



Economic Environmeal of Business

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Abstract: Economic environment comprises economic systems, economic economic planing and industrial policy, There are three types of economic system: Capitalism, and Mixed economy depending on how the means of production are controlled- by pricate individuals, The State, orjointly. The objective of industrial policy is to achieve balanced and accelerated industrial development of the county.

WHAT IS ECONOMIC ENVIRONMENT- The most important element of economic environment is economic systems, There are three different types of economic systems - capitalist, socialist and mixed economy.

A capitalist system is one where resouces are allocated through the price or price mechanism.

There is another economic system which is just the opposite of ca[italism; itis called socialist system. IUnder this system resources are allocated not through price mechanism but through enterprise and regulated sectors work side-by-side.

CAPITALISM- A capitalist economy is an economy where the laws of demand and supply operate freely. The capitalist system is one which is characterized by private ownership of the means of production, individual decision-making and the use of market-mechanism to carry in markets. decisions of indicialual participants and facilitate teh flow of goods and services in markets.

The capitalist system has following features:

1. Market- mechanisms are the key factors that gugulate the capitalist econjomy: A market economy is one in which buyrs and sellers express thir opinions about how market economy is one in which buyers and sellers express their ipinions about how much they are wiliong to pay for goods and services. Prices guide the purchasing decisons of the consumers. At the same time, while they decide to buy or not to buy a product, consumers vote for or against the product by using their money. Thus, market pices, which reflect the desires of millions of consumers, provide guidelines to investors and other business persons. The market system, also called the price system, may therefore, be regarded as the organising force in a capitalist economy.

2. Consumers' sovereingnty- This is at its in the capitalist system where consumers have complete freedom of choice of consumption. The production decisions in hte free market economy are based on the consumer's desires which are reflected in the demand patten, Under capitalism, the condsumer is the king. Under capitalism, the condsumer is the king.

3. Competition- A mong sellers and buyers competitoon ius an essential feature of an ideal capitalist system. Competition reduces market imperfections and related problems, Therefore in a free market economy, a sufficient amount of competiton is necessary in a private enterprise economy to keep initiative constantly on alert, to protect the consumer and to maintain a sufficiently flexible price system.

4. Private ownership- In a capitalist economy, the factors of production - labour and capital are privately owned and production ovvurs at private initiative. Individuals have their properly rights protected and are usally free to use thir proপর্য as they like as loing as they do not infringe on hte legal property rights of others. Private property is protected, controlled and enforced by law.

5. Free enterprise- This feature of the capitalist system is merely an extension of the concept of property rights. The term free enterprise implies that orivate firms are allowed to abtain resources to organise production and to sell the resultant product in any way they choose. In other words, there will not be any restriction on the freedom and ability of the private individuals to carry out any business.

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6. Freedom of choice of occupation- In a capitalist economy the individual is free to choose any occupation he is qualified for. This freedom of choles enables the worker to meke the best possible bargtain for his labour. This implies that the employers have to competitively bid for labour. Freedom of occupational choice is practically limited by the extent of availbillty of the jobs.

7. Freedom to Save and Invest- The freedom to save is implied in the freedom of consumption. The term saving implies the sacrifice of consumption. The right to save is supported by the right to rransmit wealthy so hthat the choice between present and future consumption is not limited to the aduldtt life of one person. The freedom to sace, inherit and accumulate wealth i8s therfore a right which is perhaps more typical for the private enterptise sstem than in free in choice of cousumpiton and occupation.

8. Linted Role of Government- Government has no role in economic activities. Capitalism believes Government is an evil necessary and that government os the best which governs the least.

New economic environments- Econmic Reforms in India were started by Prime Minister Rajiv Gandhi. He daid, "the public sector has entered into too many areas where it should not be. We shall open the economy to the private sector in several areas hitherto restricted to it, "Consequently, a number of measures were taken to remove control, open areas to private sector players. However, Rajiv Gandhi did not take a very strong and categorical position on the issue of privatisation and globalisation, though some liberalisation of hte economy did take place. It was when Mr. Narasimha Rao took over as Prime Minister in 1991 that a now industrial policy was announced which marked a sharp departure from the earlier undusrual policy of 1956.

There were three aims of the New Economic Policy-Liberalistion, Globalisation and Priv atisation.

The list of industries in which industrial licensing is compulsory:

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

2. Globalisation - Globalisation intends to untegrate the Indian economy with the world economy. Globalisation is considered to be an important element in the reforms packags, It has four parameters:

- (1) Reduction of trade berriers so as to permit free flow of goods and services across national frontiers;
- (2) Creation of an environment in which free flow of capital can take place;
- (3) Creation of an environment permittng free flow of technologies among nation-states; and
- (4) Creation of an environment in which free movement of labour can take place in different countries of the worls. To pursue the objective of globalisation, the ffollowing measures have been taken.

(1) Reduction of inport duties- There has been a considerable reduction in import during the last five years. The maximum rte was reduced from 150 per cent in 1991-92 to 110 per cent in 1992, to 85 per cent 1993-94 and 50 per cent in 1995-96. Custom duties on imports of capital goods were reduced to 80 per cent in july 1991 , to 55 per cent in 1992 and to 25 per cent in 1925. Tariffs on imports of raw materisls and manufacture intemediates have been reduced.

(2) Encouragement of foreign investment- The government has taken a number of measures to encourage foreign investment. The main measures taken in this regard are:

- (a) Approval would be given for direct investment up 51 per cent foreignn equity ini high priority industries as per Industrial Policy of 1991. Such cleaannces will be given if foreign equity covers the foreignn exchange requirements for imported capital goods.
- (b) to provide to international markets, majority foregn equity holding up to 51per cent equity would be allowed for trading companies primarily engaged in export activities.

(3) Encouragement to foreign technology agreement- The Industrial Policy of 1991 undertook the



following measures: (a) Automatic permission will be given for foreign technology agreements in high priority industries up a lumpsum payment of Rs.1 crore, 5 per cent royalty for domestic sales and 8/ per cent for exports subjecto to total payments of 8 per cent sales over a 10-year period form hte date of the agreement or 7 years from the commencement of production.

(c) No permission will be necessary for hjiring of foreinn technicians and foringn testiing of indigenously developed technogies.

3. Pricatisation - Pricatistion is the process of involving the pricate sector in the pwnership or operation of a state-owned or punlic sector undertaking. It can take three forms: (1) Ownership measures, (2) Organistional mesures and (3) Operational measures.

(1) Ownership Measures- The degree of privatisation is judged by the extent of ownership transferred from the public enterprise to the private sector. Ownership many be transferred to an individual co-operative or corporate sector, This can have three forms:

(a) Total denationalisation implies 100 per cent transfer of ownership of a public entersprise to private sector.

(b) Joint venture implies partial transfer of a public enterprise to the private sector, IT may have several variants- 25 per cent transfer to pricate sector in a joint venture impkies that majority ownership and control remanis with the public sector. Fifty one per cent transfer of ownership to the private sector shifts hte balance in favour of hte private sectr, though the pubic sector retains a substantial stake in hte undertaking. enterprise.

(c) Liquidation implies sale of assets to a person who may use them for the same purpose or some other purpose. This solely depends on hte preference of the buye.

(d) Workers' Cooperative is a special form of denationlisation. In this form, ownership of hte enterprise is transferred to workers who may form a co-operative to run the enterprise.

(2) Organisational Measures- These include a variety of measures to limit stae control. They include-

(a) A holding company structre may be designed in which the government limits its contol to a holding company structre may be designed in which the government limits its contol to top level major decisions and leaves a sufficient degree of autonomy for the operating companies in their day-to -day operations. A big company like the Steel Authourity of India may acquire a holding company status, there by transferring a number of functions a holding comany status, thereby transferring a number of functions to its smaller units. In hteis way, a decentrlised patteern of menagement emerges. (b) Leasing: In this arrangement, the government agrees to transfer the use of assets of a public enterprise to a private budder for a specified period, say five years.

(c) Restructuring- It is of two types - Finacial Restructuring and Basic Restructuring.

(i) Finacial Restructuring implies the writing off orf accumulated losses and rationlisation of capital composition in respect of debt equity ratio. The main purpose of this restructuring is to improve the finacial health of the enterprise. (2) Basic Restructuring is said to occur when the public enterprise decides to shed some of its activities to be taken up by ancillaries or small-scale units.

(3) Operational Measures- The efficiency of public sector enterprises depends upon the organisational structure. Unless this structure grants a sufficient degree of outomy to the operators of the enterprise or develops a system of incentives it cannot raise its efficiency and productivity. These measures include (a) grant of autonomy to punlic enterprises in decision-making, (b) provision of incentives for workers and executives consistent with inrease in efficiency and productivity, (c) freedom to acquire certain inputs from the markets with a view to reducing costs, (d) development of proper criteria for investment planing and (e) permission to pubic enterprises to raise resources from the capital market to execute plans of diversifications. Aims of Liberalisation, Globalisation and Privatisation- Liberalisation, globalisation and privatisation are all means to chieve certain ends of the society just as nationlisation and regulatory frameworks were intended to



achieve certain goals. These are-

1. To achieve high rate of growth of national and per capita income.
 2. To achieve full employment.
 3. To achieve self-reliance.
 4. To reduce inequality of income and wealth.
 5. To reduce the number of society based on equality and absence of exploitation.
 6. To develop a pattern of society based on equality and absence of exploitation .
- (1) The excessive development of bureaucratic controls acted as shackles on growth.
 - (2) Overstaffing in public sector enterprises led to an increase in cost of operation.
 - (3) Low rate of return on investment in public sector.
 - (4) Poor work ethic in public sector enterprises due to excessive job security and absence of incentives for better work.
 - (5) Entry of public sector in areas of consumer goods for which it was never meant. Thus unnecessary expansion resulted in the absence of focus and dilution in the quality of management.
 - (6) Some public sector enterprises were incurring losses year after year and as such had become a burden on the public exchequer, instead of being an asset to the nation.

The measures undertaken are all designed to rectify these problems so that working of the economy becomes more efficient and the rate of growth of the economy improves.

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