growth schemes. The mutual funds are managed by well-experienced and knowledgeable professionals who devote their time solely to track and update the portfolio. Thus, mutual fund investments save investor’s time and effort and are also likely to generate better results.

Disadvantages of mutual funds

Investment in mutual funds has its disadvantages as well. For one, the investors cannot choose the securities they want to invest in, or the securities they want to sell. Secondly, the investors face the risk of the fund manager not performing well. Also, if the fund manager’s compensation is linked to the fund’s performance, he may be tempted to show good results in the short-term without paying attention to the expected long-term performance of the fund. This would harm the long-term interest of the investors.

6.7.4.2 Venture Capital

Venture capital refers to organized financing done privately or through an institution to offer substantial amounts of capital through equity purchases and debt offerings. This enables the growth oriented firms to grow and succeed.

Characteristics of venture capital

The three primary characteristics of venture capital funds are: (1) that it is either equity or quasi equity investment, (2) it is a long-term investment; and (3) it is an active form of investment. In a venture capital fund, the investor assumes risks and there is no security for the investment made by the investor.

6.7.4.3 Public deposits

Public deposits as defined under Section 45-I (bb) of the RBI Act, is money received by way of deposit or loan or in any other form, excluding certain specified items. The section also provides the list of items that are to be excluded from being considered as public deposits.

Another major regulation that has been brought about by the NBFC Public Deposit Directions is the linking of the NBFCs credit rating to the acceptance of public deposits. Thus, an NBFC will be allowed to accept public deposits if it has a minimum Net owned Fund (NOF) of Rs 25 lakhs but less than 200 lakhs, it has a minimum investment grade to other specified credit rating for FDs from any one of the approved credit rating agencies at least once in a year, and it has complied with all prudential norms. In June 2008, the ceiling on public deposits for NBFCs has been revised. As per the revised regulations, the maximum rate of interest an NBFC can offer is 12.5 percent and the period for which these deposits can be accepted/renewed by the NBFCs should not be less than 12 months and exceed 60 months.

6.7.4.4 Insurance

The term 'Insurance' conveys different meanings to different people. Webster's explains Insurance as an "indemnity against risk of loss or harm, or, in case of loss, damage or beneficial payment against the death."

Meaning and concept

The amount of compensation for the loss through insurance will be based on various factors such as the perceived value of the insured object, the value or benefit that is being and that will be accrued on the insured object, and of course the value for which the object is insured for. Therefore, only an entity with a value and which provides a basis for evaluation to determine its value can be insured. All General Insurance contracts insure non-life properties, and are entered into only after a careful evaluation of the value based on the prevailing market price and on the revenue generating capacity of such an asset. But to value a life for a life Insurance contract is a difficult proposition.

There are two reasons for this difficulty:

- Unlike general insurance, there cannot be any compensation for loss of life. It is only the loss of income due to the death of the individual that may be compensated; and
- Loss of income to the family of the insured itself depends on factors like longevity and earning capacity of the individual.

Once these two parameters are reasonably determinable, a value can be assigned to that particular life. On the basis of such value, a policy' can be taken to 'insure' that life. Determination of the value of the subject matter in case of general insurance is based on its present value at the time of taking up insurance, while it is the future streams of cash inflows of the insured that is considered for valuing life in case of life insurance.

Terminology

Any insurance contract sold by an insurance company is termed as a Policy. A policy can be any type of contract of insurance that is liable to be paid by the insurance company on fallen due. A policy is said to have fallen due if the insured risk translate to losses.

The contribution that is to be paid by the insured in order to maintain the continuity of the policy is termed as Premium. The amount of premium that is paid for the continuation of the policy depends on various factors (these will be examined in detail later in the discussion).

Sum Insured is the amount that is promised by the insurance company in case of a claim either by maturity (in case of life insurance policies) or by loss to the insured subject.

Surrender Value is the amount which the insurer is prepared to pay to the assured if the insured discontinues the policy to the insurer. The policy is said to be paid-up when a payment is made by the insured. The 'Life of the Policy' refers to the time period during which the insurance policy is in effect. The policy is said to have expired when the cover ceases to exist.

Hazards are conditions that increase the frequency/severity of losses. Based on the attitude of the insured, hazards are classified into Moral Hazard and Morale Hazard. Moral Hazard refers to the malafide intentions of either of the parties of the contract in fulfilling their obligations with respect to the performance of the contract. A Morale Hazard in insurance terminology refers to the "indifference to the loss created by the purchase of insurance contract."

Classification of insurance

Insurance has been classified on the lines of kinds of coverage it is able to offer. Primarily, insurance is offered either as Life Insurance or as General Insurance. Life Insurance covers insurance of life, and covers risks related to the death of a person for whom insurance is bought. In case of loss of life of the person who has bought insurance (the insured), the insurance company (insurer) will pay an amount to the deceased's family General Insurance encompasses all those kinds of insurance contracts that cover non-life subjects. It has to be noted that insurance of health or insurance against personal disability is also classified under General Insurance.

While the primary classification of insurance remains as Life and General, there are various sub-classifications in General Insurance based on the peril against which the general insurance is sought. Insurance may be sought against loss by fire (fire insurance), water (marine insurance), earthquake, theft, infidelity and fraud. The Insurance industry around the world has, in fact, been able to offer insurance for any kind of loss, provided it is predictable and quantifiable.

Various kinds of insurance products

Life insurance: Insurance provided for the payment of a sum of money on the death of the insured person due to natural causes (such as disease, old age, debility, etc.) or on the expiry of a certain number of years if the insured person is then alive, fall within the purview of life insurance. Primarily, there are two types of life insurance policies. They are (i) Whole Life Policy (amount payable in the event of death) (ii) Endowment Policy (amount payable at the end of a certain period of time or death, whichever is earlier).

General insurance: Insurances other than life insurance fall within the purview of General Insurance. General insurance covers loss of every other physical or non-physical asset. The loss may be due to the fire, theft, accident, etc.

Insurance of interest: This classification comprises mainly the fidelity guarantee insurance and the guarantee insurance. Fidelity insurance covers loss by fidelity of an employee in the company. Guarantee insurance covers loss by providing of garnet on a product offered by the company that is getting such insurance.

Insurance of liability: Public (third party) liability insurance, products liability insurance, and professional indemnities fall under this classification. All risks arising out of performance of one's own duty or mistake and the effect of such mistake to others and damage thereof is insured as liability insurance. That is, this insurance covers any unforeseen liabilities arising out of damage to others (including or excluding those persons not directly involved) in the process of usage of the product or service offered by the company.

The below exhibit 6.1 explains HDFC's journey.

Exhibit 6.1: HDFC Life's Journey from 'Good to Great'.

HDFC with the market cap of Rs 1.45 lakh crores is the biggest life insurance company among the private insurers followed by SBI Life's Rs. 87,838 crore, ICICI Prudential Life's Rs. 68,645 crore and Max Insurance, at No. 4 position with a little under Rs. 31,000 crore. The first three life insurance companies were listed

between November 2016 and November 2017. The credentials of all the three companies are impeccable with strong pedigree. Though in terms of size HDFC Life is behind SBI Life , in terms of business , they are ahead of SBI life. and investors look at better potential in HDFC life over SBI life.

There are few factors to strengthen the investors' confidence in HDFC life. The strong management team headed by M/S Padalkar, the excellent brand benefit, providing a natural trust element. The product mix of HDFC Life is well diversified with both savings and protection options. The company has strong distribution capabilities, in the online channel as well. It is said that the DNA of HDFC is so strong that there is no place for complacent does not allow the management and entire team to be complacent. The right product mix coupled with good distribution system are key to success for HDFC life. To put it right, the company officials say that it is the diversified product mix, with diversified distribution mix.

The company undertook certain challenging decisions such as decreasing the portfolio of Unit linked plans, working on increasing the Term insurance products and annuity products which are the fastest-growing portfolios now.

Another feather on the cap of the company is the significant portion of bank assurance with over 250 partners and brokers (both traditional and non-traditional).

Investing in technology is another area which helped the company to scale new heights. Integration with the core insurance system helped the company during Covid times. Video discussions, doing KYC digitally, tele-medical services and video connectivity providing servicing helped HDFC Life to clock 8 % growth during the three quarters ended December 2020. The EAT for the period ended December 2020 stood at Rs1,042 crore, as against Rs1,064 crore for the corresponding period ended December 2019 in spite of the terrible impact of Pandemic. In India, insurance penetration levels are

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also low at 17 % as against 60 % in developed countries and this is a great advantage for the companies to penetrate in India as there is a large uncovered market.

Vibha Padalkar, the chief of the company says that the aim of the company is to be the most profitable organization.

Source: https://businessindia.co/magazine/hdfc-lifes-journey-from-good-to-great Dated-8th March 2021

6.7.5 Financial Inclusion

Of the 24.67 crore households in the country (2011 census), 10.19 crore do not have access to banking services. In rural areas, 44 per cent households and in urban areas 33 per cent still do not have a bank account. Financial Inclusion will address this anomaly.

The Committee on Financial Inclusion headed by Chairman Dr. C. Rangarajan defined Financial inclusion as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost . Financial Inclusion refers to universal access to a wide range of financial services at a reasonable cost; services including banking products and other financial services such as insurance and equity products

Financial inclusion broadens the resource base of the financial system by developing a culture of savings among large segment of rural population. As low income groups come under the ambit of financial inclusion it protects their financial wealth and other resources in difficult circumstances and mitigates the exploitation of vulnerable sections by the usurious money lenders by facilitating easy access to formal credit.

The Pradhan Mantri Jan-Dhan Yojana was initiated on 15th August 2014 starting new plan of action by opening bank accounts for all covered under financial inclusion definition. The result was very encouraging. As on last working day of September 2021in [9]Jan Dhan Yojana scheme 43.47 Crore beneficiaries banked so far with a ₹144,791.35 Crore Balance in beneficiary accounts.

6.7.6 Banking

The Indian banking system works under the limitations that go with public ownership and social control. The public ownership of banks was achieved in three stages: 1955, July 1969, and April 1980. In addition to the public sector banks, private sector and foreign banks are also required to meet targets in sectoral deployment of credit, and regional credit deposit ratios, and regional distribution of branches.

[9] Source : https://pmjdy.gov.in/ data taken on 30th September 2021

Theoretical basis of banking operations

Commercial banks are simple commercial or business concerns that offer several financial services to customers in return for interest, fees, discounts, and commission. The objective of these banks is to make profits. They differ from other business concerns in the way they balance the principle of profit maximization with other principles.

Liquidity

In banks, the liquidity maintenance is greater than other business concerns due to the nature of their liabilities. Since banks deal with other people's money, a substantial portion of the money has to be repaid on demand. Hence, liquidity management is important for banks.

Banks hold some part of the deposits as cash reserves. The ratio of cash reserves to deposits is known as the Cash Reserve Ratio (CRR) prescribed by the Central Bank of the country.

Scheduled Banks

According to the Second Schedule of Banking Regulation Act, 1965, scheduled banks are those that, "(a) must have paid-up capital and reserve of not less than Rs 5 lakhs; (b) it must also satisfy the RBI that its affairs are not conducted in a manner detrimental to the interests of its depositors." Scheduled banks are required to maintain a certain amount of reserves with the RBI; they, in return, enjoy the facility of financial accommodation and remittance facilities at confessional rates from the RBI.

Nationalization of Banks

The Government of India, under Prime Minister Mrs. Indira Gandhi nationalized 14 banks on 19th July, 1969. All commercial banks with a deposit base over Rs.50 crores were nationalized. The second stage of bank nationalization took place in April 1980 when 6 more banks were nationalized. One of the nationalized banks, New Bank of India was merged with Punjab National Bank in 1993.

Major objectives of nationalization were

- The removal of control of financial system by a few private players
- Facilitate smooth and adequate & prioritizing credit facilities to agriculture, small industry and exports
- To bring professionalism to bank management and expansion of branch network
- To encourage of new classes of entrepreneurs encouraging SSIs
- The provision of adequate training as well as reasonable terms of service for bank staff

Privatization of Banks

Recognizing the need to introduce greater competition in the Indian banking sector which can lead to greater productivity and efficiency, the RBI allowed the entry of new private sector banks.

While permitting the new private sector banks, the RBI set out that they should promote the underlying goals of the financial sector reforms, be financially viable, result in up gradation of technology in the banking sector, avoid shortcomings such as unfair pre-emption and concentration of economic power, cross holdings with industrial groups, and other such factors that beset the private sector banks prior to nationalization.

Branch Banking

The phenomenon of branch banking has aggravated the problem of organizational and operational inefficiency in the banking sector. Some banks in India were operating inefficiently due to their large scale. Branch banking has highlighted another problem, namely, the drain of resources taking place from rural to urban areas, so much that the authorities had to set diverse targets of credit/deposit ratio for areas differing by geography.

Unit Banking

In branch banking, a single bank accepts deposits through its branches at one or more locations in the same city, district or state. On the other hand, in a unit banking system, the bank conducts its overall operations from a single office. Unit banks are found to be compact in size, facilitating cutting of red tape, promoting good rapport between the staff and management, motivating the staff, and giving better service to the customers and community.

Regional Rural Banks

Regional Rural Banks (RRBs) were established in 1975 under the provisions of the Ordinance promulgated on the 26th September 1975 and followed by Regional Rural Banks Act, 1976. The idea was to develop the rural economy and to create a supplementary channel to the 'Cooperative Credit Structure' to enlarge institutional credit for the rural and agriculture sector.

Share capital of RRBs is in the proportion of 50%, 15% and 35% by the Government of India, the concerned State Government and the bank, which had sponsored the RRB. The area of operation of the RRBs is limited to selected few districts in the State. The RRBs mobilize deposits from rural/semi-urban areas and provide loans and advances mostly to small and marginal farmers, agricultural labourers, rural artisans and other segments of priority sector.

After the recommendations of the Dr Vyas Committee, the consolidation process was initiated in RRB sector in the year 2005.

[10]As on March 31, 2020, there were 45 RRBs functioning in 685 districts of 26 states and three union territories (UTs). These RRBs were sponsored by 15 commercial banks and operating through a network of 21,850 branches. Total business of RRBs stood at Rs 7.77 lakh crore as on March 31, 2020.Deposits and advances of RRBs increased by 10.2 per cent and 9.5 per cent, respectively during FY2019-20. Gross outstanding loans stood at Rs 2.98 lakh crore as against Rs 2.80 lakh crore in FY19.

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[10] *https://economictimes.indiatimes.com/industry/banking/finance/banking/regional-rural-banks-incur-net-loss-of-rs-2206-crore-in-fy20-nabard-data-*
ET news item Oct 04, 2020,

Local Area Banks (LABs)

With a view to providing institutional mechanisms for promoting rural savings as well as for the provision of credit for viable economic activities in the local areas, it has been decided to allow the establishment of new local banks in the private sector. This idea was conceived in 1996 by the then finance minister and it was mentioned in that year's budget. LAB is expected to bridge the gaps in credit availability and enhance the institutional credit framework in the rural and semi-urban areas. LAB is to be registered as a public limited company under the Companies Act, 1956. It will be licensed under the Banking Regulation Act, 1949 and will be eligible for including in the Second Schedule of the Reserve Bank of India Act, 1934. There are 3 LABs in the country as on September 2021. They are Coastal Local Area Bank Ltd, Krishna Bhima Samruddhi LAB Ltd and Capital Local Area Bank Ltd. One of the Labs started in 2000, South Gujarat Local Area Bank (LAB) was amalgamated with Bank of Baroda (BoB) in 2013. The Reserve Bank of India (RBI) had cancelled the banking licence issued to Subhadra Local Area Bank Ltd., Kolhapur, Maharashtra on December 24, 2020.

Banking Products

Deposits

Commercial banks deal with money deposited by people. These deposits are used as a means of payment and medium of saving.

Indian banks accept two main types of deposits-demand deposits and term deposits. Demand deposits can be subdivided into two categories: current and savings. Current deposits are chequable accounts that have no restrictions on the number of withdrawals or the amount to be withdrawn. Savings deposits earn interest. Although checks can be drawn on savings accounts, the number of withdrawals and the maximum amount to be withdrawn from the account without prior notice is restricted.

Call deposits is a subcategory of demand deposits. They are taken from fellow bankers and are repaid on demand. They carry an interest charge. They form an insignificant portion of the total bank liabilities. Term-deposits are also known as "fixed deposits" and they are an authentic medium for saving. They have different maturity period and rate of interest on the maturity period.

[11]According to the RBI, bank credit stood at Rs. 108.41 trillion (US$ 1.45 trillion) and bank deposits stood at Rs. 152.98 trillion (US$ 2.05 trillion), as of June 25, 2021.

Bank credit

Types of credit: The various types of advances provided by them are: loans, cash credit, overdrafts (OD), demand loans, purchase and discounting of commercial bills, and installment or hire purchase credit. A Loan is an advance received for a fixed amount which is repayable in installments or on demand. They are repayable made in lump sums and interest is paid on the entire amount. There are two categories of loans: demand loans and term loans. Demand loans

[11] https://www.ibef.org/industry/banking-india.aspx

are short-term loans that are repayable on demand. Term loans are defined as loans approved for a period of more than a year with a precise schedule of repayment.

Cash credit and overdrafts are running accounts wherein a borrower can withdraw funds as required. Purchasing and discounting of bills-internal and foreign-is a method used by banks for advancing credit. It is done mainly to finance the movement of goods and trade transactions.

Another categorization of banking credit is priority sector advances and commercial advances.

Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. Priority Sector includes (i) Agriculture (ii) Micro and Small Enterprises (iii) Education (iv) Housing (v) Export Credit. Every Bank has to lend 40% of their net back credit to priority sector.

According to the RBI, bank credit stood at Rs. 108.41 trillion (US$ 1.45 trillion) as of June 25, 2021.

6.7.7 Non-Banking Finance Companies

The Reserve Bank of India is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934.

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

According RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without a) obtaining a certificate of registration from the Bank and without having a Net Owned Funds of Rs two crore. However, in terms of the powers given to the Bank. To obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI.

All NBFCs are not entitled to accept public deposits. Only those NBFCs to which the Bank had given a specific authorization are allowed to accept/hold public deposits.

There is a ceiling on acceptance of Public Deposits by NBFCs authorized to accept deposits. An NBFC maintaining required minimum NOF,/Capital to Risk Assets Ratio (CRAR) and complying with the prudential norms can accept public deposits and these limits change from time to time.

The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.

6.7.6.1 Environment

The regulations governing the NBFCs were relatively low compared to the other type of financial intermediaries like banks and DFIs. Entry barriers were low, there were no capital adequacy norms, no prudential norms, and to add to all this, there was little restrictions on the interest rates they could offer to the depositors. All this culminated in the booming of a number of NBFCs operating in India. And by offering higher interest rates, these NBFCs were attracting a large volume of deposits. This boom in the NBFCs led to the entry of many fly-by-night operators. Incidents of depositors losing their money either due to mismanagement or due to fraud were cropping up. Since NBFCs have an important role in the financial environment, it is important to ensure a proper regulatory framework for their operations. The regulatory provisions for the NBFCs were given in Chapter III-B, III-C and V of the Reserve Bank of India Act, 1934.

Check Your Progress-2

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

6. Which of the following households businesses and units of government's current income receipts exceed their current expenditures, giving them extra funds to lend to other units in the financial system?
   a. Savings-deficit units
   b. Savings-surplus units
   c. None of the above
   d. All of the above

7. Unit banking refers to the system
   a. With a single bank having units at different places
   b. With the overall operations of a bank conducted from a single office
   c. Which deals with the units of UTI
   d. Which deals with credit operations only

8. Which of the following refers to the borrowing of relatively short-term funds from savers and making long-term loans?
   a. Denomination intermediation
   b. Default-risk intermediation
   c. Maturity intermediation
   d. Liquidity intermediation

9. Which of the following intermediation(s) is/are performed by financial intermediaries?
   a. Information intermediation
   b. Maturity intermediation
   c. Denomination intermediation
   d. All of the above
10. Mutual funds can be classified on the basis of:
    a. Term of the fund
    b. Management style
    c. Both a and b
    d. None of the above
11. In which of the following is a front load mutual fund?
    a. At the time of exit from the fund
    b. At the time of investment in the fund
    c. At the time of reallocation of the fund
    d. None of the above
12. Which of the following is an organized private or institutional financing that can provide substantial amounts of capital?
    a. Venture capital
    b. Mutual funds
    c. Insurance
    d. None of the above

6.8 Summary

- The Gross Domestic Product is the total monetary value measured from the goods and services produced in a country for one financial year. It is measured either as the flow of products or as the sum of earnings method.
- A financial system operates as an intermediary that facilitates the flow of funds from areas where funds are in surplus to areas where funds are in deficit.
- A financial market is a market where financial assets are either created or transferred. Financial assets represent a claim to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend.
- In a rudimentary economy, there are no financial markets. In such an economy, each person has to be financially self-sufficient. The presence of many financial intermediaries in an economy indicates that the economy is in an advanced stage of financial development.
- A financial institution is a business firm whose principal assets are financial assets or claims-stocks, bonds, and loans-instead of real assets, such as buildings, equipment and raw materials. The term “Financial

intermediation" primarily means facilitating the supply of funds to the buyer of funds from the seller of funds.

- Financial Inclusion is a the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost
- Mutual funds mobilize funds from various categories of investors and channelize them into productive investments. Mutual funds can be classified on the basis of term of the fund, investment objective, and type of investors, management style, and load.
- Venture capital refers to organized private or institutional financing that can provide substantial amounts of capital, mostly through equity purchases and occasionally through debt offerings, to help growth oriented firms develop and succeed.
- Insurance provides monetary compensation for the loss suffered. The occurrence of loss must be within the framework covered by the specific terms of the insurance contract.
- Commercial banks ordinarily are simple business or commercial concerns that provide various types of financial services to customers in return for payments in one form or another, such as interest, discounts, fees, commission, and so on.

6.9 Glossary

- **Capital to Risk - Weighted Assets Ratio**: Capital to risk-weighted assets ratio is also called as capital adequacy ratio. It is the ratio of bank's capital to its risk. The risk can be either in the form of weighted assets or the minimum total capital requirements of the respective nation's regulator.
- **Intermediaries**: Third parties that specialize in facilitating imports and exports.
- **Life insurance:** Insurance on the person.
- **Mutual funds**: Financial intermediaries that gather funds from investors in exchange for mutual fund shares, investing the money in specified stocks, bonds, government obligations, savings bonds, and other instruments.
- **Net owned Fund**: Net owned Fund consists of free reserves, capital reserves that arise out of sale proceeds of assets, paid up equity capital, and balance in share premium account. It is computed on the basis of last audited balance sheet.
- **Nonlife insurance**: Insurance that covers direct and indirect losses from damage to property and from legal liability.

6.10 Self-Assessment Test

1. Define money supply and gross domestic product. Describe the methods to measure GDP.
2. Define financial system. Briefly explain the functions of the financial system.

3. Financial markets are sometime classified as primary and secondary markets. Explain them in detail.
4. Explain the concept of development of financial markets.
5. Define financial intermediation. Briefly explain the kinds of financial intermediation.
6. What are mutual funds? Describe its various classifications.
7. Describe in brief the characteristics of venture funds.
8. Define Insurance. Describe in brief the kinds of insurances.

6.11 Suggested Readings / Reference Material

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6.12 Answers to Check Your Progress Questions

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

1. (d) All of the above

Gross Domestic Product (GDP) is measured either as the flow of products or as the sum of earnings method. It is also measured using methods such as product flow approach, sum of earnings or income approach, and spending approach.

2. (a) Consumption function

The functions of a financial system include the savings function, liquidity function, payment function, risk function, and policy function. Therefore, consumption function is not a function of the financial system.

3. (b) Financial asset

Financial asset represents a claim to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend.

4. (a) Offers resources for working capital needs

A money market deals with all transactions in short-term instruments. It offers resources for working capital needs.

5. (c) Capital market

Capital market deals with transactions related to long-term instruments (with a period of maturity of above one year, like corporate debentures, government bonds, etc.) and stocks (equity and preferences shares).

6. (b) Savings surplus units

Savings-surplus units are those households businesses and units of government whose current income receipts exceed their current expenditures, giving them extra funds to lend to other units in the financial system.

7. (b) **With the overall operations of a bank conducted from a single office**

   In a unit banking system, the bank conducts its overall operations from a single office.

8. (c) **Maturity intermediation**

   Maturity intermediation refers to the borrowing of relatively short-term funds from savers (who often cannot commit their funds over long periods) and making long-term loans to borrowers who require a long-term commitment to funds.

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

   The term 'Financial Intermediation' primarily means facilitating the supply of funds to the buyer of funds from the seller of funds. It performs denomination intermediation, default-risk intermediation, maturity intermediation, liquidity intermediation, and information intermediation.

10. (c) **Both a and b**

    Mutual funds mobilize funds from various categories of investors and channel them into productive investments. They can be classified on the basis of term of the fund, management style, investment objectives, types of investors, and load funds.

11. (b) **At the time of investment in the fund**

    In a front load fund, the load is charged at the time the investors invest in the fund.

12. (a) **Venture capital**

    Venture capital refers to organized private or institutional financing that can provide substantial amounts of capital, mostly through equity purchases and occasionally through debt offerings, to help growth oriented firms develop and succeed.

Unit 7

Trade Environment

Structure

7.1 Introduction
7.2 Objectives
7.3 Liberalization and Globalization
7.4 Globalization of Indian Industry
7.5 Import Policy
7.6 Export Policy
7.7 EXIM Policy (2002-2007)
7.8 EXIM Policy (2004-2009)
7.9 EXIM Policy (2009-2014)
7.10 EXIM Policy (2015-2020)
7.11 International Licensing
7.12 International Franchising
7.13 Home Trade
7.14 Issues in the Global Economic Environment
7.15 Summary
7.16 Glossary
7.17 Self-Assessment Test
7.18 Suggested Readings / Reference Material
7.19 Answers to Check Your Progress Questions

7.1 Introduction

In the previous unit, the financial environment and how businesses are affected by financial markets and institutions was discussed. In this unit, the trade environment is discussed.

Most third world countries are characterized by a colonial past marked by extensive and intensive exploitation of their economies by colonial powers. Foreign trade served as one of the important instruments of this exploitation. The colonies or the underdeveloped countries, however, had the worst of both worlds, as consumers of manufactured articles and producers of raw materials. This imbalance was a result of declining prices of raw material or primary goods and increasing prices of manufactured goods, which in course of time led to considerable deterioration in the terms of trade for the under-developed countries (which were exporters of raw material). Therefore, foreign trade and investment was viewed with a certain amount of suspicion by many underdeveloped countries that won independence in the post-World War II period.

However, the outlook toward foreign trade has now undergone a radical change. Programs of import liberalization and export promotion adopted by many developing countries in the sixties have achieved remarkable success.

To add, the framework of the India's latest Foreign Trade Policy 2015-20 is done with a vision 'Make in India'. The policy holds goods for five years from the year 2015 to 2020. It is focused on different areas, primarily to increase the exports of goods and services, employment generation and to encourage the value additions in the country. To attain its vision, Indian government is on the path of simplifying the concept 'ease of doing business'. The said policy became effective from April 1, 2015 and holds good till March 31, 2020.

Due to Covid 19 in the year 2020 the FTP 2015-20 which came into effect on 1stApril 2015 was extended by one year till 31 March 2021, due to Covid-19 pandemic. Again on 31st March 2021 the Government announced that the FTP 2015 -20 would be in [12]force till end of September 2021.

In this unit, the process of liberalization and globalization is discussed. The unit then discusses import policy, export policy, EXIM policy, international licensing, free trade policy and international franchising. The unit also explains the organization of home trade and issues in the global economic environment.

7.2 Objectives

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

- Explain the concept and nature of globalization
- Describe the meaning and concept of globalization of Indian industry
- Describe the import policy and its constituents
- State the objectives of the export policy
- Identify the objectives of EXIM policy
- Glance the Free Trade Policy 2015-20
- Underline the basic issues in international licensing
- Describe franchising and state the issues in international franchising
- Define home trade and list the kinds of middlemen
- Identify the issues in the global economic environment

[12] https://pib.gov.in/PressReleseDetail.aspx?PRID=1708765 announced on 31st March 2021 by Ministry of Commerce & Industry

7.3 Liberalization and Globalization

Liberalization of trade is the process of breaking down government and artificial barriers to international trade and investment. It permits more number of firms to access the market in a bid to enhance competition. The liberalization includes the reducing of tariffs, quotas, non-tariff barriers and facilitating the free flow of goods and services between the countries. It is a well accepted tool for encouraging the international trade.

The liberalization of trade has the advantages and disadvantages. The advantages include-helping the countries to have comparative advantages, availability of goods at competitive prices, increased cooperation and healthy competition, economies of scales, increased savings and deployment of funds, and disadvantages include-natural death of certain industries and services, exploitation of resources, damage to the developing countries as they may not be able to compete with the products and services of developed countries, domination of developed countries.

They arise from various forces that influence the Indian Economy and its equation with the rest of the world. They either poses a challenge or an opportunity for the Indian Government, trade and industry towards fulfilling the vision 'Make in India'. The government, trade and industry needs to work together and interchangeably for India's economic growth. The Free Trade Policy 2015-20 is the policy released by the Indian government with this objective.

7.3.1 The Process of Liberalization in India

In June 1991, the then finance minister, Manmohan Singh announced a New Economic Policy (NEP). The policy aimed at reducing fiscal deficits, wiping out the current account deficits, cutting down government expenditures, rationalizing subsidies, controlling inflation, alleviating poverty, and achieving social equity. The fundamental objective of the New Economic Policy was to bring about a qualitative and sustained improvement in the standard of living of the people of India. The NEP consists of two sets of economic reforms: a group of measures which was implemented as short-term stabilization and aimed at containing inflation, reducing the fiscal deficit, and correcting the adverse balance of payments; another set of reform measures dealing with the aspects of structural adjustment of medium term nature and are aimed at achieving the goals of poverty alleviation and social justice.

[13]India's real gross domestic product (GDP) at current prices stood at Rs. 135.13 lakh crore (US$ 1.82 trillion) in FY21, as per the provisional estimates of annual national income for 2020-21. Simultaneously, the per capita income with GDP at current prices was estimated at Rs. 145,680 (US$ 1,960.96) in FY21. India's trade and external sector had a significant impact on the GDP growth as well as expansion in per capita income.

[13] Source : https://www.ibef.org/economy/trade-and-external-sector

According to data from the Ministry of Commerce and Industry, India's overall exports between April 2021 and June 2021 were estimated at US$ 147.64 billion (a 50.24% YoY increase), while overall imports were estimated at US$ 156.58 billion (80.75% YoY increase).

Merchandise exports stood at US$ 95.39 billion between April 2021 and June 2021, while imports touched US$ 126.15 billion. The estimated value of services export and import between April 2021 and June 2021 stood at US$ 52.25 billion and US$ 30.44 billion respectively.

The true effects of large, multilateral trade liberalization exercises are beginning to be understood by economists. It has been found that despite overall global gains, there are also going to be some losers in the process, namely the poorer countries. The reason underlying these negative effects is the removal of agricultural subsidies in the European Union and the US. This will result in higher world prices for some agricultural products. Many countries are net importers of these products and will hence suffer a 'terms of trade loss': it will cost them more to buy imports than it used to, but their income from export will not increase. However, in the long run, nearly all countries gain. The spillover effects from rich countries offset the preliminary losses incurred by poor countries.

7.4 Globalization of Indian Industry

A short definition of globalization is "the growing liberalization of international trade and investment, and the resulting increase in the integration of national economies.

With the advent of globalization, Indian companies have begun to think about marketing globally. This changed attitude towards trade is making a big difference in the way they do business. It also implies that the age of the Indian multinational has arrived. Almost every Indian company is thinking of globalization, from textiles to pharmaceuticals and from plantations to engineering.

A significant area of globalization is foreign investment. With the relaxation of the rules pertaining to foreign investment, many Indian companies are, in fact, setting up manufacturing base abroad for various products. Some of these bases are even being set up in developed countries.

In addition to this relaxation, recently introduced Free Trade Policy 2015-20 also came up with some measures to uplift the India's global market. The policy is released by the Indian Government with an aim for trade facilitation and to enhance the ease of doing business in/with India. Underneath, 'Approved Exporter System', 100% Export Oriented Unit (EOU) Scheme, Electronics Hardware Technology Park (EHTP) Scheme, Software Technology Park of India (STPI) Scheme and Niryat Bandhu Scheme are some of the examples in this regard.

As a step ahead, the government reduced the mandatory documents required for exports and imports to three, which is comparable with the international benchmarks. A facility has been created to upload the requisite documents in their respective exporter or importer profile thereby avoiding the submission of documents repeatedly. Further, 'Aayat Niryat Forms' are simplified in order to bring clarity in statutory provisions, avoiding ambiguities and to increase the electronic governance.

Most of the Indian businesses are still in a nascent stage as far as going global is concerned. Moreover, since liberalization is a fairly recent phenomenon, it will take years for Indian businesses to catch up with Japanese businesses, or even businesses in South Korea or China. However, many Indian companies have started going overseas. For instance, some Indian pharmaceutical companies have merged with, or acquired foreign pharmaceutical companies. Similarly, Indian IT companies have merged with global companies as part of their growth strategy.

7.4.1 The New Boom Global Markets

The Asia-Pacific region represents a huge consumer market in which multinationals can reap big returns. The rapid pace of development and enormous size of the Asia-Pacific region had attracted several western multinationals. This region thus serves as a high potential area for multinationals.

However, in spite of the phenomenal growth rates and huge numbers of consumers, western companies entering Asia have found that it not so easy to do business in the region. Such large populations and geographical markets as are found in this region require equally large investments. Inflation poses a major problem and the cost of real estate is exorbitant. In addition, a major challenge lies with the distribution networks in countries of the size of China and India. Other hurdles arise due to bureaucracy, the problem of finding the right local partner, and putting together an effective sales force.

There are other challenges, too. Asia is not just one market but represents a mix of cultures, media and advertising sectors. The Asian region is viewed as a very complex collection of different cultures and different countries which are at different stages of development.

The Greater China region, which comprises Hong Kong, Taiwan and China, is a sub-region where advertisers can use a common ad message. However, China a far less sophisticated ad market than the other two and in some areas has more in common with Indonesia and India.

The year 1993 witnessed SAARC countries entering into an agreement on 'South Asian Free Trade Area (SAFTA)' to strength their economic cooperation and to maximize their regional potential for trade and development in the interests of their public. On a preferential basis, the agreement helped in the adoption of several trade liberalization instruments.

[14]The BRICS (Brazil, Russia, India, China and South Africa) has been forged as a formal association is to become a more constructive and progressive group in the developing world. BRICS constitute around 18 per cent of world GDP and more than 40 per cent of its currency reserves, estimated at around USD 4.5 trillion.

[15]India's Trade with BRCS (in Billion US$)

Counterpart	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-20
Brazil	11.4	6.7	6.5	8.6	8.2	3.5
China	72.3	70.7	71.5	89.7	87.1	44.7
Russia	6.3	6.2	7.5	10.7	8.2	4.9
South Africa	11.8	9.5	9.4	10.7	10.6	5.4
India's Intra-BRICS	101.9	93.1	94.8	119.6	114.1	58.5

Data pertaining to 2019-20 was April to September, 2019.

7.4.2 Select Key Business Strategies to create India's MNCs

To identify key business strategies for creating Indian MNCs, one must first identify areas in which India possesses or is in a position to develop and sustain competitive advantage on a rapid scale. Such advantage should also have the potential to be sustainable in a low tariff environment and be able to compete with the world's best companies and products. The success of good companies lies in the identification of key industries and subsequent focused support by their respective governments. Some Indian companies are going for overseas mergers and acquisitions, and strategic alliances in order to make a global presence.

Blackstone-backed IT services Indian company Mphasis announced (in September 2021) the acquisition of Blink UX, a user experience research, strategy, and design firm headquartered in Seattle for a consideration of $94 million (over Rs 680 crore) in an all cash deal.

Technology investor Prosus NV (a Nederland's based company) who owns PayU, a payment gateway company announced in September it had purchased 100% of the equity in Indian payments platform Bill desk for $4.7 billion.

7.4.3 Nurturing India's Multinationals

Indian companies that are well-positioned and have global aspirations can be nurtured to enter global markets. The Indian government should play a crucial role in encouraging financial institutions to set up a fund that would support the Indian multinationals.

[14] *https://www.eximbankindia.in/blog/blog-pontent.aspx?BlogID=18&BlogTitle=BRICS*
[15] *https://pib.gov.in/Pressreleaseshare.aspx?PRID=1594938*

Indian firms invest in foreign shores primarily through mergers and acquisition (M&A). With rising M&A activity, companies will get direct access to newer and more extensive markets and better technologies, which would enable them to increase their customer base and achieve a global reach.

[16]Cumulative ODI Outflows invested by Indian corporate companies in other countries (from April, 2000 to June, 2021) amounted to (Equity + Loans + Guarantee Invoked) US$ 246.95 billion whereas the commitment was (Equity + Loans + Guarantee Issued) US$ 565.04 billion.

According to the Reserve Bank of India (RBI), India's outward foreign direct investments (OFDI) in equity, loan and guaranteed issue stood at US$ 3.77 billion in May 2021 vs. US$ 3.43 billion in April 2021. Some of the investments in 2021 were given below. [17]During 2021 Tata Steel invested US$ 1 billion in a wholly owned subsidiary in Singapore. In May 2021, the Serum Institute of India announced plan to invest GBP 240 million (US$ 332.38 million) in the UK to expand its vaccine business and open a new sales office.

7.5 Import Policy

A trade policy of a country consists of its import policy and its export policy. In the post-independence period, India's import policy was guided by considerations of a growth-oriented approach and the following are some of the considerations in framing the trade policy of the government leading the country to self-reliance:

a. As far as possible, imports should be limited so as to conserve foreign exchange.
b. Imports of those items which would help the industrialization of the economy were to be encouraged while imports of such items which could be produced at home were discouraged or completely banned. It was necessary to differentiate between essential and non-essential items of import in view of the fact that, in a developing economy, even the demand for imports of capital goods and other equipment could be at such a magnitude that there might be difficulty in finding the foreign exchange for development imports.
c. The nature of imports should be so modified as to help export promotion, and thus ultimately mitigate the deficit in the balance of payments position.

However, the situation started changing in the subsequent decades. By the 1980s, the government liberalized imports with the aim of enhancing the export competitiveness of large sections of Indian industry. From 1985 to 1989, import liberalization extended to capital and intermediate goods. The 1991 economic reform further liberalized trade. The period from 1995-2001 was marked by elimination of quantitative restrictions on several consumer and agricultural product imports by the government.

In 2008, the import policy of India had three objectives:

[16] Source: https://dea.gov.in/overseas-direct-investment
[17]Source : https://www.ibef.org/economy/indian-investments-abroad

- To make essential imported goods easily available, including necessary capital goods for upgrading and modernizing technology
- To simplify import licensing procedures
- To promote self-reliance and efficient import substitution

In 2015, Free Trade Policy 2015-20 of India came into effect. Chapter 2 of the said policy contains certain provisions with regard to imports or exports that reflect the India's import/export policy. Some of them are

- Imports/ exports of goods and services are said to be free unless regulated the same via restriction, prohibition or exclusive trading through State Trading Enterprises (STEs), as laid down in the Indian Trade Classification (Harmonized System) of Exports and Imports.
- Imports/exports are said to be free subject to the conditions as laid down under other Acts or Laws that are in force.
- New Foreign Trade Policy was due to be announced from April 2020 but due Covid 19, the existing Foreign Trade Policy of 2015-20 was extended to end of September 2021.

7.5.1 Import Restrictions

In the context of Free Trade Policy 2015-20, Director General of Foreign Trade (DGFT) is the statutory authority to impose restrictions on imports or exports. This can be done by passing a notification in the official gazette. The restrictions can be imposed on the various specified grounds such as Protection of public morals, Protection of human, animal or plant life or health etc.

The goods or services categorized as restricted can be imported or exported, only in terms of procedure prescribed in a notification or public notice issued in this regard.

7.5.2 Import Regulations and Procedures

Imports fall under four categories:

- *Freely importable items*: Items in this category do not require import licenses and can be imported freely by an individual or entity.
- *Licensed imports*: Items such as consumer goods; products related to safety and security; precious and semi-precious stones; seeds, plants and animals; some insecticides, pharmaceuticals and chemicals; some electronic items; several items reserved for production by the small-scale sector; and 17 miscellaneous or special-category items can be imported using licenses.
- *Canalized items*: Here the items can be imported by specific public-sector agencies.
- *Prohibited items*: Products like animal rennet, tallow fat, unprocessed ivory, and wild animals are banned from importation.

7.5.3 Import Substitution

The important substitution policy in India went through various phases. At first, import subscription mostly took the form of domestic production of consumer goods followed by replacement of the import of capital goods. Finally, emphasis was laid on reducing dependence on imported technology by developing and encouraging the use of indigenous technology.

7.6 Export Policy

The broad objectives of foreign trade policy 2015-20 are:

- To increase India's share in world exports from 2% to 3.5% by 2020.
- To provide a stable and sustained policy environment for export of merchandise and services.
- To connect varied policies, procedures, and guidelines of foreign trade with other major initiatives such as "Make In India", "Digital India", Skill India" to create a "Export Promotion Mission" for India.
- To widen export product basket by identifying new sectors that have potential.
- To provide a mechanism for regular appraisal for rationalizing imports and reducing trade imbalance.

New Foreign Trade Policy was due to be announced from April 2020 but due to Covid 19, the existing Foreign Trade Policy of 2015-20 was extended to end of September 2021.

7.6.1 Export Promotion Policies: An Overall View

The following are the important export measures undertaken by the Government of India.

Cash Compensatory Support (CCS)

Introduced in 1966, CCS was designed to provide compensation for unrelated indirect taxes paid by exporters on inputs, higher freight rates, and market development costs.

Duty Drawback System

The objective of the duty drawback system is to reimburse exporters for the tariffs paid on imported materials and intermediates, and central excise duties for inputs produced domestically and which enter into production of exports. The duty drawback system is practiced worldwide.

Replenishment Licenses

In order to help the exporters procure imported raw materials and other components necessary for export production, the government introduced the Import Entitlement Scheme (IES) in 1957. Although the devaluation of the Indian rupee in 1966 led to the withdrawal of the IES, it was soon reintroduced in another garb in a revised from and under a new name – Import Replenishment Scheme (IRS). Replenishment licenses granted under this scheme make it possible for exporters to obtain items that are either canalized or restricted in the import policy, subject to the limits and conditions specified.

EPZ and 100 Percent EOUs

Export Processing Zones (EPZs) have been set up by the government in order to give an impetus to exports. These EPZs provide an almost free trade environment for export production so as to make Indian exports products competitive in the world market.

Export Credit and Assistance of EPCS

During the early 1980s, CCS accounted for a major part of market development assistance (almost 90 to 95 percent). Of what remained, about two-third was used to finance the assistance to commercial banks on export credit extended by them in the form of pre-shipment and post-shipment credit. Export promotion councils and approved organizations, export houses, consultancy organizations and individual exporters are also granted assistance in the form of grants-in-aid to undertake (a) market research, area survey, etc; (b) exports publicity and dissemination of information; (c) trade delegations and teams; (d) participation in exhibitions and trade fairs; (e) establishment of offices and branches abroad; (f) research and development schemes, etc; and (g) any other scheme that would promote the development of the market for Indian goods abroad.

7.7 EXIM Policy (2002-2007)

The Export-Import policy of the government of India guides the foreign trade in the country. It is regulated by The Foreign Trade Development and Regulation Act 1992. It consists of several policy decisions concerning import and exports. The central government prepares and announces the EXIM policy. The Indian EXIM policy aims to develop export potential, improve performance of exports, encourages foreign trade, and creates favorable balance of payment position.

The new EXIM policy, 2002-2007, was announced by the Government of India on February 5, 2002.

The general objectives of the EXIM Policy (2002-2007) were:

- To set up the framework for globalization
- To encourage the productivity competitiveness of the industries in India
- To enable the industries to attain international standards of quality
- To boost export by allowing access to raw material, components, capital goods, and consumables from the international market
- To encourage import substitution and self-reliance.

7.8 EXIM Policy (2004-2009)

In 2004, the Government of India felt that the EXIM policy 2002-2007 was limited in its scope and insufficient to meet the country's objectives related to foreign trade. Hence, an integrated approach for developmental requirements of foreign trade in India was taken up. This led to the announcement of Foreign Trade Policy 2004-2009 in August 2004.

The objectives of Foreign Trade Policy 2004-2009 were:

i. To double the percentage share of global merchandize trade within 5 years
ii. To act as an effective instrument of economic growth by giving a thrust to employment generation.

To achieve these objectives, special focus initiatives were announced in sectors such as agriculture, handicraft, handlooms, leather, gems & jewelry, and marine sector. In addition to these, new sectoral initiatives were announced from time to time. In April 2007, an annual supplement to the Foreign Trade Policy 2004-2009 was announced. The supplement aimed to provide momentum to exports growth. The export target that was fixed at US$ 160 billion in 2007-2008 was raised to US$ 200 billion for 2008-2009. In 2008, the Government of India released another annual supplement to Foreign Trade Policy 2004-2009.

7.9 EXIM Policy (2009-2014)

- In 2009, the Government of India released the Foreign Trade Policy 2009-2014. According to Ministry of Commerce, the exports grew to US$ 168 billion in 2008-2009 from US$ 63 billion in 2003-2004. India's share of global merchandise trade rose to 1.45% in 2008 from 0.83% in 2003 as per the estimates by WTO. India's share of the global commercial services exports stood at 2.8% in 2008 from 1.4% in 2003. The total share in goods and services trade of India increased to 1.64% in 2008 from 0.92% in 2003. The government also claimed that nearly 14 million jobs were created either directly or indirectly due to augmented exports from 2004-2009.

The objectives of Foreign Trade Policy 2009-2014 are:

i. In the short term, to arrest and reverse the declining trend of exports and to provide additional support especially to those sectors which have been hit badly by recession in the developed world.
ii. To achieve an annual export growth rate of 15% with an annual export target of US$ 200 billion by March 2011.
iii. To double the country's export of goods and services by 2014.
    - To meet these objectives, the Government of India was taking up various measures including fiscal incentives, institutional changes, procedural rationalization, enhanced market access across the world and diversification of export markets. It was considering bringing in improvement in infrastructure related to exports; bringing down transaction costs, and providing full refund of all indirect taxes and levies.

7.10 EXIM Policy (2015-2020)

Foreign Trade Policy (2015-20) aims at enhancing the country's exports and use trade expansion as an effective instrument of economic growth and employment generation

Key highlights of this policy are:

a. **Merchandize Exports from India Scheme (MEIS):**

- Existing multiple schemes such as Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agri Infrastructure Incentive Scrip, and Vishesh Krishi and Gram Yogana have been merged into MEIS.
- Notified goods exported to notified markets/countries would be eligible for benefits ranging from 2 -5 % of FOB value of exports or FOB value realized whichever is less.
- Export of goods (FOB value up to INR 25,000) through courier or foreign post office using e-commerce is also eligible for benefits.
- MEIS scrip can also be used for payment of custom duty, excise duty, and service tax.
- Basic/Additional custom duty, excise duty, and service tax paid through cash or debit to scrip is available for credit to CENVAT or drawback.
- Scrip and goods imported/locally procured against the scrip are freely transferable.
- MEIS benefits extended to SEZ units except Freetrade Warehousing Zone units.
- Exports until 31st March, 2015 and scrips applied for or issued against them will be governed by rules of the earlier relevant schemes.

b. **Service Exports from India Scheme (SEIS):**

- Served from India Scheme is replaced by SEIS. However, all benefits duty exempted scrip of the previous scheme will be extended to service providers located in India and exporting notified services in a specified mode.
- Eligibility of such benefits to service providers requires minimum net foreign exchange earnings of $ 15,000 in the preceding financial year.
- Service providers will be issued SEIS scrip of 3% or 5% of net foreign exchange earned depending on the type of service.
- Benefits of SEIS like MEIS are extended to SEZ units also.
- SEIS benefits are similar to MEIS (including availment of CENVAT credit and drawback). These scrips and the goods imported or locally procured can be freely transferred.
- Exports until 31st March, 2015 and scrips applied for or issued against them will be governed by rules of SFIS.

c. **Export Promotion Capital Goods (EPCG) Scheme:**

- Capital goods import under EPCG scheme carries six times export obligation of the duty saved. Reduced export obligation up to 25% has now been prescribed for domestic sourcing of capital goods.
- Exporters registered with the excise authorities subject to conditions now have the option to furnish installation certificate confirming receipt of capital goods by a Certified Engineer.
- Normally, installation certificate is to be furnished within six months of the completion of imports. However, licensing authority can now extend the period of submitting the installation certificate by another 12 months.
- In case of exit of an EOU or SEZ unit under the EPCG scheme, guidelines for maintenance of average export obligation and specified export obligation are notified.

d. **Export Oriented Unit (EOU)/ Software Technology Park (STP) Scheme:**

- Board of Approval (BoA) may grant one year extension for achieving net foreign exchange earnings under special circumstances on a case to case basis.
- Letter of Permission (LoP) will now have initial validity of two years (earlier three years) for implementation of project and commencement of production. Extension of one year (earlier three years) may be considered on a case to case basis.
- Unit sharing of infrastructural facilities between EOUs/STPs may be permitted by Approval Committee (UAC)/Inter Ministerial Standing Committee (IMSC) on a case to case basis or on recommendations of BoA. However, such sharing is not permitted between EOUs/STPs and SEZs.
- STP unit can set up for undertaking repairing, re-conditioning, remaking, testing, etc for exports subject to the approval of IMSC and other conditions.
- Procedures simplified for fast track debonding/exiting of STP units which have not availed duty exemption benefits.
- Facility to set up a warehouse outside the premises and near a port of export permitted subject to conditions.
- Fast track clearances on procurement are allowed to EOUs having a physical export turnover of Rs 10 crore and above,

e. **Others:**

- Duty Free Import Authorization Scheme which exempted all customs duty is now restricted to only basic custom duty. However, on certain conditions, additional customs duty will be available as CENVAT credit.

- Eligibility criteria for grant of 'status' to an exporter is revised. Deemed export will now be considered for 'export performance. Self certification, export promotion, etc are extended as additional facilitation.
- Advance Authorization Scheme which earlier provided 18 months for export obligation period for exports of defense, military stores, aerospace, COMET items, etc has now been stretched to 24 months.
- Recovery and penal proceedings in case of mis-declaration and mis-representation of facts to claim deemed export benefits notified.
- Measures were introduced to facilitate trade for slashing transaction costs and crashing documentation handling time in terms of on-line application filing, on-line inter-ministerial consultation, physical record maintenance, submission of multiple documents, etc.
- Nomenclature of Export House, Star Export House, Trading House, Premier Trading House certificate changed to 1,2,3,4,5 Star Export House.

Check Your Progress-1

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

1. Which of the following is not a basic objective of the New Economic Policy (NEP) of India announced in June 1991?
   a. Reducing fiscal deficits
   b. Wiping out the current account deficits
   c. Controlling inflation
   d. Achieving self-sufficiency in food grains production

2. Which of the following is part of the trade policy of a country?
   a. Import policy
   b. Export policy
   c. Tariff policy
   d. Both import and export policy

3. Which of the following were the objectives of the import substitution program of India's import policy?
   i. To preserve scarce foreign exchange
   ii. To achieve self-reliance in production of as many goods as possible
   iii. To remove quantitative restrictions on imported goods
   a. (i) only
   b. (ii) only

c. (i) and (ii) only
d. (i), (ii) and (iii)

4. Which of the following are the objectives of India's export policy?
   i. To earn adequate foreign exchange to finance the required volume of imports.
   ii. To raise unit value realization by promoting exports of value-added items.
   iii. To effect a change in the directional patterns with a view to reducing dependence on a single or limited number of countries.
   a. (i) and (ii) only
   b. (ii) and (iii) only
   c. (i) and (iii) only
   d. (i), (ii) and (iii)

5. Which of the following export measure was designed to provide compensation for unrelated indirect taxes paid by exporters on inputs, higher freight rates, and market development costs?
   a. Cash Compensatory Support
   b. Duty Drawback System
   c. Duty Exemption Scheme
   d. Export Promotion Capital Goods Scheme

7.11 International Licensing

Licensing is a means of entering a foreign market. In the process, a firm called the licensor sells the right to use its intellectual property – technology, patents, copyrights, business methods, brand names, or trademarks - to another firm, called the licensee, in return for a fee. As an entry mode, the use of licensing is affected by host country policies. When there are no host country restrictions, licensing serves as a popular mode for entering foreign markets. The meager out of-pocket costs associated with it make it a popular choice of many international firms. Through licensing, a firm can select an international location and enjoy the benefits of foreign production without any obligation related to ownership, management, or investment.

7.11.1 Basic Issues in International Licensing

A firm involved in licensing negotiations must carefully consider not only the terms of the proposed license but also its advantage and disadvantages. The issues to be addressed include:

Boundaries of the Agreement: In a licensing agreement, the rights and privileges should be clearly communicated in the agreement.

***Compensation**:* Compensation under a licensing agreement is termed as royalty. It is usually paid to the licensor, most commonly in the form of a percentage of the sales of the licensed product or service or otherwise in the form of a flat fee or a fixed amount per unit sold.

***Rights, Privileges, and Constraints**:* The rights and privileges given to the licensee and the constraints imposed on it by the licensor is another basic issue that needs to be addressed in licensing agreements. Licensing agreements are framed in such a manner as to limit the licensee's freedom to divulge the information obtained by him/her from the licensor to some other third party. Licensing agreements, hence, specify the type and form of records that have to be kept by the licensee regarding sales of the licensed products or services, and define standards regarding product and service quality that will be adhered to by the licensee.

***Dispute Resolution**:* The manner in which disputes and disagreements are to be resolved should also be specified in detail in the licensing agreement. For instance, suppose the licensor feels that the materials used by the licensee are inferior, but the latter argues that they meet the minimum quality standards, it could be expensive and time-consuming for both the parties to take the matter to the court. If the licensing agreement requires, for example, the use of a third-party mediator for the resolution of disagreements, it is possible to reduce the costs of such conflicts.

***Duration of the Contract*:** The licensing agreement may be a short-term strategy of the licensor to obtain low-cost, low-risk data about the foreign market. Only if the sales of its products and services are strong, the licensor may want to enter the market himself after the duration of the agreement has ended. However, if the contract's duration is too short, the licensee may be unwilling to invest in necessary consumer research, distribution networks, and / or production facilities, due to the belief that it will be unable to amortize its investment over the life of the licensing contract.

7.11.2 Advantages and Disadvantages of International Licensing

Similar to importing and exporting licensing too has advantages and disadvantages.

Licensing has relatively low financial risk, provided licensor fully investigates its market opportunities and the abilities of its licensees. Licensing also allows the licensor to know more about the sales potential of its products and services in a new market without incurring significant investment in financial and managerial resources. At the same time, licensees too benefit from the opportunity to make and sell the products and services that have been proven successful in other international markets and incurring relatively little R&D cost.

Licensing, however, is accompanied by opportunity costs. The market opportunities for both parties are restricted as a result of licensing agreements. There exists a mutual dependence between the licensor and the licensee to promote the brand image of the product and maintain its quality. Improper actions by one party can damage the interests of the other party. There is always the risk of problems and misunderstandings accompanying a licensing agreement, no matter how carefully it may be worded. Finally, the long-term strategic implications of licensing a firm's technology are of great concern to any firm. Most firms are concerned that sharing their technology will inadvertently create a potential competitor. The licensee can learn the manufacturing secrets of the licensor or develop new production methods of his own while producing under the licensing agreement.

Check Your Progress-2

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

6. In the process of licensing, the party or firm that sells the right to use its intellectual property to another firm known as ……………………
   a. Franchisor
   b. Licensor
   c. Exporter
   d. Importer
7. In international licensing, the term used to refer to the firm that obtains the right to use the intellectual property of another firm, in exchange for a fee …………….
   a. Licensor
   b. Franchisor
   c. Licensee
   d. Franchisee
8. Which of the following are issues addressing in licensing agreement?
   i. Boundaries of the agreement
   ii. Compensation
   iii. Rights, privileges and constraints
   iv. Dispute resolution
   v. Dispute of the contract
   a. (i) and (ii) only
   b. (iii) and (iv) only
   c. (i), (ii) and (iv) only
   d. (i), (ii), (iii), (iv) and (v)
9. The compensation under a licensing agreement termed is………………….
   a. Patent
   b. Tariff
   c. Royalty
   d. Tax

Activity: The increasing popularity of its Hyderabadi Biryani and other food items in countries like the US and the UK, made Hyderabad-based Hyd Specials Private Limited (HSPL) decide to expand internationally in 2019. To maintain consistency in the quality of its food items, the company signed agreements with local restaurants in the cities of New York in the US and London in the UK. The company gave the recipe details to the local restaurants, in return for 35% of the revenues earned by the restaurants for selling its food items. However, it did not share the recipe of a major ingredient with the restaurants. The ingredient played a major role in differentiating the company's food items from that made by the other restaurants. What kind of an agreement has HSPL entered into with the local restaurants in the US and the UK? Explain the issues involved in this agreement.

Answer:

7.12 International Franchising

Franchising serves as yet another popular strategy for internationalizing a business. Essentially, franchising is a special form of licensing. Franchising allows the licensor more control over the licensee and provides for support from the licensor to the licensee. International franchising is one of the rapidly developing forms of international business. Under a franchising agreement, a franchisee such as an independent entrepreneur or organization is permitted to operate a business under another company's name, called franchisor, in return for a fee. The franchisor provides trademarks, operating systems, and well-known product reputations, as well as continuous support services such as advertising, training, reservation services (for hotel operations), and quality assurance programs to its franchisees.

7.12.1 Basic Issues in International Franchising

The existence of certain market conditions is a prerequisite for the success of international franchising:

- Considerable success in franchising has already been achieved by the franchisor in its domestic market. For instance, prior to building the first of its restaurants abroad, McDonald's already had hundreds of franchised restaurants in the United States.
- The firms need to be successful domestically because of their unique products, operating procedures, and systems. The initial success of McDonald's was an outcome of its consistent and popular menu, and quick and efficient service.

- Domestic success factors should be transferable to foreign locations. In the case of McDonald's, the popularity of "American" food in other countries, value given to efficiency and lower prices by consumers worldwide, and the desire among foreign visitors to visit a McDonald's restaurant, have been instrumental in its success.
- There must be foreign investors who are interested in entering into franchise agreements, which is not a problem for well-established franchisors.

Similar to licensing agreements, franchising, agreements too, are spelled out in formal contracts with terms as listed below:

- Based on the franchisee's sales, the franchisor receives a fixed payment plus a royalty for the rights available to the franchisee to use the franchisor's name, formulas, and operating procedures.
- The franchisee agrees to adhere to the franchiser's requirements regarding appearance, financial reporting, and operating procedures. Franchisors, however, are likely to allow some degree of flexibility in order to meet local customs and tastes.
- The franchisor assists the franchisee in setting up a new business.

7.12.2 Advantages and Disadvantages of International Franchising

There are both advantages and disadvantages of international franchising.

On one hand, franchisees can enter a business that has an established and proven product and operating system. Franchisors can expand internationally with relatively low risk and cost. Also, it is possible for the franchisor to obtain critical information about local market customs and cultures from the host country entrepreneurs. Further, the franchisor can learn valuable lessons from franchisees that apply to the host country as well as many others.

On the other hand, just as with licensing both parties to a franchising agreement have to share the profits earned at the franchised location. Also, compared to domestic franchising, international franchising may be much more complicated.

7.13 Home Trade

The term 'Trade' refers to mere buying and selling of goods. The term 'Commerce,' on the other hand, is a more comprehensive term and includes not only the transfer and exchange of goods but the activities of various agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers. These agencies are referred to as "auxiliaries to trade" or "aids to trade". Hence, the term "Commerce" in short, includes "trade" as well as "aids to trade".

Thus "Commerce" is related mainly to the distribution of goods.

Commercial activities are further classified into the following subdivisions:

- Trade
- Transport
- Warehousing

- Insurance
- Banking and Finance
- Mercantile agents

Trade is, in turn, broadly divided into two types:

- Home Trade
- Foreign Trade

7.13.1 Organization of Home Trade

The increasing complexity of the production process and the gap between the products and buyers increases the function of the middlemen and makes them more important. Middlemen are merchants who act as intermediaries between the producer and the consumer. There are two types of middlemen:

Mercantile Agents

Mercantile agents are those persons who meditate between the producers and the consumers and earn a commission for their services. They do not, however, obtain ownership of the goods. Mercantile agents comprise of the following:

Brokers*:* Agents who negotiate sale or purchase of goods on behalf of other parties are termed as brokers. They earn a certain percentage commission on the value of the transactions concluded by them.

Commission agents*:* Commission agents are agents who sell goods on behalf of the principal. They take possession of the goods and arrange for their proper storage. They are paid a commission at a certain percentage on the sale affected by them. They sometimes agree to sell the goods on credit and assume the risk of collecting the amount. A special commission called the "*del credere* commission" is paid to them for assuming the risk of bad debts. These agents are known as "*del credere"* agents. Certain additional functions such as sorting, grading, packing etc. may also be undertaken by commission agents in order to facilitate the sale of goods. The commission agents who have enlarged authority and liability over the consigned goods are called "Factors".

Auctioneers*:* Auctioneers take possession of the goods and make arrangements for their display and sale at a public auction. An auctioneer is entitled to receive a commission for his services and has a lien on the goods for the charges.

Clearing, forwarding and shipping agents*:* These agents make arrangements for completing all customs formalities and clearing goods from the docks-either for export or import. They forward the imported goods to their clients and make arrangements for shipping the export goods to foreign countries on behalf of their clients.

Warehouse keepers*:* The business of warehouse keepers is to receive the goods for the purpose of diligence in the storage of goods. They have a lien on the goods for the charge payable to them.

Merchant Middlemen

Merchant middlemen are those merchants who buy the goods outright and sell them to the consumers at a profit. They purchase and sell the goods at their own risk. Merchant middlemen are of two kinds – wholesalers and retailers.

Wholesalers: A wholesaler represents the first link in the sequence of intermediaries between the producer and the consumer. The wholesaler may also be defined as the trader who buys goods in large quantities from the manufacturers and producers and sells them to retailers in smaller quantities. A wholesaler's business may also consist of supplying raw materials to industrial consumers, viz., manufacturers. The wholesaler, in some cases, functions as an importer and exporter.

A number of marketing functions such as grading, sorting and packing of goods, are undertaken by the wholesaler (who also arranges for the safe-keeping of the goods). In the course of this business the wholesaler follows the principle of small margins and a quick and large turnover.

Retailers: A retailer represents the last link in the distribution chain, and is engaged in the sale of goods to the ultimate consumer. The retailer serves both the consumer, with whom he comes into direct contact, and the manufacturer or wholesaler. Retail agencies may be classified into small scale retailers and large scale retailers.

Small scale retailers: This category includes all those traders who conduct their business from properly established shops, but whose turnover and capital are limited. These small shops or unit stores may be further classified into general shops and single line shops.

Large scale retailers: Large retail stores have come into existence due to the mass production of goods and the need for their distribution. Large scale retailers are further classified into department stores, multiple shops, and cooperative stores.

Activity: Arts & Crafts Private Limited (A&C) is an organization that sells antique pieces, paintings, etc. The company secures the items from various people, puts them on public display, and sells them. A&C retains 30% of the sale proceeds as commission, and gives the remaining amount to the people from whom the items have been collected. In the given situation, what role does A&C play? Explain.

Answer:

Check Your Progress-3

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

10. Which of the following is the difference between the licensing and franchising?
    i. Franchising allows the licensor more control over the licensee
    ii. Franchising provides for support to the license from the licensor
    a. (i) only
    b. (ii) only
    c. Both (i) and (ii)
    d. Neither (i) nor (ii)
11. The process of mere buying and selling of goods is referred to as …………
    a. Commerce
    b. Business
    c. Trade
    d. Transaction
12. Which of the following terms is used to refer to the process that involves not only the transfer and exchange of goods but also the activities of various agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers?
    a. Trade
    b. Commerce
    c. Business
    d. Transaction
13. The various agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers referred to as ………………
    a. Aids to trade
    b. Auxiliaries to trade
    c. Either of the above
    d. Neither of the above
14. The 'trade' and 'aids to trade' together constitute …………….
    a. Business
    b. Commerce
    c. Import
    d. Export

15. ‘Home’ and ‘Foreign’ are the broad divisions of which of the following?
    a. Commerce
    b. Trade
    c. Logistics
    d. Banking

7.14 Issues in the Global Economic Environment

7.14.1 General Agreement on Tariffs and Trade (GATT)

GATT is a treaty which was signed in 1947, with the objective of reducing barriers to international trade by lowering tariffs, quantitative restrictions and subsidies. Twenty three major nations, including India, signed the agreement on January 01, 1947. Member nations met at frequent intervals to discuss tariffs and quotas. Effectively, GATT represented a contractual agreement between willing nations. With the passage of time, it turned out to be a permanent international mechanism working for the growth of international trade.

Objectives

Although GATT was formed with the sole objective of reducing tariff barriers and discrimination in international trade, the following objectives were enshrined in GATT:

- International trade expansion
- Increasing world production by ensuring full employment in the member nations
- Development and maximum utilization of world resources
- Raising the standard of living of the world population

7.14.2 Most Favored Nation Clause

Article I of the Agreement explains the concept of Most Favored Nation (MFN) as each participating nation agrees to grant the status of the MFN to the other nation in respect of export duties. In other words, it means that if a favor, privilege, advantage, or immunity is granted to a product of a nation, a similar favor, privilege, advantage, or immunity is permissible to a similar product of the other participating countries. If a bilateral agreement is reached and a benefit is decided between two MFNs, the same stands are extended to the rest of the member nations.

7.14.3 Tariff Negotiation

Tariffs’ were a general impediment in the growth of international trade. Negotiations for the reduction of tariffs were allowed for member countries of the GATT agreement. The guidelines specified for such a reduction were:

- A ‘Reciprocal’ and ‘Mutual’ basis must always be attempted while negotiating a reduction;
- Negotiation may be for a tariff reduction or a binding low tariff;

- An atmosphere of utmost good faith must prevail during negotiations.
- Two countries with some commodity may negotiate and arrive at terms convenient to them under GATT. As per the 'most favored nation scheme,' these terms would be uniformly applied to all other member countries.
- The following difficulties were, however, likely to arise with this procedure:
  - The underdeveloped member nations finding the terms arrived at to be unfavorable;
  - Tariff structures were subject to variation;
  - Difficulties in the case of low tariff countries due to their already low tariff and harm is likely to be caused due to further reduction;
  - Slow pace of tariff reduction

7.14.4 World Trade Organization

The World Trade Organization (WTO) was formed on January 1, 1995, replacing GATT. Around 76 governments became members of WTO on the day of its formation. WTO, which unlike GATT is a permanent institution with its own secretariat, is committed to establishing a stable foundation of international cooperation in trade and commerce, through adoption of principles such as non-discrimination, trade negotiations, trade liberalization, etc. WTO was formed after the series of trade negotiations held under GATT. The first round of negotiations primarily dealt with reduction in tariffs. Later it included other areas such as non-tariff and anti-dumping measures.

The WTO replaced GATT for several reasons. While GATT rules were applicable only to trade in merchandise goods, WTO rules were applicable to trade in services and Intellectual Property Rights. Other reasons included formation of a multilateral agreement which required commitment from all members while GATT was a multilateral agreement with several urilateral agreements that made it selective in nature. Moreover, the disputes in WTO were settled faster than the GATT system

[18]As on 2021 WTO membership was 164 and observers status was given to 25. The observer country has to start negotiations with WTO to become member within 5 years from the day they become observers. (Refer Exhibit 7.1)

Exhibit 7.1: WTO- Is Multilateral Trading System Relevant Today?

WTO is an intermediary to act as a mechanism for governments to discuss and arrive at a common path to reduce trade barriers and ensure freer and smoother trade based on the laws and principles
of the multilateral trading system of WTO.
The five principles are the guiding framework of WTO which include
1. Working towards the eventual aim

Contd. ……

[18] Source : https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm

2. There should be no discrimination in trade
3. Necessary for developing Freer trade through negotiation
4. One should predict the future of trade based on the transparency
5. Promoting fair competition and encouraging development and economic reform.

In addition to the above principles, WTO provides clear and specific direction by setting out what member States should or should not do. The challenge that the WTO is facing is whether the principles and laws are relevant today

Stalemate in Negotiations

The most important problem faced by WTO is the stalemate in negotiations which in turn affects the very credibility of WTO as an organization to fulfil its existence. The differences between the rich and poor nations over the agricultural subsidies is the major issue that WTO is facing today. While Uruguay round achieved success in reducing tariffs and nontariff barriers, Doha Round failed on resolving the left over issues. Bali round in 2013 made some progress where the first multilateral treaty was agreed upon resulting in good benefits to least developed nations.

However countries are imposing more restrictions leading to more protectionist policies thereby creating challenges to multilateral trading system and the need for WTO to mete out more severe legally binding measures. G20, the world's wealthiest nations group have been in the forefront in introducing higher customs duties and new import bans. Thus there is an urgent need to reform the WTO's laws to enforce adherence to freer trade post negotiations. However the powerful nations tend to control the rules of the game.

WTO is caught in the bilateral issues and tensions between US and China. Due to poor relations between two giants, the very basic principle of freer trade through negotiations is undermined. The trade restrictive measure in

Contd. .....

2019 imposed by US on China was around 47 % through tariffs and protectionist methods. As a result, the disputes settlement system can no longer mete out predictable consequences for members that default on their obligation to promote freer trade. There can be a solution by including the introduction of laws which will ensure that both the big powers do not abuse through which they can get benefited and achieve their political aspirations.

The preferential trade agreements (PTAs) similar to MFN status are contrary to the WTO's principles but has become part of the WTO through its laws. This principle is closely associated with the "Most-Favoured Nation (MFN)" clause, thus jeopardizing the level playing field amongst the member nations. Though the principles of the WTO are relevant in today's context, there has to be further reforms to the statutes of WTO to reinforce the objectives of the WTO and the obligations of its members.

Source: https://www.eslr.ed.ac.uk/2020/12/17/are-the-principles-and-laws-of-the-multilateral-trading-system-as-embodied-by-the-world-trade-organization-still-relevant-today/ Dated 17th December 2020

7.15 Summary

- Liberalization is the process of breaking down government and artificial barriers to international trade and investment.
- Globalization is "the growing liberalization of international trade and investment, and the resulting increase in the integration of national economies.
- The import policy of the Government of India has two important constituents (i) import restriction and (ii) import substitution.
- The objectives of the export policy is to earn adequate foreign exchange to finance the required volume of imports.
- The Export-Import policy of the government of India guides the foreign trade in the country. It is regulated by The Foreign Trade Development and Regulation Act 1992.
- In the process, a firm called the licensor sells the right to use its intellectual property – technology, patents, copyrights, work methods, brand names, or trademarks - to another firm, called the licensee, in return for a fee.
- In a franchising agreement an independent entrepreneur or organization, called the franchisee, is allowed to operate a business under the name of another, called franchisor, in return for a fee.
- The term 'Trade' refers to mere buying and selling of goods. The term 'Commerce,' on the other hand, is a more comprehensive term and includes not only the transfer and exchange of goods but the activities of various agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers.
- General Agreement on Tariffs and Trade (GATT) confines itself to a general agreement between willing nations for negotiating of tariff fixation.
- WTO is committed to establishing a stable foundation of international cooperation in trade and commerce, through adoption of principles such as non-discrimination, trade negotiations, trade liberalization, etc.

7.16 Glossary

- **Franchiser**: Franchiser is a firm that allows an independent entrepreneur or organization to operate a business under its name.
- **Franchising**: Franchising is a special form of licensing allowing the licensor more control over the licensee while also providing more support from the licensor to the licensee.
- **General Agreement on Tariffs and Trade (GATT)**: General Agreement on Tariffs and Trade (GATT) confines itself to a general agreement between willing nations for negotiating of tariff fixation. It represents an international forum for discussion of tariffs.

- **Import substitution**: According to import substitution, a country should promote and protect those local industries that compete directly with imports in order to minimize balance of payment deficits.
- **Intermediaries**: Intermediaries are third parties that specialize in facilitating imports and exports.
- **Liberalization**: Liberalization is the process of breaking down government and artificial barriers to international trade and investment.
- **Licensee**: Licensee is a firm that buys the rights to use the intellectual property of another firm.
- **Licensing**: Licensing refers to a transaction in which a firm (called the licensor) sells the rights to use its intellectual property to another firm (called a licensee) in return for a fee.
- **Licensor**: Licensor is a firm that sells the rights to use its intellectual property to another firm.
- **Most favored nation (MFN) principle**: According to the most favored nation principle, any preferential treatment granted to one country must be extended to all countries.
- **Tariffs**: Tariffs refer to taxes levied on imported goods.
- **Trade**: Trade is a voluntary exchange of goods, service, or assets between one person or organization and another.
- **World Trade Organization (WTO)**: The World Trade Organization (WTO) was formed on January 1, 1995. It is committed to establishing a stable foundation of international cooperation in trade and commerce, through adoption of principles such as non-discrimination, trade negotiations, trade liberalization, etc.

7.17 Self-Assessment Test

1. Describe the process of liberalization in India.
2. With the advent of globalization, Indian companies have begun to think about marketing globally. Explain.
3. Explain the concepts of import restriction and import substitution.
4. List the objectives of India's export policy. Give an overview of export promotion policies.
5. Define the EXIM policy and list its objectives.
6. What are the basic issues in international licensing?
7. What is international franchising? Briefly explain its advantages and disadvantages.
8. Briefly explain mercantile agents and merchant middlemen.
9. Describe the issues in the global economic environment.

7.18 Suggested Readings / Reference Material

1. Francis Cherunilam, "Global Economy and Business Environment," Himalaya Publishing House, 2017
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7.19 Answers to Check Your Progress Questions

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

1. **(d) Achieving self-sufficiency in food grains production**

   In June 1991, the then finance minister, Manmohan Singh announced a new economic policy (NEP). The policy aimed at reducing fiscal deficits, wiping out the current account deficits, cutting down government expenditures, rationalizing subsidies, controlling inflation, alleviating poverty, and achieving social equity. Hence, achieving self-sufficiency in food grains production is not a basic objective of NEP.

2. **(d) Both import and export policy**

   A trade policy of a country consists of its import policy and its export policy.

3. **(c) (i) and (ii) only**

   The import substitution program in India had two broad objectives: (a) to preserve scarce foreign exchange for the import of more important goods, and (b) to achieve self-reliance in the production of as many goods as possible. Hence (c) is correct.

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

   The broad objectives of India's export policy are:
   - To earn adequate foreign exchange to finance the required volume of imports
   - To effect a change in the directional patterns with a view to reducing dependence on a single or limited number of countries
   - To supplement domestic demand for increasing employment opportunities
   - To raise unit value realization by promoting exports of value-added items
   - To impose minimum price regulation (floor pricing) where competition is intense
   - To impose controls when domestic availability is less than adequate.

   Hence option (d) is correct.

5. **(a) Cash Compensatory Support**

   Introduced in 1966, Cash Compensatory Support was designed to provide compensation for unrelated indirect taxes paid by exporters on inputs, higher freight rates, and market development costs.

6. **(b) Licensor**

   In the licensing process, a firm called the licensor sells the right to use its intellectual property – technology, patents, copyrights, work methods, brand names, or trademarks to another firm.

7. (c) **Licensee**

   In international licensing, the firm that obtains the right to use the intellectual property of another firm, in exchange for a fee is termed as a licensee.

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

   The basic issues in international licensing include boundaries of the agreement; compensation; rights, privileges and constraints; dispute resolution; and duration of the contract.

9. (c) **Royalty**

   Compensation under a licensing agreement is termed as royalty.

10. (c) **Both (i) and (ii)**

    Franchising is a special form of licensing. Franchising allows the licensor more control over the licensee and provides for support from the licensor to the licensee.

11. (c) **Trade**

    The term 'Trade' refers to mere buying and selling of goods.

12. (c) **Commerce**

    The term 'Commerce,' on the other hand, is a more comprehensive term and includes not only the transfer and exchange of goods but the activities of various agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers.

13. (c) **Either of the above**

    The agencies that ensure a free flow of goods and services between the actual producers and the ultimate consumers referred to as aids to trade and auxiliaries to trade.

14. (b) **Commerce**

    The term "Commerce" in short, includes "trade" as well as "aids to trade" since they ensure a free flow of goods and services between the actual producers and the ultimate consumers.

15. (b) **Trade**

    Trade is broadly divided into home trade and foreign trade.

Unit 8

Technological Environment

Structure

8.1 Introduction
8.2 Objectives
8.3 Defining Technology and Technology Transfer
8.4 Technology Selection
8.5 Environmental Liability and the Costs of Technological Advances
8.6 Summary
8.7 Glossary
8.8 Self-Assessment Test
8.9 Suggested Readings / Reference Material
8.10 Answers to Check Your Progress Questions

8.1 Introduction

In the previous three units, we discussed the economic, financial, and trade environment. In this unit, the technological environment is discussed.

Technological environment consist of forces affecting technology and which result in the creation of new products, markets, and marketing opportunities.

In this unit, we will discuss technology, technology transfer, and the factors to be considered while selecting a technology. The unit also explains the new risks introduced by technology and environmental liability and the costs of technological advances.

8.2 Objectives

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

- Define technology and technology transfer.
- Identify the factors involved in technology selection.
- Analyze the new risks introduced by technology.
- Explain environmental liability and the costs of technological advances.

8.3 Defining Technology and Technology Transfer

Technology is knowledge of methods to perform certain tasks or solve problems pertaining to products and services. The basic elements of the technology continuum are formed from the information on product design, production techniques, quality assurance measures, human resources development, and management systems.

Technology transfers covers developing and marketing of technology, selection of technology, mechanism and process, economic, political and legal aspects; and government policies. The complexity of technology transfer depends on the nature of the industry and the technical and commercial aspects involved.

Example: Technology Transfer: A Global Phenomenon

Technology has brought about dynamic changes in the way organizations work. And organizations that use the latest technologies have shown tremendous growth compared to those that have resisted such technology. It is quite evident that in today's technology era, more and more organizations are showing a preference for the latest technologies to improve their businesses.

Of all the technologies, information technology has a special place and has become indispensable to businesses. It has changed the way organizations function. Businesses, large or small, have realized that it is in their interests to adopt the latest technology. But the extent to which an organization adopts technology is difficult to assess. It may vary from employing a computer to carry out business transactions to making huge investments in using management information systems to carry out numerous transactions. Most businesses have even created separate departments for managing information systems.

Earlier, any innovation would take place in a handful of developed countries. Developing countries had to buy and adopt this technology through the process of technology transfer. However, rapid developments in the fields of space research, electronics, semiconductors, medical science, information technology, automobiles, etc., during the end of 20th century made it difficult for a single country or a firm to carry out research and development in all fields. Therefore, technology transfer became an integral part of global innovation and many countries and firms are now engaged in technology transfer in one field or the other, creating a borderless global economy. Technology transfer has taken place primarily in fields like manufacturing, agriculture, defense, pharmaceutical and medical products, and computers.

Moreover, information technology has played a big role in transferring a large amount of information between businesses established in different countries within a short time. For instance, computers connected through networks make it easy for people to share and transfer information. They allow them to communicate quickly and thus reduce the time required to pass on information.

However, transfer of technology or adoption of a new technology is not an easy process. Sometimes technology transfer involves a huge amount of investment and the transfer takes place mostly among established producers or among developed countries. Developing countries thus find it difficult to

Contd. .....

get access to such technology. Also, the dynamic nature of technology makes it difficult for developing countries to apply the latest technologies. There are many prerequisites for technology transfer to take place efficiently. One needs to have a clear idea about the right kind of technology to be used and how to adopt the technology to suit local conditions. Most developing countries lack expertise in these areas.

Compiled from various sources.

8.4 Technology Selection

Technology needs of any large organization, which operates in a high technology area in the engineering sector, are characterized by continuous product innovation and large spending on R&D. Most companies around the world recognize that technology needs cannot be solely met through their own engineering and R&D efforts. Usually each 'technology requirement' is subjected to the make-or-buy decision and judicious mix of indigenous and imported technologies. In some areas, the rate of technological obsolescence is so fast that by the time a technology is selected, imported, absorbed, and adapted, the technology gets outdated. Hence, the strategies for selection of technologies must be dynamic.

8.4.1 State-of-the-Art Production Technology

One crucial lesson from the COVID-19 era is that cost-effective [19]digital manufacturing solutions are needed to keep factories and supply chains running smoothly while producing high-quality products: whether OEM, parts or assembly supplier, contract manufacturer or manufacturing services supplier. Generation of huge data in a single production line necessitates next level information technologies like cloud computing, AI, edge computing and cybersecurity to use the huge data to the advantage of industry.

Group technology, where parts are classified according to manufacturing characteristics and produced in clustered cells of machines, results in significant savings. This leads to the development of flexible manufacturing systems.

The introduction of industrial robots into the manufacturing process has altered the economies of manufacturing productivity.

Machine vision systems for automatic inspection have been developed, which provide for accuracy, precision, repeatability, tirelessness, and rapid payback. These systems are important in speeding up the process of measurement, to keep up the speed of automation. Modern parts require extremely close tolerance or have complex dimensions. These systems eliminate human error and subjectivity.

8.4.2 Factors to be considered in the choice of technology

The main factors to be considered in the selection of technology are:

- Product competitiveness and market potential
- Customer preferences

[19] https://www.ibm.com/in-en/industries/manufacturing?utm_content

- Speed of introduction of new products and processes
- Comparative studies of technology gap between India and the rest of the world
- Availability of technology for import in strategic areas
- Suitability of technology in the context of organizational culture
- Outflow of resources, foreign exchange, etc.

Activity: Kylie wanted to join her father's auto component manufacturing business upon finishing her MBA. The company was facing a downturn for quite some time, and therefore, the top management of the company decided to replace the existing technologies and equipments used in the manufacturing process to new ones. Kylie, who was also a mechanical engineer, has been given the responsibility to select the technology that would benefit the company. As she was new to the system, Tom, the purchase manager, who had been with the company ever since its inception, assisted her. Imagine yourself as Tom. Explain to Kylie the various factors to be considered while selecting a particular technology.

Answer:

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8.4.3 Technology Hazards

Advances in technology are increasing the complexity of systems, thereby increasing the uncertainty in predicting untoward events. The main risk factors in the complex systems are the low-probability and high-security events. The potential for disasters has been further increased by the highly interactive, tightly coupled, and high risk technological systems. However, most research studies indicate that management teams whose members are characterized by higher levels of functional heterogeneity, education, shorter organizational tenures, and high tenure heterogeneity can manage these postindustrial risks effectively. Proper staffing of teams creates an atmosphere that duplicates complex thinking and better decision making.

8.4.4 Computer Fraud and Failures

Firms cannot always be protected from exposure to risks by state-of-the-art security and recognition and integration of organizational factors. Signatures can be forged and encrypting devices be broken into. It is a well-known fact that electronic fraud-credit card abuse and ATM thefts-already exist.

8.4.5 Liability Issues

Employment liability and harassment suits are the major concerns and potentially damaging areas of liability exposure to firms. E-mails disposed off now can be retrieved at a later date from the computer system. Such facilities are helping lawyers to search for incriminating messages by summoning electronic files and computer records. Exposure to liabilities may also occur when resentful employees send internal data of the company outside or through the copyright violations while employees download or post copyright material.

The laissez faire attitude employees increase the risk of electronic copyright infringement. Firms need to institute risk management procedures to safeguard against such risks.

Companies whose employees use the Internet for research and distribution of material also face risks due to plagiarism for websites. Further, defamation can also pose liability to firms.

8.4.6 Damage to Systems and Records

Employee carelessness is also responsible for the increase in risk faced by companies. Many times an employee might unknowingly install a devastating virus on the system and damage data records. Many firms are therefore imposing restrictions on the downloading of software by employees into company computers. Companies need to build strong 'firewalls' to safeguard their systems.

Activity: Baby Care Ltd. (BCL), a provider of baby care products planned to launch a new food product for babies in the market. However, before it could do so, the file containing the composition of the food product was corrupted. After investigation by the BCL's management, it was found that the file was corrupted by a virus. What kind of technology risk has the company faced in this case? What measures can BCL take in order to avoid such incidents in the future? What are the other risks introduced by technology for business organizations?

Answer:

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8.4.7 Invasion of Privacy

The new technology also has a significant influence on an individual's right to privacy. Data collected over a period of time may be used to trace the consumption and lifestyle behaviors of individuals, who may prefer to keep such information private. Though such information enhances the target marketing abilities of firms, they also expose them to lawsuits pertaining to invasion of privacy. Though at present the laws regulate the privacy rights of individuals as well as government agencies, the laws pertaining to the ability of the private sector to gather, disseminate and use information about an individual are not very clear. Legislation on such matters is expected in future. Exhibit 8.1 discusses about challenges of cybersecurity.

Exhibit 8.1: The Cybersecurity Challenges of 2021

Cyber security is the greatest challenge and this is realized very well by corporate leaders and are increasingly elevating its importance. Global Risks Report 2021, of the World Economic Forum classifies cyber risks among the global risks. Lot needs to be done in years ahead based on the high-profile attacks especially the Solar winds supply chain attack. Let us look at some of the challenges in cyber security

Complex cybersecurity challenges- Digitalization, software, hardware, cloud infrastructure have impacted our lives in a big way. The world is racing towards adoption of AI leading to increased complexity as sooner or later, technology will overtake the human intelligence and we will be slave to technology. This leads to more cyber-attacks on critical infrastructure. The risk is multi fold now and we all need to accept the fact that cybersecurity is a national security priority. Thus companies and Governments have to secure their assets by incorporating cybersecurity to safeguard from the hackers, terrorists especially the ISIS who are gaining proficiency in cyberattacks.

Complex regulations- The people who commit cybercrimes do not have any borders nor do they need to comply with country jurisdiction. This makes things more difficult for the organizations to adhere to complex rules and regulations such as laws pertaining to Data Protection, Consumer Privacy Act, the Cybersecurity Law which are in vogue in various countries across the world. With limited budgetary allocations, it will be extremely difficult for companies to safeguard data against attack while at the same time have to follow the laws of countries under which they operate.

Shortage of cybersecurity expertise-There is a dearth of experts who can provide proper security for organizations against cybercrime. Thus it is imperative that every organization has to develop their own security experts by a proactive plan, build and maintain its own cybersecurity workforce. Organizations should consider develop the experts within.

Difficulty tracking cyber criminals- This is another big challenge for the organizations. People involved in cybercrimes go unpunished as there is no proper mechanism for detection and prosecution. Experience shows that the prosecution of tech criminals is dismal in other countries as well. There has to be an international criteria to bring the criminals to justice. Since the cybercrime is a global issue, there has to be a cooperation amongst business organizations and governments as well and it should be recognized by one and all that security features should become integral to technology and business leadership has to pay serious attention to cybersecurity.

Source: https://www.weforum.org/agenda/2021/01/top-cybersecurity-challenges-of-2021/ Dated 21st January 21

8.5 Environmental Liability and the Cost of Technological Advances

8.5.1 The Problem

The development of any product or technology is associated with side effects, usually in the form of waste or pollutants. Though technological advances are generally beneficial for mankind, they may produce potentially deadly byproducts as a natural side effect.

Growing environmental concerns have paved way for a drastic increase in regulation and legislation regarding environmental pollution. These laws hold businesses liable for any environmental pollution caused by them and allow governments to sue the offending firms, individually or collectively.

The Costs

For individual firms that develop or use advanced technology and cause environmental damage, the costs of cleaning up and paying compensation to the parties involved are usually enormous. Very few companies and insurers can sustain losses incurred as a result of such damages.

Who is Liable

Many of the major corporations are purchasing environmental liability insurance to transfer some of the risks they face because of such environmental liabilities. The magnitude of this pollution identification problem is causing problems for the insurance industry.

The pollution liability problem can be split into two segments:

1. Liability for clean-up of existing pollution due to past technological advances.
2. Liability for preventing or controlling new pollution from new advances. However, it is difficult to decide who should be held responsible for cleaning up this “trash from technology”. Also, it might be difficult to fix responsibility unless the limits for liabilities of prior pollution are set up.

8.5.2 New Threats to the Environment

Technological advancement is a continuous process and so is pollution. This is compounding the existing pollution problem. A part of this pollution can be controlled by regulating the systems and monitoring fresh pollution. The estimated costs for the technology-based pollution might grow even larger in the future. Moreover, procedures which are currently considered environmentally safe could prove to be dangerous later because the identification of damages of technological advances is done by the measurement of successively small dose levels. New dangers may also be discovered.

Pollution is continuously degrading the global ecosphere. Though a strict liability system in one country might reduce pollution, it would simultaneously give firms an incentive to locate the industry in countries with less stringent regulations.

e-waste

Electronic waste or e-waste is a great threat to the society. The advancement of technologies makes the electronic devices and gadgets as obsolete within a short time and is thrown as waste. They have different classes of metals and products capable of causing various diseases to human beings and the animals. The technology advancement also brought many home appliances to ease the work of the home makers. They also contribute the pollution of the environment. The government has made guidelines for safe disposal of the electronic waste after due treatment. Compliances of the guidelines and rules, framed thereunder is essential and part of the business activity. Awareness has to be brought to the citizens about the use and adverse effects of electronic waste.

8.5.3 Possible Solutions

There seems to be neither a simple and efficient method of financing the environmental clean-up nor a method to compensate equitably the injured parties.

Mutual Insurance Pools

Mutual insurance pools can be formed to insure select classes of exposure or a particular industry group to overcome the barriers to insurability (uncertainty in predicting losses). This pool may be owned by a group of insurers. These insurers are presumed to be experts in a particular technological area and to possess superior loss prevention and underwriting capabilities.

The pool is expected to accept only those risks which would meet the acceptable underwriting standards. Hence the pool could function as a way of suggesting minimum acceptable industry standards. Moreover, all the insurers would have vested interests in the financial operations of the pool.

The policy makers could help in designing state-of-the-art pollution control mechanisms which could reduce negligence penalties. They could also dictate the extent to which the government and the insurance industry should share the burden of the clean-up costs. The prices and insurer uncertainty could be reduced by investing more money into clean-up by sharing these costs on a no-fault basis.

Assigned Risk Pools

Some firms may not be able to obtain insurance from the private market. Such firms might obtain insurance from the assigned risk pools created by the government. Government can mandate participation in such pools, thereby expanding its risk spreading ability. A major limitation of these pools in the past has been the severe underpricing of insurance. This has resulted in a large deficit, which was ultimately paid by taxpayers.

Environmental Trust Funds

In situations where no international polluter is identified, the Environmental Trust Funds pay for the clean-up of those hazardous sites. The environmental Trust Funds are financed through end-use taxes or broad-based taxes.

Technological Advances in Financial Markets The differences between the financial and traditional risk management approaches are fast reducing. Insurers are using the currency futures and financial desirable instruments to hedge the risk of assets. In addition, the loss exposure is being hedged using the knowledge that value of special commodities and loss exposures are strongly correlated. The commodity futures market could be used to partially hedge the loss exposure. However, managing traditional risks through reinsurance contracts is now being replaced by innovative techniques like Act of God bonds, etc. As a result the insurance prices would remain more stable. The ultimate benefit of this shift is to insurance customers and insurance company owners.

Most companies are usually unaware of the risks they are exposed to in derivatives. The use of derivative instruments has not yet resulted in a risk in insurance premiums. This, however, can change with the occurrence of a single identified multibillion dollar derivative loss. The new financial derivatives have many advantages. They not only provide access to broader and richer capital markets but also allow the hedging and transfer of previously unavailable risk coverage. However, these derivatives have their disadvantages too. If left unmonitored, they make the firms vulnerable to tremendous potential losses.

Check Your Progress - 1

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

1. The knowledge of methods to perform certain tasks or solve problems pertaining to products and services known as
   a. Planning
   b. Innovation
   c. Technology
   d. Knowledge Management
2. The basic elements of technology continuum are formed from:
   a. Information on product design and production techniques
   b. Quality assurance measures
   c. Human resources development and management systems
   d. All of the above
3. What is the process that covers developing and marketing of technology, selection of technology, mechanism and process; economic, political, and legal aspects; and governmental policies?
   a. Innovation Process
   b. Technology Transfer
   c. Technical Documentation
   d. All of the above

4. The risks introduced by technology include:
   a. Technology hazards
   b. Damage to systems and records
   c. Computer frauds and failures
   d. All of the above
5. Which group of insurers is formed to insure select classes of exposure or a particular industry group to overcome the barriers to insurability (uncertainty in predicting losses)?
   a. Assigned risk pools
   b. Mutual insurance funds
   c. Mutual insurance pools
   d. None of the above
6. Which of the following has the limitation of severe underpricing of insurance?
   a. Assigned risk pools
   b. Mutual insurance pools
   c. None of the above
   d. Both and b
7. Which category of funds is financed through end-use taxes or broad-based taxes?
   a. Assigned risk pools
   b. Environmental trust funds
   c. Mutual trust funds
   d. All of the above

8.6 Summary

- Technology is knowledge of methods to perform certain tasks or solve problems related to products or services.
- Technology transfer covers developing and marketing of technology, selection of technology, mechanism and process, economic political and legal aspects, and government policies.
- The technology needs of any organization are met by continuous product innovations and large spending on R&D.
- With advances in technology, organizations now face new risks like computer frauds and failures, liability issues, damages to systems and records, technology hazards and invasion of privacy.

- Technological advances also produce potentially deadly by-products as a natural side effect. It threatens not only the financial survival of the firms manufacturing this technology, but also the health of the society. Possible solutions to these environmental threats are: mutual insurance pools, assigned risk pools, and environmental trust funds.

8.7 Glossary

- **Technology hazards**: Dangers that are by-products of innovations or technology.
- **Technology transfer**: The process that covers developing and marketing of technology, selection of technology, mechanism and process, economic, political and legal aspects; and government policies is termed as technology transfer.

8.8 Self-Assessment Test

1. Define technology and technology transfer.
2. Explain the factors to be considered while selecting a technology.
3. Briefly explain the risks introduced by technology.
4. Describe the concept of environmental liability and the costs of technological advances.

8.9 Suggested Readings / Reference Material

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8.10 Answers to Check Your Progress Questions

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

1. (c) Technology

Technology is defined as the knowledge of methods to perform certain tasks or solve problems pertaining to products and services.

2. (d) All of the above

The basic elements of the technology continuum are formed from the information on product design, production techniques, quality assurance measures, human resources development, and management systems.

3. (b) Technology transfer

Technology transfer is the process that covers developing and marketing of technology, selection of technology, mechanism and process; economic, political, and legal aspects; and governmental policies.

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

   The risks introduced by technology consist of technology hazards, computer fraud and failures, liability issues, damage to systems and records, and invasion of privacy.

5. **(c) Mutual insurance pools**

   Mutual insurance pools are group of insurers formed to insure select classes of exposure or a particular industry group to overcome the barriers to insurability (uncertainty in predicting losses).

6. **(a) Assigned risk pools**

   Firms that do not obtain insurance from the private market obtain it from assigned risk pools created by the government. The major limitation of assigned risks pools is of severe underpricing of insurance.

7. **(b) Environmental Trust Funds**

   Environmental trust funds are financed through end-use taxes

Business Environment and Law

Course Components

BLOCK I	**The Socio-Political Environment of Business**
Unit 1	Business Environment: An Introduction
Unit 2	Demographic and Social Environment
Unit 3	Cultural Environment
Unit 4	Political Environment
BLOCK II	**The Economic and Technological Environment of Business**
Unit 5	Economic Environment
Unit 6	Financial Environment
Unit 7	Trade Environment
Unit 8	Technological Environment
BLOCK III	**The Legal and Ethical Environment of Business**
Unit 9	Legal and Regulatory Environment
Unit 10	Tax Environment
Unit 11	Ethics in Business
BLOCK IV	**Business Contracts**
Unit 12	Law of Contracts
Unit 13	Special Contracts
BLOCK V	**Law Relating to Corporate Business Entities**
Unit 14	Insolvency and Bankruptcy Code, 2016
Unit 15	A Brief Note on Companies Act, 2013
BLOCK VI	**Tax Laws**
Unit 16	Direct Taxes
Unit 17	Goods and Services Tax: An Overview