Business Environment and Ethics

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School of Distance Education
Bharathiar University, Coimbatore - 641 046

Author: Vivek Mittal

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BUSINESS ENVIRONMENT AND ETHICS

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UNIT I

LESSON

1

BUSINESS ENVIRONMENT: THE CONCEPT

CONTENTS

1.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept of business environment
- Know various types of business environment and its impact on business
- Know how to analyze the environment
- Know how does environment influenced the business decision-making

1.1 INTRODUCTION

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organization is "the aggregate of all conditions, events and influences that surround and affect it." Davis. K, *The Challenge of Business*, (New York: McGraw Hill, 1975), P43.

Environment refers to all external forces which have a bearing on the functioning of business. Jauch and Gluecke has define environment in following manner "The environment includes factors outside the firm which can lead to opportunities or a threat to the firm. Although there are many factors the most important of the sectors are socio- economic, technological, supplier, competitor and govt."

1.2 CHARACTERISTICS OF ENVIRONMENT

1. ***Environment is complex:*** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these interact with each other to create entirely new sets of influences.

2. ***Environment is dynamic:*** The environment is constantly changing in nature. Due to many and varied influences operating there is dynamism in the environment causing it to change its shape and character continually.

3. ***Environment is multi-faceted:*** The same environment trend can have different effects on different industries. As the GATS is an opportunity for some companies and threat for some companies.

4. ***Environment has a far reaching impact:*** The environment has far reaching impact on the organization. The growth and profitability of an organization depends critically on the environment in which it exists.

5. ***The impact of an environmental trend often differs significantly for different firm with in the same industry:*** Any change in environment may have different impacts on different firms operating in the same industry. As in pharmaceuticals industry in India the Impact of new patent law will different on research based pharmacy companies as Ranbaxy and Dr. Reddy's Lab and will be different on small pharmacy companies.

6. ***The general environment usually holds both opportunities for, and threat to, expansion:*** Development in general environment often provides opportunities for expansion in terms of both products, and markets. For example liberalization in 1991 opened lot of opportunities for companies and HLL took the advantage of opportunities and acquire many companies like Lakme, TOMCO, KISSAN etc. Changes in environment also pose serious threat to entire industry. As liberalization of poses serious threat of new entrants in the form of MNC to Indian firms.

7. ***Development in the general environment change competitive battle line:*** General environmental changes may alter the boundaries of an industry and change the nature of its competition. This has been the case with deregulation in the telecom sector In India. Where since the deregulation every second year new competitor emerges old foes become friends, M&A take place with every new regulation.

8. ***Many developments in the general environment are difficult to predict with any degree of accuracy, while others are readily predictable:*** Macroeconomic development such as interest rate fluctuations, the rate of inflation, and exchange rate variations are extremely difficult to predict on a medium – or long-term basis. On the other hand some trends as on demographic, income level, age can be forecast.

The process by which organization monitor their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.

Factors to be considered for environmental scanning: The external environment consists of variety of factors we can explain them as follows:

1. Events are important and specific occurrences taking place in different environment sector.

2. Trends are the general tendencies or courses of action along which events takes places.
3. Issues are the current concerns that arise in responses to events and trends.
4. Expectations are the demands made by interested groups in the light of their concern for issues.

Check Your Progress 1

Define Environment.

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1.3 TYPES OF ENVIRONMENT

Environment can be divided into three broad categories:

- Internal Environment
- Macro Environment (General Environment)
- Micro Environment (Relevant Environment, Competitive Environment)

1.3.1 Internal Environment

Internal environment is internal to the organization and it is controllable. In brief important internal factors are as follows:

1. ***Culture and Value System:*** Organizational culture can be viewed as a system of shared values and believes that shape a company' behavioral norms. A value is an enduring preference for a mode of conduct or an end – state. The value systems of founders have a great and lasting impact on the value system of organization. Value system not only influences the operations and behavior it also influences the choice of business.
2. ***Mission and Objectives:*** The business domain of the company. The mission and objectives of the company guide priorities, direction, of development, business philosophy, and business policy.
3. ***Management Structure and Nature:*** Structure is the way in which the tasks and sub tasks are related. Structure is about the hierarchical relationship, span of management relationship between different functional areas. Structure of top management, pattern of share holding etc.
4. ***Human Resource:*** It deals with factors like manpower planning, recruitment and selection, and development, compensation, communication, and appraisal.

Besides this internal environment includes corporate resources, production/ operation of goods and services, finance and accounting system and methods, marketing and distribution.

1.3.2 Macro Environment

Macro/ General Environment consists of factors external to the industry that may have significant impact on the firm's strategies. Here we will look at six broad dimensions: Demographic, Socio-cultural, political/legal, technological, economic and global.

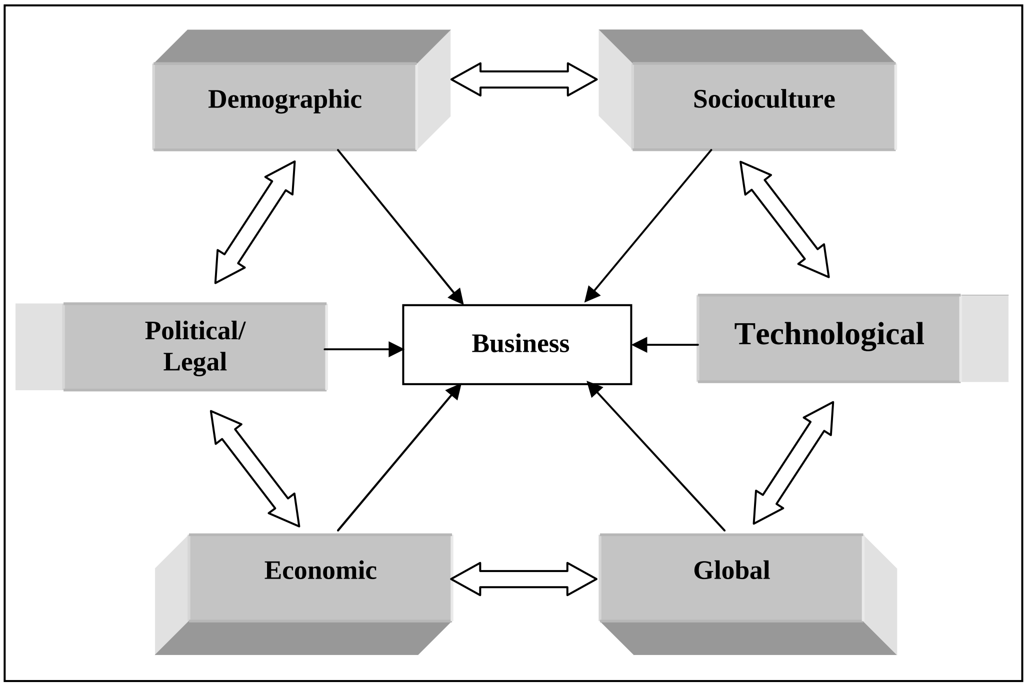

Figure 1.1: Dimensions in General Environment

1. ***Political Environment:*** It is the political environment of the country which decides the fortune of the business in a country. After 1917 revolution in USSR suddenly a political change transform the whole equation of business. In Indian in 1977 Janta government came in power and because of this Coca Cola and IBM have to leave the country. Because of Janta government all liquor company have to close their operations. After the change in the regime in the USSR in late 1980s and early 1990s the whole equation of business changed in Russia. Recently when P.V. Narsimha Rao came in power and new economic policy changed the whole definition of business in India on the one hand it gave a bulk of new opportunities for business on the other hand it also brought threat for inefficient organization. Not only political philosophy but also political stability has a significance importance. More stable will be the political environment of country the more conducive will be the environment for business. Not only stableness but also the consensus among various political parties on key issues also have a significant importance.

2. ***Regulatory and Legal Environment:*** Political environment decides the legal and regulatory environment of country. Regulatory environment plays a vital role by telling dos and don'ts to business. Every country has its legal environment. In India we have companies act which governs companies, MRTP act which restricts monopoly, there are various laws regarding shares, consumer protection act, environment laws and recent development in WTO and implementation of GATS which resulted in the implementation of international law regarding Patent, import export law, licensing etc. has drastic impact on business and the future of organizations.

   Once an NRI, Lord Swaraj Paul, a British citizen, tried to takeover Escorts then Nandas approached govt to save their company then a new law came into force which restrict any NRI to purchase the share of an Indian company and Escorts was saved.

3. ***Demographic:*** It is Demographic environment which decides the all the marketing mix for the organization. Structure of demographic decides type of product as in India lot of research is going on to reduce the cost of product and launce products at cheapest possible as 1 Rs sachet of shampoo or 5Rs ice-cream

cone. It is demography which decides the pricing, promotion and distribution strategy. India’s 70% population is leaving in villages and of this 70% major part is youth that’s why every business house is launching new products specifically for rural market. ITC launched its unique and ambitious programme called e-chaupal targeted at rural market.

4. ***Socio Culture:*** Socio culture variable like the beliefs, value system, attitudes of people, their demographic composition have a major impact on their personality and behavior style. The conspectus of needs and the pattern of consumers’ preferences have undergone a change in 1990s. This change has led to the production of more cars, refrigerators, air conditioners and other articles which were at one time considered to be ostentatious and luxurious. Not only this socio culture decides the preference of consumer even in India itself, company's launched products in south and north are many times different because of changes in preference. Companies have to change their product portfolio because of cultural preferences as Macdonald and KFC did when they launched their restaurant chain in India.

5. ***Technological:*** Technological forces present wide range of opportunities and threats which have to be accounted for in the process of business strategy formulation. Technological advancement may dramatically affect “organization’s products, service, markets, suppliers, distributor’s competitors, customers, manufacturing process, marketing practices, financial composition, and competitive position.” Some of the important factors that influences operating in the technological environment are as follows:

   - Sources of technology, like company sources, external source, and foreign sources, cost of technology acquisition, collaboration in and transfer of technology.
   - Rate of change in technology, rate of obsolesce.
   - Impact of technology on human being, the man machine system, and the environmental effect of technology.
   - Communication and infrastructural technology in management.

   In fact technology is today a decisive factor. And from FMCG to Microprocessor industry every body is investing heavily on technology. Level of technology of consumer also influences the decisions. As organizations have to modify the product according to the level of technology of the target costumer as in developing nations any complex household machine, which needs programming, will not work.

6. ***Global Environment:*** The international environment consist of all those factors that operates at the transnational, cross cultural, an across the border level which have an impact on the business of an organization. World is today a global village. World is getting closer and closer as far as business is concern. For the sake of business countries are burying their grievances and are developing economic relationship. Erstwhile hard poles as America and Russia are today goods friends, China and India is coming closer, India have signed bilateral treaty with Sri Lanka, India is developing close economic relationship with South Africa and Brazil, India is planning to develop a road network with South East Asia, India is close ally of ASIAN, India is a signatory of WTO which is multilateral trade agreement among more than 100 nations. India is in a process of laying down a gas pipeline from Iran to India through its archrival Pakistan. All this is just a glimpse of International environment. Every new bilateral and multilateral agreement opens new vistas for business and also gives new threat in the form of global competition.

7. ***Economic Environment:*** The economic environment consists of macro level factors related to the means of production and distribution of wealth, which have an impact on the business of an organization. The economic structure whether it is socialist, mixed or capitalist, its stage whether its developing or developed, economic policies such as foreign trade policy, industrial policy, fiscal policy, GDP growth rate, policy of licensing, monetary policy, development of financial institutions, development of money and stock market, extent of globalization all have a drastic impact on business. As slight change in monetary policy can release 1000crore of rupees in economy which result in decrease in interest rate, which further increases the investment and inflation too. Banks lending rate decides the level of investment in any country. Higher the interest rate lower the level of investment. In most industrialized nations like USA this interest rate is between 4%-6% on the other hand in India in 1991 PLR (prime lending rate) was 17%-18% which was reduced to 8%-10% by 2000 because of change in economic policy.
8. ***National Competitive Advantage:*** Despite globalization number of industries are clustered in specific and small number of countries. As many of the most successful computer and biotechnology firms are based in USA, many of the successful chemical and engineering industry is based in Germany, many of the successful electronics industry is based on Japan. Many of the successful call centers are situated in India, many of the customized software companies are clustered in India. This suggest that in nation in which a company is based may have an important bearing on the competitive position of that company in the global market place.

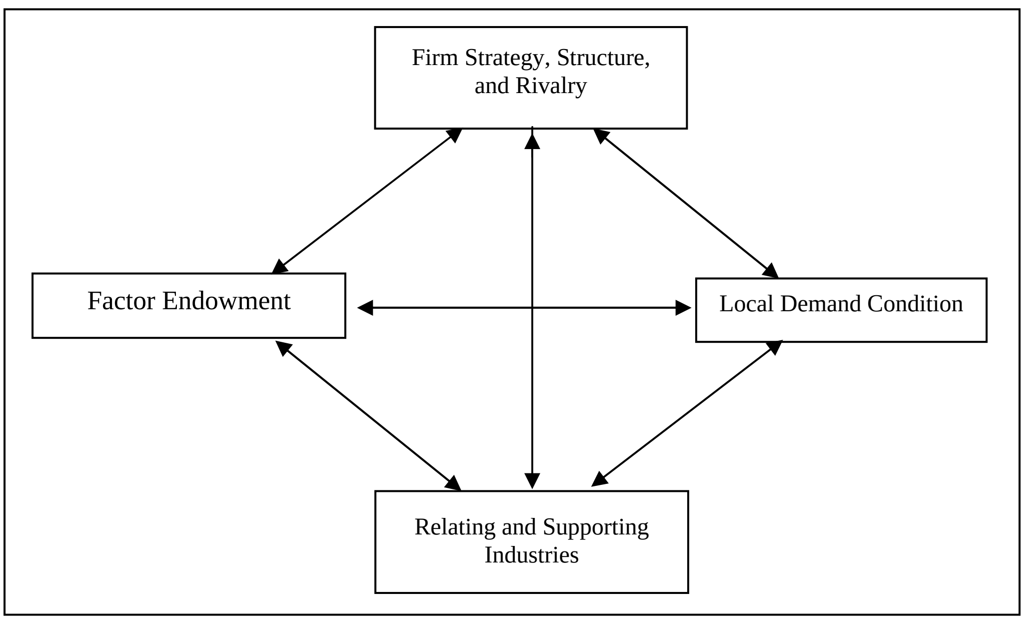

Figure 1.2: Michael Porter's International Competitiveness Model

In a study of national competitive advantage Michael Porter identified four attributes of a national or country – specific environment that have an important impact on the global competitiveness of companies located within that nation.

1. ***Factor Endowment:*** A nation's position in factors of production such as skilled labor, capital, technology or the infrastructure necessary to compete in a given industry.
2. ***Demand Condition:*** The nature of home demand for the industry's product and service.

3. ***Relating and Supporting Industry:*** The presence and absence in a nation of supplier industries and related industries that is internationally competitive.
4. ***Firm Strategy, Structure and Rivalry:*** The condition in the nation governing how companies are created, organized and managed and the nature of domestic rivalry.

Check Your Progress 2

What is macro environment? What are the broad dimensions of macro environment?

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1.3.3 Micro Environment

Microenvironment or competitive environment refers to the environment, which an organization faces in its specific arena. This arena may be an industry, or it may be what is referred to as strategic group. Besides looking at primary demand and supply factors, the firms examine state of competition it faces. Because it also determines that whether it remains in same or will start new business. All the business decision that is new business, pricing, distribution channel, promotion strategy, product portfolio etc depends upon to extent upon the competitive position of the firm. Like every new entrant in the glucose biscuit segment have to study and consider the marketing mix strategy of existing players as Britttania, Parle, Priyagold etc., before deciding its marketing mix.

Professor Michael Porter of the Harvard Business School has convincingly demonstrated the state of competition in and industry is a composite of five competitive forces.

The Five Forces of Competition

According to Michael porter five forces of competition are:

1. The rivalry among sellers in the industry. (threat of competitors)
2. The potential entry of new competitor. (the threat of new entrant)
3. The market attempts of companies in other industries to win customers over to their own substitutes products. (threat of substitute)
4. The competitive pressure of stemming from supplier-seller collaboration and bargaining. (bargain power of supplier)
5. The competitive pressure stemming from seller-buyer collaboration and bargaining. (bargain power of buyer)

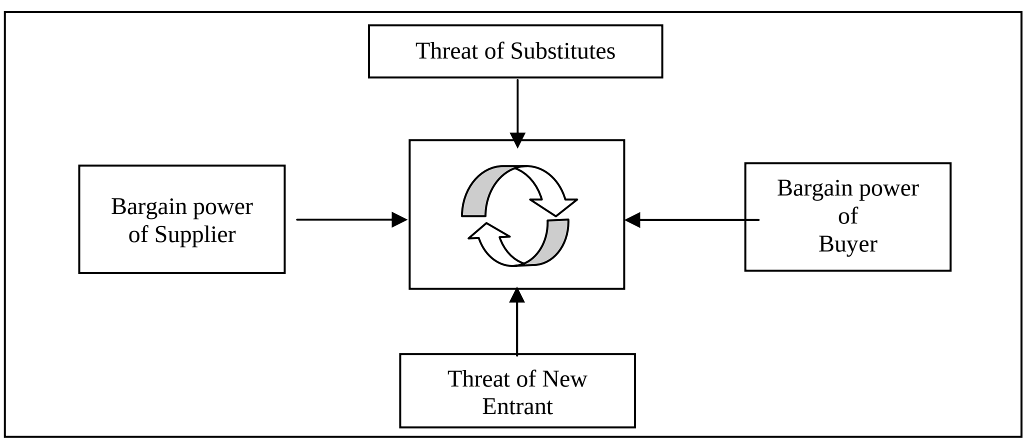

Figure 1.3: Michael Porter Model of Five Forces

Threat of New Entrant

A new entrant in an industry represent a competitive threat to the established firms, sometimes called the incumbents. The entrants add new production capacity and bring substantial resources that were not previously required for success in the industry. There are various entry barriers which hinders the entry of new entry. This barrier are challenge for a new entrant and a protective shield for the established player. The barrier are:

1. ***Economies of Scale:*** Existing large firms enjoy low cost per unit. They have enough room to reduce price as they may taking high profits or they may be selling product at such a low price that new player couldn't produce it at that cost as it might be producing small quantity.
2. ***Cost disadvantage independent of scale:*** Besides economies of scale existing firm have other many cost advantages as proprietary product knowledge, such as a patent, favorable access to raw material, favorable location, lowering borrowing cost and government subsidies etc.
3. ***Learning and Experience Curve:*** Established companies an advantage of learning curve. Because of this learning curve established firm are in a better position as they better skilled and equipped human resource.
4. ***Product Differentiation:*** It differences in physical or perceived characteristics make an incumbent's product unique in the eyes of the consumer, new entrant must overcame the resulting brand loyalty.
5. ***Capital requirement:*** It is said the offender must have three times power than that of defender. Thus offender required capital not only to establish new business but also to compete from established firms. Even the cost of capital is higher for a new firm as lenders hesitate to lend to lend new people.
6. ***Switching Cost:*** Sometimes the costs (Physical, Psychological and financial) incurred in switching from one supplier to another supplier. This also resists the customer to go for new vendor.
7. ***Access to Distribution:*** The middleman is reluctant to deal with the product which is new to market. It is more critical in industrial and international market as there are few middle man and who usually prefer only establish products.

Government and Regulatory Environment

Government policies as license, permit, broadcasting regulations, liquor policies, anti monopoly policies like in India MRTP and in America Anti trust law, etc. also work as barrier for new entrant.

1. ***Bargain Power of Supplier:*** Suppliers have little or no bargain power when there are many suppliers and supply exceeds demand and supplier competes with each other to grab the order. On the other hand bargain power is very high when in question is of high technology and supplier have an expertise, or supplier is working at economies of scale so having a significant cost advantage, or supplier regular augment the product in interest of consumer, or supplier also finance the buyer, sometime supplier also increase its bargain power buy advertising its product directly to end consumer. As INTEL even being an industrial product it advertise its processor heavily among end consumer and thus created as brand value among end use, the result of this was that before buying computer ask for "s Pentium Inside" and this increases the bargain power of supplier that is supplier.
2. ***Bargain Power of Buyer:*** Today we are leaving in market oriented economy, where consumer is king. Buyer enjoys as significant bargain power when sellers are many and buyers are few or when production capacity exceeds the demand.

Buyer can bargain for reduction of prices, quantity discount, better quality at same price, better after sale service even they can ask for credit or finance facility. As Boieng arranges finances for its buyers, today all the consumer durable, two wheeler and automobile industry arranges finances in collaboration with banks for their clients.

3. ***The market attempts of companies in other industries to win customers over to their own substitutes products (threat of substitute):*** Firm in one industry are quite in close competition with firm in another industry because their respective products are good substitutes. The producer of scooter compete with motorcycle, Newspaper compete with television, tea compete with coffee, CD player compete with DVD player, Aspirin manufacturer compete with the makers of acetaminophen, ibuprofen and other pain reliever, eyeglasses compete with the makers of contact lenses, road transport compete with railways. Strong competitive pressure from substitute product depends upon three factors:

   (a) Whether attractively prices substitutes are available.

   (b) Whether the buyers view the substitutes as being satisfactory in terms of quality, performance, and other relevant attributes,

   (c) Whether buyers can switch to substitutes easily.

   The presence of readily available and attractively prices substitutes create competitive pressure by placing a ceiling on the prices an industry can charge for its product without giving customers an incentive to switch to substitute and risking sales erosion.

4. ***Rivalry among Competing Sellers:*** The strongest force in the rivalry with competitors. When compete with each other to get favorable attitude of customer, to please customer, to improve market share or profitability. The intensity of rivalry among competing sellers is a function of how vigorously they employ such tactics as lower prices, snazzier features expanded customer service, longer warranties, special promotions, and new product introductions. All this leads to adverse impact on the profits of the firm. Rivalry intensifies as the number of competitors increases and as a competitors become equal in size and capability, Rivalry is more stronger when demand of a product in growing more slowly, rivalry become more intense when industry condition tempt competitors to use price cuts or other competitive weapons to boost unit volume, rivalry in stronger when one or more competitor are dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals, rivalry ends to be more vigorous when exit barrier is very high and it cost more to get out of business then to stay in and compete rivalry increase when stronger companies outside the industry acquire weak firms in the industry and launch aggressive, well funded moves to transform tier newly acquired competitors into major market contenders.

   Rivalry is weak when most competitors in the industry are relatively well satisfied with their sales growth and market shares, rarely make concerted attempt to steal customers away from one another, and have comparatively attractive earning and returns on investment.

   Besides this five force there are many other factors which have a direct impact on business and constitute micro environment of business these are:

   (a) *The Sixth Force:* Andrew Grove the former CEO of Intel has argued that Porter’s five forces model ignores a sixth force: the power, vigor and competence of complementors. Complementary products are those product are those products which add value to some other product. They are consumed together with some other product. Because they are used together that’s why demand of one product depends upon the demand and availability of another product. Like demand of personal vehicle in a country depend upon the availability and price of fuel. Demand of Personal Computer depends upon the availability and affordability of user friendly software. In fact whole business of accessories like car accessories, Motorcycle accessories, Computer accessories etc depend upon key product. So both substitute and complements product influence demand. So while study the environment one should not forget complement product as some time they can be decisive factor for sales and profits.

(b) *Marketing Intermediaries:* These are firms and persons which help in distribution, promotion, selling, gives consultancy etc. Almost every business have to take the help of these intermediaries. Some time they play a decisive role. Like in FMCG distribution is of critical importance and firms are in intense competition to acquire support of strong distributor. The major reason, because of which Coca-Cola acquires Parle is to have an access to the distribution network of Parle which was very wide and penetrated. Besides this there are brokers, agents, logistics companies, private transporters, which play an important role.

There are incidences of retailer boycotting the product of particular companies because of low margins.

Not only this promotion and advertising firm also have an direct bearing as on them success of marketing strategy is not only dependent but it also constitute the significant amount of marketing expenditure for the companies like HLL it is as high as Rs. 800 crore.

(c) *Financial Institution:* For any business FIs plays a critical role. FIs not only make available the finance but also create environment for investment. FIs also give expert opinion and consultancies to the corporate. Every corporate is dependent on FIs whether it is banks or consultancies or NBFCs for its financial needs. These also facilitate the mode of payment. For the industrial development of any country a well-established financial institutions is prerequisite. These FIs mobilize the savings of public to corporate world. An organization which has a good rapport with FIs usually get the finance easily and at easy terms which makes a lot of difference in this competitive environment.

1.4 ENVIRONMENTAL ANALYSIS

1.4.1 Collection of Information

The analysis is done by means of a search of verbal and written information, spying, forecasting and formal studies and information system.

At first there is the gathering of verbal information, the sources of verbal information are:

1. Media such as Radio and Television
2. The firm’s employees such as peers, subordinates, and supervisors.

Other source of verbal information out side the firm are: Customer of the enterprise, persons in industry channel (as wholesalers, brokers, distributors etc), suppliers doing business with the firm, competitors and their employees, financial executives such as bankers, stockholders, and stock analysts, consultant, government an university employees.

Besides verbal sources, information can be gathered through reading. Information about environment is readily available in newspapers, trade journals, industry newsletter, Journals publications, government reports, reports of various marketing research agencies as Gallop, ORG etc. It is said that behind every business activity there is one govt. department and one association. This department and association publish the information related to business on regular intervals.

Second solution to environment analysis in to design a Management Information System. A formal MIS gives quick relevant information to the decision makers, which helps a lot in taking timely decisions. Beside this, information regarding competitor can be gathered through Corporate Intelligence and Spying.

Environmental analysis can be divided into two parts:

i) Environmental evolution

ii) Process of environmental analysis

Environmental Evolution

There are three components, which are useful to describe changes in the environmental segments:

- Type of Change
- Forces driving change
- Type of future evolution

Changes in the micro environment may be systematic or discontinuous. Gradual, or changes in phased manner which are predictable are systematic changes. As change in the ratio of youth in population of India, rise in the income of middle class and specially the youth after Liberalization. Unpredictable, sudden changes are discontinuous as attack on twin tower in USA and its aftermath.

Some time changes in one segment may be the result of driving forces in other segment. Driving force behind the acceptance of packaged food in India can be increased purchasing power of middle class or it can be because more and more women are working or it can be more awareness among youth from mass media. Driving force interact with each other.

Evolution of change in the future, evolution can be completely predictable and some time they are dependent upon actions of the firm or other entities in the environment.

Process of Environmental Analysis

Process of environmental analysis can be divided into four parts:

- scanning the environment to detect warning signals,
- monitoring specific environmental trends,
- forecasting the direction of future environmental changes and
- assessing current and future environmental changes for their organizational implications.

1. ***Scanning:*** Environmental scanning is aimed at alerting the organization to potentially significant external impingement before it has fully formed or crystallized. Successful environment scanning draws attention to possible changes and events well before occurrence, giving time for suitable action. Scanning frequently detects environmental change that is already in an advanced stage. Scanning is most ill-structured and ambiguous environmental analysis activity. The data sources are many and varied. Moreover a common feature of scanning is that early signals often show up in unexpected places. Fundamental challenge for the analyst in scanning is to make sense of vague, ambiguous and unconnected data and to infuse meaning into it.

2. ***Monitoring:*** Monitoring involves following the signals or indicators unearthed during environmental scanning. In monitoring the data search is focused and much more systematic than scanning. By focused it is meant that the analyst is guided by a priori premonition. Systematic refers to the notion that the analyst has the general sense of the pattern and he is looking for and collects data regarding the evolution of the pattern.

   As monitoring progress the data frequently move from the imprecise and unbounded to reasonably specific and focused. The output or monitoring are three fold:

   (a) A specific description of environmental patterns to be forecast.

   (b) Identification of trends for further monitoring and,

   (c) Identification of patterns requiring further scanning.

3. ***Forecasting:*** Forecasting is concerned with the development of plausible projections of directions, scope, speed and intensity of environment change, to lay out the evolutionary path of anticipatory change. There are number of key analytic tasks and outputs involved in forecasting. The first concern untangling of forces that drive the evolution of a trend. The second concern understanding the nature of the evolutionary path; that is whether the change is a fad or of some duration, or cyclical or systematic in character. The third concern more or less clearly delineating the evolutionary path or paths leading to projections and alternatives futures. Forecasting is well focused and is much more deductive and complex activity.

4. ***Assessment:*** Assessment involves identifying and evaluating how and why current and projected environmental change will affect strategic management of an organization. In assessment, the frame of reference moves from understanding the environment – the focus of scanning, monitoring and forecasting – to identifying what that understanding of environment means for the organization. Assessment thus tells about the implication of environment change on the organization.

There is not always a liner relationship between scanning, monitoring, forecasting and assessment. If some trends are disclosed in scanning process a organization can directly jump to find out how it is going to influence the organization.. Even after having the assessment of the external environment factor an organization may continuously monitor and forecast the factor about is future development. So sometime assessment monitoring and forecasting go simultaneously. A good strategist always keep an eye on development in environment. Like when Vijay Mallaya came to know that there is some internal problem in Chabaria (owners of Shaw Wallace) family, he started monitoring it and when he found suitable time he purchased his arch rival that is Shaw Wallace and became second largest brewery of world.

Benefits of Environmental Analysis

1. Environmental analysis gives the idea of whole environment organization.
2. Environmental analysis gives in brief about competitors.
3. Environmental analysis tells us about opportunities to reap profits.
4. Environmental analysis gives detail about threats in the environment.
5. Environmental analysis keeps the manager informed and alert.
6. Business is all about taking right decision at the right time without proper Environmental analysis right decision can’t be taken.
7. Environmental analysis helps in predicting future.
8. Environmental analysis helps in suitable modification of strategies as and when required.

Check Your Progress 3

Fill in the blanks:

1. _______________ is important and specific occurrences taking place in different environment sector.
2. A ___________ is an enduring preference for a mode of conduct or an end-state.
3. ____________ Act restricts monopoly.
4. Once an NRI ______________ a British citizen tried to takeover Escorts.
5. India is in a process of laying down a gas pipeline from ________ to India through its archrival Pakistan
6. The concept of National Competitive Advantage is given by ______________.
7. ____________ the former CEO of Intel has argued that Porter's five forces model ignores a sixth force.
8. In ______________ GATS (General Agreement on Trade and Services) has been implemented in India

1.5 LET US SUM UP

Every business operates in an environment and business unit has its own environment. A change in environment gives opportunity to some and threat to some. Environment has specific characteristics as, environment is complex, environment is dynamic environment is multi faceted, environment has a far reaching impact, the Impact of an environmental trend often differs significantly for different firm with in the same industry, the general environment usually holds both opportunities for, and threat to, expansion. Development in the general environment change competitive battle line, many developments in the general environment are difficult to predict with any degree of accuracy, while others are readily predictable.

The environment which influences the business can be divided into three types:

- Internal Environment
- Macro Environment (General Environment)
- Micro Environment (Relevant Environment, Competitive Environment)

Internal Environment is all about culture and value system, mission and objectives Management Structure and Nature, Human Resource.

Macro Environment deals with Political Environment, Regulatory and Legal Environment, Demographic, Socio Culture, Technological, Global Environment, Economic Environment, National Competitive Advantage etc.

Micro Environment analysis: The Five Forces of Competition, The Sixth Force, Marketing Intermediaries, Financial Institution. There are various techniques of analyzing the environment. To analyze the environment the very first step is collection of information. Information can be collected in verbal and written form. There can be various source of information such as Radio and Television, the firm's employees such as peers, subordinates, and supervisors, Corporate Intelligence, Spying etc. Process of environmental analysis, includes the steps like Scanning, Monitoring, Forecasting and Assessment.

1.6 LESSON END ACTIVITIES

1. A multinational two wheeler company wants to starts its operation in India. Identify the relevant environmental factor influencing the decision and describe how they will influence the decision.
2. Prepare a report on the changes took place in the economic environment in India because of changes took place in political environment in country since last 10 years.

1.7 KEYWORDS

GATS: General Agreement on Trade and Services.

CPI: Communist Party of India.

LPG: Liberalization, Privatization, and Globalization.

NBFC: Non Banking Financial Companies.

CSF: Critical Success Factors.

Industrial Spying: Process of getting the information of competitor through the spying.

1.8 QUESTIONS FOR DISCUSSION

1. Discuss the various macro environmental factors, which can have an impact on business.
2. Describe micro environmental factors, which influences the business.
3. Describe the various sources of information for the environmental analysis.
4. Describe the various characteristics of environment and the process of analyzing the environment.
5. Write brief short notes on the following:
   (a) Five Forces Model
   (b) Corporate Intelligence
   (c) Critical Success Factors (CSFs)
   (d) Driving Force

Check Your Progress Model Answers

CYP 1

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists.

CYP 2

Macro/General Environment consists of factors external to the industry that may have significant impact on the firm’s strategies. Here we will look at six broad dimensions: Demographic, Socio-cultural, political/legal, technological, economic and global.

CYP 3

1. Events	2. Value	3. MRTP
4. Lord Swaraj Paul	5. Iran	6. Michael Porter
7. Andrew Groove	8. January 2005	

1.9 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books.

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LESSON

2

SOCIAL RESPONSIBILITY OF BUSINESS

CONTENTS

2.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept of social responsibility
- Know the responsibility of business towards various stake holders
- Explain that how investment in the social responsibility can even increase the profits of the business

2.1 INTRODUCTION

By "Social Responsibility we mean the intelligent and objective concern for the welfare of society that restrains individuals and corporate behavior from ultimately destructive activities of positive contributions to human betterment, variously as the latter may be defined." - Kenneth R. Andrews, (*The Concept of Corporate Strategy* [Burr Ridge, IL: Irwin Co. 1971] P.120)

Does corporate social responsibility translates into fiscal responsibility? A landmark study by Professors Stephen Erfle and Michael Frantantuono found that firms that were ranked highest in terms of their records on a variety of social issues (including charitable contributions, community outreach programs, environmental performance, advancement of women, and promotion of minorities) had greater financial performance as well. Financial performance is better in terms of operating income growth, sales-to-asset ratio, sale growth, return on equity, earning to asset growth, return on investment, return on assets, and asset growth. (Joel Makeover, Beyond the Bottom Line (New York: Simon& Schuster, 1994, pp.70-71)

Look at well-run company and you will see the needs of its stockholders, its employees and the community at large being served simultaneously. – Arnold Hiatt, Former CEO Stride Rite Corp.

Business is not only an economic function but also a social function. It is the only activity, which influences every aspect of society and nation. Business innovates, it develops new products and services to serve human, it produces goods and service for the nation and society, it invent new molecules to cure human ailments it gives employment, it generates earning, it exports, it gives taxes for the smooth functioning of government it utilizes the resources of society and nation. But it is one side of picture, other side is all about exploitation of natural resources, exploitation of human resource, sexual harassments at work place, political funding for business interest, spreading pollution, spreading materialism, abetting terrorism to increase sale of arms and ammunition, selling smoke and liquor, global warming, acid rain and many other surfing of human kind is only because of business.

All this raise questions do business has some social responsibility? Do business can be performed while performing social responsibility? Do business is accountable to society?

2.2 SOCIAL RESPONSIBILITY

The Socio-Economic obligation of business refers to its obligation to prevent economic consequences of business from adversely affecting public welfare. Social – Human obligation refers to the obligation of business to nurture and develop its human resource so that employees get every opportunity to grow and develop and advance through life and their careers; to make the organization more humane and humanistic and to promote human values within the organization. Keth Devis has defined social responsibility as:

"*Social responsibility refers to the businessman's decision and actions taken for reasons at least partially beyond the firm's direct economic or technical interest*."

Business and society interact with each other. So organizations have to fulfill their social responsibilities some they volunteer do that some time there are many forces, which induces social responsibilities.

Keith Davis model of Corporate Social Responsibility

Davis model gave a list of five proposition that describe why and how business should adhere to the obligation to take action that protects and improves the welfare of society as well as the organization:

Proposition 1: Social Responsibility Arises from Social Power: Business in the country primarily determines the proportion of employment and prevailing condition of the environment in which the citizens are living. Davis reasons that since business has this power over society, society can and must hold business responsible for social condition that result from the exercise to this power.

Proposition 2: Business shall operate as a two way open system, with open receipts of inputs from society and open disclosure of its operations to the public: According to this proposition business must be willing to listen to what must be done to sustain to improve societal welfare. In turn society must be willing to listen to business reports on what it is doing to meet its social responsibilities.

Proposition 3: The social costs and benefits of an activity, product or service shall be thoroughly calculated and considered in deciding whether to proceed with it: This proposition stresses that business should consider both the long term and short term societal consequences of all business activities before undertaking them.

Proposition 4: The social costs and benefits of an activity, product or service shall be passed on to the consumer: The cost of socially desirable activities with in the business should be passed on to consumer through higher prices for the goods or service related to these activities.

Proposition 5: Business institutions as citizens have the responsibility to become involved in certain social problems that are outside their normal areas of operations: David reasons that because business eventually will reap an increased profit form a generally improved society; business should share in the responsibility of all citizens to generally improve society.

There are four important groups which influences and are influenced by business and business is suppose to accept its responsibilities towards these groups they are:

1. The owner of the business i.e. shareholders
2. The employees
3. The customer
4. The society at large

Interest of this diverse group is not identical rather they are conflicting. Every group wants lions' share of the pie. Customer crave for value added but economical product, employees claim for better remuneration and working conditions, society expects philanthropy and healthy environment and owner demand for higher and higher ROI. Management has to bring effective synthesis and secure good relation among these four diverse interests.

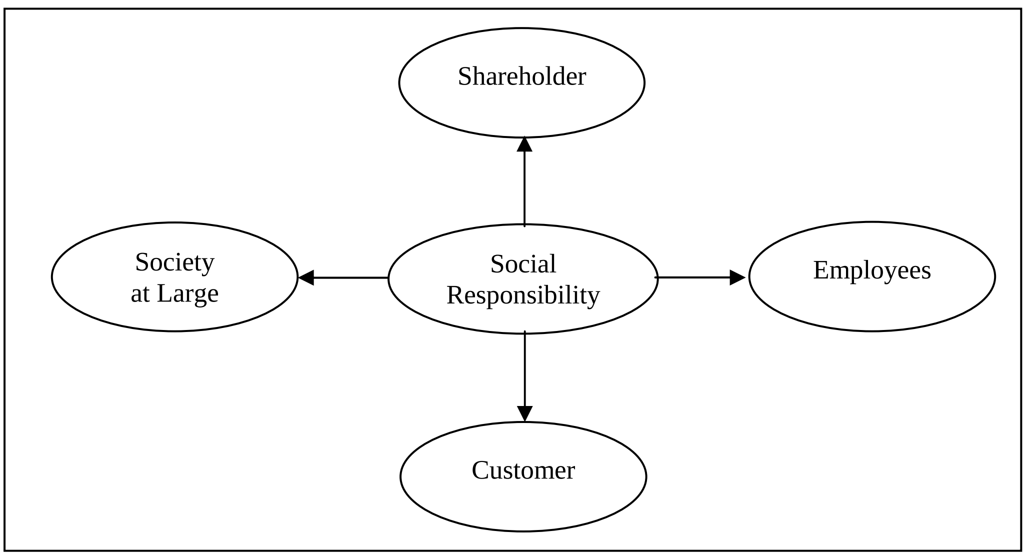

Figure 2.1

Check Your Progress 1

What do you understand by the social responsibility of business?

……………………………………………………………………………………..

……………………………………………………………………………………..

2.2.1 Responsibilities to Shareholders

Men and women who invested in business are interested in only one thing that is money. They have invested money to make money. As Milton Friedman claims that the ethical mandate of business is to increase shareholders profit. Primary responsibility of business is to increase shareholders wealth, to give good return on investment, to give dividends at proper time, to protect the interest of even small shareholders, to hear and respect shareholders, to regular invite shareholder to participate in decision making. So basic responsibility of business towards shareholder is to create wealth for shareholder. Economic Value Added analysis is effective tool to measure the increment in shareholders wealth. Economic values added are increment in shareholders wealth beyond its expected return. Debt has its cost in terms of interest but in financial terms equity doesn't has any cost. So in EVA Equity cost are the risk-adjusted rate of return that investor should expect from this type of investment. Could be met and above this it is EVA and if it is below this then company may be in profit but in terms of EVA it is decreasing shareholders wealth. These expected returns should be met and if returns are above this then EVA is positive and if it is less than this than EVA is negative, that is that firm may be in profit but it is not meeting expectations.

2.2.2 Responsibility to Employees

Success of the organization is dependent on its employees. Gone are the days when employees were the most neglected resource of the organization. Today HRM is the Critical Success Factor for the success of all the industries whether it is old economy industry as Steel, Cement or FMCG or new economy industry as BPO and software. Organization has much responsibilities toward their employees they are:

1. Fair treatment.
2. No discrimination on the basis of sex, cast or creed.
3. Fair wages.
4. Fair Appraisal system.
5. Healthy and safe working environment.
6. Establishment of fair work standards and norms.
7. The provision of labor welfare facilities.
8. Fair opportunity for accomplishment and promotion.
9. Proper recognition, appreciation and encouragement of special skills and capabilities of the workers.
10. Installation of an efficient grievances handling system.
11. An opportunity for participating in managerial decision to the extent desirable.
12. Proper training and development programmes so that workers can develop themselves according to changing environment.
13. Family Welfare. That is if workers have less problem in their family life then their productivity will be high. It is this reason that TATAs have invested lot in family welfare of its employees. JRD has also won UNESCO's world population award. JRD have invested a lot in making its employee understand about the family planning which ultimately resulted in happier families of its employees. India's most work force is employed in private sector imagine if every private sector concentrate on family planning then it will not only help a lot to India but also to its organization.

2.2.3 Responsibility to Consumer

1. Providing products of proven quality.
2. Regular R&D to augment the product and to innovate the product.
3. To ensure that product is reached to customer and to check any sort of black marketing or profiteering by middleman and anti social elements.
4. To supply goods at reasonable price.
5. To provide required after sale service, and to ensure that spare parts should be available in the market.
6. To fulfill its commitments impartially and courteously in accordance with sound and straightforward business principles.
7. To provide sufficient information about the product, including their adverse effects, risks and care to be taken while using the products.
8. To ensure that product supplied doesn't have any adverse effect on customer.
9. To hear and redress the genuine grievances of customer.
10. To avoid any type of cartel formation and to reap monopoly profits.

2.2.4 Responsibility to Community

Business has following responsibilities towards community:

1. To prevent environmental pollution and to prevent the ecological balance.
2. Improve the efficiency of business operation.
3. Contributing to research and development.
4. Development of backward areas.
5. Promotion of small scale industry.
6. Development of region in which they are operating.
7. Social development of region in which organization is working as development of schools, social awareness programmes, adult education, health, medical facilities, helping NGOs and Government for social cause as Pulse Polio mission etc.
8. Taking steps to conserve scarce resources and developing alternatives, wherever possible.

2.3 MAJOR SOCIAL RESPONSIBILITIES OF BUSINESS

1. ***Optimum Utilisation of Scarce National Resources:*** All corporations must use the resources in a judicious manner in a optimum way and should not waste, misutilise, damage or cause to deteriorate the resources at its disposal. It is essential in energy/power scare country like India. Not only this they should develop alternative sources of energy and power. Like ITC is using wind power in some of its projects. M&M is doing research in developing alternative fuel.

   Reliance is a classical example of efficient utilization of resources as it uses byproducts and waste of one project in another its Petrochemical plants and refineries are so integrated they use each other products.

2. ***Responsibility Not to Make Losses:*** A loss making unit is burden on society. Loss making unit not only wastes the resources of society but in fact it don't perform any of its duty that is towards customer by not providing better products , towards shareholder by not creating wealth , towards society by wasting its resources and

towards its employees by not meeting better HR standards. As most of the PSUs which are had make losses and are making losses but are kept alive in the name of socialism and employment are basically a burden on society. There losses are met by taxing the society. So we can say that society is paying higher tax to subsidies the inefficiency of PSUs question arises why should they.

3. ***Improved Quality of Life:*** Any organization should prove to be a reason to the development of standard of the quality of life in both terms that is in terms of standard of living which is based on financial power and material growth and in terms of one's internal growth, the growth of one's character, growth of mind and soul.

4. ***Responsibility of Employment and Income:*** Every business should make provision for the payment of fair wages, satisfactory working conditions, steady employment and job security, prospects for promotion, growth and development of workers and also take adequate measures for employee welfare. Not only this, it should also ensure.

5. ***Offering Quality Product at Fair Prices:*** Business is all about creating customer, and customer can be created only when customers are satisfied. Customer can be satisfied when they will be provided with value added products, at fair prices, providing after sales service giving correct and timely information, ensuring that product is reaching to the customer etc.

6. ***Environmental Protection:*** Business has done and is doing so much irreparable harm to the environment that it becomes an obligation for them, not only morally but also legally to undo the damage by taking serious and responsible steps to protect the environment and keep it in healthy condition. They should adopt all the modern technology which are there to ensure that their operation doesn't harm the environment. With the protective action business should also take corrective action that is to grow more and more trees, to educate its employees and people in general about environment.

7. ***Fair Trade Practices***

   Fair trade practices of business constitutes of:

   (a) Avoidance of formation of cartel or following monopolistic practices.

   (b) By creating shortages, for the purpose of black marketing and speculation.

   (c) By exaggerating and making false statements about the claims.

   (d) Not buying political favors to sway decisions it its favour.

   (e) Following healthy competition with competitors by not indulging in industrial espionage or other unethical means.

   (f) Not deliberately make organization sick to avoid obligations or to escape from responsibilities.

   (g) Not to involve in insider trading or to take undue advantage of inside information.

   (h) Not bribing public servants and corrupting democratic structure of country.

   (i) Paying taxes, duties and other dues timely and honestly.

   (j) To give required information to shareholders and all other stake holders.

   (k) Making timely payment of borrowing and interest.

   (l) While dealing with suppliers instead of using bargain power corporation should use reward and cooperation power that is establishing good relation with supplier and helping supplier in maintaining quality and developing new product for the organization but it may look costly affair initially but ultimately it pays Japanese usually believes in establishing good rapport with their suppliers.

(m) Not making any communication strategy is which is not compliant with social norms.

(n) Law of the land should abide business.

8. ***Local development:*** As business uses the resources of society so business is also responsible of local development. Business can perform various function to develop local area. In fact, if every business house take responsibility of some villages then miracle can happen in India. Business houses like TATA Chemicals, ITC, HLL are doing so. Cooperative as IFFCO is following this concept. Here business house adopt some village and then he construct road in village, spread education in village, ensure health programmes, promotes family planning, and other social reform programmes, helps farmers in agriculture and marketing of their product, promoting handicraft and cottage industry in villages. HLL is giving employment and empowerment to the women of villages through its Operation SHAKTI and ITC is revolutionizing the village distribution system through its e- choupal system.

Check Your Progress 2

Fill in the blanks:

1. ________________claims that the ethical mandate of business is to increase the shareholders profit.
2. _______________analysis is effective tool to measure the increment in shareholders wealth.
3. _____________ has won UNESCO's world population award.
4. HLL is giving employment and empowerment to the women of villages through its Operation ______________.
5. M&M is doing research in developing alternative _________________.

2.4 LET US SUM UP

Business is not only an economic function but also a social function. It is the only activity, which influences every aspect of society and nation. The socio-economic obligation of business refers to its obligation to prevent economic consequences of business from adversely affecting public welfare, responsible for forcing the business to recognize and honor the new social responsibilities.

There are four important groups which influences and are influenced by business and business is suppose to accept its responsibilities towards these groups they are:

1) The owner of the business i.e. shareholders
2) The employees,
3) The customer
4) The society at large

Major Social Responsibilities of Business is to use the resources in a judicious manner in a optimum way and should not waste, misutilise, damage or cause to deteriorate the resources at its disposal. A loss making unit is burden on society. A business should offer quality product at fair prices to society and should follow fair trade practices of business. Business can perform various function to develop local area.

2.5 LESSON END ACTIVITIES

1. Prepare a report on the steps taken by TATA for the well being of society.
2. Prepare a report on the impact of e-chaupal on the rural life.

2.6 KEYWORDS

EVA: Economic Value Added, it is an increment in shareholders wealth beyond its expected return.

FMCG: Fast Moving Consumer Goods.

BPO: Business Process Outsourcing.

JRD: Jahangir Ratan DadaBhai TATA.

NGO: Non Govt. Organization, the organizations that work for social welfare.

PSUs: Public Sector Units.

2.7 QUESTIONS FOR DISCUSSION

1. Define social responsibility. In recent times what factors have influenced the social responsibility?
2. Discuss the various responsibilities of the business to its various stake holders.
3. "Expenditure in social responsibility is not an expenditure rather it is a investment". Discuss the statement.
4. What are the various social responsibilities a business should perform?
5. Discuss how organizations are using social responsibility strategically.

Check Your Progress: Model Answers

CYP 1

Social responsibility refers to the businessman's decision and actions taken for reasons at least partially beyond the firm's direct economic or technical interest.

CYP 2

1. Milton Friedman
2. Economic Value Added
3. JRD
4. SHAKTI
5. Fuel

2.8 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books.

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LESSON

3

SOCIO-CULTURE ENVIRONMENT

CONTENTS

3.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand various aspect of culture and society
- Know the impact of culture and society on business decision
- Study the changing role of women in society
- Understand the impact of the business on the culture

3.1 INTRODUCTION

If any thing is there, which influences the every aspect of the lifestyle of a prospective individual then it is society and culture. Individual's eating habits, buying behavior, dressing priorities; physical possessions etc. all are influenced by the society. People invest lakhs of Rupees for the sake of society and culture as it is only societal pressure that people spend so much money in marriages, celebrations, and even in funeral. In India the expenditure on festivals like Holy, Diwali, Eid, Raksha Bandhan, Durga Puja, Ganesh Puja, Pongal, etc is billions every year. So culture itself is a big opportunity for business.

If we study the Maslow's Hierarchy of Human Needs we will find that after fulfilling physiological, safety and security needs it is only social needs for which human being works. Not only this, in most cases for the after reaching social needs most of the people remain there that is they never approach for ego and self actualization needs. So his whole life is all about fulfilling social needs. When a person purchase a gift for someone, when he purchases a clothes for party or for morning walk, when he purchases a particular model of motorcycle or automobile, when he take admission in a particular college/college, or he do any sort of purchase every purchase is influenced by societal and cultural environment. As with all these purchases he is satisfying his social needs as in all these purchase he has desire in his subconscious mind to be looked as smart and intelligent consumer and individual in the eyes of society. It has been seen that in the case of middle class and above the spending on social needs constitutes higher part of their income. This ratio increases in favor of social needs as we go above in the income strata. It is the reason that most of the organizations tries to hit and position their product around social needs.

3.2 IMPACT OF SOCIO-CULTURE ENVIRONMENT ON BUSINESS

To study the socio culture environment on business we can divide the socio-culture environment in following way:

- The Family
- The Social Class
- Culture

3.2.1 Family

A consumer is born every ten seconds.

(Edwin Newman, 1976)

Family is the smallest unit of society. It is also the first school of child and of course it is the school which has maximum and lasting influence on an individual. A family plays a key role in the development of attitude regarding the objects in environment, regarding beliefs, and preferences of a child. Drastic differences have been seen in the attitude and preferences of individuals who have been nurtured in combined family, nuclear family, or a family where both husband and wife are professional or have been brought up in hostel. Family perform four basic function for a individual that is economic support, emotional support that is love, affection, intimacy etc, establishment of suitable lifestyle for the family and socialization of family. Socialization is a central function of family as here family impart basic value and modes of behavior consistent with the culture to child. These generally include moral and religious principles, interpersonal skills, dress and grooming standards, sociably acceptable manners and speech, and a selection of suitable educational and occupational goal.

Role of Family Member in Decision-making

Family plays a following role in decision-making of members:

1. ***Influencer:*** Individual whose opinion are sought concerning criteria the family should use in purchase and which products or brands most likely fit those evaluative criteria.
2. ***Gatekeeper:*** Influencer and initiator provides information on the other hand gatekeeper restrict flow of information. He control the flow of information about a product or service into family.
3. ***Decider:*** The person with financial authority or power choose how the family’s money will be spent and on which products and brands.
4. ***Buyer:*** The person who acts as the purchasing agent by visiting the store, calling suppliers, writing checks, bringing products into the home, and so on.
5. ***User:*** The family member who makes actually use of the product.

6. ***Disposer:*** A family member(s) who initiate or carry out the disposal or discontinuation of a particular product or service.

Family Life Cycle

Family goes through various stages in its whole life. These stages are called as Family Life Cycle. Roger D. Blackwell (Consumer Behavior, Thomson South western, Vikas Publishing House, Ninth edition) has describe stages of life cycle in Indian context which can be described in following manner:

Young Singles: Bachelors, young, live alone or with their family, or with friends, low individual income, usually don't have any financial burdens, less price sensitive, usually buy two wheeler, audio system, gifts items, fashions, movies, computer, mobile phones etc. Purchases are influenced by opposite sex.

Newly Married Couples: These families tend to spend a substantial amount of their incomes on cars, clothing's, vacations and other leisure activities. They are more susceptible to advertising.

Full Nest I: At this stage first child arrives and role of family member changes. Purchases shift from leisure to baby products and toys.

Full Nest II: At this stage youngest child has reached school, and family spending is children centric and money is invested in various financial instrument for future of children and themselves.

Full Nest III: At this stage parents enters in their 40s. Family income increases simultaneously expenditure as children are more demanding, major share of income goes for their education, their belonging like motorbikes, computers, clothings, fashion, mobile etc.

Empty Nest I: At this stage children has left the home and establish their own nest. Financial condition of the couple become better as now they have less responsibilities and income is at its peak. In Indian contest at this stage nowadays spending is usually on health products, tonics, and gift for their newly married children. It has been seen that in India usually at this stage biggest spending is on newly married couple and on their children. In fact in some cases spending on grandchildren is very high. This means that in India target customer for baby product is not only their parents but also grand parents.

Empty Nest II: At this time income earner get retires so their income reduces in India in case of business families and private jobs they get dependent on their children and their spending is on their grand children and health.

Solitary Survivor: Spending habits of solitary survivor remain same as that of empty nest II.

Family life cycle influences the product mix and marketing mix of almost every company.

3.2.2 Social Class and its Affects on Taste and Lifestyle

The term social class is now used more generally o describe the overall rank of people in as society. Social class is defined Roger D. Blackwell *et al* (Consumer Behaviour, Thomson South Western, ninth edition) as relatively permanent and homogenous divisions in a society into which individuals or families sharing similar values, lifestyles, interests, wealth, status, education, economic position, and behavior can be categorized.

People who are grouped within same social class are approximately equal in terms of their social standing in the community. They work in roughly similar occupations, and they tend to have similar lifestyles by virtue of their income levels and common tastes. These people tend to socialize with one another and share many ideas and values regarding the way of life should be lived.

Status group reflects a community's expectations for style of life among each class as well as the positive or negative social estimation of honor given to each class.

Social Stratification

Social stratification can be described as the processes in social system by which scarce and valuable resources are distributed unequally to status positions that become more less permanently ranked in terms of the share of valuable resources each receives. It can also be describe as perceived hierarchies in which consumers rate others as higher or lower in social status. Those who earn a higher status due to work or study have achieved status, whereas those who are lucky to be born wealthy or beautiful achieve ascribed status.

Social class can be classified into six distinct segments as defined by W. Lloyd Warner in 1941:

1. ***Upper Upper:*** World of inherited wealth.
2. ***Lower Upper:*** Inherited wealth and newer social elites drawn from current high achiever professional.
3. ***Upper Middle:*** Professionals, Small businessperson.
4. ***Lower Middle:*** Average pay white color workers.
5. ***Upper Lower:*** Underpaid white color workers and blue color workers.
6. ***Lower Lower:*** Living hand to mouth.

Component (Subjective measure) of Social Class

The factors like occupation, income, possessions, associations, education and level of influence are the subjective measures or component of social class.

1. ***Occupation:*** What person does for its living is one of the most telling indicators of social class. It is the occupation which dictates other signs of class membership as income, personal associations, and status. Not only this occupation also decides other things that is availability and use of leisure of time, allocation of family resources, political orientation, stress on type of education to children and many other things. Some time Occupation is also seen as a synonym of class as we think that CAs, Doctors, Businessman etc belong to upper class, Teachers, Engineers etc. middle class etc.
2. ***Income:*** Income is a most critical determinant of social class as it decides the buying power and market potential. People performing same occupation can have different level of income. Consumer's consumption pattern is determined by level of income.
3. ***Possessions:*** Possessions are symbols of class membership-not only the number of possessions, but also the nature of the choices. Conspicuous consumption, people's desire to provide prominent visible evidence of their ability to afford luxury goods, helps explain why different buy different products. For example possessions of luxury cars and membership of a particular club are clearly indicative of one class and possession of small cars or two-wheeler are clearly indicative of particular class.
4. ***Associations:*** Consumption pattern and interaction network are intimately linked: people spend their leisure time with others who shares their tastes and recreational

activities, and they learn new tastes, lifestyles, dressing sense etc from those with whom they associate. Selection of and Interaction with friends, relatives and even life partner vary according to class membership.

5. ***Level of Influence:*** Class rank and influence go hand in hand. Members of high class usually commands higher level of influence. Even marketer use them as a opinion leader to influence the lower class.

Values, Attitudes and Lifestyles across, Social Classes

Social class in a big sense determines the values, attitude and lifestyle of a particular person. As a person moves from one social level to other his values also changes.

Values and Attitude

Values and attitude differs with society and person belongs to it society shares same values and attitudes. Values towards sex, education, profession, possessions differ with level of social class. As attitude towards education and type of education differs with the level of society, middle class gives much stresses on professional education as it become source of livelihood for them, on the other hand lower class emphasis on learning some skills.

Lifestyle

Number of hours spend in house or outside, how they spend their evenings, for how long they watch TV in a day, at what time they take dinner in night or day, at what time they go to bed and at when they get awake in morning, how they spend their holidays how much time they spend in activities like reading, art, aerobics, or serving the community, etc are determined by the social class a person belongs to.

Check Your Progress 1

1. What do you understand by family life cycle?

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. Define social stratification.

   ……………………………………………………………………………….

   ……………………………………………………………………………….

3.2.3 Culture and its Influence

There can be many ways to think about culture. Dutch management professor Geert Hofstede refers to culture as the “software of mind” and says that it provides a guide for human on how to think and behave. Leon G. Schiffman and L.L.Kanuk has described culture as the sum total of learned beliefs, values and customs that serve to direct the consumer behavior of members of particular society. Roger D. Backwell *et.al* has described culture as “Culture can be referred as a set of values, ideas, artifacts and other meaningful symbol that help individuals communicate, interpret and evaluate as members of society”.

Culture is learned. We are not born with specific values, behavior. These are passed on to us. Members of the society passes the culture norms to new member of society. It can be in three ways. In formal learning adults and other siblings teach young family member how to behave, in informal learning child learns primarily by imitating the behavior of selected others such as family, friends, or TV heroes and in technical

Learning a it is teacher in school and colleges who instruct the child in an educational environment about what should be done, how it should be done, and why it should be done.

Elements of Culture

Following can be treated as the elements which influence most the culture:

Technology, Family, Education Political Structure The Media, Belief System Art, Music Drama, Dance, Language. The four social institutions that most strongly influence values and behavior are schools, religion, families and most recently the media.

Family: The family is a learning center for an endless stream of attitudes, behaviors and skills that the child carries through life. Family experience also serve as an interpreter of the world. The position of men and women in society, what is so called good or bad how to behave, how to greet, what to wear, what to eat etc are taught to young one by family. Why in India usually boys strive for career and girls are more interested in future groom is only because of family as from childhood it is taught that boy will become officer and girl will get marry with dream boy and the result is that in India for girls to be housewife is considered to be satisfactory role, on the other hand in the families where girls and boys were treated equally there both strive for career.

Religion: When there was no law religion was the only law. Religion came into existence as a social law. At the early civilization stage when there was no law to control the behavior of human being in the interest of society, when there was no explanation of the happening in the society then religion came into force. Since then till today religion controls the human behavior all over world. The kind of religious training, or lack of it, that we receive during socialization affects behavior as consumers. Religious practice may dictate the use of some goods and services or prohibit the consumption of others. Some time religious rules are more abiding than law of the land. In strict religious culture such as the Islamic culture of Iran, religion is a part of all aspects of life, from family to education to the workplace to the Govt. On the other hand in India which is a secular state there are many religions. All over world companies have to change their product portfolio, packaging and communication strategy according to the religion. In Hindus saffron color is sacred on the other hand in Muslims it is green. KFC doesn’t include beef and pork in its portfolio in India only because of religion. Religious beliefs are so strong that in whole world there are people who can kill other only because he/she follows different religion.

It is the religion which decides many social events like marriage, polygamy, monogamy, number of children in family, festivals, rituals etc. These festivals decides the purchasing pattern of different religions as Hindus do most of there purchasing in Deewali, Christians in Christmas and Muslims in Ed. That’s why accordingly companies launched there campaigns.

Education: Education and educational institutions are a major socialization influence in the lives of the members of the culture. Socialization through educational institutions influence consumption in several ways. Interaction with teachers, for example may lead to more informed choices in the marketplace. A teacher’s guidance on appropriate food choices, basic, medical and dental care, reproductive health, concern for the environment and the problems associated with drugs, alcohol, and tobacco products all encourage certain marketplace behavior.

It is the level of education on which success of many products depend. In India it is because of level of education that campaign like Pulse Polio couldn’t get success. AIDS, once which is considered to be the problem of west is now biggest social problem of east and Africa, it is because of level of education only. As west now knows how to check AIDS but in country like India or continent like Africa where level of education is very low it is very difficult to communicate message to everybody. And it is spreading like fire in jungle.

Mass Media The mass media are those communication options with which large share of the population have contact on a regular basis. It is a critical question that do mass media mirror the culture, or do they shape it. Television, Newspaper, Magazines, radio, Internet, Cinema Hall are some examples of mass media. Modern culture and society has been revolutionized by mass media. Today's fashion products, beauty aids, cars, soft drinks, and foods are all promoted in such a way as to make them seem socially "right" for the target customer. But only all this mass media have beget altogether new cultural norms which is considered to be taboo yesterday is fashion today thanks too mass media. It is the mass media who beget the concept of Valentine Day, Mother's Day, Rose Day, Friendship Day etc in India.

Language and Symbols: To acquire common culture, the members of a society must be able to communicate with each other through a common language. It is the language through which people communicate with each other and it is distinct with every nation and culture. In India itself there are more than 25 languages and more than 800 dialects spoken. Every organization must have a deep understanding of the language of people with whom they want to do business. Every culture and nation loves its language and feel proud on it. Even he feel elevated if some foreigner talks in his language.

Technology: Every culture has its own level of technology. And attitude of culture towards technology depend upon there level of technology. A culture's level of technology is manifest in many ways. Countries like United States, Japan, Germany other counties have a high level of technology, the general population has a broad level of technical understanding that allows them to adapt and learn new technology. In countries like India, Sri Lanka, Pakistan, Bangla Desh, etc level of technology is low that's why they resist any technological change. The level of technology in culture that farmers of Haryana (former Punjab) believed that water of canal of Bhakra Nagal Dam is useless for irrigation purpose as in dam power of water has been extracted in producing electricity. Same way initially in many organizations resist computers. It is the level of technology that people search answer of every happening in nature or body in superstitions rather in science.

Aesthetics: Aesthetics that is arts, folklore, music, drama and dance have an effect on people and are part and parcel of culture. Aesthetics are of particular interest to the marketer because of their role in interpreting the symbolic meanings of various methods of artistic expression, color, and standard of beauty in each culture. Customers everywhere respond to images, myths, and metaphors that help them define their personal and national identities and relationship within a context of culture and product profile.

Rituals: Culture includes various ritualized experiences and behavior. A ritual is a type of symbolic activity consisting of series of steps occurring in a fixed sequence and repeated over time. In practice these rituals are extended overtime from birth to death. To a extent these rituals are eternal too. As in India we are following same ritual in many cases as in Marriage and death as we use to do so 3000 years back. These rituals can be very public, elaborate, religious, or civil ceremonies. From the standpoint of business with every ritual certain products are associated. As sale of sweets and crackers is all time high in India during Deewali. In north India at many places Butchers and barber keep their shop close as because of ritual many persons don't eat meat and don't take hair cut on Tuesday.

Cultural Values

Individualism verses Collectivism: Individualism is a culture where member of society put their personal advancement and welfare above all. In such societies, people are personally focused, have loose connections with others, and place there interest and goals above those of other individuals and the groups to which they belong. Collectivism as its opposite, pertains to societies in which people from birth onwards are integrated into strong, cohesive groups, which throughout people's lifetime continue to protect them in exchange for unquestioning loyalty. In collectivism people put the good of others, the groups, they belong to and the society as a whole above their own. As Japan, India has much more collectivist culture than the Unites States.

Masculinity versus Femininity Cultures: Culture may also be judged on how the roles of men and women are differentiates and how publicly or privately segregated the two genders are one from another. Societies are classed as "masculine" if male roles are considered superior to those of the female and "feminine" if the reverse is true. Some culture are strictly masculine leading to strict gender segregation and very restrictive behavior norms, especially for females. The value of a male child may be greater than female.

High verses Low Power Distance: Power distance with in a culture is tied to level of social responsibility that exist and how willing members or society are to accept authority at all levels. This includes accepting authority at the family level in social settings at work, from Govt. agencies and the like. Very high power distance are those culture are those where the difference in power between the most and least powerful individual is great. In high power distance societies there is strict social caste system. Even at work place distance is maintained with boss, and senior and subordinate relations are strictly maintained. In low power distance cultures, relationship are more informal across social level, more equality is found among all people, and authority is more shared. Countries with high power distance are like India, Japan, Malaysia etc. and with low power distance are Germany, Sweden, USA etc.

High verses Low Uncertainty Avoidance Cultures: Uncertainty tells that to what extent culture accepts uncertainty and ambiguity. High uncertainty avoidance is found in cultures where people have low tolerance for new ideas or new ways to do things. They believe in routine behavior pattern. They want to live in a very predictable and certain environment. On the other hand low uncertainty avoidance means that culture is ready to welcome new ideas and people are ready to face uncertainties in life. India is to a extent have a high uncertainty avoidance. But in India itself we find that the cast who have low uncertainty avoidance and are ready to face uncertainties are very successful in business as Marwaris, Gujratis, Parsis, Punjabis.

Abstract versus Associative Culture: Culture where members believe in the principle of cause and effect are classified as Abstract thinking culture. Abstract culture is more scientific society. Here science is given more importance, technical know how is more, and level of education is more, people are more logical and take decision on basis of logical reasons. Associative thinking culture are more related to God, supernatural or mystic beings, events or places to various life events. In these societies importance of things are associated with people, celebrities and events. India is more considered as associative culture as here more importance is given to God. But it is not true basically India is very scientific culture. As one Adiguru Shankaracharya said and I quote here "chahe Lakh ved kahe agg thandi hai mat mano kyonki yeh dharma ka nahi vigyan ka vishaya hai" (even if Vedas says million time that fire is cool don't believe as it is not the subject of religion but of science.) In a sense he declared that if one have to choose from religion and science he must choose science.

Materialism and Leisure: Societies are also classified as how much importance they give to materialism. Societies who give more importance to materialism are likely to have more interested in business and personal achievement. In these culture, to market the product, product are usually associated with achievement on the other hand in culture having less importance to materialism product are associated with family and enjoyment. Though India is taken as having less materialism and having a philosophy of detachment. But traditionally India has a very high materialism culture as it is only country where Goddess of Wealth is Worshiped. War of Mahabartha was fought for material. In fact if we go to old literature we find that wealth was given a big importance and acquiring wealth was considered as Pursharth (Achievement).

Trust: In countries where trust is high the cost of business is low and on the other hand where trust is low cost of business will be high. As in USA people believe less on people and more on written documents and legal cases in business in USA is very high. Litigation is major cost center in business. ON the other hand countries like Japan and India cost to litigation is very less as even big organization have faith in words and they tries their best to keep there words. In these countries business worth million is done without having any legal formalities.

Future Orientation: Countries also differ to what extent individuals live for the present or future. In countries where future orientation is high people live for future and tries to secure their future. It is the reason that in India people give more importance to Govt. Jobs as there future is secure. Same way Japan is future oriented and organizations there provide social and future security not only to person but also to its next generation. On the other hand in USA more importance is given to present.

P-time versus M-Time: North American are more time bound than Indian or than Latin American. M-time or monochromic time cultures tend to concentrate on one thing at a time. They divide time into small units and are concerned with promptness. M-time is used in linear say and it is experienced as being almost tangible in that one saves time, wastes time, bides time, spend times and losses time. Most low context culture operate on M-time. P-time or polychronic time is more dominant in high context cultures, where the completion of a human transaction is emphasized more than holding to schedules. P-time is characterized by the simultaneously occurances of many things and by “great involvement with people” p-time allows for relationships to build and context to be absorbed as parts of high context cultures.

High Context and Low Context: High context culture is one which gives importance to intangible aspects also and Low context culture are cultures which are very specific about things low context culture concentrate on logical and aspect of things. As America, Germany, France etc are Low context culture there marketer have to concentrate more on cognitive aspect of product and in negotiations in low context culture talk about only figures and facts and reaches on decisions on the other hand high context culture like Japanese prefer to establish relations before taking about business and in these type of culture marketer have to concentrate on aesthetic and emotions associations with product.

Ambitious or complacent: An ambitious individual is highly motivated, is wealth acquisitive has a strong urge to excel is prepared to change organization and even take risks. Economy becomes vibrant if a large production of the population comprises ambitious people. As people in Japan and Britain are more ambitious and achievement oriented so does there economy is flourishing. On the other hand in economies like India much importance is given to ascetic life and renunciation. We give importance to contentment which results in complacent behavior.

But that is not true in fact India is the country where utter most importance has been given to achievement. Our whole ancient literature is filled with war between Aryas and Anaryas. They explored wealth in sea. Our Vedas contains many verses for wealth and riches. In almost all the prayers we ask for wealth, and prosperity. So there is no reason to say that we don't believe in ambitious. It is only in medieval age that complacency become part of our culture.

Marriage: Marriage is the smallest unit of culture. Attitude towards marriage influences a culture a lot. There are cultures where marriage is a personal matter and it remained confined to two persons, on the other hand there are cultures where marriage is social event with which whole society is concern and it became a family affaire. In India where marriage is family affaire, there marriage season is big opportunity for business. In India most of the Jewelry, white goods and kitchen ware is purchased in marriage season on the other hand in western culture the most associated product with marriage is honey package.

Check Your Progress 2

Fill in the blanks:

1. ___________ is the smallest unit of society.
2. ___________ restrict flow of information.
3. ___________ is a family member(s) who initiate or carry out the disposal or discontinuation of a particular product or service.
4. __________ is a stage first child arrives and role of family member changes.
5. Social class determines where people _______________.
6. ____________ came into existence as a social law.
7. KFC doesn't include ____________and ___________ in its portfolio in India only because of religion.
8. In ______________ societies there is strict social caste system.
9. M-time or monochromic time cultures tend to concentrate on __________ thing at a time.
10. High context culture is one which gives importance to __________ aspects also.

3.3 LET US SUM UP

Individual's eating habits, buying behavior, dressing priorities, physical possessions etc all are influenced by the society. We can divide the socio-culture environment in following way:

1. Family
2. Social Class
3. Culture

A family plays a key role in the development of attitude regarding the objects in environment, regarding beliefs, and preferences of a child. Socialization is a central function of family as here family imparts basic value and modes of behavior consistent with the culture to child. Family plays a critical role in the decision making of individual it plays the role of Influencer, Gatekeeper, Decider Buyer, User, Disposer etc. In its whole span Family goes through various stages from bachelorhood to the empty nest.

In the present scenario the role of woman in family decision-making is changing drastically. Which have to considered seriously by the organizations.

The consideration of social class is also very important from the organization point of view. The term social describes the overall rank of people in as society. People who are grouped within same social class are approximately equal in terms of their social standing in the community. Social class can be classified on the basis of Occupation, Income, Possessions, etc. Social class in a big sense determines the values, attitude, lifestyle, and buying habits of a particular person. As a person moves from one social level to other his values also changes.

Culture is something which a person inherits from his/her parents and family. Throughout the life a person may move upward or downward in social strata but his culture remain usually same. The four institution i.e. School, religion, family and media influence most the culture. The cultural values are divided in many ways. These cultural values change with the place and people. The cultural values can be : - Individualism verses Collectivism, Masculinity versus Femininity Cultures, High verses Low Power Distance, High verses Low Uncertainty Avoidance Cultures, Abstract versus Associative Culture, Materialism and Leisure, Future Orientation, Ambitious or complacent, Sex etc. As the cultural values changes the buying and consumption behavior changes.

3.4 LESSON END ACTIVITIES

1. Prepare report on the changing cultural values in last fifteen years.
2. Prepare an assignment on organizations who have faced set back because of not understanding the culture.
3. Find out the organization/marketing campaign who have tried to change the culture/habits of consumer. (As Cadbury's campaign to position Chocolate as a substitute for sweets in India.)

3.5 KEYWORDS

Family Life Cycle: Family goes through various stages in its whole life. These stages are called as Family Life Cycle.

Social stratification: It can be described describe as perceived hierarchies in which consumers rate others as higher or lower in social status.

Disposer: A family member(s) who initiate or carry out the disposal or discontinuation of a particular product or service.

3.6 QUESTIONS FOR DISCUSSION

1. What is the difference between the society and culture? Discuss the role of family in the decision-making.
2. Discuss the Family Life Cycle and its role in decision making of an individual.
3. Discuss the changing role of woman in the present society.
4. Describe the social class and discuss how it influences the buying behavior.
5. Describe the elements which influence the culture.
6. Describe the various cultural values and how they influence the individual as a customer and consumer.

Check Your Progress: Model Answers

CYP 1

1. Family goes through various stages in its whole life. These stages are called as Family Life Cycle.
2. Social stratification can be described as the processes in social system by which scarce and valuable resources are distributed unequally to status positions that become more less permanently ranked in terms of the share of valuable resources each receives.

CYP 2

1. Family,	2. Gatekeeper	3. Disposer
4. Full Nest I	5. Shop	6. Religion
7. Beef, Pork	8. High Power Distance	9. One
10. Intangible		

3.7 SUGGESTED READINGS

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LESSON

4

POLITICAL AND GOVERNMENT ENVIRONMENT

CONTENTS

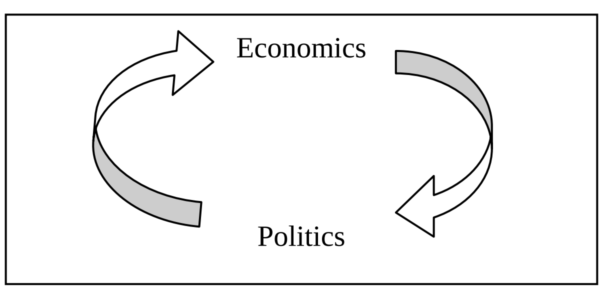
4.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand how Government influences the economic environment of the nation
- Know the various role of Government

4.1 INTRODUCTION

Does politics influences the economics or economics influences the politics. It is a critical question. But if we see the world history we will find that it is both way traffic, which is both influences each other. In medieval history we find that foreigners invaded India for the sake of wealth but it changed the whole political system of India, The whole World War II was fought for the sake of colonies (money which colonies used to give). Because of prevailing economic condition famous revolt of France, Russia, USA and of China took place and all these revolt not only changed the political system of respective country but also their economic system.



In India British came for business and what ever they did they did for money, and all this changed the whole political system of India. Not only this Indian freedom movement got the strength when common man that is farmers, and artisans joined the movement and they joined the movement only when there condition became miserable because of British Policies. Gandhiji's first organized campaign in India was in Champaran for the economic rights of the peasant of Champaran, similarly second big campaign which earn the title 'Sardar' for Sardar Vallabh Bhai Patel was 'Bardoli Satyagraha' 'Dandi March' 'Swadeshi' seeds of all these were somewhere in economics.

So it is very clear that economics and politics are closely related. It is because it is the believes of political leaders which decide the fate of economic policies and it is the economic condition of country and masses which decides the political fate of the country.

The present lesson throws light that how Government can influence the business.

It is the Govt. influences and in some states it even decides the following things:

1. What to Produce?

2. Where to Produce?

3. When to Produce?

4. How much to Produce?

5. How to Produce? (Manufacturing Process)

6. To whom to sell?

7. How to distribute?

8. What should be the price?

Answer to these entire question to a great extent lies with Government. It is very much true in India as before liberalisation license and permit raj in India was so deep that before starting any venture entrepreneur or industrial house have to obtain had not only to get registered with the Govt. authority but also have to obtain various licenses from the Govt. Not only this in India prior to 1991 it is the Govt. who used to decide that private sector will produce what, where it will produce , how much it will produce, not the market forces but the Govt used to decide the interest rate and forex rate. So in totality prior to liberalization in India business was at the mercy of Govt. And to do business one don't have to be expert in business strategy but one have to be good at liasoning with Govt. Soon after freedom Liberalization policy of Congress Govt. (1991) gave numerous opportunities to business organization and also prove to be an threat for many as after liberalization many companies expanded manifold and many have to close their operation or have to sell their operations. Mergers and Acquisition has taken place in last 15 years. Soon after liberalization HLL acquired Lakme, TOMCO, Kissan, Modern foods, etc. UB group acquired Herbenston and Shaw Wallace and become second largest liquor player of the world. TATA launched its small car, which they couldn't launch in 1980s because of Govt. policy, India became the battleground for Multinational Automobile companies, Coca Cola purchased Parle, Pepsi purchased Uncle Chipps. Soon India may see the advent of Multinational Retail giant Wal-Mart.

4.2 ROLE OF GOVERNMENT IN BUSINESS

We have seen that how slight change in Government policy can change the whole scenario of Business. Government can influence the business in the following manner:

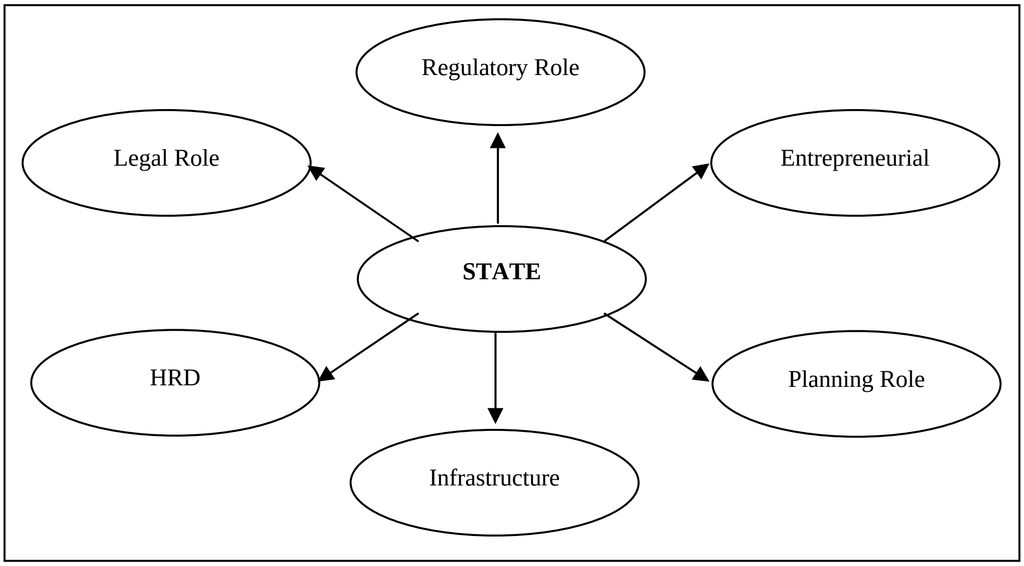


Figure 4.1: Role of Government in Business

4.2.1 Regulatory Role

Government regulates the business. It not only decides the rule of the game it also looks after the implementation of the rules.

1. ***Reservation:*** It limits the spheres of investment by reserving the industry for small scale, public and co-operative sector. As prior to liberalization Petroleum, Telecommunication, Coal, Power, et c were the monopoly of Public Sector, but liberalization bring new investment opportunities of investment for private sector as now only two sector railways and atomic energy are reserved for public sector. Many sectors are still reserved for small scale sector. Because of this policy we see boom in many industry in last fifteen years. As now India has mobile user than that of Land line users, Reliance established one of the largest grass root refinery of the world, and besides other big players as Bharti Telecom , Reliance and TATA have invested heavily in Telecommunication new power projects were established by private sector, Aviation is no more an Govt. monopoly dozen of private players are there as Sahara Airlines, Kingfisher Airlines, Spice jet, Air Deccan etc., host of new player enters in finance sector specially in Insurance Sector as now to tap new opportunity many business houses like TATA, AV Birla, Bajaj, ICICI etc have forayed in insurance sector.

2. ***Licensing:*** License is a very effective tool in the hands of Govt. to regulate the business. Earlier for almost every new venture license is required through it Govt. used to keep tight control on the production in private sector, but now only investment in few industries requires license. Though in few cases Industry may have to acquire license from different other authorities as Pollution control, ISI, Ministry of Environment and Forest, Food and Drug Administration etc.

3. ***Expansion:*** Government can give the opportunity to the business house to expand to its height and can even limits its expansion programmes. As earlier through MRTP Act Govt. have restricted the expansion of big houses, not only this various restriction were imposed on increasing production capacity or launching new variants, even restriction were their on advertisement budget of big houses. Restriction were their on investment in abroad. It is the reason that we were

driving the same car in 1980 which we were driving in 1950, by 1990 also we got only one new option that is Maruti. But when this restriction was repealed the whole equation of business have changed. Ranbaxy, AV Birla, Dr. Reddy's Lab, ONGC, L&T are now Multinational Companies, Asian Paints has operation in 28 nations of the world. Indians companies are producing at economies of scale, consumer have a wide choice from big product portfolio of companies. Even the expansion of the programme is on the mercy of Govt.

4. ***Foreign Direct Investment:*** It is the Govt. who decides, whether MNC can invest in a country or not. Because of Govt. policy there are very few MNCs in India. Even companies like IBM and Coca Cola had to leave India because of Govt. policy. Today MNC are in the field of even sectors like insurance ,petroleum, banks and publication but are they are not in Retail sector as Govt. don't allowed foreign participation in retail sector.

5. ***Import and Export Policy:*** With a small declaration Govt. can open and close various avenues for export and import. As a policy matter Govt. can use various tool to impose restriction on import as Quota, Tariffs, cumbersome import process, import licenses etc. Till 1991 India followed a protectionist policy and protected the industry from import through various tools. But now policy has been changed and import is easy. It begets new opportunities and treat for the business. As because of this Indian Toy industry very badly affected and many have to shut down their operation. So it is the Govt., which decides that what can be imported or exported, and what can not be.

6. ***Taxes:*** Through taxes also Government regulates the industry. Govt. usually impose high rate of tax on the industry which it don't want to encourage as after independence very high excise was imposed on product like ACs, Automobile etc and there was virtually no tax on production of product reserved for small scale industry and to increase the use of particular product Govt. even provide subsidy as on Fertilizer and Tractor and other farm equipment. Govt. also influences the location of industry by giving tax breaks in establishing industry in a particular region.

7. ***Supply of Money:*** Demand depends upon the purchasing power of the consumer and the purchasing power depends upon supply of money and supply of money is decided by the Govt. (RBI). There are many ways through which Govt. regulate the supply of money. RBI can increase the supply of money in the market by decreasing the CRR , SLR etc. which decreases the interest rate in the market. In last 15 years interest rate have been decreased drastically, which have given more purchasing power to consumer. It boosted the consumer goods industry and Housing industry. Govt. can also increase or decrease the supply of money by increasing or decreasing income tax rate and interest rate on savings. So industry is to an extent dependent on Govt. to increase the demand.

8. ***Supply of FOREX:*** Government not only regulate import and export through policy decision it also control it through control of supply of foreign exchange. Prior to liberalization it is the Govt. which used to decide the exchange rate, to restrict the import it usually restrict the supply of Forex, to boost export and discourage import Govt. also devaluate the currency. After liberalization when Rupee is convertible then also RBI control the supply and exchange rate through open market operation.

Besides all these Government regulates the business through administrative and physical controls. So we see that Govt. regulates almost every aspect of business and not only this it gives opportunity to invest and simultaneously it restrict investment in particular area.

9. ***Incentives***: Govt. also regulate the industry by giving incentive in key thrust area. As Govt. gives tax beaks if industrial unit is established in backward area. It also gives subsidy under various schemes to small scale sector. To support export it establishes special Zones like SEZs, it gives subsidy on export, tax relaxation on export, import licenses and less import duty for exporters, and easy financing through banks. To support a particular industry in national interest it also direct the financial institution to give liberal loans to that sector that too at easy terms. To give boost to housing industry Govt. has given exemption to housing loan from Income Tax.

Check Your Progress 1

Mention some of the instruments through which the Government regulate the business.

…………………………………………………………………………………………

…………………………………………………………………………………………

4.2.2 Legal Role

Parliament is the law making authority and it is the council of ministers who present the proposed law on the table of parliament. It is Govt. which decides and implement the legal environment of the country. When in 1980s NRI Swaraj Paul tried to took over Escorts then it is the legal environment which saved the Escort as new law was enacted which said that an NRI could not take the stake in an Indian company above a certain limit. Govt. has enacted many laws to regulate the industry. As IDRA, to control their expansion MRTP Act, which was repealed to Competition Act to ensure fair competition among organization, Essential Commodities Act, to protect the environment, Environment Act, Companies Act, SEBI Act, to protect the consumes the Consumer Protection Act, to protect the human resource from exploitation Labor laws are their. So while doing business the enterprises have to abide by the law, it not only ensures healthy competition but it also gives companies a level playing field. It is the law only which protects the intellectual capital of organization. Business flourishes only in states where there is a healthy legal system.

4.2.3 Infrastructure Development

In developing nations development of infrastructure is the essential and Govt. plays a critical role in it. It is said that take care of Roads and Electricity and development and employment generation will take care of itself. Well-established infrastructure is the basic requirement for the establishment and growth of industry. In a developing nation where infrastructure is in poor state, their state has to take steps to develop the infrastructure, that is construction of roads, development of railways, supply of power, transport , finance sector, training and guidance, research and development etc. Since independence state has invested heavily on infrastructure. Now under new regime even private sector is playing a critical role in developing infrastructure. In the budget of 2005-06 provision of SPV (special purpose vehicle) has been made for the development of infrastructure.

4.2.4 Human Resource Development

The whole stage of industry is reallocating its location around availability of human resource. Today it is not raw material or nearness to market which decides the location of unit, but it is availability of human resource which is playing decisive role in deciding the location of establishment. Today when research, new product development, economies of scale, low production cost are the mantra to success trained and skilled human resource has become the critical success factor for every industry. But in developing nation like in India state plays critical role in developing a human resource as at time of independence private sector was not in a position to invest in higher and technical education, and unlike developed nation masses of India was and is not in a position to afford higher technical education. It is the reason that state invested heavily higher technical education established premier education like IITs, IIIT, IIMs, IVRIs, AIMS, BHU, and other Universities, recently Dr. Manmohan Singh the Prime Minister of India declared to invest Rs 100 crore in a university in Bangalore to develop it as research house in science, not only this thanks to J.L. Nehru that India kept English as a medium of instruction in education. Because of these effort of state India feel proud of its human resource and it help a lot to business. Today many business are flourishing in India because of these human resource as BPO, Software, Electronics, India is becoming a manufacturing hub for Mobile Phones, Pharmaceuticals, Fundamental Research etc.. Technical and Knowledge Level of HR is also a critical thing for industry and state plays a vital role in influencing and deciding that.

4.2.5 Entrepreneurial Role

State also plays the role of entrepreneur. It invest in the business. Indian Govt. has done it significantly since Independence. Through its investment Govt. significantly influences the business environment. In India after independence Govt. has reserved some industry for only Public Sector, where private sector cant invest. Though Govt. has invested even other areas, which were not reserved for private sector. In a developing nation in some way investment by Govt. helps a lot to private sector. After independence Indian Govt. heavily invested in capital intensive industry where gestation period is also very high and private entrepreneurs are not interested in investing there, as Steel (SAIL), Aluminum (Indal), Railways, Power (NTPC), Heavy Machines, Earth Moving Machines, Heavy Electrical Machinery (BHEL), Petroleum, Telecommunication etc. all these investment promoted the private industry by making available the raw material and machines. Investment by Govt. also changed the competitive environment. It itself become a competitor to private sector in alluring consumer. As its investment in Automobile (MUL) changed the whole competitive environment of automobile industry of India , same way it invested in soft drink and launched brand ‘Double Seven’ it also invested in Consumer Electronics (Jolly, Uptron), Two Wheeler (Scooter India), Cosmetic Soaps, Bakery Products, Milk Products, Distribution network, etc. Though new industry policy is not in favor of any further investment but rather following a policy of disinvestment and privatization. But in altogether in last fifty years it has played critical role in deciding the business environment of the country.

4.2.6 Planning Role

State is an architect of industrial scenario in a country. It is more true for the country like India where state also perform the task of planner. India have followed a policy of five year planning system. Where planning commission plans the direction of investment for the following five years. This significantly influences the business environment. As planning commission declares the key areas where state is going to invest and support in coming five years. And all this influences the investment decision of the even private sector, as they get support from Govt. when they invest in priority sector.

So we see that state /govt. plays a vital role in deciding and influencing business environment. It not only influences in fact it make the rule of the game and also act as umpire and referee.

Besides all this political stability also plays a critical role in generating conducive environment for business. Today India is attracting foreign investment only because almost all political parties have consensus on foreign investment except some issues like foreign investment in retail or more than 50% investment in print media. Even the political parties like CPI is trying hard to attract foreign investment in their ruled states. How much political differences may be their but almost chief ministers of all the states are promoting foreign investment. Resent visits of foreign diplomats of Indian IT hub shows increasing confidence of foreigners in Indian Political system. So political stability itself is a positive statement for industry.

Check Your Progress 2

Fill in the blanks:

1. Gandhiji's first organized campaign in India was in _______________for the economic rights of the peasant.
2. Soon after liberalization – acquired Lakme.
3. ___________ established one of the largest grass root refinery of the world.
4. As earlier through ____________ have restricted the expansion of big houses.
5. _________ can increase the supply of money in the market by decreasing the CRR.
6. Govt. invested in soft drink and launched brand '______________'.

4.3 LET US SUM UP

There is a close relationship between political environment and economic environment of country. The Governing body of the State regulates and influences the every aspect of the business. It is true not only with socialist economies but it is also true with capitalist economies. Govt. performs various functions, which directly influences the business as it is the Govt. who is a regulatory authority in state. As a regulator of the economy it decides the reservation policy by which it limits the spheres of investment by the industry for small scale, public and co-operative sector. It decides the Licensing and Expansion policy through it restrict the entry and exit in business. Through its Foreign Direct Investment policy it decides that how much and where the FDI can be invested. Through its Import and Export Policy it can increase or decrease the trade barrier.

Through the taxes and monetary policy Govt. can influence the disposable income of people, interest rate , availability of fund for the industry thus it can influence both the supply and demand.

Not only this it is the Govt. influences the business by investing in infrastructure projects thus creating a conducive environment for business. It also invest in the development of HRD thus it provides trained and skilled HR to industry. It is the Govt. who make the law for the smooth functioning of Business. So we see that Govt. influences every aspect of business.

4.4 LESSON END ACTIVITY

Prepare an assignment on the changed role (Pre and after 1991) of the Govt. in regulating the business.

4.5 KEYWORDS

RBI: Reserve Bank of India.

CRR: Cash Reserve Ratio.

Forex: Foreign Exchange.

SEZ: Special Economic Zones.

MRTP: Monopolies and Restrictive Trade Practices.

SEBI: Securities and Exchange Board of India.

SPV: Special Purpose Vehicle.

4.6 QUESTIONS FOR DISCUSSION

1. Discuss how Govt. regulates the business.
2. Tell in brief that how Govt. can influence the business by investing in infrastructure.
3. "Industry gets the Human Resource because the blessing of Govt." Discuss the statement.

Check Your Progress: Model Answers

CYP 1

Government's Regulatory Tools:

(a) Reservation

(b) Licensing Policy

(c) Policy towards FDI

(d) Exim Policy

(e) Taxation

(f) Monetary Policy, etc.

CYP 2

1. Champaran	2. HLL	3. Reliance
4. MRTP Act Govt.	5. RBI	6. Double Seven

4.7 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books.

Bedi Suresh (2006) *Business Environment*, Excel Books.

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LESSON

5

CONSTITUTION AND ITS ROLE IN BUSINESS

CONTENTS

5.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand fundamental rights and their role in business decisions
- Know directive principles and how they influences policy decisions
- Know the Lok Sabha, Rajya Sabha and Judiciary of India

5.1 INTRODUCTION

The main objective of economic legislation is (a) to support economic policies of Government (b) to control and regulate economic activities (c) to protect consumer interest and rights (d) to restrict negative aspect of development i.e. to protect environment.

Indian freedom fighters were quite influenced by the Russian economic system. They used to believe in socialism or in communism. While struggling for freedom everybody dreamt of a country as a land of 'Opportunity', a Nation where every citizen has equal opportunity, every citizen is treated equally, a Nation where there is no economic disparity a nation where economics and wealth is not concentrated in few hands, in nutshell they have dreamt of utopia.

All this is reflected in our constitution. Our Constitution does not includes only fundamental rights but also Directive Principles which tells the state that what they should do for the welfare of common man. Not only this constitution also includes the Duties of Citizen. Government decides the legal framework of business, and legal framework is designed on the guidelines given by the constitution. To understand the role of constitution in business first of all we have to understand The Preamble of the Constitution.

5.2 PREAMBLE

Our constitution states that "We the people of India having solemnly resolved to constitute India into a SOVEREIGN SOCIALIST DEMOCRATIC SECULAR REPUBLIC and to secure all its citizens:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship

EQUALITY of status and opportunity; and promote among them

FRATERNITY assuring the dignity of the individual and the unity of the Nations

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949, do HEREBY ADOPT, ENACT AND GIVE OURSELVES THIS CONSTITUION. "

[The word SOCIALIST SECULAR were inserted in The Preamble through the 42 Amendment which came into force on 18th December, 1976]

The Preamble of the Constitution began with the word We the people of India having solemnly resolved to ……….and ends with the word ……..do hereby adopt, enact and give ourselves this constitution, it clearly depicts that people are ultimate authority and source of Constitution. Indian Constitution derives its strength from the sovereignty of the people. As all governmental organs and institutions owe their origin to the sovereignty of the people, they cannot enjoy unlimited powers. They can enjoy only such powers which are conferred by the Constitution. Though Parliament possesses the power to amend the Constitution but the power should be exercised in such a manner that the framework of the basic structure of the Constitution may not be abridged or destroyed.

From the economic point of view the word SOCIALIST that was inserted through 42 Amendment is of critical importance. It mentions the economic objectives and policy of the state and guides the state in making law which should attain Socialist Pattern of society. It also paves the way for the nationalization of many industries in 1970s. Though Indian socialism is quite different from the western type of socialism, which involves nationalization of all means of production. As Indira Gandhi explained:

"We have always said that we have our own brand of socialism. We will nationalize the sectors where we feel necessity. Just nationalization is not our type of socialism".

Therefore though Indian Constitution doesn't abolish private property altogether but seeks to put it under restraints so that it may be used for public benefit.

Shri J. L. Nehru had declared the 'Socialistic pattern of society and not socialism' as the objective of planning. He observed "Socialism to some people means: Distribution which means cutting off the pockets of the people who have too much money and rationalization. Both these are desirable objectives, but neither is by itself socialism.

Any attempt to distribute by affecting the productive machinery is utterly wrong; to do so would be weaken us.

Secondly there is a question of nationalization. I think it is dangerous merely without being prepared to work it properly. To nationalize we have to select things. My idea of socialism is that every individual in the State should have equal opportunity for progress."

So we see that term 'Socialist' has been accepted in India in a different manner than that of in Communism. Though this term is the guiding principle for the economic policy of India. Behind all the major economic policy decisions as active participation of Govt. in Business, heavy investment in Public Sector, reservation of industry for PSUs and small scale, highly progressive tax rate, heavy excise on luxury items as automobiles, curb on expansion on private sector etc. the guiding force was the philosophy of SOCIALISM.

Socialism is also reflected in the Fundament Rights and Directive Principles of State Policy mentioned in Constitution. These Directive Principle have the everlasting and maximum impact on the economic policy of State, thus have the direct impact on the every aspect of business whether it is scope of business (where to invest), supply of raw material, level of competition, purchasing power of consumer, R&D, entry barrier, level of technology, pricing, HRM etc.

5.3 FUNDAMENTAL RIGHTS

"The object of Fundamental Right as far as I can gather from a reading of the Constitution was….to provide certain standard of conduct, citizenship and fair play." (Justice Sapru)

The Constitution of India contains an exhaustive list of Fundamental Rights. They are above all other law of land. The Courts ensures their observance by the State. The Constitution has granted fundamental rights to the citizen they are as follows:

1. ***Right to Equality (Article 14):*** Article 14 of the Constitution guarantees equality of all persons before law. Article 15 prohibits any discrimination on the basis of religion, race, cast, sex or place of birth as between citizens. It abolishes untouchability and ensures equality of opportunity in the matter of public employment.

   Article 14 prohibits hostile discrimination and not reasonable classification for the purpose of legislation.

2. ***Right to Freedom (Article 19):*** Article 19(1) of the Constitution gives right to following six freedoms:

   (a) Freedom of speech and expression

   (b) Freedom to assemble peacefully and without arms.

   (c) Freedom to form associations or unions;

   (d) Freedom to move freely throughout the territory of India;

   (e) Freedom to reside and settle in any part of the territory of India; and

   (f) Freedom to practice any profession or to carry on any occupation, trade or business.

   These freedoms are not absolute; there are limitations on these freedoms. The first Amendment Bill to the Constitution was passed by the parliament on June 2, 1951. It allowed the State to impose reasonable restrictions on the freedom of the individual in the interest of the security of the State, friendly relations with foreign states, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence.

3. ***Right to Life and Personal Property:*** Article 31, 31A and 31B guaranteed the right of the individuals sand trusts to own and trusts to own, and administer their property. The Constitution says that no person shall be deprived of his property except by lawful authority. Right to property has been deleted by 44th amendment and now it has been made only a legal right.
4. ***Right to Freedom of Religion:*** Article 25 says that all the persons shall be entitled to freedom of conscience and the right to practice and propagate the religion freely.
5. ***Right to Cultural and Educational Freedom:*** Constitution allows all the minorities in India to preserve and promote their languages, script and culture. The Constitutions permits all the minorities, whether based on religion, to start and run their educational institutes and get financial aid without any discrimination from the State.
6. ***Right against Exploitation:*** Our Constitution recognizes the dignity of the individual and protects him against him any form of exploitation either by the State or by the privileged classes in the society.
7. ***Right to Constitutional Remedy:*** Article 32 confers on the people the right to move the Supreme Court in case of encroachment of the Fundamental Rights by the State.

Can Parliament Amend Fundamental Right

On April 24, 1973 the Supreme Court gave ruling that Parliament has the Right to amend the Constitution including Fundamental Right but not the basic structure of framework of the constitution.

Some of the Fundamental Rights have economic importance. The Right to equality for example, prohibits discrimination against any citizen on grounds of religion, race, caste, sex or place of birth. But it support protective discrimination. To support development of the socially and economically backward section of the society Legislature is given sufficient latitude for making selection or differentiation and so long as such a selection is not arbitrary and has rational basis having regard to the object of the Act.

Right to freedom allows the citizen to choose the profession of their choice and gives freedom to practice the profession or to do the business in any part of the country. Fundamental right against exploitation prohibits the exploitation of weaker section and of human resource. Article 23 prohibits traffic in human beings and forced labor. Indirectly it ensures a conductive environment for working. Article 24 prohibits to child labor.

So we see that Fundamental Rights guarantee several economic rights to the citizen.

Check Your Progress 1

Describe, in brief, the current status of right to property in Indian Constitution.

……………………………………………………………………………………….

……………………………………………………………………………………….

5.4 DIRECTIVE PRINCIPLES OF STATE POLICY – POSITIVE DIRECTIONS FOR STATE

"Although the Directive Principles of State Policy confer no legal rights and create no legal remedies, they appear to be like an Instrument of Instructions, or general recommendations addressed to all authorities in the Union reminding them of the basic principles of the new social and economic order which the Constitutions aims at building. These fundamental axioms of State Policy, though of no legal effect, have served as useful beacon-lights to courts". (M.C. Setalvad)

Directive principles of State Policy are contained in Part IV of the Constitution. Article 37 says that the Directive Principles, although not enforceable by the court, are nevertheless fundamental in the governance of the country and it shall be the duty of the state to apply these principles in making law.

5.4.1 Classification of Directive Principles and their Influence on Economy and Business

Principles which help in the establishment of a Welfare State or Socialistic Principles

Article 38 of constitution declares that the primary concern of the state shall be to promote the welfare of the people and create a social order in which justice- social, economic and political- shall be practiced by all the national institutions. The ideal of the welfare state is to be achieved by the state by:

1. Providing adequate means of livelihood
2. Distributing the ownership of material resources in a way that it does not lead to monopolistion.
3. Reorganizing the economic system in a way that it does not lead to concentration of wealth in a few hands.
4. Securing equal pay for work for both men and women.
5. Securing suitable employment for men, women and children so that their health is not undermined.
6. Guarding the children and young men against exploitation an moral degradation,
7. Taking effective steps to provide for work, education and public assistance in case of unemployment, old age, sickness and disablement.
8. Improving the conditions of work and providing material relief.
9. Securing for all the workers reasonable wages and a decent standard of life, reasonable leisure and culture opportunities.
10. Making arrangement within the 10 years from the commencement of the constitution for free an compulsory education for all children up to the age of 14;
11. Doing its best to raise the standard of living and to improve public health.

Those Principles which Conform to the Gandhian Thought or Gandhian Principles

The Directive Principle which intends to give a shape to Gandhian ideals are:

1. The State shall take steps to organize village Panchayats and make them powerful enough to work as units of self –governemnt.
2. It shall be the effort of the states to start and encourage cottage industries on an individual or co-operative basis in the villages
3. The State shall work for the uplift of the Scheduled Castes and Scheduled Tribes by educating them and protecting their economic interest
4. The State shall consider it their primary duty to stop the use of intoxicating drinks and drugs except for medical purpose.

5. It will be part of duty of the state to improve the breeds of cattle and stop the slaughter of cows and calves.
6. The State shall also try to protect every monument and place of artistic and historic interest from destruction or disfigurement.
7. The State shall take steps to separate the Judiciary from the Executive.
8. Article 39(b) says that ownership and control of the material resources of the community are so distributed as best to subserve the common good.
9. Article 39(c) says that operation of economic system should not result in concentration of wealth and means of production to the common detriment. Small scale industry also helps increasing employment and promote industrial economy in harmonious manner. That's why IDRA makes provision for support, encouragement and protection to small scale industries.

Directive Principle Added by 42nd Amendment

In 1976 Mrs. Indira Gandhi during the Internal Emergency brought about 42nd Amendment of the Constitution. 42nd Amendment added 39A to enjoin the State shall secure that the operation of the legal system promotes justice, on a basis of equal opportunity, and shall, in particular, provide free legal aid, by suitable legislation or schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen by reason of economic or other disabilities.

Article 43A had been inserted which state that the State shall take steps, by suitable legislation or in other way, to secure the participation of worker in management of undertaking, establishment or other organizations engaged in any industry.

Article 48A stated that the State shall endeavor to protect and improve the environment and to safeguard the forests and wild life of the country.

The 42nd Amendment Act, 1976 enacted during Emergency had accorded primacy to the Directive Principles of State Policy in comparison with the Fundamental Rights.

The importance and utility of the Directive Principle in the economic policy of state can be seen in the steps taken by the then Congress Govt. which was followed by later governments as follows:

To establish welfare state and to check concentration of economic power following steps were taken:

1. Zamindari pratha was abolished.
2. Highly Progressive tax rate were introduced.(which were at its peak during Indira Govt.)
3. Few industry were nationalized as Aviation, HAL, Banking, Insurance etc.
4. Higher excise were introduced on the luxury items as AC, Automobile etc.
5. License and Permit were imposed on the industry.
6. Expansion of established big houses was controlled trough MRTP.
7. Prices and distribution for essential commodities were controlled by Govt.
8. Various industries were declared reserved for public sector and small-scale sector.
9. To use the resource in the interest of nation and to check concentration of economic power in few hands and to make thing available to common man at reasonable prices and to reduce dependency on import heavy investment was done in Public Sector in every field as Aviation, Railways, Defence, Power, Heavy Machines, Infrastructure and even in consumer goods as Bread (Modern), Soft drink (Double Seven).

10. By 44th amendment Right to Property was abolished as a fundamental right, and it has been made only a legal right.
11. To use the scarce national resources in national interest, investment and research in non key thrust areas were checked through license system.
12. To check the concentration of economy small scale and cottage industry were promoted. Even commodity products like steel and cement were promoted to produce in small plants called mini steel plants or mini cement plants.
13. To have a balanced regional growth, to generate employment, to reduce economic disparity Small Scale, Tiny and Cottage industry were promoted. They were given subsidy and loan at low interest rate compare to big firms as Banks were in the hand of Govt.
14. Excise and other taxes were also low or nill on small scale sector. It is the key reason that NIRMA gave a tough fight to HLL as NIRMA used to come in small scale and have to pay no excise on the other hand HLL have to pay this results in higher production cost for HLL. Similarly small scale factories of Match Box have to pay less excise then that of organized sector company as WIMCO. Many industries like Bread, Candle etc were reserved for small scale. Govt. establishes various institutions and corporation to help small scale industry.
15. Various laws were enacted to give conducive environment to work force to protect the consumer from unfair practices, to protect environment to protect small scale from the jaws of big houses as Minimum Wage Act, IDRA, MRTP, Consumer Protection Act, Essential Commodities Act, Standard and Weights and Measures Act etc, Environment Protection Act etc.
16. The biggest private sector in the country was the private sector of the peasants with his small holding. As per the instruction of Directive Principles Govt took several measures for the welfare of farmers as there is no tax on earnings by agriculture, subsidy on fertilizers is provided, Govt. announces minimum support prices for selected crops, it has also establishes the proper purchase and distribution system of agri-Products. An exclusive bank NABARD was established for the development of Agriculture.

So we see that whole regulatory environment of the country is guided by one force and that is Directive Principle.

Check Your Progress 2

What do you understand by ‘Directive Principles of State Policy?

…………………………………………………………………………………….

…………………………………………………………………………………….

5.5 DISTINCTION BETWEEN DIRECTIVE PRINCIPLES AND FUNDAMENTAL RIGHTS

There is great difference between the Directive Principles and Fundamental Rights. According to Glehill “Fundamental Rights are injunctions to prohibit the Govt. from doing certain things, the Directive Principles are affirmative instructions to the Govt. to do certain things.” Another point of difference between two is that where as Fundamental Rights have a legal sanctions behind the Directive Principles have moral sanction only. The Former are Justiciable and enforceable, the later are not so.

When the Govt and executive imposes certain restrictions upon the Fundamental Rights, the Courts have to decide in the light of Directive Principle of State Policy whether the restrictions imposed upon the Fundamental Rights are reasonable or not, whether they are in he public interest or not.

As acquisition of property sought to be effected by the U.P. Zamindari Abolition and Land Reform Act of 1961, is for the purpose of implementing one or more of the Directive Principles of State Policy.

5.6 POLITICAL INSTITUTIONS

India is a Union of States. The Structure of Govt. is federal in nature. The three wings of any Government are : The Executive, The legislature and the Judiciary. The Legislature makes Laws for the country; the Executive enforces those laws and administers the guardian angel of the Constitution; the Judiciary guarantees fairness and justice and protects the individual from the despotism of Govt.

5.6.1 Legislative Organ

Legislative organ of India is Parliament. Parliament consist of President, Lok Sabha and Raj Sabha. Parliament make law for governance of the country. The Parliament has absolute control over the purse of the nation. No new tax can be levied or expenditure incurred without its consent. The Parliament exercise fair measures of control over the day to day activities of Council of Ministers. In extreme cases they can compel the Govt. to resign by expressing their want of confidence the Executive. Parliament can amend Constitution of India.

- ***Delegated Legislation:*** Parliament delegate some power to other authorities (usually Government or some Board or authority like RBI) to make rules, regulation and issues notification. This is called delegated legislation. Often these are required to be published in Official Gazette.
- ***Ordinances:*** Any Act can be passed when parliament is in session. But sometime need is urgent and it is not possible to wait for the commencement of session of Parliament, in such cases President has been empowered to issue Ordinance. Such Ordinance has the same force as Act of Parliament, except that the Ordinance is valid only for limited period. Indian Govt. enacted new Patent Law through ordinance [Patents (Amendment) Ordinance 2004] as to fulfill WTO requirement, it has to be implemented from 1st January 2005 and there was no time to get it pass through parliament so Ordinance was issued on 27th December 2004 to enact new Patent Law.

5.6.2 Executive (Administrative) Organ

Administration is looked after by Government for which Council of Ministers is at its head. President of India is on paper the Head of he State but to all intents and purposes the real power to rule is vested in the Council of Ministers. Thus the Union Cabinet consists of the Prime Minister and his colleagues. Each minister is assigned a particular ministry. Govt. deals with the matter through various departments and generally head of the department who is senior Govt. officer is called ‘Secretary’. In some cases where department is too big Board in formed to control the department as Railway Board. Further various junior and senior officers are appointed by Govt. for the purpose of administration. The Union Cabinet formulates the general policy of the country. Cabinet also prepare the draft of all important Bills and present it before the Parliament for approval. Finance Minister with the co-operation of Ministers prepares a budget for the next financial year and present it in Lok Shabha. So all the administrative powers lies with the Council of Ministers.

5.6.3 Judicial Organ

Our Constitution provides independent judiciary with wide powers. The Highest court in India is Supreme Court.

- ***Supreme Court:*** The Constitution of India gives both original and appellate jurisdiction to Supreme Court. Original Jurisdiction means that the court can hear and entertain suits directly from the parties in dispute. Under appellate jurisdiction the court entertain appeal against a decision by any other court of India. Supreme Court interprets any clause of Constitution and renders legal advice to the Union Govt. Principle function of the Supreme Court is to act as the guardian of the Constitution, particularly the Fundamental Rights, guaranteed to the citizens. Article 136 grants discretion to Supreme Court to grant special leave to appeal from an judgment, decree, determination, sentence or order in any cause of matter passed or made by any court or tribunal in India. Article 141 of Constitution provides that law declared by Supreme Court is binding on all courts within India.
- ***High Court:*** High Court has both appellate and original jurisdiction. It is also a court of record. It means that the judgment of the High Court are considered authoritative and they serve as case laws. It functions include both judicial and administrative. A High Court has the right of superintendence over all other courts subordinate to it. High Courts have been granted to issue writs. The Writ is an order or process issued by court or judicial officers, asking any person to perform or refrain from performing the Act. This is a very powerful right and is very useful in case Government or other authorities of not give justice to a person. Application made to High Court for this purpose is called Writ Petition.

  Besides High every state has three type of Subordinate Courts: Criminal Courts Civil Courts, and Revenue Courts.

  Constitution of any country is a decisive force in creating a conducive environment for business. It administers and regulates the environment. Judiciary also plays a critical role in supporting business. Business flourishes in only in those countries that have a healthy judicial system, Legislature and Administrative body.

Check Your Progress 3

Fill in the blanks:

1. As all governmental organs and institutions owe their origin to the ___________of the people.
2. Government can enjoy only such powers which are conferred by the ____________.
3. Word________________ was inserted through 42 Amendment.
4. ______________ of the Constitution guarantees equality of all persons before law.
5. The structure of Govt. is ____________ in nature.

5.7 LET US SUM UP

The Constitution is not only a document which tell about the formation and running of Govt. Rather it influences the life of every individual. It is the torch in the light of which our elected Govt. works and takes decision. The decisions, which affect our business. Our Constitution provided the Fundamental Rights to the citizens of nations. And they allow the person to engage in business or occupation of their choice. Our Constitution not only give fundamental rights, in not only tell how the Govt. will be formed and work it even lay the guidelines in Directive Principles for the Govt. These directive principles influences the decision making of Govt. and these decisions influence the business.

The Structure of Govt. is federal in nature. The three wings of any Government are: The Executive (Council of Ministers), the legislature (Parliament) and the Judiciary. The Legislature makes Laws for the country; the Executive enforces those laws and administers the guardian angel of the Constitution; the Judiciary guarantees fairness and justice and protects the individual from the despotism of Govt.

5.8 LESSON END ACTIVITIES

1. Prepare a report on the role of Judiciary in present environment.
2. Analyze the role of Public Interest Litigation (PIL) and its role in present economy. Prepare a report on how PIL influenced the industry in Delhi.

5.9 KEYWORDS

Directive Principles: Added by 42nd Amendment, they are the suggestions to the Govt. about their objectives to be achieved.

HAL: Hindustan Aeronautics Limited.

5.10 QUESTIONS FOR DISCUSSION

1. Discuss the impact of Constitution on the Policies of Govt.
2. Describe Fundamental Rights.
3. Discuss the Directive Principles.
4. Analyze the role of Directive Principles in deciding the economic policies of nations.
5. Why the conflict arise between Directive Principles and Fundamental Rights while making policies.
6. Discuss the various political institution of India and there role.

Check Your Progress: Model Answers

CYP 1

Article 31, 31A and 31B guaranteed the right of the individuals and trusts to own and trusts to own, and administer their property. The Constitution says that no person shall be deprived of his property except by lawful authority. Right to property has been deleted by 44th amendment and now it has been made only a legal right.

CYP 2

"Although the Directive Principles of State Policy confer no legal rights and create no legal remedies, they appear to be like an Instrument of Instructions, or general recommendations addressed to all authorities in the Union reminding them of the basic principles of the new social and economic order which the Constitutions aims at building.

CYP 3

1. Sovereignty, 2. Constitution, 3. Socialist,

4. Article 14, 5. Federal

5.11 SUGGESTED READINGS

Mittal Vivek (2007), *Business Environment*, Excel Books.

Bedi Suresh (2006), *Business Environment*, Excel Books.

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UNIT II

LESSON

6

ETHICS

CONTENTS

6.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept and origin of ethics
- Understand the role of ethics in business decision
- Know the relationship between ethics and business decisions

6.1 INTRODUCTION

The word 'Ethics' has been originated from the word 'ethos', meaning character or manners. Ethics is thus said to be the science of morals; a treatise on this: moral principle; recognized rules of conduct. Ethics involves judgment as to good and bad, right and wrong, and what ought to be. Ethics deals with things to be sought and things to be avoided by ways of life. An ethical dilemma exists where two or more values are in conflict, and we seek from ethics a resolution to this conflict. Business ethics refers to the measurement of business behavior on standards of right and wrong, rather than relying entirely on principles of accounting and management. Ethics is not only desirable but is essential for the smooth functioning of business. If business does not follow ethics then there will be an utter chaos and there will be no trust and in this situation there is no scope of business. Ethics plays a role whether it is a buyer and seller relationship or it is a competitor relationship. The objectives of Ethics are:

1. Studying human behavior and makes evaluative assessment about them as moral or immoral (diagnostic goal).

2. Established moral standards and norms of behaviour.
3. Makes judgment upon human behavior based on these standards and norms.
4. Prescribe moral behavior and makes recommendation about how to or how not to behave (therapeutic goal)
5. Express an opinion or attitude about human conduct in general.
6. TISCO never faced any lock out or labor problem only because of ethical standards followed by TATA. TATA is one of the most trusted brands of India only because of its ethical standards.

Matsushita Electric Co. follows the following value system

The seven 'Spiritual' Values

1. National Service through Industry
2. Fairness
3. Harmony and Cooperation
4. Struggle and Betterment
5. Courtesy and Humility
6. Adjustment and Assimilation
7. Gratitude

Prof. S.K. Chakraborty in his book "The Management and Ethics Omnibus" cited following values which are deep rooted in Indian Culture and Society:

1. The Individual Must be Respected
2. Cooperation and Trust
3. Jealousy is Harmful for Health
4. 'Chitta-Shuddhi' or Purification of the Mind
5. Top Quality Product/ Service
6. Work is Worship
7. Containment of Greed
8. Ethico-moral Soundness
9. Self-discipline and Self-restraint
10. Customer Satisfaction
11. Creativity
12. The Inspiration to Give
13. Renunciation and Detachment

6.2 ETHICAL THEORIES

Ethical theories can be divide into two categories: Teleological and Deontological. The teleological determine the ethics of an act by looking the consequences of the decision (the ends), while deontological theories determine the ethics of an act by looking to the process of the decision. (Means)

1. ***Teleological (Utilitarianism) Ethical System:*** The teleological morality of a decision is determined by measuring the probable outcome. The theory most representative of this approach is utilitarianism, which seeks end the greatest "good" (or Utility) for the greatest number. The most basic form of utilitarian analysis is cost – benefit analysis, where one tallies the costs and benefit of a given decision and follows the decision that provides for the greatest overall gain. Utilitarianism hold that actions are right in proportion as they tend to promote happiness, wrong as they tend to produce the reverse of happiness.

2. ***Deontological Ethical System:*** A deontological system is based on rules or principles that governs decisions. In this system ethics are measured by the rightness of an act depends little on the results of the act. According to it moral persons is one of goodwill, and that person renders ethical decisions based on what is right, regardless of the consequences of decision. Thus the student who refuses to cheat on exam is morally worthy if her or his decision springs from duty. But morally unworthy if the decision is merely one born of self interest, such as fear of being caught.

3. ***Hybrid Theory:*** Robert Nozick holds that justice and fairness, right and wrong are measured not by equality of results for all, but from ensuring equal opportunity for all to engage in informed choices about their own welfare.

   Enlightened ethical egoism says that it is important to the individual that the world is a "good" world; therefore the individual may have a self interest in curbing pollution or in community projects, even though she or he may not individually and personally benefit from the decision.

4. ***Distributive Justice and Social Contract:*** Prof. Rawls of Harvard University propounded this theory. Who says that when people get together, they form societies and cooperation, and when they come together their arises conflict because people do not receive a just distribution of the benefits yielded through their activities. Rawls believe that the base of all distribution systems should be just and the primacy of justice in the basic structure of our system of society requires greater equality.

5. ***Individual Freedom:*** According to this theory all individuals must be allowed to make informed choice by all in society. Though choice must be within the law and the same freedom enjoyed by one individual in the society, must be extended to all within the society.

Check Your Progress 1

1. Define ethics.

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. Describe, in brief, the ethical theories.

   ……………………………………………………………………………….

   ……………………………………………………………………………….

6.3 CHARACTERISTICS OF ETHICS

1. Ethical decision differs with the individual perspective of different persons. Each person has its own perception and believes regarding ethics. Hence ethical decision of not have unique solutions, but have a multitude of alternatives.

2. Ethical decisions are not limited only to themselves, but affects a wide range of other situations as well. Similarly, unethical decision do not end in themselves, but have widespread ramification.
3. Most ethical decision involves a trade off between costs incurred and benefits received.
4. Many times consequences of ethical decision are not clear. They are ambiguous in nature. Similarly it is not clear what the consequences will be of an unethical decision, either of an individual or of on organization.
5. Ethical decisions have long term impact. Ethical decision may give bitter results in short term as lost of sales but in long term it reaps not only good results but results will also of persist for long. As high quality management may effect bottom line in short turn but it in long term it position the product in the mind of prospective customer, which gives lasting impression.
6. Every person is individually responsible of the ethical or unethical decision and action that he or she takes but the consequences of decision have to be faced by whole organization.
7. Ethical decisions are voluntary human actions. A person can not escape his personal liability by quoting that he committed because of seniors pressure.

6.4 MODERN DECISION-MAKING AND ETHICS

The economic activity and competition are no longer considered to be bedfellows altogether incompatible with ethics and morals. This is correct because man is always much more than mere commerce and competition. He has the ineffable of ethics and morals also to manage – whether in business or politics.

Two academics, Victor and Cullen, conclude a research study by pointing out;

It is our belief that organization theory needs to attend more explicitly to the ethical content in organizational processes. Ethical issues in organizations increasingly preoccupy theoreticians and practitioners. Firms are attempting to control the ethical decision-making of individuals, and society is attempting to influence directly the ethical decisions making of firms.

Business decision based on moral reasoning can be too absolute and decision based on only realities and logic can be too harsh and inhuman. To avoid these two extremes one can resort to traditional stakeholder model of decision-making. Stake holder theory suggests that in reaching ethical decision, we respond to the following inquiries:

1. What is the moral dimension?
2. What is ethical issue?
3. Who are the interested parties?
4. What values are involved?
5. What alternative do you have in your decision?
6. What is the weight of the benefits and the burdens of each alternatives on each impacted party?
7. Are there any analogous cases?
8. Can I discuss the case with relevant others?
9. Can I gather additional opinion or perspectives?
10. Is the decision in line with legal and organizational rules?
11. Am I comfortable with the decision? Can I live with it?

Philosopher Laura Nash suggest asking oneself 12 question prior to reaching a decision in an ethical dilemma (Laura Nash "Ethics without the sermon", Harward Business Review 56, no.6 (1981) pp. 80-81)

1. Have you defined problem accurately?
2. How would you define the problem if you stood on the other side of the fence?
3. How did the situation occur in the first place?
4. Who was involved in the situation in the first place?
5. What is your intention in making this decision?
6. How does this intention compare with likely results?
7. Who could your decision or action injure?
8. Can you engage the affected parties in a discussion of the problem before you made your decision?
9. Are you confident that your decision be as valid over a long period as it seems now?
10. Could you disclose without qualms your decision or action to your boss, your CEO, the board of directors, your family, or society as a whole?
11. What is the symbolic potential of your action if understood?
12. Under what condition would you allow exceptions to your stand?

In evaluating decision two elements should be considered: Integrity and Accountability. Integrity, means consistency in values, would require that the decision maker define her or his values, as well as create a prioritization of those values. Accountability means no matter which direction is taken, the decision maker must be accountable to all stakeholders who are impacted by this decision.

6.5 ETHICAL DECISION-MAKING DILEMMA

Managers experiences the dilemma of ethical decision making during performing their duties as:

1. I have to satisfy inspector from the electricity board to maintain adequate power supplies in times of recurrent shortages.
2. I have to oblige, entertain, and enrich an important customer to keep him from switching over to competitor.
3. I have to do manipulation in accounts statement to show high profit figure.
4. To increase profits I have to sell same product in three different packing at different price.
5. Without having any improvement in product I have to advertise New and Improved.
6. I have to sign a transfer orders of an officer to satisfy the prejudice of a higher level officer.
7. I have to oblige bank officer to get loan for the project.

American Accounting Association (AAA) published in 1988 a report on Ethics in the Accounting Curriculum which included a "decision model" for analyzing ethical dilemmas. Its steps are shown in Figure 6.1.

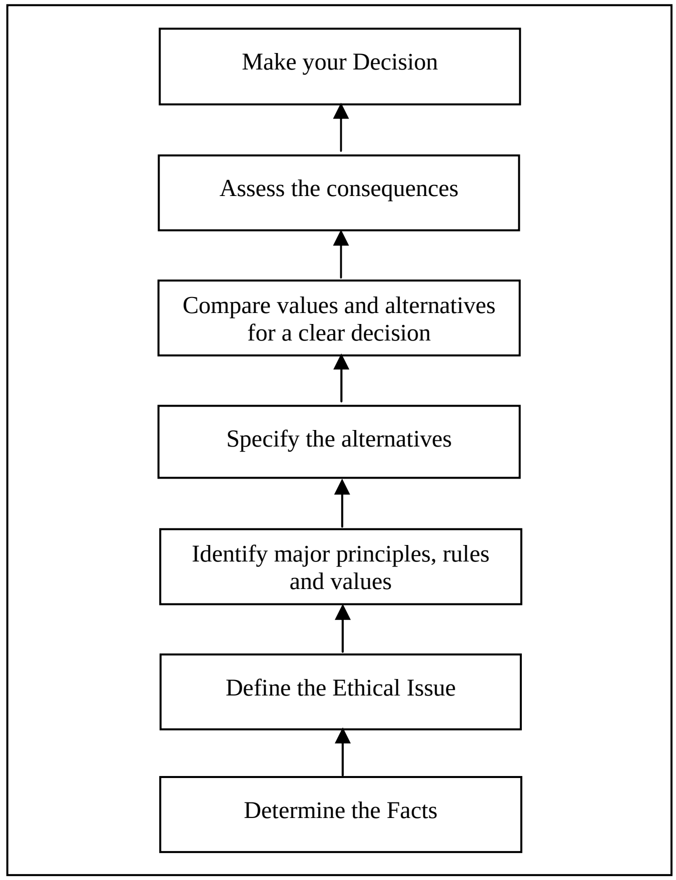

Figure 6.1: Decision Model for Analyzing Dilemmas

Modern theories of ethics may prove useful in understanding and encouraging ethical behavior in business. Imagine a lawless system where every human action is influenced by market forces. Does in this situation organization can remain ethical? Does business can exist if every firm took decision on the basis of self interest at any cost? Does lawless market forces ensure justice and fair business. Of course not.

Economist Dwight Lee and Richard Mckenzie support this contention. They explain that a businessperson may act honestly because of the high cost of dishonesty.

An economy in which people deal with each other honestly produces more wealth than one in which people are chronically dishonest because more exchanges occur directing resources into their most productive employments.

[Dwight Lee and Richard Mckenzie, “How the Marketplace Fosters Business Honesty”, Business and Society Review (Winter 1995) pp. 5-9]

6.6 SOURCES OF ETHICS

Sources of ethics are as follows:

1. ***Genetic Inheritance:*** There are persuasive evidence and arguments suggesting that the evolutionary forces of natural selection influences the development of traits such as cooperation and altruism that lie at the core of ethical system. The very first school of ethics is the home. More ethical the parents will be higher the chances that children will be following the same ethics. Ethics are passed on generation from one generation to second generation and process goes on.

2. ***Religion:*** Religion plays a critical role in deciding ethics. Before effective law system it is the religion that has played a role of restriction on unsocial activities. Today also a common man tries to abide by the ethics describe by the religion. As the Brihadarayaka Upnishad states, the Karmavada states:

Yathakari, Yathachari tatha bhavati

Sadhukari sadhur-bhavati, papakari papi bhavati;

Punyah punyena karmaan bhavati, papah papena.

[As it does, and as it acts, so it becomes: the doer of good becomes good, and the doer of evil becomes evil ; he become virtuous through a virtuous act and vicious through a vicious act.]

All religion preach humanity, all religion preach peace all religion preach development of whole society. Ethics has its roots in religion. Sacred Geeta preaches about Niskam Karma that is work with out sake of result.

Following verse of Isha Upanishad talks about enjoyment in detachment:

Isha vasyanidam sarvah,

Yatkincha Jagatyam jagat

Tena tyaktena bhunjitah

Ma gridha kasyaswiddhanam

(All this whatsoever moves on earth should be understood as covered by the lord. So let your enjoyment be done with detachment. Do not covet the wealth of others.)

3. ***Culture:*** Culture also begets ethical standards. Culture refers to rules, customs and standards transmitted through generation to generation. Though culture changes with region but their ethical standards remain same. Different places may have different cultures regarding dress sense but no culture believes in dishonesty, or in the deceiving others in the name of others. There are three aspect of culture:

   (a) *Universal, trans-cultural human values and ideas:* These are universal ideals. Which is expected from sages, saints etc. As in its ideal form it is culture to spend a part of life in vanprastha, that is in forest after fulfilling worldly duties, or to chant sacred mantras in the morning or to meditate in tapovans.

   (b) *Culture specific, operative human values that translate the ideals into actionable conduct in a given culture:* It is the cultural values expected from common man it is all about day to day operations and believes. As in India 'mother' image being most dominant in relation to woman in India, we have the operational value that even a father cannot touch his daughter's body once she attains puberty.

   (c) *Culture Specific, operative human values that derive for certain altogether different human ideals:* This predisposition contributes to purity of mind and is check against permissive and incest. In India it is translated into practical conduct through the tradition of a son or a daughter bowing down and touching the feet of his/her parents or by a student doing the same to a teacher.

4. ***Philosophical System:*** Philosophical system also influences the ethics. Aristotle, Pluto, Shri Aurbindo, Vivekanand, Subhash Chandra Bose, Swami Dayanand, Mahatma Gandhi have left lasting impact on the ethics with their philosophies. There are difference of opinion to. On the one hand there is a philosophy of Karl Marx according to him it is unethical to do business to accumulate wealth etc on the other hand Mahatma Gandhi believes in business and preached trusteeship according to which business man should look after the welfare of its employee. Jamna Lal Bajaj, JRD TATA, G.D.Birla who were influenced by M. Gandhi adopted this philosophy and invested heavily on the welfare of employees. On the

other hand countries like China erstwhile USSR etc were influenced by the philosophy of Karl Marx and they declared business as unethical in their respective countries. Vivekananda has given great importance to means of achieving results:

"with means aright end must come …..if we take care of the cause the effect will take care of itself. The realization of the ideal is the effect. The means are the cause: attention to the means, is therefore is the great secret of life."

5. ***Legal System:*** In society take the activities as hoarding the stock, black marketing, cheating, giving wrong information etc as unethical and there is law to restrain all these activities. There even laws against exploitation of labour, sexual harassment etc and all this activities are considered as unethical.

6. ***Code of Conduct:*** Steiners and Steiner identify three primary categories of such codes. First Company codes, ordinarily belief and highly generalized. Second company operating policies often contain an ethical dimension. As policies regarding, customer complaints, hiring and other decisions serve as a guide to conduct and as a shield by which the employee can protect against unethical advances fro m those outside the firm. Third many professional and industry associations have developed codes of ethics, such as in India Association of advertising agencies have develop a code of conduct for themselves. Council for Fair Business Practices (CFBP) established in 1966 adopted following code of fair business practices:

   (a) To charge only fair and reasonable prices and take every possible step to ensure that the prices to be charged to the consume are brought to his notice.

   (b) To take every possible step to ensue that the agents or dealers….do not charge prices higher than fixed.

   (c) In times of scarcity, not to withhold or suppress stocks of goods with a view to hoarding or profiteering.

   (d) Not to produce or trade in spurious goods of standards lower than specified.

   (e) Not to publish misleading advertisement.

   (f) To invoice goods exported or imported at their correct prices.

   (g) To maintain accuracy in weights and measures of good offered for sale.

   (h) Not to deal knowingly in smuggled goods.

   (i) Providing after sales service where necessary or possible.

   (j) Honoring the fundamental rights of the consumer- right of safety, right to choose, right to information and right to be heard.

   (k) Discharging social responsibilities and the responsibilities to protect the environment and nature's infrastructure.

   (l) Ensuring that the product warranty is offered in simple, unambiguous and concise language, highlighting the rights of the consumer under it.

Check Your Progress 2

State whether the following statements are true or false:

1. The word 'Ethics' has been originated from the word 'ethos'.
2. The deontological system of a decision is determined by measuring the probable outcome.
3. A teleological morality is based on rules or principles that governs decisions.
4. Before effective law system it is the religion that has played a role of restriction on unsocial activities.
5. TUFF shoes launched a advertisement featuring Milind Soman and Madhu Sapre.
6. TATA launched a indigenously developed car Fiesta.

6.7 ETHICS AND PROFIT

The Business Roundtable had introduced a survey report on corporate ethics by US business which included among others the following sentences:

One of the myths about business is that there is a contradiction between ethics and profits. The myths are thoroughly debunked by the attitudes and action of top managers in the companies that contributed to this report. There is a deep conviction that a good reputation for fair an honest business is a prime corporate asset that all employees should nurture with the greater care.

Ethics and profit both go together. It may be possible that in short run an organization can get an edge or good profits because of unethical means but it is the ethics which lasts. As an organization may get good initial sales by communicating false message about product but he will not get repeat sales and he will earn bad name too. As in India few years back TUFF shoes launched a advertisement featuring Milind Soman and Madhu Sapre, in the advertisement both were node and covered there body with Snake and were wearing only shoes. These advertisement gave them instant publicity and soon TUFF shoes became household name in India, but all this publicity went in vain as TUFF shoes does not get sales, in fact this advertisement earned a bad name for TUFF shoes, and even after years they couldn't manage sales for them. Take the case of Reliance Infocom, it was launched in India with a big bang but increased sale they adopted every sale gimmick, frequent changes in price and tariffs, frequent changes in policy, even they frequently changed their policy regarding distribution network which resulted in losses to thousand of Youth who became their distributor all this gave them initial sales and finance but also rotten image and this influenced their sale and profits.

By late 1990s Indian automobile market was totally dominated by MNC as Hundai, Daewoo, and Suzuki, at that TATA launched a indigenously developed car INDICA, and it got very good response from day one, even when critics didn't appraise the car it is only believe of Indians in the ethics of TATA that people always welcome any product from TATA and never oppugn its quality. Which results in the low expenditure in advertisement high initial and repeat sales of any new launch all this means big profits for years not from only existing product portfolio but with every new and prospective launch.

People want to do business with honest person that means with ethical companies attract more supplier, and business contracts. As GM and FORD followed a policy of having many supplier for the same product to increase their bargain power they also used threat of backward integration to increase their bargain power, on the other hand TOYOTA take their supplier as their business partners it kept the number of supplier as low as possible help them in R&D help them in their production system and all this resulted in a good rapport among them. And instead of bargain power and threat they achieved one of the lowest procurement cost in automobile industry in world through cooperation.

Even the dishonest people love to work for those who believe in ethics. Ethical companies attract more and good quality human resource, it has low executive turnover, they less labour problem and lock out. All this decreases the cost and increases the production, which results in high revenues and profits.

In totality we can say that ethics give sale, good relation with industry and better human resource all this results in higher profits and long-term eminence.

We can conclude the chapter with the golden words of Mahatma Gandhi who gave a Talisman to solve the dilemma of decision-making:

"I give you a talisman, when you are in doubt or when the self becomes too much with you apply the formula test.

Recall the face of the poorest and the weakest man whom you may have seen and ask yourself if the step you contemplate is going to be of any use to him, will he gain any thing by it, will it restore him to a control over his ruined life and destiny? In other word will it lead to Swaraj for the hungry and spiritually starving millions.

Then you will find your doubts melting away."

6.8 LET US SUM UP

Ethics deals with things to be sought and things to be avoided by ways of life. Business ethics refers to the measurement of business behavior on standards of right and wrong, rather than relying entirely on principles of accounting and management. If business does not follow ethics then there will be an utter chaos and there will be no trust and in this situation there is no scope of business. Ethics plays a role whether it is a buyer and seller relationship or it is a competitor relationship. Ethical theories can be divide into two categories: teleological and deontological. The teleological determine the ethics of an act by looking the consequences of the decision (the ends), while deontological theories determine the ethics of an act by looking to the process of the decision. (Means)

Ethical decision differs with the individual perspective of different persons. Most ethical decision involves a trade- off between costs incurred and benefits received. Managers experiences the dilemma of ethical decision making during performing their duties as:

Whether to satisfy inspector from the electricity board or to maintain adequate power supplies in times of recurrent shortages, Whether to oblige, entertain, and enrich an important customer to keep him from switching over to competitor.

Ethics are passed on generation from one generation to second generation and process goes on. Religion plays a critical role in deciding ethics. Today also a common man tries to abide by the ethics describe by the religion. Culture also begets ethical standards. Philosophical system also influences the ethics. Laws represent a rough approximation of society's ethical standards. Company codes, company operating policies often contain an ethical dimension. Third many professional and industry associations have developed codes of ethics, such as in India Association of advertising agencies have develop a code of conduct for themselves.

There is a close relationship between ethics and profit. Organizations who follows ethics earn good profit in long run. As ethics not only increase there customer base but it also reduces it cost. Ethics helps a lot in maintaining good relation with buyers, suppliers and even with competitor. So following ethics may look a luxury in short term but in long term it is milk giving cow.

6.9 LESSON END ACTIVITIES

1. Prepare an assignment on the role of ethics in decision-making in Indian corporate.
2. Prepare a report on the role of ethics in the functions of TATA.
3. Pick a company of your choice and find that how ethics it in making good decision.

6.10 KEYWORDS

TISCO: Tata Iron and Steel Company.

AAA: American Accounting Association.

CFBP: Council for Fair Business Practices.

6.11 QUESTIONS FOR DISCUSSION

1. What is ethics? Discuss the various ethical theories.
2. What is the role of ethics in decision-making?
3. Discuss the various sources of ethics.
4. “Ethics and profit both go together”. Discuss the statement.

Check Your Progress: Model Answers

CYP 1

1. The word ‘Ethics’ has been originated from the word ‘ethos’, meaning character or manners. Ethics is thus said to be the science of morals; a treatise on this: moral principle; recognized rules of conduct. Ethics involves judgment as to good and bad, right and wrong, and what ought to be.
2. Ethical theories can be divide into two categories: Teleological and Deontological. The teleological determine the ethics of an act by looking the consequences of the decision (the ends), while deontological theories determine the ethics of an act by looking to the process of the decision. (Means)

CYP 2

1. True	2. False	3. False
4. True	5. True	6. True

6.12 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books.

Bedi Suresh (2006) *Business Environment*, Excel Books.

Mishra, Puri (2006) *Economic Environment of Business*, Himalaya Publications House.

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Starling, Grower (1996) *The Changing Environment of Business*, Cincinnati, OH, South Western College Publishing.

Weidenbaum, Marray L. (1999) *Business and Government in the Global Market Place*, Upper Saddle River, NJ Prentice Hall.

LESSON

7

CORPORATE GOVERNANCE

CONTENTS

7.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept and scope of corporate governance
- Explain the impact of corporate governance on the stakeholders
- Know how corporate governance influences the bottom line of the firm

7.1 INTRODUCTION

"Capitalism with integrity outside the government is the only way forward to create job and solve the problem of poverty. We, the business leaders are the evangelists of capitalism with integrity. If the masses have to accept this we have to become credible and trustworthy. Thus we have to embrace the finest principles of corporate governance and walk and talk." (Narayan Murthy)

Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general. However, the concept of corporate governance is poorly defined because it potentially covers a large number of distinct economic phenomenon. As a result different people have come up with different definitions that basically reflect their special interest in the field. It is hard to see that this 'disorder' will be any different in the future so the best way to define the concept is perhaps to list a few of the different definitions rather than just mentioning one definition.

7.2 CORPORATE GOVERNANCE – DEFINITIONS

1. "Corporate governance is a field in economics that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of return", www.encycogov.com, Mathiesen [2002].

2. "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance", OECD April 1999. OECD's definition is consistent with the one presented by Cadbury [1992, page 15].

3. "Corporate governance is about promoting corporate fairness, transparency and accountability" J. Wolfensohn, president of the Word bank, as quoted by an article in Financial Times, June 21, 1999.

4. "Some commentators take too narrow a view, and say it (corporate governance) is the fancy term for the way in which directors and auditors handle their responsibilities towards shareholders. Others use the expression as if it were synonymous with shareholder democracy. Corporate governance is a topic recently conceived, as yet ill-defined, and consequently blurred at the edges…corporate governance as a subject, as an objective, or as a regime to be followed for the good of shareholders, employees, customers, bankers and indeed for the reputation and standing of our nation and its economy" Maw et al. [1994, page 1].

5. Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. (Report of SEBI Committee on Corporate Governance)

   The simplest definition is given by Cadbury Report (UK). 'Corporate Governance is the system by which businesses are directed and controlled'.

6. The Cadbury committee said "The primary level is company's responsibility to meet its material obligations to shareholders, employees, customer, suppliers, creditors, to pay its taxes & to met its statutory duties. The next level of responsibility is the direct result of actions of companies in carrying out their primary task includes making the most of the community's human resource and avoiding damage to the environment. Beyond these two levels, there is a much less well-defined area of responsibility, which takes in the interaction between business and society in a wider sense."

The Cadbury Committee on to a formula for governance progress that has become the industry standards- it developed a list of 'best practices' standards to which companies should aspire. Among other recommendations, the committee opined that:

- It is board's duty to present a balanced and understandable assessment of a company's position,
- An objective and professional relationship with auditors must be ensured,
- An audit committee of at least three non-executive directors with written terms of reference should be established,
- It must be reported that a business is going concern.

At its broadest, corporate governance comprehends the framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations. Relevant rules include applicable laws of the land as well as internal rules of a corporation. Relationships include those between all related parties, the most important of which are the owners, managers, directors of the board (when such entity exists), regulatory authorities and to a lesser extent employees and the community at large. Systems and processes deal with matters such as delegation of authority, performance measures, assurance mechanisms, reporting requirements and accountabilities.

In this way, the corporate governance structure spells out the rules and procedures for making decisions on corporate affairs. It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring the performance of those objectives.

Corporate governance is the method by which a corporation is directed, administered or controlled. It includes the laws and customs affecting that direction, as well as the goals for which it is governed. The principal participants are the shareholders, management and the board of directors. Other participants include regulators, employees, suppliers, partners, customers, constituents (for elected bodies) and the general community.

Check Your Progress 1

What do you understand by corporate governance?

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……………………………………………………………………………………

7.2.1 Scope of Corporate Governance

Corporate Governance covers the following functional area of governance:

1. Preparation of the entity's (Company) financial statements
2. Internal controls and the independence of the entity's auditors
3. Review of the compensation arrangements for the chief executive officer and other senior executives
4. The way in which individuals are nominated for positions on the board
5. The resources made available to directors in carrying out their duties
6. Oversight and management of risk.

7.2.2 Participants to Corporate Governance

Corporate Governance is concerned with governing or regulatory body (e.g. the SEBI), the CEO, the board of directors and management. Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large.

The shareholder delegates decision rights to the managers. The managers are expected to act in the interest of shareholders. This results in the loss of effective control by shareholders over managerial decisions. Thus a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders, in order to limit the self-satisfying opportunities for managers.

A board of directors plays a key role in corporate governance. It is their responsibility to endorse the organisation's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organisation to its owners and authorities.

A key factor in an individual's decision to participate in an organisation (e.g. through providing financial capital or expertise or labor) is trust that they will receive a fair share of the organisational returns. If some body receives more than their fair return (e.g. exorbitant executive remuneration), then the participants may choose to not continue participating, potentially leading to organisational collapse (e.g. shareholders withdrawing their capital). Corporate governance is the key mechanism through which this trust is maintained across all stakeholders.

Check Your Progress 2

Who are the participants to corporate governance?

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7.2.3 Principles of Corporate Governance

Commonly accepted principles of corporate governance include:

1. ***Rights of, and equitable treatment of, shareholders:*** Organisations should respect the rights of shareholders and help shareholders to exercise those rights.
2. ***Interests of other stakeholders:*** Organisations should recognise that they have legal and other obligations to all legitimate, stakeholders.
3. ***Role and responsibilities of the board:*** The board needs a range of skills and understanding - to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.
4. ***Integrity and ethical behaviour:*** Organisations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.
5. ***Disclosure and transparency:*** Organisations should clarify the role of board and management and it should be convey to public. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organisation should be timely and balanced to ensure that all investors have access to clear, factual information. Transparency is the best principle of corporate governance.

7.2.4 Role/Importance of Corporate Governance

The role of effective corporate governance is of immense significance to society as a whole it can be summarized as follows:

1. Corporate Governance ensures efficient use of resources
2. It makes the resources flow to those sectors or entities where there are efficient production of goods and services and the return is adequate enough to satisfy the demands of stakeholders.

3. It provides for choosing the best managers to administer the scarce resources.
4. It helps the managers to remain focused on improving performance, making sure that they are replaced when they fail to do so.
5. It pressurizes the organization to comply with the laws, regulations and expectations of society.
6. It assist the supervisor in regulating the entire economic sector without partiality and nepotism.
7. It increases the shareholders value which attract more investors, thus Corporate Governance ensures easy access to capital.
8. As corporate governance leads to higher consumers satisfaction thus it helps in increasing market share and sales. Thus it also reduces the advertising and promotion cost.
9. Employees are more satisfied in the organizations which follows corporate governance policies thus it reduces the employee turnover which results in the reduction in the human resource management cost. A satisfied employee can only create a satisfied customer.
10. Corporate Governance reduces the procurement and inventory cost. As it helps in maintaining good rapport with suppliers, which results in better and economical inventory management system.
11. Corporate Governance helps in establishing good rapport with distributors thus gives not only better access to the market but also reduces the distribution cost.

So in zest we can say that on the one hand it increase the revenue by fetching more sales on the other hand it reduces the cost in every field, so the ultimate impact will be a big leap in bottom line.

7.3 MECHANISM AND CONTROL

Internal corporate governance controls monitor activities and then take corrective action to accomplish organisational goals. Examples includes:

1. ***Monitoring by the board of directors:*** The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided.
2. ***Audit committees:*** There should be an Audit Committee, which shall have access to all financial information. Major role of Audit Committee is to have an oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
3. ***Financial Reporting:*** Financial reporting is a crucial element necessary for the corporate governance system to function effectively. Accountants and auditors are the primary providers of information to capital market participants. The directors of the company should be entitled to expect that management prepare the financial information in compliance with statutory and ethical obligations, and rely on auditors' competence.

The Enron collapse is an example of misleading financial reporting. Enron concealed huge losses by creating illusions that a third party was contractually obliged to pay the amount of any losses. However, the third party was an entity in which Enron had a substantial economic stake. In discussions of accounting practices with Arthur Anderson, the partner in charge of auditing, views inevitably led to the client prevailing.

However, good financial reporting is not a sufficient condition for the effectiveness of corporate governance if users don't process it, or if the informed user is unable to exercise a monitoring role due to high costs.

Check Your Progress 3

What is the role of audit committee in corporate governance?

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7.4 CORPORATE GOVERNANCE AND FIRM PERFORMANCE

In its 'Global Investor Opinion Survey' of over 200 institutional investors first undertaken in 2000 and updated in 2002, McKensey found that 80% of the respondents would pay a premium for well-governed companies. They defined a well-governed company as one that had mostly out-side directors, who had no management ties, undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues. The size of the premium varied by market, from 11% for Canadian companies to around 40% for companies where the regulatory backdrop was least certain.

Basel Committee has issued several papers on corporate governance, where the importance of corporate governance is emphasized. These papers suggested the following practices to be avoid governance problems in banking organization though which is applicable to all organization:

Establishing strategic objectives and setting up corporate values and communicating them across the banking organization.

Setting up and enforcing a clear line of authority and responsibility:

1. Ensuring that the board members are well qualified and not subject to pressure.
2. Ensuring that the board has a clear understanding of their role in corporate governance
3. Ensuring that there is appropriate overseeing by the senior management.
4. Effectively utilizing the work done by internal and external auditors, in recognition of the important control function they provide.
5. Ensuring that the compensation approaches are consistent with the bank’s ethical values, objectives, strategy and control environment.

7.5 CORPORATE GOVERNANCE IN INDIA

In India, Corporate Governance has matured well and today’s we have the proud privilege of New York Stock Exchange citing Infosys Technologies, an Indian company, as a role model regarding disclosure of information to shareholders. Good corporate governance is good business because it inspires investor’s confidence, which is essential in attracting capital.

In India corporate governance is not a new thing, the roots of Indian working ethos is in values. Indians have never ranked the person according to wealth and power but in fact they have praised standard of learning, virtue and character which he had attained. We can see the glimpse of Corporate Governance in the Arthashastra of Kautliya. As he said:

“Only if a king himself energetically active, do his officers follow him energetically. If he is sluggish, they too remain sluggish. And besides, they ear up his works. His enemies thereby easily overpower him. Therefore he should ever dedicate himself energetically to activity. The vow of the king is energetic activity, his sacrifice is constituted of the discharge of his own administrative duties; his sacrificial fee (to the officiating priest) is his impartiality of attitude towards all; his sacrificial consecration is his anointment as king” (Arthshastra 8.2)

So it is quit obvious that Indians used to believe in high level of standards. In modern times even Mahatma Gandhiji gave the principle of “Trusteeship” which can be an ideal Corporate Governance as in the principle he Gandhiji said that Entrepreneurs is a trustee of the organization and of its employee and he should look after the organization and employee as their trustee. In present scenario India is reinventing the principles of Corporate Governance.

Scams as of share scam after liberalization in 1991, failure of banks as of Global Trust Bank, Lala Kashinath Bank, issue of the age of directors in the TATAs, fiasco of UTI, with the introduction of option of share buyback, big remunerations and perks enjoyed by top management and in a peculiar condition where most of the business is with business families where Chairman and Managing Director is the same person, and in many cases the son becomes the CEO there is urgent need of Corporate Governance to protect the right and safeguard the interest of small shareholders and other stakeholders in India.

In purview of this situation government and the industry took a step to be more accountable. Both tried at their level to make Indian business to be more responsible to the shareholders. Result of this was the constituents of various committees both by CII and SEBI. Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance – a voluntary code published by the CII, and the first formal regulatory framework for listed companies specifically for corporate governance, established by the SEBI. Which resulted in the amendment in the Companies Act to introduce effective Corporate Governance in India.

SEBI constituted a committee on corporate governance under the chairmanship of Sri N.R. Narayana Murthi. The committee included representatives from the stock exchange, chamber of commerce and industry, investor associations and professional bodies; debated on key issues and made recommendations as under:

1. All audit committee member should be ‘financially literate’ at least one member should have accounting or related financial management expertise.
2. Mere explanation as to why a company has followed a different accounting standard from the prescribed standards will not be sufficient.
3. Board members should be informed about risk assessment and minimization procedures.
4. Board members should be trained in the business model of the company as well as the risk profile of the business parameters, their responsibilities as directors and the best way to discharge them.
5. Use of proceeds of IPO should be disclosed to the audit committee.
6. There shall be no nominee directors when a directors is to be appointed on the board and such appointment shall be made by shareholders.
7. Compensation paid to non-executive directors may be fixed by Board of Directors, limiting the maximum number of stock options that can be granted to non-executive directors in any financial year.

8. The performance evaluation of non-executive board members should be made by a peer group comprising the entire board of director, excluding the director being evaluated.

The Narayan Murthy committee has mentioned about correct approach for successful Corporate Governance, it has said:

"Corporate Governance is beyond the realm of law. It stems from the culture an mindset of management, and cannot be regulated by legislation alone. Corporate Governance deals with conducting the affairs of a company such that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. It is about openness, integrity an accountability. What legislation can and should do, is to lay down a common framework – the 'form' to ensure standards. The 'substance' will ultimately determine the credibility and integrity of the process. Substance is inexorably linked to the mindset and ethical standards of management".

From the government's side there have been swift moves through law and regulations made by the Department of Company's affaire (DOC) and SEBI to hasten the process of bringing improvements in the corporations functioning. Number of provisions regarding Corporate Governance have been inserted in Companies Act through Companies (Amendment) Act, 2000. Important changes to improve Corporate Governance are:

1. Providing for Director's responsibility statement.[Section 217 (2AA)]
2. Board to report in cases where buyback was not completed within the time specified in sub-section (4) of section 77.
3. Small shareholders to get a representation through a Director (Section 252)
4. Limitations in Directorships in companies (Section 274 & 275)
5. Constitutions of Audit Committees.
6. Providing for higher penalties (tenfold increase) for offences provided in various sections of the Companies Act.

Recommendations of the Birla Committee

KM Birla Committee was a 19 member committee appointed by SEBI on 7th May 1999. It submitted its report in 1999/2000. On the basis of this report, clause 49 of the Listing Agreement was issued by the SEBI. KM Birla committee recommended a code for the effective implementation of corporate governance. Some of the recommendations are core and are considered as mandatory and while others can be considered as desirable. SEBI accepted the KM Birla committee recommendation which is reflected in the takeover codes and statutory requirement under clause 49 of Listing Agreement which is to be certified by the statutory auditors. Clause 49 of Listing Agreement calls for the following:

1. Attendance of Each Director at the Board Meetings and AGM
2. Appropriate mix of executive and Independent Directors to maintain the independence of the Board: - Board of Directors should consist of a combination of executive and non- executive directors. At least 30% of the board should consist of non executive directors if one of them is chairman. The non- executive member should comprise at least 50% of the board if the chairman and the managing director is the same member. The Birla Committee also laid down recommendation for the induction of independent executive directors. Independent directors are the directors who do not have any material pecuniary relationship of transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may effect their independence of judgment.

3. Following board committees are recommended:
   (a) Audit
   (b) Remuneration
   (c) Shareholders
   (d) General Body
   (e) Disclosures
   (f) Means of Communication.

The Birla Committee also took note of various steps taken by SEBI for strengthening corporate governance, some of which are:

1. Stringent disclosure norms for initial Public Offers
2. Providing information in directors' reports for utilization of funds and variation between projected and actual use of funds as per the requirement of the Companies Act.
3. Declaration of Quarterly results.
4. Mandatory appointment of compliance officer for monitoring share transfer process.
5. Timely disclosure of material and price sensitive information having a bearing on the performance of a company.
6. Dispatching one copy of complete balance sheet to every household and abridged balance sheet to all shareholders,
7. Issues of guidelines for preferential allotment at market related process, and
8. Issue of regulations providing for a fair and transparent framework for takeovers and substantial acquisitions.

Check Your Progress 4

Fill in the blanks:

1. ______________ is the system by which business corporations are directed and controlled.
2. _______________ found that 80% of the respondents would pay a premium for well-governed companies.
3. Mahatma Gandhiji gave the principle of "_____________" which can be an ideal Corporate Governance.
4. Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance – a voluntary code published by the _____________.
5. ____________ committee was a 19 member committee appointed by SEBI on 7th May 1999.

7.6 CODE OF CONDUCT FOR CORPORATE GOVERNANCE

Revised clause 49 of SEBI proscribes that there should be a code of conduct for BOD. Part E of this clause reads as under:

1. It shall be obligatory for the Board of a company to lay down the code of conduct for all board members and senior management of a company. This code of conduct should be posted o the website of the company.

2. All Board members and senior management personal shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO and COO.

To safeguard the interest of small shareholders and stakeholders clause 49 has many tight provision for the appointment of independent directors. Appointment of independent director will certainly change the face of Indian Corporate. To follow and implement the new law Indian Corporate need huge number of independent directors. As Business Standard said (April 11, 2005) that:

“India Inc will require over 15,000 trained independent directors before the end of 2005, as most of the existing independent directors will fail to make the grade once Clause 49 of the listing agreement comes into effect from January 1, 2006, according to the UK-based World Council for Corporate Governance (WCCG), a global body that promotes greater boardroom transparency.”

The New Law disqualifies the company’s existing legal, audit or consultancy associate, or suppliers, and relatives of promoters to be independent directors. It even disallows a shareholders with more than a 2% stake in a company form being as independent director, as well as former senior executives who left the company less than three years ago. All this make the situation more stringent for the Indian Corporate.

Situation is more difficult for many family-owned companies which feel that giving up half the board positions to independent directors is hardly fair when they own the lion’s share of the company.

Under the new Board Members be responsible for a variety of legal compliances issues about which they may not have personal knowledge. This will require host of compliance officers since the law in question are diverse and compliance officer will also have to be diverse – accountant, lawyers and engineers. This will certainly increase the expenditure of compliance.

What will be the role of independent directors in public sector is a critical issues. As will independent directors in oil companies force their boards to oppose the government’s policy of enforcing these companies to absorb the rising oil process. In India we need a Corporate Governance code which is rooted in Indian Corporate reality. In today era of consumerism, in the long run only those companies are going have healthy balance sheet that willingly follows high standards of ethics and corporate standards.

To ensure corporate governance the securities and Exchange Board of India (SEBI) has stipulated that effective from January 2006 at least one-third of the directors on the board of a company should comprise "independent directors". Known as 'revised clause 49', SEBI has fixed the December 31, 2005 as the date by which all the listed that all listed entities would have to comply with clause 49.

The revised clause 49 stipulates that in companies which have executive chairmen, 50% of board should constitute independent directors. For companies with non-executive chairmen one-third of the board must comprise independent directors.

The companies which will not be ensure it may have to face penalties such as suspension of trading and delisting from the stock exchange. While SEBI can delist a company for non-compliance, even individual stock exchanges have been empowered to suspend the trading of shares of defaulting companies. Acoording the clause the functions of the board of the directors now includes:

- The corporate as well as the operational strategy
- Policies determining the terms of employment of the top management; its performance evaluation, compensation and succession, etc.
- Determining and propagating the right values and culture in the organisation.
- Ensuring healthy governance practices within the organisation
- Ensuring co-ordination between the CEO and the top management and balancing the relationship with various stakeholders
- Statutory Responsibilities
- Ensuring legal compliance with 'clause 49' of SEBI's 'listing agreement'

Now companies are to form various committees like a 'nomination committee', 'compensation committee', 'governance committee' and other committees like to adhere to corporate governance.

The function of the 'compensation committee' for instance, is to ensure credible and transparent policy in determining and accounting for specific remuneration packages for executive directors including pension rights and any compensation payment. According to the new law the nomination committee of the board to be composed entirely of independent directors, who will be responsible for the evaluation and nomination of board members.

Companies Act defined the Independent Director in following manner:

- Are not relatives of the chairman, managing director, whole time director, or the company secretary
- Should not have been auditors, internal auditors, legal advisors or consultants to the company during any of the preceding three financial years
- Should not have been suppliers, vendors or customers of the company
- Should not hold below two per cent of the shares of the company, presently or in past
- Should not have held any position in the company
- Should not have been a director for a continuous period of nine years
- Nominee directors of banks or FIs cannot be considered independent directors

Independent directors according to SEBI's clause 49 of the listing agreement:

- Should not be related to promoters or the management at the board level or at one level below the board
- Should not have been a partner or an executive of the statutory audit firm or an internal audit firm or legal and consultancy firm, during the last three years
- Should not have been suppliers, service providers or customers of the company
- Should hold below two per cent of the shares of the company
- Should not have been an executive of the company in the immediately preceeding three financial years
- Appointment of non executive director a beyond continuous period of nine years not permissible
- Nominee directors of banks or FIs will be considered as independent directors

Table 7.1: Instructions Organization have to Follow to have Corporate Governance

- 50% of the board should comprise of non-executive directors
- If Chairman is Executive, 50% of Board consisting of Independent Directors
- Else 1/3 of BoD should be independent
- Nominee Directors
- Information to be made available

Management Discussion and Analysis report to be attached with annual report. The following should be covered:

- Opportunities and Threats
- Segment-wise or product-wise performance
- Outlook
- Risks and concerns
- Internal control systems and their adequacy
- Discussion on financial performance with respect to operational performance
- Material developments in Human Resources /Industrial Relations front, including number of people employed

Corporate governance improves the economic efficiency of a firm. Corporate Governance emerges from the culture and mindset of management and cannot be regulated legislation alone. Corporate Governance ensures that organization works in the interest of all the stakeholders, it ensures that corporate doesn’t work in the favor of majority shareholders. It is about openness, integrity and accountability. It take cares of that management act as trustees of the shareholders at large and prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

7.7 LET US SUM UP

Corporate Governance is a buzzword today in Corporate. After the fiasco of Enron and Global Trust Bank and after various corporate scams the importance of corporate governance increase very much. Corporate Governance is about governing the corporate in the interest of the every shareholder in a fair manner that should not be biased towards majority shareholders. Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.

Corporate Governance is concerned with governing or regulatory body (e.g. the SEBI), the CEO, the board of directors and management. Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large. Corporate Governance ensures efficient use of resources. It provides for choosing the best managers to administer the scarce resources. It helps the managers to remain focused on improving performance, making sure that they are replaced when they fail to do so. It pressurizes the organization to comply with the laws, regulations and expectations of society. It increases the shareholders value which attract more investors, thus Corporate Governance ensures easy access to capital. As corporate governance leads to higher consumers satisfaction thus it helps in increasing market share and sales. Thus it also reduces the advertising and promotion cost.

Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance – a voluntary code published by the CII, and the first formal regulatory framework for listed companies specifically for corporate governance, established by the SEBI. SEBI constituted various committees for the implementation of Corporate Governance in India. These Committees are Birla Committee under the Chairmanship of Kumar Manglam Birla, and Narayan Murthy committee under the chairmanship of Sri N.R. Narayana Murthi. Recommendation of these committees are implemented by SEBI. On there recommendation SEBI also introduce the clause 49 to ensure better corporate governance by inducting more and more independent directors in the Board.

7.8 LESSON END ACTIVITIES

1. Pick few companies and find the change in their Board Members after the implementation of Clause 49.
2. Pick few companies and out relationship between profit and corporate governance.

7.9 KEYWORDS

Corporate governance: Corporate Governance is the system by which businesses are directed and controlled.

CII: Confederation of Indian Industries.

SEBI: Securities and Exchange Board of India.

Narayan Murthy Committee: Committee constituted by SEBI on Corporate Governance under the chairmanship of Sri N.R. Narayana Murthy.

KM Birla Committee: KM Birla committee was a 19 member committee appointed by SEBI on 7th May 1999 on Corporate Governance.

Clause 49: Clause introduce by SEBI for the implementation of Corporate Governance.

7.10 QUESTIONS FOR DISCUSSION

1. What is corporate governance? Discuss the scope and importance of corporate governance.
2. Write a brief note on the development of corporate governance in India.
3. Write short notes on: (a) Birla Committee, (b) Narayan Murthy Committee, (c) Clause 49, (d) Independent Director.

Check Your Progress: Model Answers

CYP 1

At its broadest, corporate governance comprehends the framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations.

CYP 2

Corporate Governance is concerned with governing or regulatory body (e.g. the SEBI), the CEO, the board of directors and management. Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large.

CYP 3

There should be an Audit Committee, which shall have access to all financial information. Major role of Audit Committee is to have an oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

Contd…

CYP 4

1. Corporate governance
2. McKensey
3. Trusteeship
4. CII,
5. KM Birla

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UNIT III

LESSON

8

GLOBALISATION

CONTENTS

8.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept of Globalisation
- Know the reasons of Globalisation
- Know how organization should cope with Globalisation

8.1 INTRODUCTION

The many meanings of the word "Globalisation" have accumulated very rapidly, and recently, and the verb, "globalize" is first attested by the Merriam Webster Dictionary in 1944. In considering the history of Globalisation, some authors focus on events since 1492, but most scholars and theorists concentrate on the much more recent past. Globalisation is not just a recent phenomenon.

Long before 1492, people began to link together disparate locations on the globe into extensive systems of communication, migration, and interconnections. This formation of systems of interaction between the global and the local has been a central driving force in world history.

In 325 BCE, Chandragupta Maurya becomes a Buddhist and combines the expansive powers of a world religion, trade economy, and imperial armies for the first time. Greeks (Selukas) sues for peace with Chandragupta in 325 at Gerosia, marking the eastward link among overland routes between the Mediterranean, Persia, India, and Central Asia.

By 1350, networks of trade which involved frequent movements of people, animals, goods, money, and micro-organisms ran from England to China, running down through France and Italy across the Mediterranean to the Levant and Egypt, and then over land across Central Asia (the Silk Road) and along sea lanes down the Red Sea, across the Indian Ocean, and through the Straits of Malacca to the China coast. 1492 and 1498: Columbus and Vasco da Gama travel west and east to the Indies, inaugurating an age of European sea-borne empires.

In South Asia, it should be noted, the Delhi Sultanate and Deccan states provided a system of power that connected the inland trading routes of Central Asia with the coastal towns of Bengal and the peninsula and thus to Indian Ocean trade for the first time.

The commodities trades continued as before well into the seventeenth century, concentrating on local products from each region of the Eurasian system – Chinese silk and porcelain, Sumatra spices, Malabar cinnamon and pepper, etc. – but by the 1600s, the long distance trade was more deeply entrenched in the production process. An expansion of commercial production and commodities trades was supported by the arrival into Asia of precious metals from the New World, which came both from the East and West (the Atlantic and Pacific routes – via Palestine and Iran, and also the Philippines and China).

Liberalisation of the 19th century is often called "The First Era of Globalisation". The "First Era of Globalisation" is said to have broken down in stages beginning with the first World War, and then collapsing with the crisis of the gold standard in the late 1920's and early 1930's. Countries that engaged in that era of Globalisation, including the European core, some of the European periphery and various European offshoots in the Americas and Oceania, prospered. Inequality between those states fell, as goods, capital and labour flowed remarkably freely between nations.

20th century is also governed by Economic Nationalism. Most of the nations of even Europe followed policy of economic nationalism. Though after second world war economic nationalism became the key factor for the most the nations in Asia and Europe. Even the nations like USA and France are not untouched with phenomenon of Economic Nationalism. As when USA started loosing jobs because of Globalisation it reacted sharply, not only this in 20th century itself it took various measures to protect its domestic industry like Automobile and Motorcycle. As it imposed quantitative restrictions on the imports of automobiles from Japan. Same way when in 2006 an Britain based NRI make a bid for the Europe's largest Steel Maker France reacted sharply.

Economic Nationalism is a term used to describe policies which are guided by the idea of protecting domestic consumption, labor and capital formation, even if this requires the imposition of tariffs and other restrictions on the movement of labour, goods and capital. It is in opposition to Globalisation in many cases, or at least it questions the perceived benefits of unrestricted free trade. Economic nationalism may include such doctrines as protectionism and import substitution.

8.2 GLOBALISATION

People around the globe are more connected to each other than ever before. Information and money flow more quickly than ever. Goods and services produced in one part of the world are increasingly available in all parts of the world. International travel is more frequent. International communication is commonplace. This phenomenon has been titled "Globalisation."

It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labor) and knowledge (technology) across international borders.

Globalisation (or Globalisation) is a modern term used to describe the changes in societies and the world economy that result from dramatically increased international trade and cultural exchange. It describes the increase of trade and investing due to the falling of barriers and the interdependence of countries. In specifically economic contexts, it is often understood to refer almost exclusively to the effects of trade, particularly trade liberalisation or "free trade".

The IMF defines Globalisation as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology" (IMF, World Economic Outlook, May, 1997). The World Bank defines Globalisation as the "Freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries".

"Globalisation" can mean:

- It shares a number of characteristics with internationalization and is often used interchangeably, although some prefer to use Globalisation to emphasize the erosion of the nation-state or national boundaries.
- ***The formation of a global village:*** Closer contact between different parts of the world, with increasing possibilities of personal exchange, mutual understanding and friendship between "world citizens", and creation of a global civilization.
- ***Economic Globalisation:*** There are four aspects to economic Globalisation, referring to four different flows across boundaries, namely flows of goods/services, i.e. 'free trade (or at least freer trade), flows of people (migration), of capital and of technology. A consequence of economic Globalisation is increasing relations among members of an industry in different parts of the world (Globalisation of an industry), with a corresponding erosion of National Sovereignty in the economic sphere.
- In the field of Management Globalisation is a Marketing or Strategy term that refers to the emergence of international markets for consumer goods characterized by similar customer needs and tastes enabling, for example, selling the same cars or soaps or foods with similar ad campaigns to people in different cultures. This usage is contrasted with internationalization which describes the activities of multinational companies dealing across borders in financial instruments, commodities, or products that are extensively tailored to local markets.

Globalisation offers extensive opportunities for truly worldwide development but it is not progressing evenly. Some countries are becoming integrated into the global economy more quickly than others. Countries that have been able to integrate are seeing faster growth and reduced poverty. Outward-oriented policies brought dynamism and greater prosperity to much of East Asia, transforming it from one of the poorest areas of the world 40 years ago. And as living standards rose, it became possible to make progress on democracy and economic issues such as the environment and work standards.

The removal of barriers to the movement of goods and services and in some cases even the movement of personnel led to the increasing specialization of nations in exports, to get engage in those goods in which they have comparative advantage over other, as rest can be imported at much economical price internationally instead of manufacturing it locally. Over the past two decade's world is observing following trends towards Globalisation.

Check Your Progress 1

Define the following:

1. Economic nationalism

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. Globalisation

   ……………………………………………………………………………….

   ……………………………………………………………………………….

8.3 CHARACTERISTICS OF GLOBALISATION

1. Over the past two decades, there is a rapid Globalisation of markets and production.
2. The Globalisation of markets implies that national markets are merging into one huge marketplace.
3. Erosion of national sovereignty and national borders through international agreements leading to organizations like the WTP and EU.
4. Development of Global Financial System.
5. Reduced transportation costs, especially from development of containerization for ocean shipping.
6. The Globalisation of production implies that firms are basing individual productive activities at the optimal world locations for the particular activities. As a consequence, it is increasingly irrelevant to talk about American products, Japanese products, or German products, since these are being replaced by "global" products.
7. Two factors seem to underlie the trend toward Globalisation: declining trade barriers and changes in communication, information, and transportation technologies.
8. Since the end of World War II, there has been a significant lowering of barriers to the free flow of goods, services, and capital.
9. Increase in international flow of capital.
10. Increase in the share of the world economy controlled by multinational corporations.
11. Increased role of international organizations such as WTO, WIPO, IMF that deal with international transactions.
12. Increase of economic practices like outsourcing, by multinational corporations Elimination of capital controls.
13. Intellectual Property Restrictions.
14. Harmonization of intellectual property laws across nations (generally speaking, with more restrictions).
15. Supranational recognition of intellectual property restrictions (e.g. patents granted by China would be recognized in the US).

16. As a consequence of the Globalisation of production and markets, in the last decade world trade has grown faster than world output, foreign direct investment has surged, imports have penetrated more deeply into the world's industrial nations, and competitive pressures have increased in industry after industry.

17. The development of the microprocessor and related developments in communication and information processing technology have helped firms link their worldwide operations into sophisticated information networks.

18. Development of a global telecommunications infrastructure and greater trans-border data flow, using such technologies as the Internet communication satellites and telephones.

19. Increases in the number of standards applied globally; e.g. copyright laws and patents.

20. The most dramatic environmental trend has been the collapse of Communist power in Eastern Europe, which has created enormous long-run opportunities for international businesses. In addition, the move toward free market economies in China, Latin America and India is creating opportunities (and threats) for Western international businesses.

21. The benefits and costs of the emerging global economy are being hotly debated among businesspeople, economists, and politicians. The debate focuses on the impact of Globalisation on jobs, wages, the environment, working conditions, and national sovereignty.

22. Some argue that even terrorism has undergone Globalisation with attacks in foreign countries that have no direct relation with the own country.

23. Culturally

    - ❖ Greater international cultural exchange.
    - ❖ Spreading of multiculturalism and better individual access to Cultural diversity.
    - ❖ The imported culture can easily supplant the local culture, causing reduction in diversity through hybridization or even assimilation.
    - ❖ The most prominent form of this is Westernization but Sanitization of cultures also takes place.
    - ❖ Greater international travel and tourism.
    - ❖ Greater immigration including illegal immigration.

24. Managing an international business is different from managing a domestic business for at least four reasons:

    (i) Countries are different,

    (ii) The range of problems confronted by a manager in an international business is wider and the problems themselves more complex than those confronted by a manager in a domestic business,

    (iii) Managers in an international business must find ways to work within the limits imposed by governments' intervention in the international trade and investment system, and

    (iv) International transactions involve converting money into different currencies.

In nutshell all the Globalisation can be characterized by four key factors which resulted in Globalisation:

1. Emergence of international organization specifically WTO. (Reduction in Tariff)

2. Emergence of Regional Trade Agreements/FTA as ASEAN, NAFTA. (Reduction in Tariff)
3. Growing role of Multinational Corporations.
4. End of Cold War/ Paradigm shift in erstwhile socialist economies
5. Emerging Technology

1. By signing the WTO more than 150 nations get agree to either reduce or to eliminate tariffs and to eliminate non tariff barrier. This results in a free flow of factors of production that is capital, labour, machines and raw material. Every next year the list of items with reduced tariffs increased. Hence world is becoming borderless as far as trade is concern and organizations have wide opportunities in terms of new market, new source of raw material and human resource and capital.
2. While the pace of scheme of eliminating trade barrier is slow at WTO and at many times faces bottleneck in talks in the crucial issues like Agriculture or NAMA, regional groupings have achieved remarkable success in not only in reducing tariff rather in eliminating them at least at regional level. As there is no trade barrier in NAFTA countries that is USA, Canada and Mexico. EU have gone one step ahead and launched one currency euro which is accepted in most EU nations. ASEAN is also eliminating their trade barrier. There is all possibility that in few years whole world will be divided into few regional economic groups.
3. Multinational Corporations: It has been said that the multinational corporation (MNC) is the most powerful institution in the world today. Indeed, the process of Globalisation, which is radically transforming our world, is driven in large part by the rapid growth and spread of corporations. Since the end of the Cold War in 1991, nearly all nations in the world have reduced the role of the state in the economy and lowered barriers to the international movement of goods, services, capital, ideas and technology. As the walls imposed by nations/states have crumbled, multinational corporations have thrived, spreading across the globe in search of new markets and factors of production. MNCs have expanded across national borders in two ways: trade and Foreign Direct Investment (FDI). Each has contributed to stable, lasting benefits to the world economy.

   The increasing power of the Multinational Corporation (MNC) is beyond doubt. The production of MNCs amounts to approximately one-quarter of world output. Fifty-one of the world's largest 100 economies are corporations, not countries. The total value of foreign sales of MNCs now exceeds world exports of goods and services, and intra-firm trade alone by MNCs accounts for about one-third of world trade. There are now approximately 63,000 multinational corporations – defined as firms that engage in international production – with over 690,000 foreign affiliates. In 1997, these firms controlled $12 trillion in foreign assets, employed 30 million workers and earned $9.5 trillion in revenues – larger than the annual GDP of the United States or the European Union (EU). The rapid growth of MNCs is a direct result of the worldwide liberalisation of trade and investment. Corporations have grown larger because they now compete in much bigger markets.
4. End of cold war and paradigm shift in the erstwhile socialist countries also brought significant change in world. International event like dismantling of USSR and end of Communist regime not only from USSR but from also Eastern Europe, unification of Germany, Communist Govt. of China inviting FDI, and erstwhile closed economy like India following a policy of Liberalisation, Privatization and Globalisation etc have contributed in changing whole world into one economic theater.

5. Technology is working as catalyst to multiply the pace of Globalisation. New technology of communication has brought significant changes in way, the business is done. Because of communication technology organizations are fragmenting there operations all over world. As now organizations are establishing there basic research centers in USA and Britain, value added research centers at China and India, production facilities are shifted to South East Asia, India, China or Mexico, designing is going on in Italy and France, quality control methods are applied from Japan and then product is marketed all over world. All these activities can be coordinated and managed only through the modern means of communication and technology. It because of technology only those organizations are able to take the advantage of such big opportunities.

8.4 IMPACT OF GLOBALISATION ON THE FUNCTIONS OF CORPORATIONS

Globalisation has influenced the every part of the Globe. Corporations are changing there strategies and are reorganizing there function to cope up with the changed scenario. In the changed scenario they are reorganizing and bringing change in all its functions whether it is production process or location, Product strategy, Marketing, Finance, HR policies etc. Few changes which an organization has to brought are as follows:

8.4.1 Designing in Global Environment

If managing product development processes was a challenge before, it is not getting any easier as companies continue to adopt global design strategies. Global design has cost benefits that are very attractive to today's manufacturer, but adds new Product Lifecycle Management (PLM) challenges and intensifies existing problem areas such as protecting intellectual property. Designing products in a distributed approach makes classic control, communication, and collaboration even more challenging, requiring better management of product innovation, product development, and engineering processes and new approaches to sharing product designs.

8.4.2 Production Location Selection

Jeffrey Immelt of GE Medical Systems (GEMS), pushed for acquisitions to build up scale because, for the leading global competitors, an R&D-to-sales ratio of at least 8 percent represented a significant source of scale economies. But he also implemented a production strategy that was intended to arbitrage cost differences by concentrating manufacturing operations—and, ultimately, other activities—wherever in the world they could be carried out most cost effectively. By 2001, GEMS obtained 15 percent of its direct material purchases from, and had located 40 percent of its own manufacturing activities in, low-cost countries.

8.4.3 Rationalized Production

Companies produce different components or different portions of their product line in different parts of the world to take advantage of low labor costs, capital, and raw materials. This is rationalized production. In a new Globalised world production rationalization is easier. As now organization can outsource or can established there own production units in those areas where it is more economical. As GE use Mexico as a manufacture base for labor-intensive operations. Today Japan sales a Japanese car to American consumer which is making in USA and Americans are selling American cars which are made in Japan. Not only this British Firms sell British Cricket Bat which are made in India, Asia manufactures the sports shoes for almost all the major sports shoe manufacturers, much of the production of motherboards for PCs is located in Taiwan, in microwave ovens, Japanese brands have less than a 50% share of the US market, but manufacturing share of Japanese companies is over 70%. After the liberalisation in economies India and China a great shift in location is going on as more and more organizations are shifting there labor intensive operations to these locations.

Thailand, Vietnam, Indonesia, Malaysia, Philippines, Singapore, and Brunei Darussalam are small countries themselves but as they become member of ASEAN the whole region became very attractive from business point of view and more and more companies started establishing there manufacturing unit there to take the advantage of cost and vast market. And today this region is one of the most active business hub.

Vertical Integration

Vertical Integration is a company's control of the different stages in a value chain of making of product- from raw material to production to final distribution of product. As international trade barriers are eliminating organizations can combine resources located in more than one country. As Indian petroleum companies who have world class refining capacities import petrol but as in new system they are allowed to invest overseas they are acquiring oil wells overseas to ensure regular supply of oil in future, same way Shell acquire oil well all over world and have refinery all over world. Companies are vertically integrating themselves. Recently to integrate vertically Videocon acquired the picture tube manufacturing capacities of Thomson with this acquisition Videocon get access to Picture Tube manufacturing in many countries including Europe. Asian Paints also have its operations in more than 27 nations. Ranbaxy and Dr. Reddy's Lab is also taking locational advantage by doing Horizontal integration by acquiring generic pharmaceutical organization in USA , Europe, Israel and other nations.

Product Strategy

It was a Coke CEO, the late Roberto Goizueta, who declared in 1996: "The labels 'international' and 'domestic'…no longer apply." His Globalisation program, often summarized under the tagline "think global, act global," had included an unprecedented amount of standardization. By the time he passed away in 1997, Coca-Cola derived 67 percent of its revenues and 77 percent of its profits from outside North America. To cross borders organization has to face a very critical question that is Product Standardization vs. Product Adaptation.

Standardization gives the advantages in the production and distribution of products and services. If cost is the decisive factor as in case of most commodities like steel the answer is economies of scale and through standardization an organization can fulfill the demand of many nations through one plant. Even in consumer goods economies standardization work at least at regional level as in India Chinese are toys are very successful and after reduction of tariff barrier they have almost captured the Indian market. Same way in industrial goods like Processors, RAM, Chemicals, etc standardization can save millions of Dollars and Globalisation helps in establishing Global plants which is win-win situation as organization reduces the cost and customer gets the product at economical price. Standardization is not possible in all the goods, specifically in most of the consumer goods.

In many goods product adaptation is essential to meet the local conditions or preferences. Some time adaptation is mandatory because of Govt.'s regulation, Local Standards (as Electrical), Measurement Standards and Product Standards and Systems. Some time product modification is done only because of making it fit for specific distribution channel as in India COCA - COLA is distributed in glass bottles which are reused on the other hand in USA they use Tin which are not recollected from the outlet. Product adaptation increases the cost. Some time when product is new to new market as few years back electric shaver to Indian market then issue of adaptation and standardization become crucial as sales volume don't justify the adaptation and the standard product don't suit the local requirement.

But organization has to choose a trade off between standardization and product adaptation.

Besides these Globalisation have influenced every aspect of organization as it may be the Sales Promotion, Research, Market Research, Distribution Strategies, Product Development Strategies etc.

After the implementation of GATS (General Agreement on Trade and Tariffs) and clause of free movement of labor in most of regional trade agreements the HR policies have seen significant change. More and more organization are adopting international HR standards because:

1. As job hopping may increase after this new opportunities will be available
2. When an MNC follows international standards in a new territory local industry also learns and follow international HR standards.
3. Because of free movement of capital and goods competition increases because of FDI and imports in this situation a Business Unit can survive only by providing a world class product. And to provide world class product it must have HR of international standards and it has to invest in the nourishment of that HR.
4. When cost of HR is a significant cost of production as in case of Software or Service industry the new trend is that shift the location of the unit where HR is available in abundance. It is the reason that more and more software companies are coming to India.

Check Your Progress 2

Fill in the blanks:

1. The verb, "globalize" is first attested by the ___________Webster Dictionary in 1944.
2. NAFTA countries that is USA, Canada and______________.
3. EU have gone one step ahead and launched one currency _____________ which is accepted in most EU nations.
4. ________________ Integration is a company's control of the different stages in a value chain of making of product.
5. _________________ acquired the picture tube manufacturing capacities of Thomson.

8.5 LET US SUM UP

The verb, "globalize" is first attested by the Merriam Webster Dictionary in 1944. The IMF defines Globalisation as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology" In nutshell all the Globalisation can be characterized by four key factors which resulted in Globalisation:

1. Emergence of international organization specifically WTO.(Reduction in Tariff)
2. Emergence of Regional Trade Agreements/FTA as ASEAN, NAFTA. (Reduction in Tariff)
3. Growing role of Multi-national Corporations.
4. End of Cold War/ Paradigm shift in erstwhile socialist economies
5. Emerging Technology

Corporations are changing there strategies and are reorganizing there function to cope up with the changed scenario. In the changed scenario they are reorganizing and bringing change in all its functions whether it is production process or location, Product strategy, Marketing, Finance, HR policies etc.

8.6 LESSON END ACTIVITIES

1. Prepare an impact on the impact of Globalisation on Indian Industry.
2. "Globalisation is a threat or opportunity for Indian organization". Discuss the statement.

8.7 KEYWORDS

Nationalism Economic: Nationalism is a term used to describe policies which are guided by the idea of protecting domestic consumption, labor and capital formation.

FTA: Foreign Trade Agreements.

ASEAN: Association of South East Asian Nations.

8.8 QUESTIONS FOR DISCUSSION

1. Define Globalisation and its characteristics.
2. Discuss the impact of Globalisation on the strategies of the organizations.

Check Your Progress: Model Answers

CYP 1

1. Economic nationalism is a term used to describe policies which are guided by the idea of protecting domestic consumption, labor and capital formation, even if this requires the imposition of tariffs and other restrictions on the movement of labour, goods and capital.
2. The IMF defines Globalisation as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology".

CYP 2

1. Merriam,
2. Mexico,
3. Euro,
4. Vertical,
5. Videocon

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LESSON

9

MULTINATIONAL CORPORATIONS

CONTENTS

9.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the characteristics of multinational corporations
- Explain various types of multinational corporations
- Discuss the impact of multinational corporations on origin country and target country
- Understand the Indian multinational firms

9.1 INTRODUCTION

It has been said that the multinational Corporation (MNC) is the most powerful institution in the world today. Indeed, the process of globalization, which is radically transforming our world, is driven in large part by the rapid growth and spread of corporations. Since the end of the Cold War in 1991, nearly all nations in the world have reduced the role of the state in the economy and lowered barriers to the international movement of goods, services, capital, ideas and technology. As the walls imposed by nations/states have crumbled, multinational corporations have thrived, spreading across the globe in search of new markets and factors of production. MNCs have expanded across national borders in two ways: trade and Foreign Direct Investment (FDI). Each has contributed to stable, lasting benefits to the world economy.

Although modern multinational firms date from the late nineteenth century, the term Multinational Corporation did not appear until 1960. At a conference at Carnegie Mellon University, David Lilienthal (1960) distinguished between portfolio and direct investment and then defined 'Such corporations – which have their home in one country but which operate and live under the laws of other countries as well..' as multinational corporations. It is of interest that from the start the multinational corporation was defined in terms of jurisdiction and potential jurisdictional conflict.

The modern multinational corporation has its roots in the Dutch and British East India Companies of the 17th century. These companies imposed some semblance of order, often forcefully and illegitimately, on the world of commerce, which until then was ruled by economic anarchy. Where once pirates threatened trade and commerce, the East India companies assembled armies and erected fortresses to protect their pursuit of profit. They often gained market share by force – against rivals, including one another, and against the inhabitants of lands they wished to colonize. Typically, the companies demanded free trade and local monopoly rights in the markets in which they operated so as to maximize profits. These predatory practices impacted the colonized lands for the worse.

Multinationals Corporations are major player in the international business. In an era of WTO, Regional Groupings, Liberalization, and Globalization role of MNCs have increased tremendously. Almost ¾ of total GDP of South Korea comes from only 5 MNC of South Korea. Out of 50 largest "economies" 14 are MNCs. In America, Japan, South Korea, Singapore, Malaysia, etc. There are now approximately 63,000 multinational corporations – defined as firms that engage in international production – with over 690,000 foreign affiliates. In 1997, these firms controlled $12 trillion in foreign assets, employed 30 million workers and earned $9.5 trillion in revenues – larger than the annual GDP of the United States or the European Union (EU). The rapid growth of MNCs is a direct result of the worldwide liberalization of trade and investment. Corporations have grown larger because they now compete in much bigger markets.

Table 9.1: An Overview of the Richest Economic Entities the World Over

	Country	**MNC Revenue / GDP (US$ billions)**
1.	US	10,417
2.	Japan	3,979
3.	China	1,237
4.	India	515
5.	WALMART	287
6.	BP	285
7.	Exxon Mobil	270
8.	Royal Dutch	268

MNC plays a significant role in all aspect of life even they play significant role in a national politics. Most of the MNCs work on the philosophy of that Merchant doesn't have any nationality. USA has a maximum number of MNCs. In Asian countries Japan had maximum number of MNCs.

9.2 MULTINATIONAL CORPORATION (MNCs)

MNCs are defined as and enterprises that is headquartered in one country but has operations in two or more countries. Sometimes it is difficult to know if a firm is an MNCs because multinationals often downplay the fact that they are foreign held. For example most of people in India are unaware that Bata is a Canadian company Bayer is German company, Nestle is a Swiss company, Cadbury is British company. Various definitions have been given to describe to MNCs. Sak Onkwist and John J. Shah have described MNCs in following manner:

Definition by Size

MNCs refer to company which is big in size. Bit this size has many dimensions. One company may be big in terms of turnover and another may be in terms of Profit and still another in terms of market value. But corporate size in terms of sales is primarily used to describe one company as Multinational Corporation. World Investment Report 1997 indicate that there were about 45,000 MNCs with some 2,80,000 affiliates, according to the World Investment Report 2002 there were about 65000 of them with about 8.5 Lakh foreign affiliates. But corporate size cant be used as criterion to be classified as MNC. As GM does not become multinational because it was large but it became large as a result of going international.

Definition by Structure

Structural definition defines MNC in terms that in how many country firm is operating and by citizenship of corporate owners and top managers. For example Coca Cola operates in approx 200 nations and wide spread share holdings. The board room and top management of top companies is becoming global.

Definitions by Performance

Definitions by performance depends on such characteristics as earnings, sales and assets. These performance characteristics indicate the extent of the commitment of corporate resources to foreign operations and the amount of reward from that commitment. As major junk of revenue of coca cola comes from overseas operations. In India Ranbaxy is considered as true MNC as half to its turnover comes from overseas market and this proportions is expected to significantly increase in coming years.

Human Resource or overseas employees are customarily considered as part of the performance requirement rather than as part of the structural requirement. Willingness of company to use overseas personnel is a significant criterion for multinationalism.

Definition by Behavior

According to this definition it is the behavioral characteristics of top management which decides that firm is a multinational or not. Thus a company becomes more multinational as its management more internationally. If a management has a geocentric thinking them this firm is treated as true MNC. In Geocentric approach firm considers the whole world rather than particular country as its target market.

9.3 MULTINATIONAL, GLOBAL, MULTI-DOMESTIC AND TRANSNATIONAL

Multinational, Global, International and Transnational are terms which are frequently used to describe the organizations which are operating in more than one nations. Though usually theses terms are used interchangeably but these terms have specific meanings.

9.3.1 Multinational Enterprises (MNE)

Multinational enterprises (MNE) is a company that takes a global approach to foreign markets and production; thus it is willing to consider market and production location anywhere in the world. The term Multinational Corporations (MNCs) is also commonly used in the international business arena and often is a synonym for MNE. Usually most of the authors prefers the MNE there are many international firms which are not organized as corporations.

9.3.2 Transnational Companies (TNCs)

Transnational Companies (TNCs) is a termed used by United Nations and most of developing nations for multinational firms. This term is used in two contexts. Some writers use this term for a company that is:

1. trying to achieve economies of scale through global integrations of its functional area while at the same time
2. highly responsive to different locational environment (a newer name is multicultural multinational).

Business people define transnational company as a firm formed by merger of two firms of approximately the same size that are from two different countries as Royal Dutch Shell is a company that is jointly owned in the United Kingdom and the Netherlands, and its corporate management is split between the two countries. Same way Unilever is a Dutch and English firm, VFK-Fokker (Germany – Netherland aircraft company). Though today frequently this term is used as synonymous for MNE/MNC. MNE as well as any other company can be categorized into two category that is a Global Company and Multi-domestic Company.

9.3.3 Global Company

The term Global Company is widely used for MNE but every MNE is not a Global MNE. Global company is company which has a global vision. It is company which looks for opportunities worldwide, it sources it products, raw material, and financing and personnel worldwide, it seeks to maintain a presence in key markets of world and look for similarities not differences among markets. The biggest characteristic of these company is that it takes the whole world as single market and it standardize operations and its product worldwide in one or more of the firm’s functional areas. If we go strictly by this definition then perhaps there is no Global firm as ever firm do some alteration in its product or functional strategy according to the local condition and if overseas market is as big as that of India and China and certain modifications are essential. Though there are firms who two a extent can be classified as Global firms as Coco Cola, Pepsi, Kellogs, SONY, etc. These are the companies who keep there product portfolio same and manufacture the product for whole world considering them as a single market, though they change many times there functional strategy according to local requirements.

9.3.4 Multi-domestic Company

It is company which treats its every unit operating in different countries as a independent profit center. It allows its foreign country operations to act fairly independently such as by designing and producing a product or service in India for the Indian market and in China for the Chinese market.

Check Your Progress 1

Define the following:

1. Multinational Corporations

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. Global Company

   ……………………………………………………………………………….

   ……………………………………………………………………………….

3. Multi-domestic Company

   ……………………………………………………………………………….

   ……………………………………………………………………………….

9.4 WHY COMPANIES CROSS BORDERS (BENEFITS OF BEING MNCs)

Undoubtedly firms cross the national boundaries and take the risk of operating in unknown environment in the hope of earning more profit increasing share holders wealth, besides this there are many other reasons as survival, new sources of supplies, cheap human resource, and even just to keep busy nearest rival in its home country. Some of the key reason of crossing national boundaries are as follows:

1. ***Survival:*** Most countries are not as fortunate as that of India, Russia, China or USA in terms of size, resources, and opportunities. Most European nations are small in size or most middle east and south east countries are rich in only one or very few resources. In these countries the organization are bound to do business in and with other countries to survive. Not only in these countries even in big countries organization are bound to find new markets for their product and cheap source of resources to remain competitive and to survive.

2. ***Growth of Overseas Market (Sales):*** This is the biggest reason of going abroad. In the past years. In last 20 years many economies have opened there doors for world. This resulted in big opportunity in terms of Market. Most of the European nations, USA, Canada, Japan etc have a stagnant population growth and very low GDP growth all this led to companies to search for new market. Emerging economies that is India, China, South East Asia form significant market perhaps more than 35% of world market give them this opportunity and MNC started expanding its wings in these areas. India and China are among top five countries of world in terms of Purchasing Power Parity. All this attracted many organization to tap new market in emerging economies. Besides this agreement/ groups like GATT, GATS, ASEAN, EU, SAPTA, NAFTA etc have also created huge opportunities of business for organizations To tap these opportunities organization are going abroad.

3. ***Diversification:*** No organization wants to keep all its egg in one basket. Every organization wants to diversify the risk and internationalization is a good manner to diversify the risk. Through internationalization a organization can diversify its risk while sticking to its core competency or old business. As different countries have different trade cycle for same product. When there is a recession in one

economy there may be boom in another economy and organization can cover losses in one country by profits in another country. As Ispat group has steel plant in almost allover world. Which is number two in almost all the countries is number one in terms of sale in India, Levers which is behind P&G in USA as much ahead of P&G in India. Thus MNC diversify risk through internationalization.

4. ***Source of Resources:*** In today's cut throat competition cost cutting is the key to success. Prices are controlled by consumers and the only thing which can be manipulated to increase profit is cost. Organizations go abroad in search of economical source of supply. A truly global firm always locate its processing in the best available location in world and outsource HR and other physical resources from best suited in world. It is the reason that more and more companies are establishing there Call centers in India. Even Wal-Mart the biggest retailer of world doesn't have any retail shop in India have a purchase office in India. Nike get its shoes manufactured in South East Asia. Nokia, IBM, Toyota, Sony, Philips, Samsung, Mitsihuta, Boeing, Airbus, Addidas, GM, Ford, etc have there Manufacturing capacities, Research Center, and ancillary unit at the place which is best suited for them in world. So companies cross the border to have economical source of resources.
5. ***To Protect Market Share:*** Firms also become MNEs in response to increased foreign competition and a desire to protect their home market share. Using a "follow the competitor" strategy, a growing number of MNEs now set up operations in the home countries of their major competitors. This approach serves dual purpose: - (1) it takes away business from their competitors by offering customers other choices and (2) it lets competitors know that, if they attack the MNEs home markets, they will face a similar response.
6. ***Tariff and Non-Tariff Barrier:*** Organizations establish there operation overseas to deal with tariff and non tariff barriers. Many time countries impose tariff and non tariff restrictions on import in such case organization establish their production unit in host country so that it can be treated as local company. As in late 1970 when USA imposes some non tariff restrictions on automobile import of Japan, Japanese firm started establishing there units in USA so that in terms of taxes they can be treated at par with US firms. And soon America become the playground of Japanese firms.
7. ***Technology Expertise:*** A reason for becoming an MNE is to take advantage of technological expertise by manufacturing goods directly (by FDI) rather than allowing others to do it under a license. Many MNCs feel it unwise to give another firm access to proprietary information such as patent, trademarks, or technological expertise.
8. ***To have an access to Economical Human Resource:*** Many a times Companies cross borders to have an access to the economical human resource. As more and more Organizations which used to import Human Resource from country are now establishing there operation in India only to take the advantage of economical human resource. The cost of human resource is rising this is the significant reason why companies are crossing borders.

9.5 IMPACT OF MNC

Multinational firms play a pivotal role in global economy, linking rich and poor economies, and transmitting capital, knowledge, ideas and value systems across borders. Their interaction with institutions, organizations and individuals is generating positive and negative spillovers for stakeholders in host countries. In consequence they have become focal points in the popular debate on the merits and dangers of globalization, especially when it comes to developing countries. MNE are profit maximizing, and thus naturally not interested in creating benefits for others without obtaining a good price for it.

9.5.1 Impact on the Trade Balance

The second macroeconomic effect of FDI is their impact on the trade balance. MNEs have a competitive advantage in both accessing global markets in importing their products to local markets. The ability to produce at central locations with large economies of scale and supply markets in several countries is a core strategy of in many manufacturing MNEs. Hence, they frequently export more than domestic firms, but also import a larger share of their inputs. A large share of both exports and imports is typically to or from affiliated companies, i.e. intra-firm international trade. Any analysis of trade impact of FDI has to consider their impact on both exports and imports.

Table 9.2: Impact on Balance of Payment on Selected Items

Balance of Payment	
Capital Outflows	**Capital Inflows**
Imports	**Exports**
Import - Intermediate goods for local assembly and sale - Machinery for local production facilities - Investors' global products for local sale *Service imports* - Fees for licenses and other services *Capital Import* - Initial equity investment - Loans from parent to affiliate	*Export* - Final goods for global markets - Intermediate goods for global markets *Service exports* - Tourism and business travel receipts *Capital Export* - Profit remittance - Interest payments - Repayment of loans

If a country runs a trade deficit, it must compensate for that deficit by reducing its reserves or receiving an influx of capital. The more capital inflow a country receives the more it can import and the more it can run a trade deficit. In recent times FDI helped a lot to Indian in managing trade deficit.

Moreover, MNEs may open new export markets, and open up new export markets for local followers that can build on the country of origin reputation that foreign investors may help building, and use the same trade channels. MNEs are more likely to share such general knowledge, as it is less industry-specific and not part of their core capabilities and its diffusion to local businesses does not endanger their own competitive advantage.

9.5.2 Promote Small Scale/Ancillary Industry

MNCs often catalyze the export of complex, technology-intensive products made by small - and medium-size firms (SMEs) located in host countries. For example, approximately two-thirds of consumer electronic products made in Korea and Taiwan are sold to MNCs such as GE, IBM and Toshiba on an "original equipment manufacture" basis. In India too companies like Maruti Suzuki, Hyundai, Samsung, LG, etc do most of their purchases from India itself it promotes ancillary industry.

9.5.3 Knowledge Transfer

Host countries, especially developing economies, aim to create indigenous technological capabilities", that is "skills - technical, managerial and institutional - that allow productive enterprises to utilize equipment and technical information efficiently. Foreign investors are a potential source for knowledge at the technical and systemic level. They can contribute not only by transferring information, but also by stimulating directly or indirectly the generation of new knowledge in the host country.

Multinational firms possess some firm-specific advantages that can be profitably combined with locational advantages at a site outside their home country. Knowledge transfer raises the productivity of the subsidiary in the host economy and thus contributes to tax revenues and national income and, possibly creates spillovers to the local economy.

9.5.4 Improves the Technology Level of Local Firms

In the era of globalize capital markets, where overseas borrowing can be used to supplement domestic savings, the importance of FDI perhaps lies less in the quantity of capital inflow than on its ability to transfer technology and business best practices to the domestic firms in the host country. Transfer of technology and business best practices significantly improves the productivity of domestic firms in the recipient countries, these firms would improve their international competitiveness, and the impact of this spillover effect on the economy of the recipient country is arguably much greater than the impact of the FDI itself. To maximize such benefits to local firms, governments in many developing countries have stipulated that foreign firms set up business operations in these countries in the form of Joint Ventures (JVs), assuming that such cooperation among multinational enterprises and their local partners would facilitate the transfer of technology and business practices.

Technology and business best practices are equally likely to be transferred from MNEs to domestic firms in developing countries by way of migration of labour from the former to the latter it is well proven truth for Indian software industry Labor and executive mobility can thus enhance productivity throughout the economy by transferring tacit knowledge that could not be transferred through informal contacts between firms.

9.5.5 Utilization of Resources

Investment by MNEs increased the local development through a more optimum combination of unemployed production factors and the utilization or upgrading of resources. It is said that India is rich country, where people lives, only because India is rich in mineral resources but unfortunately they have not been used. MNE may enable idle resources to be used. MNE are always in search of new sources of resources. MNE not only uses idle resource but they also use them at optimum level as they use modern equipment, technology, and production methods. This increases their productivity and reduces the production cost.

Development of Infrastructure and Economic Development

FDI is a transfer of capital across borders, which allows the receiving economy to increase investment beyond its on savings rate. Traditionally, development economics has focused on this addition to the capital stock as core contribution of foreign investment to economic development. FDI is a source of capital because it has a more long-term character than portfolio investment. It cannot be withdrawn quickly if the volatile environment goes through an economic downturn, such as the exchange rate crises in Mexico 1995, East Asia 1997 or Russia 1998.

FDI in infrastructure and business services has a direct impact on productivity its customers. In industries such as telecommunication, foreign investment leads to substantial improvement of services required by businesses; in other cases, such as accounting or IT services, foreign investors provide services previously not available locally.

For instance foreign investment in telecom operators leads to major improvements in technology and competition in the sector. This ultimately reduces firms' communication costs and thus increases productivity. Similar effects arise from FDI in other utilities, such as energy distribution, or motorway and airport projects.

9.5.6 Inter-industry Linkage Effects

There is a strong industry linkage in terms of vertical integration. Vertical integration can be forward and backward. In a forward integration organization goes one step ahead to customer and in a backward linkage they go one step backward from customer means that in forward linkage new unit is customer of organization and in backward linkage old unit, and in backward linkage new unit becomes the supplier of organization. If a MNC establish any type of relation (forward and backward integration) with local entity it improves its productivity.

Forward and Backward Linkages

Foreign firms often purchase intermediate goods (backward integration) from domestic suppliers. These backward linkages create several impacts on domestic supplier. Foreign investors may transfer knowledge directly to local suppliers by training and even joint product development. MNEs improve the productivity of indigenous firms by providing technical assistance and training of employees to increase the quality of suppliers products', by helping in management and organization, and by assisting them in purchasing of raw materials. Moreover, the FDI may increase demand for intermediate goods, and thus allow local suppliers to realize scale economies. In India almost all the MNCs like McDonalds, Pepsi, Coco-Cola, Suzuki, Hyundai, Samsung etc. have transferred technology and imparted training to personnel to so they that they can supply products of international standards to them. McDonalds have even appointed agriculture engineer to help farmer to improve their crop.

Foreign-owned customers (forward integration) may set higher requirements regarding product quality and service-aspects of the supply relationships, such as just in time delivery, thus providing incentives for improving product quality and production processes.

Local firms acting as marketing outlets for foreign investors may receive considerable support in form of training in sales techniques and supply of sales equipment such as umbrellas or refrigerators, and by generating more economies of scale.

Increases Employment

MNC begets new opportunities of employment in host country. MNC transfers their routine jobs and non core jobs to the destination where labor is cheap. It is the reason that lot of jobs from Europe and USA have been transferred to India in last decade. MNCs also transfers its operation to new and economical destination this also increases the opportunity for employment. MNC plays a critical role in economic development and in raising income level of people this also increases, this also increases level of employment. In last decade directly or indirectly MNC have created millions of Jobs in India in almost all the sector as infrastructure, software, hardware, old economy industry, entertainment, media, etc.

9.6 DEMERITS OF MNC

Multinational corporations have become too powerful in absolute terms as well as relative to governments

The enormous resources controlled by multinational corporations give them a tremendous amount of power, especially relative to individuals and governments. The ongoing reduction of national barriers to trade and investment enables these firms to close shop and head overseas if government, workers or NGOs place restrictions (e.g., minimum wage, taxation, labor standards, fines for pollution, etc.) on them or otherwise inhibit their ability to earn profits. Certainly, there is a danger that any organization that controls resources and market share on a par with giant conglomerates like HLL, Reliance or TATA, AV Birla, may abuse its power, perhaps in ways that undermine democratic processes or hurt consumers. But these corporations earn their profits through efficiency and innovation, without which they would quickly lose market share to rivals. They employ millions of workers with competitive wages, provide relatively low-cost/high-quality goods and services to consumers and enrich shareholders. Moreover, they must accomplish all of this without stepping beyond the boundaries of Competition/ Antitrust Law/ Consumer Act in the countries in which they operate. In light of the profit motive, firm spend money to influence legislation to its favor if doing so is likely to enhance profitability.

Multinational corporations put profits before people

Critics contend that too much emphasis is placed on attaining profits and enhancing shareholder value. The sharp focus on shareholder value causes firms to undertake activities that reduce the level of social welfare in order to make a buck It is true that the sole focus of a corporation is to earn profits. However, the simplicity of the corporate incentive system facilitates regulation while encouraging efficiency. For example, a firm will not pollute if the cost (e.g., a fine, for instance) is greater than the benefit (e.g., money saved by bypassing proper disposal). That is why legislation based on the “polluter pays” principle is so effective and so efficient. A corporation will not abuse its workers, consumers or shareholders, lest these parties abandon the corporation for one of its competitors. Laws, penalties and surveillance are, in most cases, sufficient to prevent such collusion. Moreover, the rapidly growing capacity of civil society, particularly NGOs, places a heavy check on corporate practices. The increasing sophistication of telecommunications and the scope of media coverage ensure that harmful corporate practices are revealed to millions of people. In this way, mobilization by citizens, fines levied by governments, class-action lawsuits and scrutiny in the media all adversely affect the single objective of any multinational corporation: profit. Consumer boycotts, fines and other penalties cut into a firm’s bottom line. Consequently, corporations attempt to avoid activities that might draw the ire of civil society groups, government and consumers. Finally, empirical evidence shows that multinational corporations typically use the more environmentally-friendly technology, which can be transferred to developing countries via FDI, even when not required, and there is little evidence that governments lower environmental standards in order to attract investment.

9.6.1 Exploitation of Workers

Another contention is that multinational firms are too powerful in relation to workers and even unions. Worldwide liberalization magnifies this mismatch. Fleet-footed multinationals can simply pick up and move jobs overseas to a place where unions are weak or illegal, wages are low and working conditions are horrific. The liberalization of trade and investment, allows MNCs to move operations from rich countries with high labor standards to poorer countries with lower or non-existent labor standards. Workers, on the other hand, cannot just pick up and head overseas in search of better wages and working conditions. The result, according to this "logic," is a "race to the bottom" in terms of labor standards and wages. This is a deeply flawed argument. First, many, though certainly not all, workers are mobile enough to move about in search of better work. Second, a firm cannot necessarily reduce labor costs by trampling labor standards.

IT has been seen that multinationals pay a 'wage premium' compared to domestic wages in the host countries: around 10%. When Modern Foods is purchased by HLL from Govt. the employ get happy as they feel elevated in becoming part of a MNC.

Oligopoly of MNC (impact on host country)

If local firms are forced to exit (or are taken over) this can lead to oligopolistic market structures that may hinder endogenous technological development, reverse the downward pressure on prices, and even trigger adverse political economy effects. In a worst-case scenario, the foreign investor may attain monopolistic market power and thus extract rents in imperfectly competitive markets that are transferred out of the country. This however would only occur in very specific cases, notably if competition constrained by high barriers to entry.

The entry of foreign firms in the host country market may increase competition and force inefficient indigenous firms to use existing technology more efficiently, or look for new technology, while the least efficient firms may be driven out of the market. As today Indian soft drink market is today totally dominated by MNC. The remaining domestic firms would recognize that to compete with FDI firms, they have to invest in advanced technology to increase their productivity. As in India many local organization improved as lot their quality as they have to compete with MNCs, companies like Videocon, Onida, Tata Motors, TISCO etc have improved themselves in all aspect and are continuously among top five player in their respective categories.

This may benefit consumers in terms of lower prices or better quality products.

M&A Activities by MNCs (impact on host country)

Mergers and acquisitions (M&As) have become increasingly important channels of cross-border industrial restructuring and foreign direct investment all over the world. In India, the policy liberalization in the 1990s has facilitated M&As including cross-border M&As. As a result, the M&A activity has boomed over the past few years. In tune with the worldwide trend, M&As have become an important conduit for FDI inflows in India in the recent years. Official figures on the relative importance of M&As in total FDI inflows are not published. However, the figures summarized in Table suggests that during 1997-99 nearly 40 per cent of FDI inflows in the country have taken the form of M&As by MNEs of existing Indian enterprises rather than organic investments. Though up to 1990 most of the FDI was in the organic establishment. As after 1991 both Coca Cola and Pepsi acquired many Indian players.

Table 9.3: Share of M&As in FDI Inflows in India

Year	**FDI Inflows ($ million)**	**M&A Funds ($million)**	**Share of M&A Funds in Inflows (%)**
1997	3200	1300	40.6
1998	2900	1000	34.5
1999 (Jan-Mar)	1400	500	35.7
Total	7100	2800	39.4

Source: Economic Times, 23rd December 1998 and 21st June 1999.

After 1991 HLL choose the inorganic rout for growth and acquired many firms, some of them as follows:

Food and Beverages

Mar 1993	-	Kothari General Foods
Jun 1993	-	Merger of Doom Dooma India
Jun 1993	-	Merger of Tea Estates India
Jun 1993	-	Merger of Brooke Bond India and Lipton India to form Brooke Bond Lipton India (BBLIL)
Jun 1993	-	Kissan Products (BBLIL)
Jul 1993	-	Cadbury's Dollops (Ice creams)
Mar 1994	-	Tata Oil Mills Company (TOMCO)
May 1994	-	Merryweather Food Products
Dec 1994	-	Kwality Ice Creams
Apr 1995	-	Milkfood Ice Creams
Jan 1996	-	Merger of BBLIL into HLL
Jan 1998	-	Kwality Frozen Foods
Dec 1999	-	Rossell Industries Ltd. (Tea plantations)
Jan 2000	-	Modern Foods Industries

Personal Care Products

Jan 1993	-	Quest International with Pond's India
Oct 1995	-	Lakme Lever Ltd.
Sep 1996	-	Lakme's manufacturing facilities
Jan 1998	-	Pond's India Ltd. with HLL

Opportunity Loss (impact on host country)

Some critics have claimed that MNEs are making investment that domestic companies otherwise would have undertaken. The result is the displacement of local entrepreneurial drive or the bidding up of prices without additional output. MNCs have ability to raise funds in various countries, MNEs thus can reduce their capital cost relative to that of local companies and apply the savings wither to attracting the best personnel or to enticing customers from competitors through greater promotional efforts.

Key Sector Control (impact on host country)

If foreign ownership dominates key industries, then decision made outside of the country may have extremely adverse effects on the local economy or may exert an influence on local politics. MNEs are more loyal to their home country as they have majority of their assets, sales, employees, managers, and stockholders in their home counties. Their home country have access to their global financial records and can tax them on their global earnings, and even influence their decision, which host country govt. cannot do. IN case of conflict among host and home countries policies of MNEs reflect the policies of home country as in India during Indo- Pak war an MNE from USA denied to supply the Air Fuel to Indian Air Force on another occasion MNE involved in Oil refining denied to refined crude oil produced in India and insist on importing it. If MNE in key sector is state owned then concern become more serious. It is the reason that countries restrict the entry of foreign investment in key industries. India doesn't allow FDI in railways and Atomic Energy, in United States the President can halt any foreign investment that endangers national security.

MNE Independence (impact on host country)

Companies can by playing one country against another, avoid coming under almost any unfavorable restriction. For instance if they do not like wage rates, union laws fair employment requirements or pollution and safety codes in one country, they can move elsewhere or at least threaten to do so. In addition they can develop structures to minimize their payment of taxes anywhere.

9.6.2 Transfer Pricing

A transfer price is price on goods and services sold by one member of a corporate family to another, such as from a parent to its subsidiary in a foreign country. Companies establishes arbitrary transfer price because of difference in taxation between countries. If tax is higher in host country than MNE will charge higher price from its subsidiary in host country for all its export from home to host countries thus it will earn profit in home country and will evade tax in host country. Companies also set arbitrary transfer prices for competitive reasons or because of restrictions on currency flows. As if the parent sells a product at low transfer price to the subsidiary the subsidiary will be able to sell the product to local consumers for less, thus improving the competitive position. And if subsidiary's countries has currency controls on dividend flows, the parent can get more hard currency out of the country by shipping in products at a high transfer price or by receiving products at a low transfer price.

Loss of Job (Home Country)

MNC may be a source of employment generator for host country but they are responsible for cutting of jobs in home country. Once US senator said that China is taking our dinner and India is taking out lunch with this he means that the job from USA are transferring to India and China. MNC from USA and Europe are shifting there production center from home country to cost effective destination like South East Asia, China and India, all this resulted loss of job in home country.

Obviously not all the MNEs have same effect on home or host country. It depends upon type of investment and the policy of Govt. One the one hand MNE creates jobs, utilizes resources, increase national income, develops infrastructure on the other hand it may use its power in exploiting consumers and some time even nations. FDI is more likely to generate growth if the product or process is highly differentiated or foreign investors have access to scarce resources in the more advance LDCs.

Table 9.4: World's Largest Corporations (Fortune Global 500)

Rank (2004)	**Company**	**Revenue ($ million)**
1.	Wal-Mart Stores(US)	287,989.0
2.	BP (Britain)	285,059.0
3.	EXXON Mobil (US)	270,772.0
4.	Royal Dutch/Shell (Britain/Dutch)	268,690.0
5.	General Motors (US)	193,517.0
6.	DaimlerChrysler (Germany)	176,687.5
7.	Toyota Motor (Japan)	172,616.3
8.	Ford Motor (US)	172,233.0
9.	General Electric (US)	153,866.0
10.	Total (France)	152,609.5

Contd…

11.	Chevron (US)	147,967.0
12.	Conocophillips (US)	121,663.0
13.	AXA(France)	121,663.0
14.	Allianz (Germany)	118,937.2
15.	Volkswagen (Germany)	110,648.7
16.	Citigroup (US)	108,276.0
17.	ING Group (Netherland)	105,886.0
18.	Nippon Telegraph &Telephone (Japan)	100,545.3
19.	American International Group (US)	97,987.0
20.	International Business Machine (US)	96,293.0
21.	Siemens (Germany)	91,493.2
22.	Carrefour (France)	90,381.7
23.	Hitachi (Japan)	83,993.0
24.	Assicurazioni Generali (Italy)	83,267.0
25.	Matsushita Electric Industrial (Japan)	81,077.7
26.	Mckesson(US)	80,514.6
27.	Honda Motor (Japan)	80,486.6
28.	Hewlett-Packard (US)	79,905.0
29.	Nissan (Japan)	79,799.6
30.	Fortis (Belgium/Netherland)	75,518.1
31.	Sinopec (China)	75,076.7
32.	Berkshire Hathaway (US)	74,382.0
33.	ENI (Italy)	74,227.7
34.	Home Depot (US)	73,094.0
35.	Aviva (Britain),	73,025.2
36.	HSBC Holdings (Britain)	72,550.0
37.	Deutsche Telekom (Germany)	71,988.9
38.	Verizon Communication (US)	71,563.3
39.	Samsung Electronics (South Korea)	71,555.9
40.	State Grid (China)	71,290.2
41.	Peugot (France)	70,641.9
42.	Metro (Germany)	70,159.3
43.	Nestle (Switzerland)	69,825.7
44.	U.S.Postal Service (US)	68,996.0

Contd…

45.	BNP Paribas (France)	68,654.4
46.	China National Petroleum (China)	67,723.8
47.	Sony (Japan)	66,618.0
48.	Cardinal Health (US)	65,130.0
49.	Royal Ahold (Netherland)	64,675.0
50.	Altria Group (US)	64.440.0

India in "Fortune Global 500"

170.	Indian Oil	29,643.2
417.	Reliance Industries	14,841.0
429.	Bharat Petroleum	14,436.9
436.	Hindustan Petroleum	14,114.9
454.	Oil and Natural Gas	13,751.7

176 companies of Fortune Global 500 companies are from USA followed by Japan who has 81 companies. Following list shows the country wise distribution of few Fortune Global 500 corporations:

Country	No. of Corporation (country wise) in Fortune Global 500
USA	176
Japan	81
France	39
Germany	37
Britain	35
China	16
Canada	13
Switzerland	11
Australia	9
Italy	8
Spain	8
Sweden	7
India	5

Source: Fortune, August 1, 2005

Check Your Progress 2

State true and false for the following statements:

1. Bata is a Canadian company.
2. Bayer is British company.
3. Nestle is a Swiss company.
4. Cadbury is British company.
5. A transfer price is price on goods and services sold by one member of a corporate family to another, such as from a parent to its subsidiary in a foreign country.
6. Alcatel's Fraud Management Group (FMG) Subex systems.
7. Essel Propack, is the single largest telecom company in the world manufacturing laminated and seamless tubes.

9.7 MNCs OF INDIA

“When the Bangalore based telecom software product company Subex systems acquired Alcatel’s Fraud Management Group (FMG) it took quite a few in the industry by surprise. After all, Subex with revenues of 90 crore and Alcatel the C 25 Billion French giant were in totally different leagues. It was a part of Subex’s well thought out strategy to move centre-stage in the global arena of its chosen space of telecom fraud management and revenue maximization. With this acquisition, Subex claims to be the largest vendor, the world over for Fraud Management Systems, based on the number of installations. It currently has 61 customers with 105 networks spread across 37 countries.” (Business India December 20, 2004 to January 2, 2005.)

“Not many know that most new generation vehicles that ply the Indian roads have Moterson’s inputs be it Toyota, Honda, Mercedes, Ford, Hyundai or even the homegrown Maruti. From wiring harnessing to cockpits to door trims to bumpers and plastic components, it chips in with its produce, not just for the cars rolled out in India but also for those rolled out in the Far East. Group has 13 plants including at Sharjah and Ireland. (Business India. September 26-October 9, 2005.”)

“If you were to ask which Indian company leads the world in a given product/ segment, chances are that you would get wrong hit. It is neither Reliance nor a company from the stable of TATA or the Birlas or even Infosys or the Wipros of the country. The right answer is Subhash Chandra’s Essel Propack (EPL), the single largest speciality packaging company in the world manufacturing laminated and seamless tubes catering to oral care, cosmetics, personal care, pharmaceuticals, food, and industrial sectors. With an estimated 32% market share in laminated tubes globally, EPL is multinational with manufacturing facilities in 13 countries through 21 plants, including the US, the UK, Russia, Germany, Mexico, Colombia, Venezuela, Philippines, Indonesia, Egypt, Nepal and China besides India. EPL which was established in 1984, ventured out to become a global player in 1993 by setting its first overseas venture in Egypt. Four years later it formed a wholly owned subsidiary in Guanghou, China. In 2000 it acquired Switzerland’s Propack A.G. then the world’s fourth largest laminated tubes company. This helped Essel gain access to markets in Latin America, Indonesia, and China”. (October10-23, 2005)

Sundaram Fasteners

Global Measures:

- Signed an MoU to acquire Precision Forging Unit of Dana Spicer Europe to manufacture cold forged products for automotive applications
- Plans to set up a factory in Haiyan Economic Development Zone (HEDZ), Haiyan County, Zhejiang province in South China to manufacture and sell High Tensile Fasteners to the Chinese automobile industry. The commencement of the production is slated for the first half of 2004.The market demand for automobile components is vast in china as the country produces 1.6mn commercial vehicles and buses, 1mn cars and 5mn two wheelers.

Asian Paint India Ltd. was set up in 1942 by four young men Champaklal H. Choksey, Chimanlal Choksy, S.C. Dani, A. Vakil, in Bombay. In 1999 it acquired 76% stake in Sri Lanka’s paint company “Delmege Forsyth & Co. In November 2000 it started its operations in partnership with Al Hassan group of companies in Oman. In November 2002 it bought 50.1% controlling stake in Berger International of Singapore ” which has a manufacturing capacity in 11 locations. In December 2002 Asian paints purchased 60% stake in SCIB chemicals AE Egypt. In September 2003 it acquired Taumbmans Paint (Fiji) Ltd.

Today Asian Paints is largest Paint company of India and among top ten decorative company in world. It has manufacturing location in 23 countries which includes Australia, China, Fiji, Solomon Island, Myanmar, Thailand, Malaysia, India, Singapore, Bangladesh, Nepal, Srilanka, Bahrain, Egypt, Mauritius, Malta, etc

Incorporated in the year 1961, Ranbaxy Laboratories Limited crossed a sales turnover of Rs 5 billion by the year 1997. In India, Ranbaxy is the largest pharmaceutical Company by sales with a domestic market share of 4.83% and is ranked third on the retail market.

In the case of Ranbaxy, 2 surveillance audits in 2000, renewed the ISO 9002 Certification for Mumbai and Baroda locations. The Company is working towards getting the ISO 14001 Certification, which includes all processes, besides ensuring safety and environmental protection. The successful establishment of Ranbaxy in US can be explained by the following sequence of events:

1. In 1988, Ranbaxy's plant at Toansa, Punjab got US FDA approval.
2. In 1990 and 1991, Ranbaxy was granted a US patents for its products
3. In 1995, it acquired Ohm Laboratories, a manufacturing facility in the US.
4. In 1998, Ranbaxy entered USA, world's largest pharmaceuticals market, with products under its own name.
5. Located at Gurgaon (Haryana), near New Delhi, and set amidst 17 acres of land, the Ranbaxy Research Centre is one of the finest R&D facilities in India.
6. Ranbaxy is ranked amongst the top 100 pharmaceutical companies in the world (9th largest generic company worldwide), it has ground operations in 25

Countries and products sold in over 70 countries, manufacturing in 7. With an annual net global sales of USD 764 million reflecting a growth of 39% for the year 2002 and a workforce of over 8000 professionals across the globe, Ranbaxy Laboratories Ltd. reaffirms its status as a potential MNC.

In ten days from Rs. 7,200 crore Indian company to a Rs. 17,500 crore global one without spending a rupee.

In November 2004, when Videocon enters the race for the colour picture tubes manufacturing capacity (19 million units a year across four plants in Europe, Asia, and North America) of Thomson SA, not to many people gave the company a chance against the likes of LG Philips display, Samsung and Matsushita. Yet not just has CMD Venugopal Dhoot (Videocon) pulled off the deal, he has done so on terms that are favorable to his company. "the world is out in the world that India and Indian companies are not just a good by themselves, but also a hedge against China." Fact is Dhoot agreed to pay the asking price of euro 240 million (Rs. 1,248 crore) without batting an eyelid (and net of cash and debt, which continue to be Thomson's); the deal was completed through a special purpose vehicle, Eagle Electronics. Then he managed to sell his oil and gas story to Thomson as a great investment. Sure enough, after due diligence study by UBS, Thomson agreed to invest $ 295 million (Rs 1,298 crore) in Videocon Industries for a 15 percent stake. The Electrolux deal was stuck pretty much the same way; in return for taking over the company's 91.85% stake in its loss making Indian subsidiary (losses as of December 2005: Rs. 118 crore) Dhoot got the Swedish major to agree to invest $94 million (Rs.413.6 crore) in Vidocon industries for around 5% stake. And since Electrolux wanted to stick to its business of consumer products, he agreed to merge Vidocon International with Videocon Industries.

Deal Mechanics

Company	What Vidiocon Invested
Thomson CPT	euro 240 million

Quid Pro Quo: Thomson to invest $ 195 - million in Vidiocon Industries, and get a 15% stake in Videocon Industries, plus two board seats.

Electrolux AB's 91.85% in Electrolux Kelvinator	Cash less deal

Quid Pro Quid: Electrolux to invest $ 94 million in Vidiocon Industries and get a 5 Percent stake plus one seat on the board. (Business Today, July 31, 2005, P.53)

After this deal Videocon group has a manufacturing foot print across four continents. And half of its sale will be coming from global operations. As list below shows:

	Country	**Facility /Interest**
1.	India	12 consumer electronics and appliances plants. CPT glass.
2.	Italy	2 million CPTs Nicci compressor plant.
3.	Poland	4 million CPTs four million CPT glass shells.
4.	China	10 million CPTs compressor plant.
5.	Mexico	5 Million CPT
6.	Oman	Consumer Durable manufacturing.
7.	South Africa	Consumer Durable/electronics New plant coming up.
8.	Sudan	Prospecting one Oil and gas field
9.	Jordan	Prospecting four oil and gas fields.

Global Advertising Agency (Law and Kenneth)

"It's a global advertising agency starting in 2005, not 1945", maverick adman Andy Law on founding Law and Kenneth in partnership with Indian adman, Praveen Kenneth. Andy Law says it is a global agency no in the sense of just having operations in multiple countries, but in that it has no global head quarter. "you don't want 250 people each sitting London, Paris an Mumbai doing the same thing," says Law. Law and Kenneth will have nodal structure, with each country run by a local entrepreneur, with a majority stake in the business, and a team of 35-40.

Rolled out almost simultaneously across London, Mumbai, Dubai, Stolkholm, Sydney and Paris, Law and Kenneth will soon enter China, the USA and Japan.. As a truly global agency it will allows clients to tap London for strategic inputs, India for creative execution and Stockholm for the interactive edge. (Business Today, July 31, 2005, P.24)

Bharat Forge India Ltd. Is India's only forging company supplying globally and the country's largest exporter of auto components. Bharat Forge has the largest single location commercial forging facility in the world. With the acquisition of German forging company in 2004 it became the second largest forging company in the world. Mr. B.N. Kalyani Chairman and MD, Bharat Forge Ltd. Gave ten basics to compete in the global market.

9.8 LET US SUM UP

It has been said that the multinational corporation (MNC) is the most powerful institution in the world today. Multinationals Corporations are major player in the international business. MNCs have expanded across national borders in two ways: trade and Foreign Direct Investment (FDI). Each has contributed to stable, lasting benefits to the world economy.

In an era of WTO, Regional Groupings, Liberalization, and Globalization role of MNCs have increased tremendously. MNCs are defined as and enterprises that is headquartered in one country but has operations in one or more countries.

Multinational Enterprises (MNEs) is a company that takes a global approach to foreign markets and production; Transnational Companies (TNCs) is a termed used by United Nations and most of developing nations for multinational firms. Business people define transnational company as a firm formed by merger of two firms of approximately the same size that are from two different countries. The biggest characteristic of Global company is that it takes the whole world as single market and it standardize operations and its product worldwide in one or more of the firm's functional areas. Multi-domestic Company is a company which treats its every unit operating in different countries as a independent profit center.

Some of the key reason of crossing national boundaries are Survival, Growth of Overseas Market (Sales), Diversification, access to more Source of Resources, To Protect Market Share at home and to increase market share overseas, to have access to technology expertise etc.

There is wide range of impact of MNC on both that is host an home countries. MNCs influences trade balance of country, Promote Small Scale/ancillary Industry as they use them as a suppliers, MNCs transfer knowledge and improves the technology of local firms. MNCs help in Economic Development, and development of Infrastructure.

But all this advantages MNCs all MNCs are also considered responsible for putting profit before people, for exploitation of workers, engaging in M&A Activities instead of Greenfield projects. Some time they become so big that controls the key sectors of the economy.

9.9 LESSON END ACTIVITIES

1. Pick an Indian MNC and see how they are performing in all over world.
2. Prepare a report on the global operations of Mahindra.
3. Prepare a assignment on the impact of MNC on Indian firms.

9.10 KEYWORDS

Transfer Pricing: A transfer price is price on goods and services sold by one member of a corporate family to another, such as from a parent to its subsidiary in a foreign country.

Global company: Global company is a company which takes the whole world as single market and it standardize operations and its product worldwide in one or more of the firm's functional areas.

Multi-domestic Company: It is company which treats its every unit operating in different countries as a independent profit center. Thus all the operations in this organizations are highly decentralized.

9.11 QUESTIONS FOR DISCUSSION

1. What is Multinational Corporations? What is difference between TNCs, MNCs, MNEs, Multi-domestic firm and Global firm?
2. Describe the various approaches to international business. Discuss the reasons because of which an organization crosses the border.
3. Discuss the impact of MNCs on host country.
4. Discuss the impact of MNCs on home country.
5. Analyze the impact of MNCs on local business organization.
6. "Multinational corporations have become too powerful in abso lute terms as well as relative to governments." Critically evaluate the statement.

Check Your Progress: Model Answers

CYP 1

1. MNCs are defined as and enterprises that is headquartered in one country but has operations in two or more countries.
2. Global company is a company which takes the whole world as single market and it standardize operations and its product worldwide in one or more of the firm's functional areas.
3. It is company which treats its every unit operating in different countries as a independent profit center. Thus all the operations in this organizations are highly decentralized.

CYP 2

1. True, 2. False, 3. True, 4. True,

5. True, 6. False, 7. False.

9.12 SUGGESTED READINGS

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LESSON

10

WORLD TRADE ORGANISATION

CONTENTS

10.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the origin of GATT (WTO)
- Explain the objectives of WTO

- How WTO promotes Globalisation by promoting international trade
- What are the advantages of WTO
- How it influences the India

10.1 INTRODUCTION

The first half of the 20th century was marked by a major worldwide economic depression that occurred between two world wars and that all but destroyed most of the industrialised nations. International trade get a set back when after First World War countries erected high tariff wall and raised other tariff barrier to intolerable height, and international trade was stalled, along with most economies. All this resulted in great depression. This was also one of the fundamental reasons of World War II.

After Second World War to avoid the repetition of the same, world leaders created GATT, a forum for member countries to negotiate a reduction of tariffs and other barrier to trade. Including India 23 countries signed the General Agreement on Tariffs and Trade. The original agreement provided a process to reduce tariffs and created an agency to serve as a watchdog over world trade. In general the agreement covers three basic elements:

1. Trade shall be conducted on a nondiscriminatory basis,
2. Protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas,
3. Consultation shall be the primary method used to solve global trade problems.

Since inception there have been eight rounds of intergovernmental tariff negotiations. And the most comprehensive was Uruguay Round.

Table 10.1: The GATT Trade Rounds

Year	Place/ name	Subjects covered	Countries
1947	Geneva (Switzerland)	Tariffs	23
1949	Annecy (France)	Tariffs	13
1951	Torquay (UK)	Tariffs	38
1956	Geneva	Tariffs	26
1960–1961	Geneva (Dillon Round)	Tariffs	26
1964–1967	Geneva (Kennedy Round)	Tariffs and anti-dumping measures	62
1973–1979	Geneva (Tokyo Round)	Tariffs, non-tariff measures, “framework” agreements	102
1986–1994	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc	123

10.2 URUGUAY ROUND AND DUNKAL PROPOSALS

Eight set (Uruguay Round) of negotiations began in 1986and concluded on September 1993. Mr. Aurthur Dunkul the then Director General of GATT submitted a proposal on in 1991 popularly known as Dunkul Proposal. It envisages the following issues.

The 1986 agenda

The fifteen original Uruguay round issues:

1. Tariffs
2. Non-tariff Barrier
3. Natural Resource Products
4. Textile and Clothing
5. Agriculture
6. Tropical Products
7. GATT articles
8. Tokyo Round Codes
9. Anti-dumping
10. Subsidies
11. Intellectual Property
12. Investment Measures
13. Dispute Settlement
14. The GAT system
15. Services

The Tokyo Round 'codes'

- Subsidies and countervailing measures — interpreting Articles 6, 16 and 23 of GATT
- Technical barriers to trade — sometimes called the Standards Code
- Import licensing procedures
- Government procurement
- Customs valuation — interpreting Article 7
- Anti-dumping — interpreting Article 6, replacing the Kennedy Round code
- Bovine Meat Arrangement
- International Dairy Arrangement

At Uruguay Round faced many bottlenecks as various countries, varying interests repeatedly stalled the talk. France wanted to veto the accord between the United States and the EU which cut production supports, export subsidy payments, and import tariffs. Japan and South Korea are insisting to continue with the ban on rise imports. The US wanted to keep import Quota on textile import and wished that EU should drop quotas on imported films and TV programmes. Agriculture disputes even led to violent protests by farmers in France, Japan, South Korea and other nations. The Uruguay Round was concluded on 15th December 1994. Developing nations like India have its own reservation on Intellectual Property, and Agriculture.

Check Your Progress 1

What do you understand by Uruguay Round?

………………………………………………………………………………………

………………………………………………………………………………………

10.3 WORLD TRADE ORGANISATION

There are a number of ways of looking at the WTO. It's an organisation for liberalizing trade. It's a forum for governments to negotiate trade agreements. It's a place for them to settle trade disputes. It operates a system of trade rules.

At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations. These documents provide the legal ground-rules for international commerce.

FACT FILE WTO

Location:	Geneva, Switzerland
Established:	1 January 1995
Created by:	Uruguay Round negotiations (1986-94)
Membership:	148 countries (on 13 October 2004)
Budget:	169 million Swiss francs for 2005
Secretariat staff:	630
Head:	Supachai Panitchpakdi (director-general)

Functions:

- Administering WTO trade agreements
- Forum for trade negotiations
- Handling trade disputes
- Monitoring national trade policies
- Technical assistance and training for developing countries
- Cooperation with other international Organisations

10.4 PRINCIPLES OF THE TRADING SYSTEM

Following principles are the foundation of the multilateral trading system. A closer look at these principles:

1. ***Trade without discrimination:*** It should not discriminate between its trading partners and it should not discriminate between its own and foreign products, services or nationals. Imported and locally produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

2. ***Freer trade gradually, through negotiation:*** Lowering trade barriers is one of the most important principle of WTO to encourage trade The WTO agreements allow countries to introduce changes gradually, through "progressive liberalization". Developing countries are usually given longer time to fulfill their obligations.

3. ***Predictability through binding and transparency:*** The multilateral trading system is an attempt by governments to make the business environment stable and predictable. It ensures that there will not be frequent and arbitrary changes in tariffs.

4. ***Promoting fair competition:*** It does not altogether eliminate tariffs and other barrier, it allows it in limited circumstances. In fact it promotes level playing field and fair completion by scrapping high tariffs, other trade barrier and to promote fair competition it anti dumping duties and support various agreements on in agriculture, intellectual property, services.

10.5 FUNCTION OF WTO

Instead of calling it Word Trade Organisation it should be called as Word Trade Opportunities. WTO gives an opportunities to the nations to sit together and talk trade. It gives them the forum where nations can negotiate with the objective of Win – Win situation. WTO administers the 28 agreement contained n the final Act and a number of plurilateral agreements and govt. procurement through various councils and committees. It enforces the multilateral trade rules. In nutshell WTO perform following function:

10.5.1 Helping Developing and Transition Economies

Developing countries make up about three quarters of the total WTO membership.

The role of WTO increases as most of these developing countries are in transition phase as they are shifting from planned economic system to market based economic system.

The WTO Secretariat's Training and Technical Cooperation Institute organizes a number of programmes to train government officials and negotiators. Besides Geneva these programmes also takes place in the country concern. Various numbers of programmes are organized jointly with other international Organisations.

WTO provides data of tariff and trade to developing nations to help them in their export.

Specialized help for export

In 1964 WTO established International Trade Center to help develop countries in their export. It is jointly operated by WTO and United Nations techniques. It provides information and advice on export markets and marketing techniques. It assists in establishing export promotion and marketing services, and in training personnel required for these services.

10.5.2 WTO in Global Economic Policy-making

WTO's cooperate with the International Monetary Fund, the World Bank and other multilateral institutions to achieve greater coherence in global economic policy-making. A separate Ministerial declaration was adopted at the Marrakesh Ministerial Meeting in April 1994 to underscore this objective.

Taking Information

WTO takes the regular information from the member countries regarding their policies and tariffs. According to many agreements Government have to notify WTO about the modified trade measures like safety standards, technical standards, anti dumping and countervailing duties etc. In this way it keeps not itself update regarding developments but also it disseminate information to the member countries, which help them in increasing their exports.

Giving Information to Public

It also disseminates the information to public about the developments in WTO through its publication and its websites.

10.5.3 Encouraging Development and Economic Reform

GATT that allow for special assistance and trade concessions for developing countries. WTO agreements give them transition periods to adjust to the more unfamiliar and, perhaps, difficult. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them.

10.6 RULES OF WTO (AGREEMENTS)

WTO agreements includes goods, services and intellectual property. It has an objective of reducing tariffs to zero. It ensures liberalization and allows limited exemption regarding duties. It establishes a system to resolve disputes and ensures transparency regarding the trade policy of government. Present WTO system is based on Uruguay Round Agreements which is as follows:

10.6.1 Binding and Cutting of Tariff

This includes commitment to cut and “bind” custom duty rate on import of good. In some cases, tariff is being cut to zero. There is significant increase in the bound tariffs.

Developed countries’ tariff cut were for the most part phased in over five year from 1st January 1995.

On 26th March 1997, 40 countries which accounts for more than 92% of old trade in information technology product, agreed to eliminate import duties and other charge on the product by 2000 (by 2005 in a handful of case).

Binding of Tariff rates represent commitments not to increase tariffs above the listed rates. The rates are “bound”. Bound rate serve as ceilings on tariffs. It is expected that the respective country will not increase the tariff above the bound rate which it has stated. Though it may be below it. Developing countries though keep tariff rate low but to maintain flexibility of hiking keep bound rate high.

10.6.2 Agriculture Rules and Policies

GATT allows countries to use some non-tariff measure such as import quota, and to subsidies. The Uruguay Round produced the first multilateral agreement dedicated to the Agriculture sector It a implemented over a six-year period and for developing nations that began in 1995.

The new rule and commitment apply to:

1. Market Access
2. Domestic Support
3. Export Subsidies

Market Access

WTO supports the tariffication in the field of Agriculture. It has replaced all non tariff barrier in the field of Agriculture by Tariffs giving same level of protection as given by previous policy which has been replaced by Tariffs.

Domestic Support

The Agriculture Agreement make differences between agriculture support programmes of Govt. as policies that do not have a direct effect on production and trade that do have a direct impact. Policies which have a direct impact on production and trade have to be cut back. This category of domestic support is sometime called the “amber box.”

Measure having a minimal impact on trade can be used freely — they are in a “green box”. They include government service such a research, disease control, infrastructure and food security. They also include payment made directly to farmer that do not stimulate production, such as certain form of direct income support, assistance to help farmer in restructuring agriculture and direct payment under environmental and regional assistance programme.

Also permitted, are certain direct payment to farmer here the farmer are required to limit production (sometime called “blue box” measure), certain government assistance programme to encourage agricultural and rural development in developing countries, and other support on a small scale (“de minimis ”) when compared with the total value of the product or product supported (5% or le in the scale of developed countries and 10% or le for developing countries).

Export Subsidies

The Agriculture Agreement prohibit export subsidies on agricultural product except those which are specified in a member’ list of commitment.

WTO makes certain measure, for the provision of food aid and aid for agricultural development of least developed and poor countries. As they cant afford costly import and need assistance to export.

10.6.3 Standard and Safety

Article 20 (GATT) allows government to make necessary arrangement in order to protect human, animal or plant life or health, provided they do not use it to discriminate or use it as tool to protectionism. In WTO there are specific arrangement regarding food, safety and animal.

10.6.4 Textile

From 1974 until the end of the Uruguay Round, the trade a governed by the Quota system (Multifibre Arrangement). This is against the spirit and principle of GATT. Since 1995, the WTO’ has replaced the Mulltifibre Arrangement with the Agreement on Textile and Clothing (ATC). By 1st January 2005, the sector is to be fully integrated into normal GATT rule. That is that the quota ill come to an end and importing countries will no longer be able to discriminate among exporters. The Agreement on Textile and Clothing is itself no longer exist.

10.6.5 Services

The General Agreement on Trade in Service (GATS) is the first and only set of multilateral rule governing international trade in service. Negotiated in the Uruguay Round, it a developed in response to the huge growth of the service economy over the past 30 year and the greater potential for trading service brought about by the communication revolution.

General Obligations and Disciplines

Total coverage the agreement covers all internationally-traded service — for example, banking, telecommunication, tourism, professional service, etc. It also define four way (or “mode”) of trading service:

1. Service supplied from one country to another (e.g. international telephone call), officially known as “cross -border supply” (in WTO jargon, “mode 1”)
2. Consumer or firm making use of a service in another country (e.g. tourism), officially “consumption abroad” (“mode 2”)
3. A foreign company setting up subsidiaries or branches to provide services in another country (e.g. foreign bank setting up operation in a country), officially “commercial presence” (“mode 3”)
4. Individual traveling from their own country to supply service in another (e.g. fashion model or consultant), officially “presence of natural person” (“mode 4”).

10.6.6 Trade Related Intellectual Property Rights

The WTO' Agreement on Trade-Related Aspect of Intellectual Property Right (TRIPS), negotiated in the 1986–94 Uruguay Round, introduced intellectual property rule into the multilateral trading system for the first time. The WTO' TRIPs Agreement is an attempt to narrow the gap in the way the rights are protected around the world, and to bring them under common international rule.

As GATT and GATS, TRIPS also work on the principle of National Treatment that is treating national and foreigner player equally),and Most-Favored-Nation that is giving equal treatment to national of all trading partner in the WTO. TRIPS agreement has an additional important principle that is that intellectual property protection should contribute to technical innovation and the transfer of technology. It says that both producer and user should benefit, and economic and social welfare should be enhanced.

TRIPS provide adequate protection of intellectual property in following categories:

1. ***Copyright:*** The TRIPS agreement says that computer program will be protected as literary work under the Berne Convention and outline how database should be protected.

   It also expand international copyright rule to cover rental right. Author of computer program and producer of sound recording must have the right to prohibit the commercial rental of their work to the public. A similar exclusive right applied to film, literary works, art etc.

   The agreement say performer must also have the right to prevent unauthorized recording, reproduction and broadcast of live performance for no less than 50 year. Producer of sound recording must have the right to prevent the unauthorized reproduction of recording for a period of 50 year.

2. ***Trademarks:*** The agreement defines the type of sign that must be eligible for protection as a trade-mark, and it describes that what are the minimum rights of trademark owners. According to it service mark must be protected in the same way as trademark used for good.

3. ***Geographical indications:*** This tool gives protection to goods that can be identified as originating or manufactured in the territory of a country, or a region or locality in that territory where a given quality, reputation or other characteristics of such goods is essentially attributable to its geographical origin.

   A place name is sometime used to identify a product. This “geographical indication” does not only say where the product is made. More importantly it identifies the product special characteristic, which are the result of the product's origin. Well-known example include “Champagne”, “Scotch”, “Tequila”, and “Roquefort” cheese. Wine and spirit maker are particularly concerned about the use of place-name to identify product, and the TRIPS Agreement contain special provision for these types of goods. Using the place name when the product is made elsewhere or when it does not have the usual characteristic can mislead consumer, and it can lead to unfair com-petition. The TRIPS Agreement say countries have to prevent misuse of place name.

   Some exception are allowed, for example if the name is already protected as a Trademark or if it had become a generic term. But any country wanting to make an exception for these reason must be willing to negotiate with the country which want to protect the geographical indication in question.

4. ***Industrial designs:*** Under the TRIPS Agreement, industrial design must be protected for at least 10 year.

One of protected design must be able to prevent the manufacture, sale or importation of article bearing or embodying a design which is a copy of the protected design.

5. ***Patents:*** The agreement say patent protection must be available for invention for at least 20 year. Patent protection must be available for both product and process, in almost all field of technology. Government can refuse to issue a patent for an invention if it commercial exploitation is prohibited for reason of public order or morality. They can also exclude diagnostic, therapeutic and surgical method, plant and animal (other than microorganism), and biological process for the production of plant or animal (other than microbiological processes). Plant varieties, however, are protect able by patent or by a special system (such as the breeder's right provided in the convention of UPOV — the International Union for the Protection of New Varieties of Plant). The agreement describe the minimum right that a patent owner must enjoy. But it also allows certain exception. A patent owner could abuse his right, for example by failing to supply the product on the market. To deal with the situation, Article 31 of TRIPs provide the provision of Compulsory license which means a situation where a government allows an agent to produce a patented product without the consent of the original patent owner. If attempts to obtain right to produce a patented product from patentee fails and if a compulsory license is issued, then adequate remuneration will paid to the original rights holder.

   If a patent is issued for a production process, then the right must extend to the product directly obtained from the process. Under certain condition alleged infringers may be ordered by a court to prove that they have not used the patented process.

6. ***Layout Design for Integrated Circuit:*** The scope of Layout design for integrated Circuit is to protect the chip and also the articles incorporated on it. TRIPS says that here protection must be given for ten years.

7. ***Undisclosed Information and Trade Secrets:*** Trade secret and other type of "undisclosed information" which have commercial value must be protected against breach of confidence and other act contrary to honest commercial practice. But reasonable step must have been taken to keep the information secret. Test data submitted to government in order to obtain marketing approval for new pharmaceutical or agricultural chemical must be protected against unfair commercial use.

Para 3 of the TRIPS state that Govt. should take steps to implement TRIPS. It further state that Govt. should impose tough penalties to check the infringement, and should keep the procedure easy, fair and equitable.

10.6.7 Anti-dumping Measures and Countervailing Duties

Dumping means selling the product at below the on-going market price and /or at the price below the cost of production.

GATT (Article 6) allow countries to take action against dumping. Anti-dumping action mean charging extra import duty on the particular product from the particular exporting country in order to bring it price closer to the "normal value" or to remove the injury to domestic industry in the importing country. There are three methods to calculate the normal value of product as follows:

1. The price which the exporter is charging in the domestic market
2. The price charged by the exporter in another country.
3. Calculation based on the combination of the exporter's production cost, other expense and normal profit margin.

Subsidies and Countervailing Measures

WTO allows the subsidies on the one hand and on the other hand it regulates the action which a country can take to deal with the effect of subsidies. An country can go to the dispute settlement body of WTO for the dispute settlement regarding subsidy and it can even take action on its own by imposing countervailing duty on subsidized import that are found to be hurting domestic producer.

10.6.8 Safeguards: Emergency Protection from Imports Surge

Article 19 of WTO provide the safeguard against the surge of imports which can cause injury or threatened the domestic industry. An import “surge” justifying safeguard action can be a real increase in import (an absolute increase); or it can be an increase in the imports’ share of a shrinking market, even if the import quantity has not increased (relative increase).

Safeguard measures should be applied only to the extent necessary to prevent or remedy serious injury and to help the industry concerned to adjust. Where quantitative restriction (quota) are imposed, they normally should not reduce the quantities of import below the annual average for the last three representative year for which statistic are available, unless clear justification is given that a different level is necessary to prevent serious injury.

10.6.9 Non-tariff Barrier

A number of agreement deals with various bureaucratic or legal issue that could involve hindrance to trade:

1. Import licensing
2. Rule for the valuation of good at custom
3. Preshipment inspection
4. Rule of origin
5. Investment measure (TRIMs)

Import Licensing

The Agreement on Import Licensing Procedure say import licensing should be simple, transparent and predictable. The agreement say the agencies handling licensing should not normally take more than 30 day to deal with an application — 60 day when all application are considered at the same time.

Rules for the Valuation of Goods at Customs

The agreement says that the rule of the valuations should by precise and transparent. The Valuation should by fair and neutral and should be based on commercial realities. Valuation should outlaw any system which is arbitrary fictitious.

Preshipment Inspection

Govt. also uses the pre-shipment inspection as a tool to hinder import. It is widely used to delay the export and to give enough room to domestic industry to get prepare for the import. The Preshipment Inspection Agreement of WTO says that while inspection country should follow a policy of non-discrimination, transparency, protection of confidential business information, and should avoid unreasonable delay.

Rules of Origin

“Rule of origin” are the criteria used to define origin of the product, that is where the product is manufactured. The Rule of Origin Agreement requires WTO members to ensure that their rule of origin are transparent; that they do not have restricting, distorting or disruptive effect on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard.

Investment Measures (TRIMS)

TRIMS state that no member shall apply any measure that discriminate against foreigner or foreign product (i.e. violate "national treatment" principle in GATT). It also outlaws investment measure that lead to restriction in quantities (violating another principle in GATT). It restricts the measures as 'local content requirement' which compels the enterprise to use particular level of local components, or which set restrictions on a level of import which an enterprise can do or which set target for the company to export (trade balancing requirement)

10.6.10 Plurilaterals

In WTO there are few agreements where there are only few signatory; they were negotiated at Tokyo Round they are known as "plurilateral agreement. Following are the Plurilateral Agreement:

1. trade in civil aircraft
2. government procurement
3. dairy product
4. bovine meat.

The bovine meat and dairy agreement ere terminated in 1997.

Trade in Civil Aircraft

The Agreement on Trade in Civil Aircraft entered into force on 1 January 1980. It now has 30 signatories. The agreement eliminate import duties on all aircraft, other than military aircraft, as well as there parts and components.

Government Procurement

The objective of the agreement is to make law, regulation, procedure and practice regarding government procurement more transparent and to ensure they do not protect domestic product or supplier, or discriminate again t foreign product or supplier.

Dairy and bovine meat agreements: ended in 1997

The International Dairy Agreement and International bovine Meat Agreement were scrapped at the end of 1997. Countries that had signed the agreement decided that the sector were better handled under the Agriculture and Sanitary and Phytosanitary agreement.

Check Your Progress 2

What is the present state multi-fibre agreement?

……………………………………………………………………………………

……………………………………………………………………………………

10.7 ADVANTAGES/BENEFITS OF WTO

Few distinct advantages are as follows:

1. The system helps promote peace

2. Disputes are handled constructively
3. Rules make life easier for all
4. Freer trade cuts the costs of living
5. It provides more choice of products and qualities
6. Trade raises incomes and stimulates economic growth
7. Free Trade Reduces the Manufacturing Cost
8. Governments are shielded from lobbying
9. The system encourages good government

10.8 IMPACT OF WTO ON INDIA

In the new WTO environment, the buzzwords would be efficiency and productivity. "Success will lie with those who exhibit competitiveness in price and quality." P.K. Kaul, Former Indian Ambassador to USA.

The Indian economy has experienced a major transformation during the decade of the 1990s. Apart from the impact of various unilateral economic reforms undertaken since 1991, the economy has had to reorient itself to the changing multilateral trade discipline within the newly written GATT/WTO framework. The unilateral trade policy measures have encompassed exchange-rate policy, foreign investment, external borrowing, import licensing, custom tariffs and export subsidies. The multilateral aspect of India's trade policy refers to India's WTO commitments with regard to trade in goods and services, trade related investment measures, and intellectual property rights.

The multilateral trade liberalization under the auspices of the Uruguay Round Agreement and the forthcoming WTO negotiations is aimed at reducing tariff and non-tariff barriers on international trade.

India is a founding member of the GATT (1947) as well as of the WTO, which came into effect from January 1, 1995. By virtue of its WTO membership, India automatically is availed of Most Favored Nation Treatment (MFN) and National Treatment (NT) from all WTO members for its exports and vice versa. Its participation in this increasingly rule-based system is aimed towards ensuring more stability and predictability in its international trade.

The Uruguay Round resulted in increased tariff binding commitments by developing countries. India bound 67% of its tariff lines compared to 6% prior to this round. the Government has simplified the tariff, eliminated quantitative restrictions on imports, and reduced export restrictions. It plans to further simplify and reduce the tariff.

All agricultural tariff lines and nearly 62% of the tariff lines for industrial goods are now bound. Ceiling bindings for industrial goods are generally at 40% ad valorem for finished goods and 25% on intermediate goods, machinery and equipment. The phased reduction to these bound levels is to be achieved during the 10-year period commencing in 1995. Tariff rates on equipment covered under the Information Technology Agreement and software are to be brought down to zero by 2005.

Quantitative Restrictions (QRs) on imports are maintained on Balance-of-Payments (BOP) grounds but nation is reducing it QR gradually and it will be reduced to minimum level up to 2005.

India has fulfilled its commitment by reducing tariff and eliminating QR, it had also implemented the TRIPS measures by implementing new patent law and now India Patent Law is at par with international patent law following a product patent that too for 20 years, India has also implemented TRIMs (Trade Related Investment Measures) and GATS.(General Agreement on Trade and Services).

The Indian economy has grown rapidly over the past decade, with real GDP growth averaging some 6% annually, in part due to the continued structural reform, including trade liberalization, according to a WTO Secretariat report on the trade policies and practices of India. Social indicators, such as poverty and infant mortality have also improved during the last ten years.

Check Your Progress 3

Fill in the blanks:

1. Including India ___________ countries signed the General Agreement on Tariffs and Trade.
2. The WTO agreements allow countries to introduce changes gradually, through "_______________".
3. In 1964 WTO established ______________ to help develop countries in their export.
4. _____________ of tariff rates represents commitments not to increase tariffs above the listed rates.
5. Since 1995, the WTO has replaced the Multifibre Arrangement with the ______________.
6. _____________ means selling the product at below the on-going market price and /or at the price below the cost of production.
7. ____________ are the criteria used to define origin of the product, that is where the product is manufactured.
8. In WTO there are few agreements where there are only few signatory, they are known as _______________.

10.9 LET US SUM UP

After Second World War to avoid the repetition of the same, world leaders created GATT, a forum for member countries to negotiate a reduction of tariffs and other barrier to trade. Including India 23 countries signed the General Agreement on Tariffs and Trade. The objective of GATT was that trade shall be conducted on a nondiscriminatory basis, protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas, Consultation shall be the primary method used to solve global trade problems.

Many rounds of talk takes place on GATT and most important was Eight set(Uruguay Round) of negotiations began in 1986 and concluded on September 1993. Mr. Aurthur Dunkul the then Director General of GATT submitted a proposal on in 1991 popularly known as Dunkul Proposal. It envisages the following key issues:

Tariffs, Non Tariff Barrier, Textile and Clothing, Agriculture, GATT articles, Anti-Dumping, Subsidies, Intellectual Property, Investment Measures, Dispute Settlement Services.

Fortunately Delegation from more than 100 countries reached to an agreement. And on 15th April, 1994 in Marrakesh, Morocco an agreement regarding multilateral trading system was finally signed and WTO came into existence. The principle of new trading system were:- Trade without discrimination, Freer trade: gradually, through negotiation, Predictability: through binding and transparency, Promoting fair competition.

WTO functions on the basis of following rules;- Binding and Cutting of Tariff, Agriculture Rules and Policies, Standard and Safety, Textile Services Trade Related Intellectual Property Rights Anti Dumping Measures and Countervailing Duties, Emergency protection from imports surge, Non Tariff Barrier, Plurilaterals.

10.10 LESSON END ACTIVITIES

1. Prepare a brief report on the Agriculture issues in WTO. Also see the impact of Hong Kong pact on Indian Agriculture issues.
2. Prepare a report on the NAMA. And find out what developed nations want in the name of NAMA.

10.11 KEYWORDS

Quota: It is Quantitative restrictions against imports. Generally they are specific provisions limiting the amount of foreign products imported

Tariff bindings: In tariff binding country commits the maximum limit of tariff which it can impose on import thus it is difficult to increase tariff beyond binding rates.

Tariffication: It is a process of converting the non-tariff barrier into a tariff barrier.

Amber Box: In GATT, Policies which have a direct impact on production and trade have to be cut back. This category of domestic support is sometime called the "amber box."

Green Box: These are measures which have a minimal impact on international trade can be used freely these are in a "green-box".

Technical Barrier: These are the trade barrier against import in the form of regulation, standards, testing and certification procedure etc.

Multifibre Arrangement: It is a type of Quota system. Usually used against the import of textile.

MFN: Most Favored Nation. It is principle of GATT which means treating one trading partner equally on the principle of non-discrimination.

Dumping: Dumping means selling the product at below the on-going market price and /or at the price below the cost of production.

Plurilateral Agreement: In WTO there are few agreements where there are only few signatory, they were negotiated at Tokyo Round they are known as "plurilateral agreement.

Singapore issues: Trade and Investment, Competition policy, Transparency in Government Procurement, and Trade "facilitation" are called Singapore issues.

10.12 QUESTIONS FOR DISCUSSION

1. Briefly describe the Uruguay round and Dunkel Proposals.
2. What are the principles and functions of WTO?
3. Describe various agreements (component of WTO agreement) of WTO.
4. Discuss the various advantages of WTO.
5. Critically evaluate the impact of WTO on the India.

Check Your Progress: Model Answers

CYP 1

Eight set (Uruguay Round) of negotiations began in 1986and concluded on September 1993. Mr. Aurthur Dunkul the then Director General of GATT submitted a proposal on in 1991 popularly known as Dunkul Proposal.

CYP 2

From 1974 until the end of the Uruguay Round, the trade a governed by the Quota system (Multifibre Arrangement). This is against the spirit and principle of GATT. Since 1995, the WTO' has replaced the Multifibre Arrangement with the Agreement on Textile and Clothing (ATC). By 1st January 2005, the sector is to be fully integrated into normal GATT rule. That is that the quota ill come to an end and importing countries will no longer be able to discriminate among exporters. The Agreement on Textile and Clothing is itself no longer exist.

CYP 3

1. 23,
2. Progressive liberalization,
3. International Trade Center
4. Binding
5. Agreement on Textile and Clothing (ATC)
6. Dumping,
7. Rule of origin
8. Plurilateral agreement

10.13 SUGGESTED READINGS

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UNIT IV

LESSON

11

FISCAL POLICY

CONTENTS

11.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the concept and role of fiscal policy in Indian economy
- Understand in details the central budget and the role of budget in business decision-making

11.1 INTRODUCTION

The sphere of state action is very vast and al pervading. It includes "maintaining public services, influencing, attitudes, shaping economic institutions, influencing the use of resources, influencing the distribution of income, controlling the quantity the of money, controlling fluctuations, ensuring full employment, and influencing the level of investment." W.A. Lewis. Philip V. Taylor gave a more comprehensive definition when he said, “Budget is a master financial plan of the government. It brings estimates of anticipated revenues and proposed expenditures, employing schedule of activities to be undertaken towards the direction of national objectives. It is a device for consolidating various interest, objectives, desires and needs of people into a programme whereby they provide for their safety, convenience and comforts”

It is through fiscal policy that the government tries to correct inequalities of income and wealth that increases with development in country. It expands internal market, reduces unessential imports, counteracts inflationary pressure, provides incentives for desirable types development projects, and increase the total volume of savings and investment. For all this government adopts appropriate taxation, budgetary expenditure and public borrowings policies.

Fiscal policy is the projected balance sheet of the country, prepared by Chief Finance Officer of country that is finance minister of the state. Public finance is the study of generating resources for the development of country and about allocation of resources. Fiscal policy is implemented through Budget, which is statement of state’s revenue and expenditure.

11.2 COMPONENT OF BUDGET

Typically budget includes four components:

1. Some review of economy
2. Major policy announcement
3. Expenditure proposal
4. Tax proposal.

There are three major functions of fiscal policy: First is allocation function of budget policy, that is, the provision for social goods. It is a process by which the total resources are divided between private and social goods and by which the mix of social goods is chosen. Second the distribution function of budget policy that is distribution of income and wealth in accordance with what society consider at “fair” or “just” distribution. Third the stabilization function of budget policy, that is marinating high employment, a reasonable degree of price stability an appropriate rate of economic growth, with due considerations of its effects on trade and the balance of payment.

The budget includes revenue and expenditure. Revenue and expenditure is divided in capital and revenue account. Thus receipts are broken into Revenue Receipts and Capital Receipts, and disbursement are broken up into Revenue expenditure and capital expenditure.

11.3 REVENUE BUDGET

It consists of revenue receipts and revenue expenditure.

1. ***Revenue Receipts:*** It includes tax revenue and other revenues.
   a) *Tax revenue:* These comprised of taxes and other duties levied by the Union Govt.
   b) *Other Revenue:* These receipts of government mainly consist of interest and dividends on investment made by government, fees and receipts for other services for other services, rendered by govt.
2. ***Revenue Expenditure:*** This is expenditure for normal running of govt. departments and various services interest charges on debt incurred by government, subsidies, etc. Expenditure which does not result in the creation of assets is treated as revenue expenditure.

Check Your Progress 1

What are the components to revenue receipts?

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11.4 CAPITAL BUDGET

It consists of capital receipts and payments.

1. ***Capital Receipts:*** It includes loans raised by government from public which are called market loans, borrowings by government from RBI and other parties through sale of treasury bills, loans received from foreign bodies and government and recoveries of loans granted by the union government to states and Union Territory govt. and other parties.
2. ***Capital Payments:*** These payment consist of capital expenditure on acquisition of assets like land, buildings, machinery, equipment, infrastructure, as also investment in shares, etc. and loans and advances granted by the Union government to state and union territory govt. companies, corporations and other parties.

11.5 MOBILIZATION OF RESOURCES

The main sources of funds for financing development expenditure can be grouped under following categories:

1. Taxation
2. Profits of Public Sector (Price)
3. Domestic non-monetary borrowing
4. External borrowing
5. Borrowing form the RBI (monetised borrowing)

Some minor source of revenue are Fees, Fines, Forfeitures and Escheats, Tributes, and Indemnities, Gifts, and Grants.

Taxation

Taxed are imposed in many ways, we can distinguish taxes in following manner:

- Direct Tax
- Indirect Tax

Direct taxes are those which are imposed on individuals or householders who bear the burden as Income tax. Indirect tax are those which are imposed on an equity at some point in the system but whose burden can be shifted to some other entity or entities, as excise, customs etc.

Some important type of taxes are as follows:

1. ***Income Tax:*** There are two type of income tax that is personal income tax and corporation tax. Personal Income tax is levied on individuals by the Central Government and the proceeds are shared between sates and Center. It is based on principle of “ability to pay” that is who company more should pay more to the Government. Corporation is a tax on income of the companies. The Central Govt. has been imposing corporation tax on the profits of the large a small companies.

2. ***Interest Tax:*** The interest tax act provided for the levy and a special tax on the gross amount of interest accruing to the commercial banks on loans and advances made by them in India. The tax is levied on the gross interest income of “credit institutions” that is banks, financial institutions, financial companies etc.
3. ***Estate Duty:*** Estate duty was imposed on the estate of a person, which was inherited by his heirs.
4. ***Wealth Tax:*** Wealth tax has been imposing on accumulated wealth or property of every individual.
5. ***Taxes on Commodities:*** Revenue from commodity taxation is the most important source of taxation for the Central Govt. Central Excise and Custom Duties are two important taxes of the Central Govt.
6. ***Central Excise (Indirect):*** These duties are levied by the center on commodities which is produced with in country. Now it has been converted to VAT.
7. ***Customs Duties (Indirect):*** These are duties or taxes imposed on commodities imported into India.
8. VAT (Value Added Tax).

It is imposed on sales.

Price: For the development of the economy Govt. has to launch public sector. As private sector don’t take interest or it is unable in some highly capital intensive and having a high gestation period projects like infrastructure projects, heavy industry etc. Some time for the rapid development also Govt. have to invest in many sector simultaneously that in consumer industry like clothes etc to meet the huge gap between demand and supply and in heavy industry to make available the resources for the economy. Govt. charges the price for the goods its manufactures or the services it provides. Income from public enterprises now constitute a substantial source of revenue.

Fee: It is a payment against the services. Though it is never more than the cost of the services. Sometime it covers only part of the services. As nominal fees in govt. hospitals, educational fees etc. Fees like license fee are much higher then the services rendered. Sometime there is no positive return in terms of services and fees is charged just to grant permission in terms of license etc. Difference between price and fees is that in fees it is public interest which is prominent that’s why part of the cost is charged in most cases on the other hand in price is payment for the service of business charter. Here usually full cost is covered.

Rates: Rates are levied by local bodies, i.e., municipalities and district boards, for local purchases. They are generally imposed on the local immovable properties.

Fines: Fine are imposed as the deterrent for breaking law.

Escheat: When a person dies heirless or without a successor or leaves no will behind, his property or assets will go the State. The claim of the state to deceased’s assets is called escheat.

Grants and Gifts: Grants are given by a government at a higher level to that at the lower level, e.g. from the Central Govt. to the state govt. or to the local district boards, municipalities etc. Gifts are sometime received from private bodies and foreign Govt. for relief in natural calamities like earthquake, floods, droughts, cyclones, for building a hospital, schools etc.

Check Your Progress 2

What are the main sources of funds of the Government of India for financing development expenditure?

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11.6 EXPENDITURE OF CENTRAL GOVERNMENT

All public expenditure classified into:

a) Non-plan expenditure

b) Plan expenditure

Non-plan Expenditure

Non-plan expenditure of the central govt. is divided into revenue expenditure and capital expenditure. Under revenue expenditure we include: interest payment, defense revenue expenditure, major subsidies (export, food and fertilizer), interest and other subsidies, debt relief to farmers, postal deficit, police, pension and other general services, social service, economic service (agriculture, industry, power, transport, communications, science and technology etc.) and grants to states and union territories, and grants to foreign government. Capital non plan expenditure includes such items as: Defense capital expenditure, loans to public enterprises, loans to states and union territories and loans to foreign government.

Plan Expenditure

Plan expenditure is to finance central plans, such as agriculture, rural development irrigation and flood control energy industry and minerals transport, communications, science and technology and environment, social services and others and Central assistance for Plans of the state and Union Territories.

11.7 BUDGETS OF STATE GOVERNMENT

In India each State Govt. prepares its own budget of income and expenditure every year. State Govt. collects the revenue from different sources to meet their expenditure. The important source of revenue for states are VAT, (earlier sales tax), grant in aid other contributions for the Center, states own non tax revenue, consisting of interest receipts, dividends, and profits, general services (of which state lotteries are the most important) social services and economic services. Besides this state also collect taxes on income and commodities. State imposes income tax on agriculture and profession. State Govt. receives income from taxes on property and capital transactions. The main sources are land revenue, stamps, and registration, and tax on urban and immovable property.

States also charges commodity taxes like motor vehicle tax, electricity duties etc. State is also empowered to impose tax alcoholic liquor, opium, Indian hemp, and other narcotics.

11.8 FINANCIAL POWER OF CENTRAL AND STATE GOVERNMENT

The Constitution of India divides the functions and financial powers of the Govt. into Central and State spheres together with the concurrent areas. It also provides for sharing of taxes in various forms and system of grants-in-aids. The Seventh Schedule of the constitution of India divides functions and financial resources between the Center and States. It contains three lists namely, List I or Union List, List II or State List, and List III or Concurrent List.

List I: Union List: It comprises of following items:

Tax Revenue

The Union List contains of 97 contains the following sources of tax revenues for the Central Govt.:

1. Taxes on income other than agriculture income.
2. Duties on customs including exports duties.
3. Duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption and (b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included this paragraph (entry 84).
4. Corporation Tax.
5. Taxes on capital value of the assets exclusively of agriculture land of individual s and companies, taxes on the capital of companies.
6. Estate duty in respect of succession to property other than agriculture land.
7. Duties in respect of succession to property other than agriculture land.
8. Terminal taxes on goods or passengers carried by railways, sea, or air taxes on railways fares and freights.
9. Taxes other than stamp duties on transactions in stock exchanges and future markets.
10. Rates on stamp duty in respect of bills of exchange, cheque, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
11. Taxes on sale or purchase of newspapers and on advertisements published therein.
12. Taxes on sale or purchase of goods other than newspaper where such sale or purchase takes place in the course of inter-State trade or commerce.
13. Taxes on inter-State consignments of goods for trade or commerce.
14. Fees in respect of any of the matters in the list but not including fees taken in any court.
15. Fees taken in Supreme Court.

Non-tax Revenue

Non-tax revenue includes Borrowings, both internal and external, income from various govt. undertaking and monopolies, income from govt. property etc.

List II: State List: Some of the financial resource as mentioned in constitution are as follows:

Tax Revenue

1. Land Revenue
2. Taxes on agriculture income
3. Taxes on land and buildings

4. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (a) alcoholic liquors for human consumption (b) opium, Indian hemp and other narcotic drugs and narcotics but not including medicinal and toilet preparations containing alcohol or any substances included in this sub-paragraph (entry 51).
5. Taxes on the entry of goods into local area of consumption.
6. Taxes on electricity.
7. Taxes on sales and purchase of goods other than newspaper excluding inter-state sale.
8. Taxes on advertisement other than advertisements published in the newspaper.
9. Taxes on vehicles for use on roads.
10. Tolls.
11. Taxes on professions, trades, callings and employment.
12. Capitation Taxes.
13. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.
14. Fees in respect of any the matters in the State List but excluding court fees.
15. Share in some specified Union Taxes.

Non-tax Revenue

1. The State Govt. can borrow upon the security of their respective Consolidated Funds, but only with in the country, including loans from the Government of India.
2. Income from govt. undertakings owned fully or partly by State Govt.
3. Income from public property owned by the State Govt.
4. Grants in aid from the Central Government.
5. Other Grants for the Central Government.

Check Your Progress 3

Mention the sources non-tax revenue of the Central Government.

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11.9 FISCAL POLICY AND ECONOMIC GROWTH

Fiscal policy is a potent tool in the hands of Govt. to regulate the economic growth. As deficit financing is the very effective tool in the hands of the govt. for increasing effective demand in recession. To fill the deficit as Govt. borrows from RBI, Market and even create additional currency and then it spends it increases the disposable income of people thus results in conductive environment for investment. Market mechanism of an underdeveloped economy is not likely to be able to generate enough of savings and investment needed for a rapid economic growth. Fiscal policy plays a leading role in effecting savings in the economy. Budgets play a direct role in capital accumulation and economic growth in an underdeveloped country. Saving potential in an underdeveloped economy is very limited partly because of shortage of several specific resources, partly due to lack of adequate demand, partly because of high cost of production. This vicious circle can be broken by the govt. with the help of saving oriented budgets.

Through the fiscal policy govt. can also encourage the growth of particular industries and in particular areas. For this industries are provided with specific tax concessions and subsidies such as tax holidays, higher depreciation allowances etc. can be designed and incorporated in the budgetary policy. Further the role of Fiscal policy in economic growth can be understood through the impact of Public Debt, Deficit Financing, and Taxes.

11.10 ROLE OF TAXES IN ECONOMIC GROWTH

Taxation is an effective tool of budget to influence the level of savings and investment in country. Abolition and reduction of various taxes pushes up profits and reduces cost of production and prices. Lower prices are expected to increase demand production and employment, which in turn add to effective demand, and so on. Similar steps can be taken in case of custom duties. Raising import duties diverts the domestic demand form imports to home produced goods, and reducing or abolishing exports duties or giving export subsidies increase the demand for export and contributes towards recovery form depression. It will be more helpful to lower tax rates on those goods which have a higher elastic demand. Demand will be very high if persons with a higher marginal propensity to consume are given a relief in direct taxation. In the same manner investment may be encouraged by specific tax concession like tax holidays, greater depreciation allowance and the like.

Taxes are also considered to be effective tool in controlling the inflation. It can do it in two ways. First as built - in stabilizers and the second relates to the common belief that taxes can be used to curb prices and demand.

Taxes as a Built in Stabilizers: Given the level of govt. expenditure the tax system itself tend to create a budgetary surplus during a boom and a deficit during a depression. A budgetary surplus would curb expenditure and demand while budgetary deficit would have the opposite effect and thus an anti-cyclical pressure is generated. This happens because revenue from indirect and direct taxes is dependent upon the level of economic activities. Moreover direct taxes are usually progressive. With increasing money incomes the direct taxes bill rises more than proportionately, and during a depression there is more than proportionate reduction in it. Therefore yield from these taxes also moves in line with the level of economic activities. The result is that during the depression the tax revenue falls and with given govt. expenditure, there is a budgetary deficit, which in turn has an expansionary effect. On the other hand during boom larger revenue causes a budgetary surplus, which has a contractionary effect.

11.11 PUBLIC DEBT IN INDIA

Public debt in Indian context refers to the borrowings of the Central and state government. Gross public debt is the gross financial liability of the government. Net public debt is the gross debt minus the value of capital assets of the government and loans and advances given by the government to other sectors. Debt obligation can be of many types as:

- Short term debt are the debt of which the maturity is less than one year at the time of issue and consist of items like the treasury bills.
- Some obligations may not have specific maturity but may be repayable subject to various terms and conditions they are called Floating Debt. As provident funds, small savings, reserve funds and deposits.

- Permanent of funded debt are loans having a maturity of more than one year at the time of issue. Usually there maturity is between three and thirty years. Some of them may even be non – terminable so that the govt. is only to pay the interest on such debt without ever repaying the principle amount.
- Obligations owed to foreigners – govt. institutions, firms and individuals are called external loans.

Debt obligation of the central govt. are broadly divided into two categories:

- Internal Debt
- External Debt

Internal debt: It includes the loans raised within the country and includes following:

(a) Current market Loans, (b) others (comprising balance of expired loans, compensation and other bonds such as National Rural Development Bonds and capital Investment Bonds), (c) Special Bearer Bonds, (d) Treasury Bills, (e) Special floating and other loans, (f) Special securities issued to the RBI, (g) Small savings (h) Provident funds, (i) other accounts, (j) reserve funds and deposits.

External Debt: External debt is raised in foreign currency and a substantial part of it as it is also repayable in foreign currency. External debt represent loans raised by a country from outside sources includes debt raised by the Govt. and by the non-govt. sources such as NRI deposits, commercial borrowings from abroad, suppliers credit and short-term borrowings etc.

Public debt in India has grown immensely in planning period. In 1999 the total debt of Central Government was Rs. 8,75,925 and in 1998 debt of State Government was Rs. 2,84,942. In the budget of 2005-2006 the 22% of total expenditure was only interest payment. If the debt is owned by central bank of India it increases inflation as RBI meets the growing demand by issuing additional quantity of money.

Public debt plays an important role in economy. Public debt contributes to the saving effort of the economy. LDCs are usually short of capital resources. As saving capacity of the masses is very low, so appropriate measures are taken to step up rates of saving and investment in the economy. The net effect of the borrowing also depends upon the sources from which they come:

- If Govt. goes of the borrowings from the market and public reduces its own consumption and lends its savings to the govt. the result will be a net increase in the rate of savings. But if loans are given to govt. by diverting the savings from private investment, then there will be no net increase in savings and investment activity. But even after that public loans can help economic growth by reallocation of resources.
- If money is borrowed from the central bank then it results in the addition to aggregate money supply in the country. This results in increment in demand and an upward pressure on prices.

11.12 DEFICIT FINANCING

Deficit financing can be defined as "the financing of deliberately created gap between public revenue and public expenditure or a budgetary deficit, the method of financing resorted to being borrowing of a type that results in a net addition to national outlay or aggregate expenditure" Therefore we can say deliberate unbalancing of the budget in such a way that government expenditure exceeds government revenue. In India great reliance has been placed on deficit financing for mobilizing resources for the plans. Deficit financing has been explained in different manner as follows:

a) ***Revenue Deficit:***

Revenue Deficit = Revenue Expenditure – Revenue Receipts.

b) ***Budget Deficit:***

Budget Deficit = Total Expenditure – Total Receipts.

Total expenditure includes revenue expenditure and capital expenditure and total receipts includes revenue receipts and capital receipts. This excess of total expenditure over total revenue is called budget deficit. It is also defined as the fiscal deficit minus government borrowing and other liabilities (public debt receipts). This is somewhat close to the concept of monetised deficit, which meant the printing of the new money by the Reserve Bank of India to part finance the deficit.

But this conventional definition of deficit has lost relevance as it does not meet international practice. So this concept of Budget deficit has been given up by the govt. in 1997-98. Now we follow the concept of Fiscal Deficit

c) ***Fiscal Deficit:*** In a simple terms fiscal deficit is budgetary deficit plus market borrowings and other liabilities of the Government of India. It is also refers to as difference between the total expenditure and the government's total non - debt receipts.

Fiscal Deficit = Revenue Receipts (Net tax revenue + non tax revenue)

+ Capital Receipts (only recoveries of loans and other receipts)

– Total Expenditure (Plan and non plan)

OR

= Budget Deficit + Government's market borrowing and liabilities.

d) ***Primary Deficit:*** Primary deficit is obtained by subtracting interest payment (a component of non plan expenditure) from the fiscal deficit. Therefore, the primary deficit is the deficit of the current year and it is accordingly triggered by an expansionary fiscal policy during the year.

Government of India adopted the deficit financing to obtain necessary resources for the development but deficit financing may beget many problems as it increases the public debt which increases the interest burden of the government. Most serious disadvantage of deficit financing is inflationary rise of price. Deficit financing increases the total supply of money in country and raises the aggregate demand of goods and services. In the absence of corresponding increase in supply of goods and services, deficit financing leads to rise in level of price. Inflation work as a forced saving or indirect taxation on people as because of increased price now they have to pay extra to maintain same living standard.

One way for a govt. to finance a budget deficit is simply to print money - a policy that leads to higher inflation. Some economist have suggested that a high level of debt might also encourage the government to create inflation. Because most Govt. Debt is specified in nominal terms, the real value of debt falls when the price level rises. This is the usual redistribution between creditors and debtors caused by unexpected inflation- here the debtor is the govt. and the creditor is the private sector. But this debtor, unlike others has access to the monetary printing press. A high level of debt might encourage govt. to print money, thereby raising the price level and reducing the real value of its debts.

11.12.1 Deficit Financing and Economic Growth

Deficit financing can be used in accelerating economic growth. The Govt. can use deficit spending for shifting productive resources of the economy into capital goods sector, developing basic and key industries and providing necessary infrastructure. Deficit financing is a very potent tool in the hands of the govt. for increasing effective demand. If deficit is financed through creation of additional currency or borrowings from the central bank of the country. Even if govt. borrows from the market and spends the borrowed sums, the aggregate expenditure is most likely to increase because during depression the investment opportunities are not much and savings of the market get spent through the govt. Though the govt.'s expenditure policy more effective when the extra purchasing power goes into the hands of those people who have a high marginal propensity to consume. That's why various security measures like unemployment relief, old - age pensions, and so on are , therefore, very helpful in raising the total demand in the market. There are two form of deficit financing which can be resorted to in combination:

1. The Govt. may borrow from the market. This procedure is equivalent to transferring of resources straight from the hands into those of the govt. The market borrowings therefore, generally amount to loans from various - institutions and this generally means diversion of investable funds from the private sector to the public sector.
2. The deficit financing namely, resorting to the printing pres amounts to taking away a portion of the private sector's resources and leaving it with extra money. This technique can be used for re-allocation of the economy's resources and thus accelerating the pace of economic growth.

11.13 IMPACT OF FISCAL POLICY ON BUSINESS

If there is any single document, which has maximum impact on business than, it is Budget. Every year budgets brings opportunity and threats for business. Every budget improves the bottom line of some business and some business go in red because of budget. As in recent budget compelled the organizations to work out on their Compensation plan because of Fringe Benefit Tax (FBT). Same way the budget of year 2005 gave a big impetus to Mutual Funds and in turn to stock market by allowing tax rebate on the investment in Mutual Funds. The introduction of VAT also have big impact on the business.

In early 1990 electronic industry was in great pressure as market growth rate was very low, understanding this the then finance minister Dr. Manmohan Sing reduce the excise on electronics specially CTVs which resulted in decrease of price and sales started rising. Not only this in last years government has reduced the taxes which increased the disposable income of the household which increased the demand and which gave birth to great Indian Middle Class and big spurt in the sale of white goods and readymade garments. Taxes on intermediary goods and industry and taxes on corporate as corporate tax and dividend tax have an obvious impact on business. One of the reason which brought a big spurt in Indian consumer industry is because of relaxation in fiscal policy as in last few budgets have reduced a savings rate a lot and have given free hand to banks to distribute consumer loans to consumers.

A smart business person always keep an eye on fiscal policy to reap the maximum advantage from the opportunity given by policy and to minimize the prospective losses because of threats in budget. Like budget of 2005-06 allow to invest in mutual funds to avoid tax now it is big opportunity for mutual funds, it now to them how the reap maximum from this step. Budget creates an atmosphere for investment.

11.14 GLIMPSES OF BUDGET 2008

Union Finance Minister P Chidambaram presented his fifth Budget (2008) in Parliament the key features of the budget are as follows:

- Changes in I-T slab. Threshold of exemption for all Income Tax assesses raised from Rs 1,10,000 to Rs 1,50,000.
- Every income tax assessee to get relief of minimum of Rs 4,000.
- No change in rate of surcharge.
- New tax slabs will be: 10 per cent for Rs 150,000 to Rs 300,000, 20 per cent for Rs 300,000 to Rs 500,000 and 30 per cent above Rs 500,000.
- For women, the income tax limit goes up from Rs 1.45 lakh to Rs 1.80 lakh. In case of senior women citizens, it increases from Rs 1.95 lakh to Rs 2.25 lakh.
- Fresh facilities, encouragement to sports and guest houses exempted from Fringe Benefit Tax.
- Five year tax holiday for setting up hospitals in tier II and tier III regions for providing healthcare in rural areas from April 1, 2008.
- Five year tax holiday for promoting cultural tourism.
- Short-term capital gains increases to 15 per cent.
- Commodities Transaction Tax to be introduced on the lines of Securities Transaction Tax.
- Banking cash transaction tax withdrawn from April one, 2009.
- Direct tax proposals to be revenue neutral. Indirect tax proposals to result in loss of Rs 5,000 crore.
- Rs 500 crore for corpus fund to subsidise all women Self Help Groups for LIC cover for permanent disability.
- Agricultural loans given by scheduled commercial banks, regional rural banks and cooperative credit institutions up to March 31, 2007 and due for December 31 that year will be covered under the waiver scheme to address the problem of indebtedness.
- No change in corporate income tax.
- To protect tigers, Rs 50 crore for National Tiger Conservation Programme. Bulk of it to be used to raise Tiger Protection Force.
- Plan expenditure fixed at Rs 2,43,000 crore and non plan expenditure at 5,74,000 crore.
- Fiscal deficit pegged at 3.1 per cent and revenue deficit at 1.4 per cent.
- Tax to GDP ratio increased from 9.2 per cent in 2004-05 to 12.5 per cent 2007-08.
- Customs duty on specified life saving drugs reduced from ten per cent to five per cent.
- Special Countervailing Duty on power imports.
- Customs duty on specified sports goods machinery down from 7.5 per cent to five per cent.
- Duty withdrawn on naptha for production of polymers.
- Duty on crude and unrefined sulphur reduced from five to 2 per cent to help raise domestic fertiliser production.

- General Cenvat on all goods to be reduced from 16 per cent to 14 per cent. Excise duty reduced from 16 per cent to eight per cent on all pharmaceutical goods manufacture.
- Excise duty on small cars reduced to 12 per cent from 16 per cent and hybrid cars to 14 per cent.
- Excise duty reduced from 16 to 8 per cent on water purification items.
- Duty on non filter cigarettes to be raised.
- Asset management service under mutual funds, services by stock exchanges to be brought under Services Tax net.
- Threshold for small service providers raised from Rs eight lakh to Rs. 10 lakh.
- Allocation for defence to be increased by 10 per cent from Rs. 96,000 crore to Rs. 1,05,600 crore.
- 75 lakh people to be covered by health insurance scheme.
- Allocation for Textile Upgradation Fund to be more than doubled.
- Micro, small and medium enterprises to continue to get special attention.
- Risk Capital Fund to be set up in SIDBI.
- PAN requirement to be extended to all transactions in capital market subject to a threshold.
- Rs. 750 crore for upgradation of 300 ITIs in 25 districts.
- Rs. 32,676 crore as subsidy to Public Distribution System.
- PDS through smart cards in Haryana and Chandigarh on pilot basis.
- Three schemes to be introduced for providing social security to unorganised sector workers.
- Sixth central pay commission to submit report by March 31, 2008.
- Rs. 624 crore allocated for Commonwealth Games
- Farmers' debt to be waived
- Complete waiver of loans for marginal farmers owning land up to one hectare and small farmers owning land up to 1 and 2 hectares.
- Agricultural loans given by scheduled commercial banks, regional rural banks and cooperative credit institutions up to March 31, 2007 and due for December 31 that year will be covered under the waiver scheme to address the problem of indebtedness.
- One time settlement of loans for other farmers.
- Agriculture loans restructured and rescheduled by banks from 2004-06 and other loans normally rescheduled under RBI guidelines will also be eligible under the waiver scheme.
- Implementation of debt waiver and debt relief will be completed by June 30 this year.
- Loan waiver scheme to involve loans liability of Rs 60,000 crore and to benefit four crore farmers.
- By loan waiver scheme, the country is discharging a deep debt and sense of gratitude to farmers, says Chidambaram.

- The corpus of rural infrastructure development fund to be raised to Rs. 14,000 crore.
- More reforms needed in coal and electricity sectors to ensure double digit growth in manufacturing sector.
- Rs. 800 crore for accelerated power reforms programme.
- National Fund for Transmission and Distribution Reforms to be launched.
- The loan waiver scheme will benefit three crore small and medium farmers and cover loans totalling Rs. 50,000 crore.
- One crore other farmers will benefit to the tune of Rs. 10,000 crore in the waiver.
- Foreign investment of 3.5 to 8 billion dollars expected for exploration and development of new oil blocks.
- Rs. 7,200 crore to be allocated to the Ministry of Women and Child Development, marking an increase of 24 per cent.
- Rs. 500 crore for corpus fund to subsidise all women Self Helf Groups for LIC cover for permanent disability.
- A target of Rs. 2.80 lakh crore for agriculture credit set for the coming year.
- Rs. 20,000 crore for irrigation projects under AIPB, showing an increase of Rs. 9,000 crore over last year.
- National Horticulture Mission to be given Rs. 1,100 crore in 2008-09 with special focus on coconut cultivation.
- Rs. 75 crore to be given to Agriculture Ministry for providing mobile soil testing laboratories in 250 districts.
- Rs. 644 crore for National Agriculture Insurance Scheme, which will be continued pending evolving an alternative crop insurance scheme.
- National Plant Protection Training Institute at Hyderabad to be made autonomous body and Rs. 29 crore will be allocated to it.
- A scheme of debt waiver and relief for small and marginal farmers announced.
- NREGA scheme to be rolled out in all the 596 rural districts in the country in 2008-09.
- Jawaharlal Nehru Urban Renewal Mission to get Rs. 6,865 crore this year against Rs. 5,482 crore past year.
- Allocation for Rajiv Gandhi Drinking Water Mission to be increased to Rs. 7,300 crore. Rs. 200 crore for potable water in schools.
- Rs. 300 crore to be set aside for desalination plant in Chennai for drinking water.
- Rs. 500 crore for identifying urgent needs of development programmes of border areas like Arunachal Pradesh.
- SC, ST and minority students to continue to get special attention.
- Allocation for several schemes in North East raised from Rs. 14,365 crore to Rs. 16,400 crore.
- Rs. 75 crore sanctioned for Rajiv Gandhi National Fellowship Programme for SC/ST students pursuing M.Phil.
- Rs. 230 crore will be extended as additional equity to developmental organisations looking after the welfare of SC.

- ST, socially and economically backward classes and minorities.
- Allocation for Minority Affairs Ministry to be doubled from Rs. 500 crore to Rs. 1,000 crore.
- Rs. 540 crore for multi-sectoral development plan for minority concentration districts.
- 288 public sector bank branches to be opened in districts having minority community concentration.
- Sarva Shiksha Abhiyan will be provided Rs. 13,100 crore, Mid Day Meal scheme Rs. 8,000 crore, Secondary education Scheme Rs. 4,554 crore.
- 410 additional Kasturba Gandhi Vidyalaya to be set up in backward blocks.
- Navodaya Vidyalayas to be opened in 20 districts with special focus on regions having SC/ST concentration.
- Allocation of Rs. 130 crore for this purpose. Rs. 750 crore more to be given for merit scholarship to students up to 10th and 12th class.
- Mid day Meal scheme extended to upper primary level in 3479 schools. 16 central universities to be opened in 2008-09.
- Three IITs to be set up in Andhra Pradesh, Bihar and Rajasthan.
- Schools of architecture and planning in Bhopal and Vijaywada. More institutes of higher education to be opened.
- Rs. 100 crore to be given to Information Technology Ministry to set up national knowledge centres.
- Allocation for NRHM increased to Rs. 12,050 crore
- Rs. 992 crore for national AIDS programme.
- A national programme for the elderly to be started at a cost of Rs. 400 crore.
- Rashtra Swasthya Beema Yojana to start from April one in Delhi and Haryana. Rs. 30,000 for each family belonging to unorganised sector.
- Allocation for ICDS increased to Rs 6300 crore.
- Rs. 85 crore sanctioned for scholarships to students pursuing science education.
- Indian Institutes of Science Education and Research to be set up at Bhopal and Thiruvananthapuram.
- Agriculture credit doubled in the first two years of the government to reach Rs. 2.40 lakh crore by March 2008.
- Eleventh Plan started on a robust growth.
- Gross budgetary support to be raised to Rs. 2,43,386 crore, an increase of more than Rs. 38,000 crore from the current level.
- Allocation for Bharat Nirman to be raised to Rs. 31,280 crore.
- Twenty per cent hike in education budget this year from Rs. 28,674 crore to Rs. 34,400 crore.
- GDP growth slows down to 8.4 per cent during quarter ended December 31, 2007 as compared to 9.1 per cent a year ago.
- Economy grew over eight per cent over 12 successive quarters since 2005, says Finance Minister P Chidambaram.
- Growth rate of agriculture estimated at 2.6 per cent during the current year.

- Services and manufacturing sectors expected to grow by 10.7 per cent and 9.4 per cent, says Chidambaram.
- Keeping inflation under check is one of the cornerstones of the Government's policy.
- Rice production estimated at 94.08 million tonnes, maize 16.78 mt, soyabean 9.45 mt and cotton 23.38 million bales.

As a last budget of the present Govt., this budget has nothing significant. The most talked about feature is the Rs. 60,000 crore loan waiver of farmers. But it is applicable to only those who have taken money from the nationalized and scheduled banks, who comprise just one third of the farmers in distress. Two thirds of the farmers have borrowed money from private money lenders. The bulk of suicides are taking place among them. There has been an increase in the allocations for health, education and other social sectors.

Check Your Progress 4

Fill in the blanks:

1. ______________ is a master financial plan of the government.
2. _____________ is the projected balance sheet of the country, prepared by Chief Finance Officer of country that is Finance Minister of the State.
3. _____________ is the study of generating resources for the development of country and about allocation of resources.
4. Fiscal policy is implemented through _____________,
5. ____________ in Indian context refers to the borrowings of the Central and State Government.
6. _____________ is obtained by subtracting interest payment (a component of non plan expenditure) from the fiscal deficit.

11.15 LET US SUM UP

Fiscal policy is a statement of Govt. about its projected source of revenue and expenditure, it tells about the schedule of activities to be undertaken towards the direction of national objectives. Fiscal policy is the projected balance sheet of the country, prepared by Chief Finance Officer of country that is finance minister of the state. Public finance is the study of generating resources for the development of country and about allocation of resources. Fiscal policy is implemented through Budget, which is statement of state’s revenue and expenditure. Typically budget includes four components: Some review of economy, Major policy announcement, Expenditure proposal, Tax proposal. The budget includes revenue and expenditure. Revenue and expenditure is divided in capital and revenue account. Thus receipts are broken into Revenue Receipts and Capital Receipts, and disbursement are broken up into Revenue expenditure and capital expenditure.

Taxation, Profits of Public Sector (Price), Domestic non-monetary borrowing, External borrowing, Borrowing form the RBI (monetised borrowing) are the main source of funds for the Govt. Expenditure of the Govt. can be divided into non - plan expenditure and plan expenditure.

Fiscal policy is a potent tool in the hands of Govt. to regulate the economic growth. Through the fiscal policy govt. can influences the demand, supply and even the level of currency in the economy. It increases the supply of currency in the economy by resorting to deficit financing thus taking public debt. Through fiscal policy Govt. also influences the level of investment and saving rate.

11.16 LESSON END ACTIVITY

Prepare a report on the impact of Present Budget on the business at large.

11.17 KEYWORDS

Deficit Financing: It is the deliberate unbalancing of the budget in such a way that government expenditure exceeds government revenue.

Public Debt: In Indian context it refers to the borrowings of the Central and State Government.

LDC: Least Development Countries.

VAT: Value Added Tax, it is imposed on sales.

Customs Duties: These are duties or taxes imposed on commodities imported into India.

Internal Debt: It includes the loans raised within the country.

11.18 QUESTIONS FOR DISCUSSION

1. What is fiscal policy? Describe the component of Budget.
2. Describe the various sources of Revenue of the Govt.
3. Discuss the role of fiscal policy in economic growth.
4. What is public debt? Discuss its role in economy.
5. Discuss the relation between deficit financing, public debt and inflation.

Check Your Progress: Model Answers

CYP 1

It includes tax revenue and other revenues.

a) ***Tax revenue:*** These comprised of taxes and other duties levied by the Union Govt.

b) ***Other Revenue:*** These receipts of government mainly consist of interest and dividends on investment made by government, fees and receipts for other services for other services, rendered by govt.

CYP 2

The main sources of funds for financing development expenditure can be grouped under following categories:

(a) Taxation

(b) Profits of Public Sector (Price)

(c) Domestic non-monetary borrowing

(d) External borrowing

(e) Borrowing form the RBI (monetised borrowing)

CYP 3

Non Tax revenue includes Borrowings, both internal and external, income from various govt. undertaking and monopolies, income from govt. property etc.

CYP 4

1. Budget,	2. Fiscal policy	3. Public finance
4. Budget	5. Public debt	6. Primary deficit

11.19 SUGGESTED READINGS

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LESSON

12

VALUE ADDED TAX, SERVICE TAX AND EXPENDITURE TAX

CONTENTS

12.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept of Value Added Tax
- Explain the various methods of calculating the VAT
- Learn the various advantages of VAT
- Know the reasons why businessmen are opposing the VAT
- Impact of VAT on Revenue

12.1 INTRODUCTION

The Govt. appointed a Tax Reform Committee under the chairmanship of Dr. Raja J. Chelliah on 29th August 1991. The Committee submitted its interim report in December, 1991 and its final report in August, 1992. The Committee has suggested far-reaching proposals to reform the tax system. Dr. Chelliah Committee has recommended value added tax (VAT) as the best option to the existing Central Excise Duty Tax system in relation to Indirect Tax System. After over a decade of debate, Value Added Tax was introduced in April 2005 by 21 Indian States.

12.2 MEANING OF VAT

Value Added Taxation is a kind of indirect tax. Value Added taxation is a percentage of tax on value (Ad valorem) added to the production or service at each selling point. It is a multi stage sales tax. VAT is levied in parts at every stage of the production and distribution process. A tax levied on business on the value they added to their purchase of raw material is known as VAT. Since Value added equals total output minus total input of purchases on current account. Thus value added is a multiple point sales tax with set-off for tax paid on purchases. Ultimately it is the customer who generally pays the full amount of the VAT. To understand the VAT, we should understand the Concept of Value Added in terms of VAT.

In brief VAT can be understood in following points:

- It is a local sales tax collected under a different system.
- It is a multi point tax with a facility of set off for tax paid on purchases.
- It is collected on each stage of the production distribution cycle.
- It based on the destination principle.
- The final and total burden by the domestic consumer.

12.3 VALUE ADDED

Before reaching to the consumer a product or service passes through many stages. In each stage from which product or service passes value addition takes place. Value added can be termed as either differences between sales and purchases or as the sum of the components which go to make up the value added such as rent, wages, interest and profit. According to economics terminology “the difference between the value of output produced by the firm in a given period and value of the inputs purchased from other firms in producing output is known as value added.” The ICMA defines value added as “the increase in the market value resulting from an alteration in the form, location or availability of a product or service, excluding the cost of bought-materials and services.”

12.4 OBJECTIVES OF VAT

VAT is implemented with following objectives:

1. To remove the double taxation having cascading effect.
2. To eliminate multiplicity of taxes such as entry tax, turnover tax, sales tax, surcharge, excise duties etc.
3. To eliminate inter-state tax.
4. To reduce inspector Raj.
5. To make the tax structure, simple, efficient, and transparent.
6. To widen the tax net.
7. Coordinate revenue growth with development by Ad valorem rate of tax.
8. To create level playing field to enable industry and trade to meet the challenge of globalised economy.

12.5 VAT CONCEPT

VAT is a tax on value added. Thus tax is paid at every stage from which good or service passes but it is paid on the value added only and not on whole cost. Thus every body in the production and distribution chain pays the tax but only on the value added at his level only. Thus in very brief we can say that if a trader X purchases a good A at price of Rs. 10 and sells it to trader Y at Rs. 12, thus value addition is only Rs. 2 and he will pay tax on that Rs. 2 only (not on Rs.12). Rate of tax is say 10% then the effective tax is 00.20 (10% of Rs 2).

We can understand it in following equation:

Producer → Manufacturer → Trader → Consumer

Producer	Manufacturer	Trader	Consumer
Pays the first Point Tax	Pays Tax on Value Added	Pays Tax on Value Added	

Total tax incidence on consumer = FP tax paid by producer

+ Tax on value added by M/F

+ Tax on value added by trader

= Tax on retail sale price

VAT is in many respect is in many respect equivalent to a last point retail sales tax. The difference between these two is that, the VAT is collected in bits at each stage of production and distribution: which is in total is equal to tax on the retail sale on the same rate as the VAT. It can be understood from the following example:

Suppose there is a retailer who purchases goods worth Rs. 200 and sells it to consumer at Rs. 250 so tax effect will be as follows:

Retailer

Purchase = 200	Sales = 250
Tax charged = 10% of 200	Tax charged = 10 % of 250
From Retailer = 20	from customer = 25

Out of Rs. 25 charged from the customer, retailer will pocket Rs. 20 (tax paid at the time of purchase) and pay balance Rs. 5 to the department.

Further it can be understood by following example:

The value added can be derived either by Subtractionor by addition.

12.5.1 Subtraction Method

According to this method VAT is calculated on the difference between selling value and purchasing value of a product-service at a predetermined tax rate. We can understand this by following example:

Suppose M is a raw material supplier,

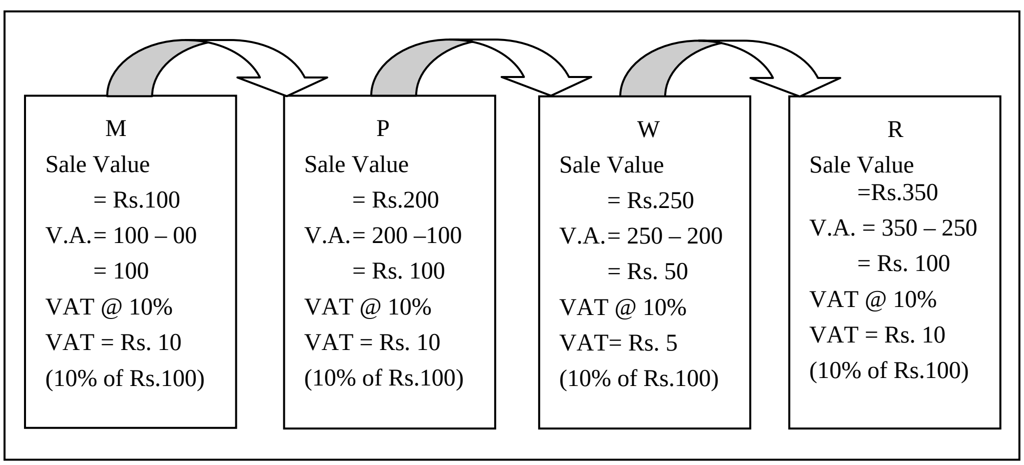
P is a Manufacturer

W is a Wholesaler

R is a retailer.

And VAT is at 10%

If M sales a product to P for Rs. 100 and pays tax at the applicable VAT rate of 10%. It is assumed that M is a primary producer of product thus his input can be assumed as zero. So the tax will be 10% of Rs. 100 that is Rs. 10. Rs. 100 is the purchase price of P. Manufacturer P will add value to the product increasing its usability through the manufacturing process. In this process he invest some money and add his profit so his sale value is 200. Value added is the difference value that is Rs. 200 - Rs. 100 = 100, tax @ 10 is Rs. 10 (10% of Rs 100 (difference)). The sale price of P is the purchase price of W the wholesaler. Wholesaler will add his operating cost and profit and thus suppose his sale value is Rs. 250. At this point value addition in terms of money is Rs. 250 - 200 = 50 and applicable VAT at the rate of 10% will be Rs. 5. The Retailer R purchases it at Rs. 250 and sells it at Rs. 350 the value addition is Rs. 350 – Rs. 250 = Rs. 100 and tax will be Rs. 10 (10% of difference.) It can be understood from following diagram:



Total VAT collected at four stages = 10 + 10 + 5 + 10 = 35

Last point retail Sales Tax @ 10 on 350 = 35.

12.5.2 Cumulative Method

As per cumulative method, tax is collected on overall sale value. In this system accumulation takes place for the cost increased for producing goods and profit added at each previous sage. In this method, tax is computed on purchasing value is deducted from the amount of tax computed on selling value. The difference amount of tax is payable to Govt. by seller of product or service. Here the tax paid at previous stage is set off against the total amount of tax on selling value for fixing net tax liability of seller at each stage. We can understand in the above mention assumption:

M	P	W	R
Sale Value = Rs.100	Sale Value = Rs.200	Sale Value = Rs.250	Sale Value = Rs.350
VAT on SV @ 10%	VAT on SV @ 10%	VAT on SV @ 10%	VAT on SV @ 10%
= 10	= 20	= 25	= Rs. 35
Less: set off pre stage = 00	Less: set off pre stage = 10	Less: set off pre stage = 20	Less: set off pre stage = 25
Net VAT = 10 – 00	Net VAT = 20-10	Net VAT = 25 – 20	Net VAT = 35 - 25
= Rs. 10	= Rs. 10	= Rs. 5	= 10

As in the example M sales a product to Mr. P for Rs. 100 and pays tax at the applicable VAT rate of 10% or Rs. 100. As M is the primary producer of product, his input could be assumed Zero. Hence the sale would be Rs. 100 and on this sale value of Rs. 100 @ 10% VAT would be Rs. 100. This Rs. 100 is the purchase price of P. Manufacturer P will add value to the purchased product. Assume that after adding all the cost incurred by him and his own profit his sale value is Rs. 200. On this sale value of Rs. 200@ 10% total VAT would be Rs. 200. As Raw material producer M has already paid VAT on his sale value of Rs. 100 @ 10% Rs. 10 and Manufacturer P will get credit/set - off for this tax. Hence net liability of VAT for P Rs. 10. Similarly the sale value of Rs. 250 by wholesaler W would have net liability of VAT of Rs. 5. And the sale value of Rs. 350 by Retailer R would also have net liability of Rs.10.

The illustration shows that VAT is collected at each stage of production and distribution channel. Thus it is broad base tax covering the value added of each product-service by a firm during all stages of production and distribution though final burden falls on the consumer.

Check Your Progress 1

What do you understand by the Value Added Tax (VAT)?

………………………………………………………………………………………

………………………………………………………………………………………

12.6 ADVANTAGES OF VAT

VAT has following advantages:

1. ***Simplicity:*** It is very simple tax system, it doesn't contain cumbersome calculations, even a simple retailer can calculate his or her tax, so the expenditure on tax collection and tax assessment is very low compared to traditional tax system.

2. ***Transparency:*** It is a fully transparent system so there is little scope of if and buts and of course of corruption.

3. ***No cascading effect:*** VAT avoids multiple taxation thus it remove the problem of cascading effect of traditional tax system.

4. ***A few rates of tax:*** In VAT regime there is mainly four tax rates (0%, 1%, 4%, 12.5%) so it is very simple.

5. ***Self Assessment:*** It replaces existing system of inspection by built in assessment by the dealers and internal auditing.

6. ***Less incentive to tax evasion (wider coverage):*** In VAT the trader pays the tax only at the value added thus it is less then that of earlier tax system second he will charge that tax from its customers, third, he can charge VAT from his customer if he has paid it to its supplier so VAT make a chain where everybody pays tax, so that he can collect tax from its customer. This is the major objective of VAT that a less amount of tax should be paid by every trades in a value chain.

7. ***Revenue security:*** VAT represents an important instrument against tax evasion and is superior to a business tax or a sales tax from the point of view of revenue security for three reasons.

   In the first place, under VAT it is only buyers at the final stage who have an interest in undervaluing their purchases, since the deduction system ensures that buyers at earlier stages will be refunded the taxes on their purchases. Therefore, tax losses due to under valuation should be limited to the value added at the last stage. Under a retail sales tax, on the other hand, retailer and consumer have a mutual interest in under declaring the actual purchase price.

   Secondly, under VAT, if payment of tax is successfully avoided at one stage nothing will be lost if it is picked up at a later stage; and even if it is not picked up subsequently, the government will at least have collected the VAT paid at stages previous to that at which the tax was avoided; while if evasion takes place at the final stage the state will lose only the tax on the value added at that point.

   If evasion takes place under a sales tax, on the other hand, all the taxes due on the product are lost to the government. A significant advantage of the value added form in any country is the cross-audit feature. Tax charged by one firm is reported as a deduction by the firms buying from it. Only on the final sale to the consumer is there no possibility of cross audit. Cross audit is possible with any form of sales tax, but the tax-credit feature emphasizes and simplifies it and is likely to make firms more careful not to evade because they know of the possibility of cross check.

8. ***Selectivity:*** VAT may be selectively applied to specific goods or business entities. VAT provides a full credit for the tax included in purchases of capital goods. The credit does not subsidize the purchase of capital goods; it simply eliminates the tax that has been imposed on them.

12.7 DIFFERENCE BETWEEN VAT AND EXISTING TAXATION SYSTEM

In brief difference between VAT and existing tax system can be understood from following table 12:

Table 12.1: Difference between VAT and Existing System

VAT	Existing System
Levied at each stage of the production distribution cycle	Mainly first point taxation
Mainly four flour rates : 0%, 1%, 4%, 12.5%	Multiplicity of rates result in hairsplitting distinction among commodities and breeds excessive litigation & economic distortion
Concessions and incentives are also deliberated to be done away with	Concessions and incentives are quite common
Uniform tax rates	Competing tax rates among various states
No cascading effect of taxes	Cascading effect of taxes

12.8 HISTORY OF VAT

At present VAT is in vogue in many countries. The most important group of countries in this respect is European Union (EU). It is not a new concept at international level. For the first time in 1921, EVON, Siemens proposed VAT as substitute for the established German Turnover Tax in Germany. France was the first European Country who adopted VAT in 1954. VAT was implemented in U.K. in 1973. China implemented it in 1994, Switzerland implemented it in 1995. Table 12.2 shows the list few countries adopted VAT and the tax system replaced by VAT:

Table 12.2: History of VAT

Country	**Year of Adoption of VAT**	**Tax system replaced by VAT**
France	1954	Wholesale Sales Tax
West Germany	1968	Multi Stage Turnover Tax
Netherlands	1968	Multi Stage Turnover Tax
Luxembourg	1970	Multi stage turnover tax
Belgium	1971	Multi Stage Turnover Tax
Italy	1973	Multi Stage Turnover Tax
United Kingdom	1973	Purchase Tax

12.9 VAT IN INDIA

The Govt. of India had set up an Indirect Taxes Inquiry Committee in 1976 of which Mr.L.K. Jha was the chairman. It strongly recommended the adoption of VAT in India. It recommended the MANVAT, a VAT at the manufacturing level. As a result the MODVAT scheme was introduced with effect from May 1, 1986. Initially it covered selected items in only 37 Chapters which was gradually extended to 77 chapters.

Table 12.3: VAT in India

Some Earlier Half Baked Effort of Implementing VAT in Country	**Some Important Milestones**
Maharashtra introduced half baked VAT from 1.10.95 and allowed input credit for tax paid above 4%. Andhra Pradesh, Kerala, Madhya Pradesh also introduced half baked VAT on some select commodities for resellers only but did not grant set-off for tax paid on inputs. But all these states withdrew such VAT within a couple of years. In 1998 West Bengal Govt. also introduced half baked VAT on few select commodities (jute goods, T.V. sets stainless steel wares, electric bulbs) on the value added by the dealer. However it was withdrawn within 6 months. Even Haryana had some scheme of VAT for manufacturers.	1986: Introduction of a restricted VAT called MODVAT 1991: Report of the Tax Reforms Committee recommends VAT, among others. recommendations accepted by Government. 1994: Introduction of Service Tax Jan, 2000: Implementation of uniform floor tax rates (1%, 4%, 8%, 12% & 20%). Abolition of tax related incentives granted by States. March, 2000: Replacement of MODVAT by Central VAT (CENVAT). July, 2000: Introduction of 'Transaction Value' in CENVAT. April, 2002: Introduction of State VAT

MODVAT was renamed as CENVAT (Central Value Added Tax) with effect from April 1, 2000. All inputs used directly or indirectly (except HSD, LDO, and Petrol) are eligible for CENVAT. What VAT is to sales tax same way CENVAT is to excise? This Central VAT has replaced the erstwhile excise duty regime. The CENVAT regimes permits the setoff of CENVAT paid on inputs/capital goods as also a setoff of the equivalent of the CENVAT which is imposed on imported goods, namely countervailing duties against the CENVAT payable on output. In addition to CENVAT, a central sales tax is also imposed on inter stat sales of goods. This tax is generally at 4%. Besides there is a provision of 10% service tax on various services. There exist following taxes on trading and manufacturing in present system:

CENVAT: A tax imposed by tax on manufacture or production of goods in India.

Service Tax: A tax on identified services. It is imposed by center.

States Sales Tax: A tax imposed by the state on the intra-State sale/ trade of goods.

Central Sales Tax (CST): A tax on inter state sale/trade of goods.

Other local tax imposed by states.

> The finance ministry will follow a gradual approach to move towards aligning the goods and services tax into a single rate. Highly-placed sources said the process can begin in the near future, but will take at least three years to complete. The finance ministry is deliberating on the road map for transition to a single rate of tax.
>
> At present, 81 services are taxed at 10%; the median central value-added tax (Cenvat) has been fixed at 16% for goods, while states levy 12.5% value-added tax (VAT) on goods. The alignment of service tax with Cenvat is essential to administer VAT credit uniformly in transactions where goods are used as inputs to provide services.
>
> A hike in the service tax rate seems unlikely this year, given that the rate was hiked to 10% in Budget 2005-06. The rate, which was fixed at 5% when the tax was first introduced in 1994, was raised to 8% in ’03-04.
>
> Top finance ministry sources said the ministry favoured a phased implementation of a common goods and services tax (GST) — an important landmark in tax reforms. “The phase-out of local sales taxes has taken 10 years. It is not easy to shift to a uniform tax regime overnight,” said this source.
>
> The Economic Times November 15, 2005

12.9.1 State Level VAT

The first state level preliminary discussion on State level VAT took place in meeting o State Chief Ministers convened by Dr. Manmohan Singh the then finance Minister. It is the efforts of the Convener of the Empowered Committee of State Finance Ministers, Sri Asim Kumar Dasgupta and the Union Finance Minister, Mr. P. Chidambaram that the VAT is implemented in the States form April 1, 2005. Today more than 21 states have implemented the VAT.

12.9.2 White Paper on VAT

The ‘white paper’ on VAT released by the Finance Minister lays down a road map for a uniform state-level tax on cover 500 items and gives the states an option to exempt food grains for a year. The key features of VAT are:

1. The VAT will replace a web of sales taxes, and will cover around 550 goods, of which large number of commodities will fall in the 12.5% tax rate. On another 270 items 4% duty and tax of 1% will have to be paid on gold and silver ornaments. 46 products were exempted form VAT of these 10 items are to be decided by state rest being common across country.
2. The Finance Minister said that three items - Textile, Sugar, and Tobacco covered under the additional excise duty structure will not be under the VAT regime for one year and the existing arrangement would continue.

3. A special 1% floor rate will cover only gold and silver ornaments, precious and semi precious stones.
4. Medicines, agriculture and industrial inputs are in 4% slab.
5. State are free to choose 12.5 or 4% VAT on tea.
6. The Threshold limit for traders under VAT at Rs. 5 Lakhs.
7. The Upper turnover limit of being classified as a 'small traders' had been raised to Rs. 50 Lakhs from Rs. 40 Lakhs in the draft documents.
8. Traders up to turnover of Rs. 5 Lakh to R. 50 Lakh can pay 1% VAT.
9. 4% Central Tax to be phased out after 2006.
10. Tax paid for export to be refunded with in 3 months.
11. VAT on imports, service tax and items under additional excise duty will be integrated into VAT system form the second year if decisions are taken expeditiously at central level.
12. Under the formula commanded by VAT panel, states would get 100% compensation for revenue loss, if any in first year, while 75% of the loss will be compensated in the second year, and 50% in the third year.

The Finance Minister Mr. P. Chidambaram said, "This is the best example of cooperative federalism and the first document which has been collectively prepared and put out by the finance ministers of all states."

12.9.3 Why Traders are Opposing VAT in India?

"We will step up our protest come what may. It is a do or die situation for us."

Praveen Khandelwal, secretary-general of the Confederation of All India Traders.

1. The power to enhance the rate of tax will rest with the finance department of the states. The industry feels that this will be largely misused, and rates could be increased at the wishes of the bureaucrats, ignoring the stipulations.
2. The bureaucracy will have full control over every dealer and trader, and will have the authority to inspect not only the books of accounts, but verify case or stock too. This is absurd feels the industry.
3. The department will have the power to attach provisionally, any money which is due or which may become due in the course of any enquiry, inspection or proceedings. The revocation of such an attachment is possible only after the submission of a bank guarantee. Though it is provided that such an attachment will cease to have effect after the expiry of one year, the commissioner has the power to extend this period up to two years.
4. Getting refunds of the VAT would be a cumbersome procedure.
5. There will be no set-off on inter-state sales.
6. The new VAT provisions give power to the authorities to create check nakas at their discretions.
7. No redressal system of recheck.
8. Audit requirement under VAT on a turnover of Rs 40 lakh is required to be audited and assessed. When there is already an audit of accounts for income tax purposes, a separate audit requirement for VAT is a duplication of the work.
9. Penal provision for a lapse of even a single day in filing return is very high, to the extent of 50 per cent of the tax payable.

10. Traders dealing in products with brand names will be required to pay additional taxes of brand name and not set-off on these is provided.

Traders have mentioned that maintaining books of accounts is an almost impossible task, especially for the very small textile traders that are spread across the country and in the interiors of the country too. The present rules give the sales tax department, finance department, etc sweeping powers, and will lead to a lot of malpractices and harassment. Even as traders are not opposed to paying tax, this should be done without harassing the traders.

12.9.4 VAT and Exports

Implementation of VAT does not have any major impact on Exports. This is because the export sector has no VAT. If imposition of VAT results in inflation, the price of exports may rise, making it less competitive for exports sector to compete in the international economy. Imposing a VAT on imports of not affect imports because the domestic products are charged VAT too.

12.9.5 VAT and Savings

A VAT can boost savings. Since the Tax is imposed on consumption, people will be motivated to consume les and save more. In this respect VAT is superior to income Tax in fostering growth.

12.9.6 VAT and Administrative Problem

Multiple VAT will not only have high administrative cost but will also create administrative problem for Govt. In multiple VAT there is a problem of definition. As in France, medical products attract less VAT than that of cosmetics. So few companies are showing there shampoo as medical product, it results in litigation and was even extended parliamentary debate. Finally it was declared that it was a cosmetic product. These types of confusion and litigation are also possible in India as we have also adopted multiple VAT. To reduce administrative cost and problem, a multiple VAT should clearly mention the items which are exempted, which are Zero rated, and which items fall in which grade of the VAT.

A multiple VAT can have tremendous administrative costs. As this is collected at almost every level through which product goes, this increases the number of persons to be contacted (involved) to collect the tax, though consumer is giving same tax. So to collect the same amount now more persons are to be contacted, it will certainly increase the administrative cost. Costs further increase because of multiple rates and various exemptions.

The success of VAT depends upon the cost - output ratio. If increase in collection as it is expected from VAT is not higher than increase in its administrative cost than certainly it will lose its purpose.

12.9.7 VAT will increase Govt. Revenues

Experience of other countries shows that it will certainly increase the revenue of Govt. As it is collected at many levels and if one misses at any particular level than it can be traced at subsequent levels. It also discouraged the purchases from the unregistered trader's purchaser have to get a tax invoice from the registered seller to avail credit. It encouraged the retailer to get registered with the department other wise they will be loosing sale/business. In many cases where tax is collected at last level, to avoid tax traders usually gives goods to consumer without mentioning it in books, consumers also welcomes it as in this case he/she doesn't have to pay tax on it But in case of VAT it is not possible as retailer/trader has already paid the tax, and if he had paid then he will certainly collect it from consumer.

VAT helps raise Bengal tax collection

Tax collections have shown a growth in the first six months of the current fiscal in the post value added tax (VAT) regime despite the scope for deductions. Speaking at the conference on the new VAT regime at the Bengal National Chamber of Commerce and Industry (BNCCI), CM Bachhawat, commissioner of commercial taxes of the government of West Bengal, said despite the prevalence of high tax rate in the state especially in the case of categories like cement, cosmetics, medicines, food processing, etc. where taxes have been rationalised, growth was satisfactory. In West Bengal, tax on cement being brought down from 20.25 per cent to 12.5 per cent and cosmetics from 26 per cent to 12.5 per cent.

Cash memo compliance was a major issue, explained Bachhawat. Modalities to improve cash memo compliance were being worked out through public awareness campaigns and technology usage, he informed.

Business Standard, Kolkata, November 24, 2005.

Check Your Progress 2

What do you understand by CENVAT?

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12.10 SERVICE TAX

As per the Finance Act of 1994, all service providers in India, except those in the state of Jammu and Kashmir, are required to pay a Service Tax in India. Service Tax is levied on the notified services. It is a union levy administered by the Central Excise Department and governed by Chapter V of Finance Act, 1994 (the Act) as amended from time to time. The rate of service tax till 9 September, 2004 was 8 per cent and from 10 September, 2004, it was increased to 10 per cent. Education cess at 2 per cent is levied on service tax amount from 10 September, 2004. The effective rate of service tax works out to 10.2 per cent. Service tax is charged on the gross value of services and is generally payable on receipt basis. It is an indirect tax - it is payable by the service provider but it is ordinarily recovered from the recipient of services. The law requires separate mention of service tax amount in the invoices.

Ordinarily, every person liable to pay service tax is required to register itself with service tax authorities and comply with procedural requirements like paying taxes, filing returns, etc. However, in case of non-residents, who do not have any office in India and who are liable to pay service tax in India, this burden is shifted to the recipient of service with effect from 16th August, 2002.

There is a basic exemption limit of INR 0.4 million which means that service tax shall be exempted for service providers providing taxable services up to INR 0.4 million. A mechanism for credit of input service tax and central excise duty on specified inputs and capital goods is also in place.

Any service for which payment was received in convertible foreign exchange in India and which was not repatriated or sent outside India was exempt from levy of service tax up to 28 February, 2003. But this exemption was withdrawn with effect from 1st March, 2003, although export of services continued to remain taxfree even after such a withdrawal. This exemption was reinstated with effect from 20th November, 2003 as a stop-gap arrangement till the government could satisfactorily determine "what constitutes export of services". The government has now notified the new "Export of Service Rules 2005" which defines as to what constitute "export of services". These rules are effective from 15th March, 2005. Consequently, the exemption from service tax on payments received in convertible foreign exchange has now been removed with effect from 15th March, 2005.

When two or more services are bundled together it would be classifiable under the category which gives essential character to the service. Classification rules are in place from 14th May, 2003. If in case of composite activities, one or more of the activities are liable to service tax and the others are not liable to service tax, service tax would ordinarily be payable only on the charges received for the services to which service tax is applicable, provided charges for each activity can be separately identified / determined and it is not incidental to the main service. There are no rules for such identification / allocation and, therefore, such allocation, if required, must be made on a reasonable basis.

Service tax is a comparatively new levy in India and very few judicial precedents are available on the subject. The language of the law is quite broad and generic and uses terms like "directly or indirectly" and "in any manner" which raise a number of issues regarding scope of specific category of service. Revenue authorities have been issuing explanatory circulars from time to time in relation to specific issues. Yet, there is, considerable ambiguity in the applicability of the service tax law to various services.

Table 12.4: Service Tax is Currently Levied on 80 notified Categories of Services

Advertising Agency	**Air Travel Agent**	**Airport**	**Architect**	**Sound Recording**
Authorized Service Station	Banking and Other Financial Services	Beauty Treatment	Broadcasting	Steamer Agent
Business Auxiliary Services	Business Exhibition	Cable Operator	Cargo Handling	Stock Broker
Chartered Accountant	Cleaning Activity Services	Clearing and Forwarding Agent	Construction	Storage and Warehousing
Construction of Complex Services	Consulting Engineer	Convention	Cost Accountant	Survey and Exploration of Mineral
Courier	Credit Rating Agency	Custom House Agent	Dredging Services	Survey and Map-making Services
Dry Cleaning	Erection, Commissioning and Installation Agency	Event Management	Facsimile	Technical Inspection and Certification
Fashion Designing	Forward Contract	Franchise	General Insurance	Technical Testing or Analysis
Goods Transport by Air	Goods Transport by Road	Health Club and Fitness Centre	Insurance Auxiliary Services	Telegraph
Intellectual Property	Interior Decorator	Internet Café	Leased Circuit	Telephone and Pager
Life Insurance	Mailing List	Mailing List Compilation	Maintenance or Repair Mailing Services	Telex
Management Consultant	Mandap Keeper	Database	Opinion Poll Access or Retrieval	Tour Operator
Outdoor Caterer	Packaging Activity Services	Pandal and Shamiana	Photography Studio	Transport of goods other than water

Contd…

Port (major and others)	Programme Production	Rail Travel Agent	Real Estate Agent	Travel Agents (other than air and rail) through pipeline or other conduit services
Rent-a-cab	Scientific or Technical Consultancy	Security Agency	Site Formation and Clearance, etc., Services	Underwriters
Video Production				

Service tax is new to India and most of the effected organization has never given such type of tax. This organizations and individuals feel uncomfortable in giving tax. This has not only increase there financial burden but also the cost in terms of time and money. People also avoid interacting tax departments/personnel etc. for the fear of harassment and Govt. interference. To avoid the tax evasion and to widen the tax net it is essential educate organizations and people regarding the tax and its procedures. In service tax even individuals are involved thus it essential to make the procedures simple and online.

Check Your Progress 3

Fill in the blanks:

1. Value Added Taxation is a kind of _____________tax.
2. Value Added taxation is a percentage of tax on value (Ad valorem) added to the production or service at each ________________.
3. ___________is in many respects is in many respect equivalents to a last point retail sales tax.
4. According to ____________ VAT is calculated on the difference between selling value and purchasing value of a product-service at a predetermined tax rate.
5. As per _____________, tax is collected on overall sale value.
6. The __________ scheme was introduced with effect from May 1st, 1986.

12.11 EXPENDITURE TAX

Expenditure tax is levied on expenditure incurred in certain hotels or restaurants and for matters connected there with or incidental there to. It is applicable to the whole of India except the State of Jammu and Kashmir.

12.11.1 Application of the Act

This Act is applied in relation to any chargeable expenditure:

1. incurred in a hotel wherein the room charges for any unit of residential accommodation at the time of incurring of such expenditure are two thousand rupees or more per day per individual and where:
   (a) a composite charge is payable in respect of such unit and food, the room charges included therein shall be determined in the prescribed manner;
   (b) (i) a composite charge is payable in respect of such unit, food, drinks and other services, or any of them, and the case is not covered by the provisions of sub-clause (a), or

(ii) it appears to the Assessing Officer that the charges for such unit, food, drinks or other services are so arranged that the room charges are understated and the other charges are overstated, the Assessing Officer shall, for the purposes of this clause determine the room charges on such reasonable basis as he may deem fit; and

2. incurred in a restaurant.

12.11.2 Tax Authorities

Regarding the authorities this Act says:

1. Every Director General of Income-tax, Chief Commissioner of Income-tax, Director of Income-tax, Commissioner of Income-tax, Commissioner of Income-tax (Appeals), Additional Director of Income-tax, Additional Commissioner of Income-tax, Joint Director of Income-tax, Joint Commissioner of Income-tax, Deputy Director of Income-tax, Deputy Commissioner of Income-tax, Assistant Director of Income-tax, Assistant Commissioner of Income-tax, Income-tax Officer, Tax Recovery Officer and Inspector of Income-tax shall have the like powers and perform the like functions under this Act as he has and performs under the Income-tax Act, and for the exercise of his powers and the performance of his functions, his jurisdiction under this Act shall be the same as he has under the Income-tax Act.

2. All officers and persons employed in the execution of this Act shall observe and follow the orders, instructions and directions of the Board.

   Provided that no such orders, instructions or directions shall be issued:

   (a) so as to require any tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or

   (b) so as to interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions.

3. Every Assessing Officer employed in the execution of this Act shall observe and follow the orders, instructions and directions issued for his guidance by the Director General or Director or by the Chief Commissioner or Commissioner or by the Additional Commissioner of Income-tax or Joint Commissioner within whose jurisdiction he performs his functions.

12.11.3 Penalty for Failure to Furnish Prescribed Return

If a person fails to furnish in due time the return which he is required to furnish under sub-section (1) of section 8 or by notice given under sub-section (2) of that section, he shall pay, by way of penalty, a sum which shall not be less than one hundred rupees, but which may extend to two hundred rupees for every day during which the failure continues.

12.11.4 Wilful attempt to Evade Tax, etc.

If a person wilfully attempts in any manner whatsoever to evade collection or payment of any tax, penalty or interest chargeable or imposable under this Act, or to understate the aggregate of the chargeable expenditure, he shall, without prejudice to any penalty that may be imposable on him under any other provision of this Act, be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine

12.12 LET US SUM UP

Value Added Taxation is a kind of indirect tax. VAT is levied in parts at every stage of the production distribution process. A tax levied on business on the value they added to their purchase of raw material is known as VAT. Ultimately it is the customer who generally pays the full amount of the VAT. VAT was implemented with the objectives of eliminating multiplicity of taxes such as entry tax, turnover tax, sales tax, surcharge, excise duties etc., to eliminate inter-state tax, to reduce inspector Raj, to make the tax structure simple and to widen the tax net thus increasing the revenue for state.

VAT has many advantages as it is simple, Transparent, it doesn't have any cascading effect, has few rates of tax, allows self assessment has less incentive for tax evasion and gives revenue security.

Center has implemented the VAT in 1986 with the name of MODVAT at the manufacturing level which renamed CENVAT in 2000. By the April 2005, more than 21 states were following the VAT. As at the State level VAT was implemented replacing erstwhile sales tax, a feeling of uncertainty proliferated among people regarding the new tax system. Govt. has launched many training programmes for traders but theses training programmes and awareness programmes is also required for consumers.

12.13 LESSON END ACTIVITIES

1. Prepare a report on the impact of VAT on the retail outlet in your colony.
2. Do a survey of 20 retail outlets and find out there perception about VAT.
3. Analyze impact of VAT on the price of consumer goods.

12.14 KEYWORDS

VAT: Value added tax, a tax levied on business on the value they added to their purchase of raw material is known as VAT.

Multi Stage Sales Tax: Tax levied in parts at every stage of the production and distribution process.

Excise: Erstwhile tax imposed on manufacturing by Center.

MODVAT: Imposed by Center on manufacturing replacing excise.

CENVAT: MODVAT was renamed CENVAT (Central Value Added Tax) in year 2000.

12.15 QUESTIONS FOR DISCUSSION

1. What is Value Added Tax? Describe its concept through example.
2. What is difference between VAT and existing tax system? Discuss the advantages of VAT.
3. Discuss the status of VAT in India.
4. Why business community is opposing the VAT.
5. Explain the Service Tax in India.

Check Your Progress: Model Answers

CYP 1

VAT is a tax on value added. Thus tax is paid at every stage from which good or service passes but it is paid on the value added only and not on whole cost. Thus every body in the production and distribution chain pays the tax but only on the value added at his level only.

CYP 2

MODVAT was renamed as CENVAT (Central Value Added Tax) with effect from April 1, 2000. All inputs used directly or indirectly (except HSD, LDO, and Petrol) are eligible for CENVAT. What VAT is to sales tax same way CENVAT is to excise? This Central VAT has replaced the erstwhile excise duty regime. The CENVAT regimes permits the setoff of CENVAT paid on inputs/capital goods as also a setoff of the equivalent of the CENVAT which is imposed on imported goods, namely countervailing duties against the CENVAT payable on output. In addition to CENVAT, a central sales tax is also imposed on inter stat sales of goods.

CYP 3

1. indirect	2. selling point	3. VAT
4. Subtraction method	5. cumulative method	6. MODVAT

12.16 SUGGESTED READINGS

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Spiro George W. (1993) *The Legal Environment of Business*, Englewood Cliffs, NJ Prentice Hall

Starling, Grower (1996) *The Changing Environment of Business*, Cincinnati, OH, South Western College Publishing

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UNIT V

LESSON

13

COMPANY LAW

CONTENTS

13.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the origin of company law in India
- Know the formation of company
- Understand the auditing of company
- Learn the winding up of company
- Earn the company law Board Tribunal

13.1 INTRODUCTION

The Company legislation in India owes its origin to the English company law. The Companies Act passes from time to time in India have been following the English Companies Act with certain modifications to suit Indian Conditions. The first legislation passed in 1850 for the registration of Joint Stock Companies Act, it was based on the English Companies Act, 1844. This Act recognizes the companies as distinct legal entities but did not introduce the concept of limited liability. In 1857 another Act was passed to give effect to the principle of limited liability. In 1860 principle of limited liability was extended to banking companies. The Companies Act 1866 repealed all the previous Act. This was followed by Companies Consolidation Act 1882. English Companies Consolidation Act was passed in 1908. Following the English Companies Act, 1908, the Indian Companies Act, 1913 was passed. As this Act closely followed the English Act the decisions of the English Courts under the English Company Law were also closely followed by the Indian courts.

Government of Independent India appointed a Committee under the Chairmanship of Shri H.C. Bhaba for the revision of the Indian Companies Act. The Committee submitted its Report in March, 1952. In mean time, Indian Companies (Amendment). At 1951 was passed as an interim measures which conferred powers upon the Govt. to intervene directly in regulating the affairs of companies in India. Bhaba Committee submitted its report in March 1952, based on the report Companies Act, 1956 was introduced in Parliament. This Act once again followed the English Companies Act, 1948. The major changes that the Indian Companies Act introduced over the Act of 1913 are:

1. Promotion and Formation of Companies
2. Capital Structure of Companies
3. Company Meetings and Procedures
4. The Presentation of company accounts, their audit, and the powers and duties of auditors
5. The inspection and investigation of the affairs of the company
6. The constitution of the Board of Directors and the powers and duties of Directors
7. The Administration of Company Law

Since then Companies Act has been amended several times. The major amendments were introduced in the years 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1974, 1977, 1985, 1988, 1991. In the era of liberalization Govt. felt that many of the provision of the company law are not conducive to the present condition. Keeping in view Amendment bill 1993 was introduced in Parliament. The bill was later withdrawn for the purpose of redrafting. In the mean time to meet the demand of the day Companies (Amendment Act), 1996, then Companies (Amendment Act), 1997 and Companies (Amendment Act), 1998 were enacted. Which was replaced by the

Companies Amendment Act 1999. This Act brought number of changes in the Act. All the changes were in line with the Govt.'s policy of liberalization, globalization and privatization. The facility to buy back companies own shares is given to corporate, provisions regarding investments, and loans were rationalized and liberalized. Govt.'s approval is no more required for investment decisions and companies were allowed to issue 'sweat equity' in lieu of intellectual property. To make the accounts of Indian companies compatible with international practices, the compliance of Indian Accounting Standards was made mandatory. For the benefits of investors provisions were made for setting up of "Investor Education and Protection Fund." It also certain measures of good corporate governance.

Soon some more changes were introduced through Companies Amendment Act, 2001 and then 2002.

13.2 OBJECTIVES OF COMPANY LAW

The Company law 1956 was passed with the following objectives:

1. To ensure that the activities of the companies are carried on not only in the interest of those directly concerned with them but also in furtherance of the ultimate ends of economic and social policy which the country has accepted.
2. To fix up minimum standards of business integrity and conduct in the promotion and management of companies' affair.
3. To protect the legitimate interest of the shareholders by ensuring effective participation and control by them.
4. To prevent misconduct and malpractices on the part of company management and abuse of power vested in them by the general body of shareholders.
5. To enforce proper performance of duties by persons responsible for the management of companies.
6. To adjust the rights of the management vis-a-vis the shareholders and other concerned persons.
7. To require full and fair disclosure of all reasonable information relating to the affairs of the companies.
8. To empower the govt. to intervene and investigate into the affairs of the company where the business of the company is being carried on in a manner prejudicial to the interest of the shareholders, the company or the general public.

Sub Division of Company Law

The subject of the Company Law is very vast. But in short it can be sub-divided into the following important heads:

1. Incorporation of Companies
2. Allotment of shares and share capital
3. Membership in Companies
4. Borrowing by companies and registration of charge
5. Management and administration of companies
6. Winding up of Companies.

13.3 COMPANY

The word 'Company' is an amalgamation of the Latin word 'Com' meaning "with or together" and 'Pains' meaning "bread". Originally, it referred to a group of persons who took their meals together. A company is nothing but a group of persons who have come together or who have contributed money for some common person and who have incorporated themselves into a distinct legal entity in the form of a company for that purpose. Under Halsbury's Laws of England, the term "company" has been defined as a collection of many individuals united into one body under special domination, having perpetual succession under an artificial form and vested by the policies of law with the capacity of acting in several respect as an individual, particularly for taking and granting of property, for contracting obligation and for suing and being sued, for enjoying privileges and immunities in common and exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers upon it, either at the time of its creation or at any subsequent period of its existence. Lord Justice Lindley has defined a company as "an association of many persons, who contribute money or, money's worth to a common stock and employs it in some trade or business and who share the profit and loss, arising there from." Chief Justice Marshall of the United States Supreme Court defined a company as "an artificial being, invisible, intangible and, existing only in contemplation of the law. Being a mere creation of the law, it possesses only those characteristics which the Charter of its creation confers upon it, either expressly or as incidental to its very existence."

However, the Supreme Court of India has held in the case of State Trading Corporation of India v/s CTO that a company cannot have the status of a citizen under the Constitution of India.

The Act does not define a company in terms of its features. Act merely states that "a company means a company formed and registered under this Act or an existing company as defined in section 3(1) (ii)". Section 3(1) (ii) lays down that "an existing companies means a company formed and registered under any of the previous law."

Check Your Progress 1

1. What do you understand by the term 'company'?

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. What are the important heads of the company law?

   ……………………………………………………………………………….

   ……………………………………………………………………………….

13.4 CHARACTERISTICS OF COMPANY

The most important feature of company are 'separate legal entity' of the company and in most cases 'limited liability' these and other characteristics of company are as follows:

1. ***Separate Legal Entity:*** Company is different from the persons who constitute it. The company is different and distinct from its members in law. In law company is regarded as an artificial legal person having its own name and its own seal, its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, borrowing money, having a bank account, employing people, entering into contracts and suing and being sued separately.

2. ***Limited Liability:*** One of the principle advantages of trading through the medium of a limited company is that the members of the company are only liable to contribute towards payment of its debts to a limited extent. The liability of the

members of the company is limited to contribution to the assets of the company up to the face value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him when called upon to pay and nothing more, even if liabilities of the company far exceeds its assets.

3. ***Separate Property:*** A company is a distinct legal entity. It can therefore hold the property in its own name. The company's property is its own. A member cannot claim to be owner of the company's property during the existence of the company.

4. ***Common Seal:*** A company is an artificial person and does not have a physical presence. Thus it cannot sign its name. It has a common seal, which is used as a substitute for its signature. The common seal is the official signature of the company. The name of the company must be engraved on the common seal. Any document not bearing the seal of the company may not be accepted as authentic and may not have any legal force.

5. ***Capacity to sue and being sued:*** Being a legal person a company can sue or be sued in its own name as distinct from its members.

6. ***Perpetual Succession:*** The term perpetual succession may be defined as the continuous existence. A company does not die or cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time but that does not affect life of the company. Death or insolvency of member does not affect the existence of the company.

7. ***Transferability of Shares:*** The Shares of a company are freely transferable and can be purchased and sold in share market, subject to certain conditions, such that no share-holder is permanently or necessarily wedded to a company. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares.

8. ***Separate Management:*** A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not be necessarily the managers of the company.

9. ***One Share-One Vote:*** The principle of voting in a company is one share-one vote. I.e. if a person has 10 shares, he has 10 votes in the company. This is in direct contrast to the voting principle of a co-operative society where the "One Member – One Vote" principle applies i.e. irrespective of the number of shares held, one member has only one vote.

13.5 TYPES OF COMPANY

The two common types of companies which may be registered under the Act are:

1. Private Companies and
2. Public Companies

Besides public and private companies there can be another types of companies as Govt. Companies, Statutory Companies, Holding and Subsidiary Companies, Foreign Companies.

13.5.1 Private Company

Private Company is a company which:

(a) Restricts the right of members to transfer its shares

(b) Limits the number of its members to fifty. In determining this number of 50, employee-members and ex-employee members are not to be considered.

(c) Prohibits an invitation to the public to subscribe to any shares in or the debentures of the company.

13.5.2 Public Company

Companies (Amendment) Act 2000 defines a public company which:

i) is not a private company;

ii) has a minimum paid-up- capital of five lakh rupees or such higher paid-up capital as may be prescribed;

iii) is a private company, which a subsidiary of a company, which is not a private company.

These companies may be incorporated either as limited liability companies or as unlimited liability companies.

Limited liability companies may be:

(i) limited by shares, (ii) Companies limited by guarantee (iii) Companies limited by guarantee and as well as shares.

i) ***Company limited by shares:*** In this case, the liability of members is limited to the amount of uncalled share capital. No member of company limited by the shares can be called upon to pay more than the face value of shares or so much of it as is remaining unpaid. Members have no liability in case of fully paid up shares.

ii) ***Company limited by the guarantee:*** A company limited by guarantee is a registered company having the liability of its members limited by its memorandum of association to such amount as the members may respectively thereby undertake to pay if necessary on liquidation of the company. The liability of the members to pay the guaranteed amount arises only when the company has gone into liquidation and not when it is a going concern. A guarantee company may be a company with share capital or without share capital.

Unlimited Company

The liability of members of an unlimited company is unlimited. Therefore their liability is similar to that of the liability of the partners of a partnership firm.

Under the Companies Act, 1956, the name of a public limited company must end with the word 'Limited' and the name of a private limited company must end with the word 'Private Limited'. However, under Section 25, the Central Government may allow companies to remove the word "Limited/Private Limited" from the name if the following conditions are satisfied:

(a) The company is formed for promoting commerce, science, art, religion, charity or other socially useful objects

(b) The company does not intend to pay dividend to its members but apply its profits and other income in promotion of its objects.

Holding and Subsidiary Companies

A company shall be deemed to be subsidiary of another company if:

(a) That other company controls the composition of its board of directors; or

(b) That other company holds more than half in face value of its equity share capital

(c) Where the first mentioned company is subsidiary company of any company which that other's subsidiary e.g. Company B is subsidiary of the Company A and

Company C is subsidiary of Company B, therefore Company C is subsidiary of Company A.

The control of the composition of the Board of Directors of the company means that the holding company has the power at its discretion to appoint or remove all or majority of directors of the subsidiary company without consent or concurrence of any other person.

Government Companies

Means any company in which not less than 51% of the paid up share capital is held by the Central Government or any State Government or partly by the Central Government and partly by the one or more State Governments and includes a company which is a subsidiary of a government company. Government Companies are also governed by the provisions of the Companies Act. However, the Central Government may direct that certain provisions of the Companies Act shall not apply or shall apply only with such exceptions, modifications and adaptions as may be specified to such government companies.

Foreign Companies

Foreign Companies are the companies incorporated in a country outside India under the law of that other country and has established the place of business in India.

Statutory Companies

A statutory company is one which is incorporated by a Special Act of the Legislature (i.e. by the Act of the Parliament or State Legislature). The statutory companies are also known as ‘corporations’. Such companies are generally created for the public utilities. The nature and the powers or such companies are defined by the Special Act, Under which they are created. In our country LIC, UTI, RBI, Food Corporation of India etc are created by Special Act of the Legislature and are considered as Statutory companies.

Registered Companies

A company registered under the Companies Act is known as registered company.

Check Your Progress 2

Define the following:

1. Company limited by the guarantee

   ……………………………………………………………………………….

   ……………………………………………………………………………….

2. Statutory Company

   ……………………………………………………………………………….

   ……………………………………………………………………………….

13.6 PROMOTION AND FORMATION OF A COMPANY

The whole process of formation of a company can be divided into three stages:

1. Promotion
2. Registration
3. Commencement of Business.

13.6.1 Promotion

Promotion refers to the entire process by which a company is brought into existence. It starts with the conceptualization of the birth a company and determination of the purpose for which it is to be formed. The persons who conceive the company and invest the initial funds are known as the promoters of the company.

The promoters have certain basic duties towards the company formed:

1. He must not make any secret profit out of the promotion of the company. Secret profit is made by entering into a transaction on his own behalf and then sell to concerned property to the company at a profit without making disclosure of the profit to the company or its members. The promoter can make profits in his dealings with the company provided he discloses these profits to the company and its members. What is not permitted is making secret profits i.e. making profits without disclosing them to the company and its members.
2. He must make full disclosure to the company of all relevant facts including to any profit made by him in transaction with the company.

A promoter may be rewarded by the company for efforts undertaken by him in forming the company in several ways. The more common ones are:

1. The company may to pay some remuneration for the services rendered.
2. The promoter may make profits on transactions entered by him with the company after making full disclosure to the company and its members.
3. The promoter may sell his property for fully paid shares in the company after making full disclosures.
4. The promoter may be given an option to buy further shares in the company.
5. The promoter may be given commission on shares sold.
6. The articles of the Company may provide for fixed sum to be paid by the company to him. However, such provision has no legal effect and the promoter cannot sue to enforce it but if the company makes such payment, it cannot recover it back.

13.6.2 Registration

It is the second stage in the formation of a company. If the company is to be formed as a public company, any seven or more persons associated for any lawful purpose may form the company be getting it registered with Registrar of Companies. And if company is to be formed as a private company, any two or more (but not more than 50) persons may get the same registered. The Company so formed whether private or public are of two types:

1. Limited Company
2. Unlimited Company

After the selection of type of company to be registered following steps are followed in registration process:

Memorandum of Association

Contents of Memorandum: The memorandum of association of every company must contain the following clauses:

a) ***Name Clause:*** The name of the company is mentioned in the name clause. A public limited company must end with the word 'Limited' and a private limited company must end with the words 'Private Limited'. The company cannot have a name which in the opinion of the Central Government is undesirable. A name which is identical with or the nearly resembles the name of another company in existence will not be allowed. A company cannot use a name which is prohibited under the Names and Emblems (Prevention of Misuse Act, 1950 or use a name suggestive of connection to government or State patronage.

b) ***Domicile Clause:*** The state in which the registered office of company is to be situated is mentioned in this clause. Every company must affix or paint its name and address of its registered office on the outside of the every office or place at which its activities are carried on in. The name must be written in one of the local languages and in English.

c) ***Objects Clause:*** It is about the activities which a company can carry on and which activities it cannot carry on. This clause must specify:

   i. Main objects of the company to be pursued by the company on its incorporation.

   ii. Objects incidental or ancillary to the attainment of the main objects.

   iii. Other objects of the company not included in (i) and (ii) above.

d) ***Doctrine of the ultra-vires:*** Any transaction which is outside the scope of the powers specified in the objects clause of the MA and are not reasonable incidentally or necessary to the attainment of objects is ultra-vires the company and therefore void. No rights and liabilities on the part of the company arise out of such transactions and it is a nullity even if every member agrees to it. Consequences of an ultra-vires transaction:

   i) The company cannot sue any person for enforcement of any of its rights.

   ii) No person can sue the company for enforcement of its rights.

   iii) The directors of the company may be held personally liable to outsiders for an ultra vires.

e) ***Liability Clause:*** A declaration that the liability of the members is limited in case of the company limited by the shares or guarantee must be given. A declaration that the liability of the members is unlimited in case of the unlimited companies must be given.

f) ***Capital Clause:*** The amount of share capital with which the company is to be registered divided into shares must be specified giving details of the number of shares and types of shares. A company cannot issue share capital greater than the maximum amount of share capital mentioned in this clause without altering the memorandum.

g) ***Association Clause:*** A declaration by the persons for subscribing to the Memorandum that they desire to form into a company and agree to take the shares place against their respective name must be given by the promoters.

Articles of Association

The Articles of Association (AA) contain the rules and regulations of the internal management of the company. The AA is a contract between the company and its members and also between the members themselves that they shall abide by the rules and regulations of internal management of the company specified in the AA. It specifies the rights and duties of the members and directors.

The provisions of the AA must not be in conflict with the provisions of the MA. In case such a conflict arises, the MA will prevail.

The important items covered by the AA include:

1. Powers, duties, rights and liabilities of Directors

2. Powers, duties, rights and liabilities of members

3. Rules for Meetings of the Company
4. Dividends
5. Borrowing powers of the company
6. Calls on shares
7. Transfer & transmission of shares
8. Forfeiture of shares
9. Voting powers of members, etc.

Alteration of articles of association: A company can alter any of the provisions of its AA, subject to provisions of the Companies Act and subject to the conditions contained in the Memorandum of association of the company. A company, by special resolution at a general meeting of members, alter its articles provided that such alteration does not have the effect of converting a public limited company into a private company unless it has been approved by the Central Government.

Registration of the Company

Once the documents have been prepared, vetted, stamped and signed, they are filed with the Registrar of Companies for incorporating the Company. The following documents must be filed in this connection:

1. The MA & AA.
2. An agreement, if any, which the company proposes to enter into with any individual for appointment as its managing director or whole-time director or manager.
3. A statutory declaration in Form 1,that the requirements of the Companies Act have been complied with in respect of the registration of the company and matters precedent and incidental thereto.
4. In addition to the above, in case of a public company, the following documents must also be filed:
    - Written consent of directors in Form 29 to agree to act as directors.
    - The complete address of the registered office of the company in Form 18.
    - Details of the directors, managing director and manager of the company in Form 32.

Certificate of Incorporation

Once all the above documents have been filed and they are found to be in order, the Registrar of Companies will issue Certificate of Incorporation of the Company.

13.6.3 Commencement of Business

A private company or a company having no share capital can commence its business immediately after it has been incorporated. However, other companies can commence their activities only after they have obtained Certificate of Commencement of Business. For this purpose, the following additional formalities as:

1. If a company has share capital and has issued a prospectus, then: Shares up to the amount of minimum subscription must be allotted, every director has paid to the company on each of the shares which he has taken the same amount as the public have paid on such shares etc.
2. If a company has share capital but has not issued a prospectus, then: It must file a statement in lieu of prospectus with the Registrar of Companies, every director

has paid to the company on each of the shares which he has taken the same amount as the other members have paid on such shares etc.

Check Your Progress 3

Define the following:

1. Promotion

   …………………………………………………………………………………….

   …………………………………………………………………………………….

2. Doctrine of the ultra-virus

   …………………………………………………………………………………….

   …………………………………………………………………………………….

13.7 CAPITAL OF A COMPANY

Capital refers to the amount invested in the company so that it can carry on its activities. In a company capital refers to "share capital". The capital clause in Memorandum of Association must state the amount of capital with which company is registered giving details of number of shares and the type of shares of the company.

13.7.1 Types of Shares

Shares in the company may be similar i.e. they may carry the same rights and liabilities and confer on their holders the same rights, liabilities and duties. There are two types of shares under Indian Company Law:

1. Equity shares means that part of the share capital of the company, which are not preference shares.
2. Preference shares means shares, which fulfill the following two conditions. Therefore, a share which is does not fulfill both these conditions is an equity share.
   (a) It carries preferential rights in respect of Dividend at fixed amount or at fixed rate i.e. dividend payable is payable on fixed figure or percent and this dividend must paid before the holders of the equity shares can be paid dividend.
   (b) It also carries preferential right in regard to payment of capital on winding up or otherwise. It means the amount paid on preference share must be paid back to preference shareholders before anything in paid to the equity shareholders. In other words, preference share capital has priority both in repayment of dividend as well as capital.

13.8 MEMBERSHIP

The members of a company are the persons who, for the time being, constitute the company as a corporate entity. One can become the member of the company in following ways:

1. ***By subscribing to the memorandum of association:*** A subscriber to the memorandum of association becomes a member on incorporation of the company in respect of the shares subscribed by him

   By agreeing in writing to become a member in any of the following ways provided the name is entered in the Register of Members of the Company.

2. ***By application and allotment:*** A person who applies for share becomes a member when shares are allotted to him and his name is entered in the register of members.
3. ***By taking a transfer of shares:*** Membership may be acquired from an existing member by purchase of the shares from open market.
4. ***By transmission of shares:*** In the case of transmission, a person can become a share holder in consequence or by reason of the death of a member, his executor or the person who is entitled to succeed to the estate of the deceased under the law, gets the right to have the shares transmitted and registered in his name.

13.9 BOARD OF DIRECTORS

Companies Act 1956 defines a ‘director’ as including “any person occupying the position of a director by whatever name called”. Thus it is not the name by which a person is called but the position he occupies and the functions and duties he discharges that determine whether in fact he is a director or not. So long as person is duly appointed by the company to control the company’s business and authorized by the articles to contract in the company’s name and on its behalf, he functions as director.

13.9.1 Powers of Board of Directors

1. ***General powers of Board:*** Section 291 of Companies Act 1956 provides for General Powers of the Board of Directors. It provides:

   Board may exercise all powers of the company and can do all such acts and things that the company can do except those which are specifically provided to be exercised or done by the company in a general meeting. But the exercise of such powers of the Board shall be in conformity with the provisions of the Companies Act or any other Act and Memorandum, Articles and resolutions of the company passed in general meeting. Certain powers to be exercised by Board only at meeting

   The Board of directors of a company shall exercise the following powers (Section 292 (1)) on behalf of the company, and it shall do so only by means of resolutions passed at meetings of the Board:

   1. The power to make calls on shares holders in respect of money unpaid on their shares

   (1a)The power to buy back its shares under section 77A

   2. The power to issue debentures
   3. The power to borrow moneys otherwise than on debentures
   4. The power to invest the funds of the company. This power shall however be subject to the provisions of sections 293 and 372A
   5. The power to make loans. Again this power is subject to the provisions contained in sections 295 and 372A

   However, the Board may, by a resolution passed at a meeting delegate to any committee of directors, the managing director, or the manager of the company or any other principal officer of the company or in the case of a branch office of the company, a principal officer of the branch office.

   Besides the powers specified in section 292 there are certain other powers also which can be exercised only at the meeting of the Board. These include:

   (a) The power of filling casual vacancies in the Board (Section 262)

(b) Sanctioning of a contract in which a director is interested. (Section 297)

(c) The power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.

(d) The power to make political contributions (Section 293 A)

2. ***Restrictions on powers of Board:*** The Board of directors of a public company, or of a private company which is a subsidiary of a public company, shall not, except with the consent of such public company or subsidiary in general meeting:-

1) sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking

2) remit, or give time for the re-payment of, any debt due by a director except in the case or renewal or continuance of any advance made by a banking company to its director in the ordinary course of business

3) invest, otherwise than in trust securities, the amount of compensation received by the company in respect of compulsory acquisition of any such undertaking as is referred to in clause (a), or of any premises or properties used for any such undertaking and without which it cannot be carried on or can be carried on only with difficulty or only after a considerable time

4) borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the company, (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will exceed the aggregate of the paid-up capital of the company and its free reserves

5) contribute, to charitable and other funds not directly relating to the business of the company or the welfare of its employees, any amounts the aggregate of which will, in any financial year, exceed fifty thousand rupees, or five per cent of its average net profits during the three financial years immediately preceding, whichever is greater.

The resolutions passed at the general meeting must specify the total amount up to which the Board may borrow or the total amount which may be contributed in a financial year.

13.9.2 Board Meetings

1. ***Board to meet once in every three months:*** In the case of every company, a meeting of its Board of directors shall be held at least once every three months and at least four such meetings must be held every year.

2. ***Notice of meetings:*** Notice of every meeting of the Board of directors of a company shall be given in writing to ever director for the time being in India, and at his usual address in India to every other director.

3. ***Quorum for meetings:*** The quorum for a meeting of the Board of directors of a company shall be one-third of its total strength (any fraction contained in that one-third being rounded off as one), or two directors, whichever is higher. Provided that where at any time the number of interested directors exceeds or is equal to two-thirds of the total strength, the number of the remaining directors, that is to say, the number of the directors who are not interested, present at the meeting being not less than 2 shall be the quorum during such time.

13.10 ACCOUNTS AND AUDIT

Every company must maintain proper books of accounts of its affairs. The following transactions must be entered in the books of accounts of the company which must be kept at its registered office:

1. all sums of money received and expended by the company and the matters in respect of which the respect of which the receipt and expenditure took place;
2. all sales and purchases of goods by the company; and
3. the assets and liabilities of the company.
4. in the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or other items of cost as may be prescribed relating to certain class of companies as the Central Government may require.

13.10.1 Balance Sheet and Profit and Loss Account

The company has to prepare its balance sheet and profit & loss account from the books of account maintained by it. The Board of directors must present to the shareholders of the company, the balance sheet and a profit and loss account for the financial year at every annual general meeting.

13.10.2 Auditors of Company

i) ***Auditors of Government Companies:*** The auditor of a Government company is appointed or re-appointed by the Comptroller and Auditor-General of India. The auditor must submit a copy of his audit report to the Comptroller and Auditor-General of India who shall have the right to comment upon or supplement, the audit report in such manner as he may think fit.

ii) ***Auditors of Other Companies:*** It is the duty of the auditor conduct the audit of the books of accounts of the company and to make his report to the members of the company on the accounts examined by him, and on every balance sheet, every profit and loss account and on every other document declared by the Act to be part of or annexed to the balance-sheet or profit and loss account and laid before the company in general meeting during his tenure of office.

13.11 AUDIT COMMITTEE (SECTION 292A)

The Companies Amendment Act, 2000, has incorporated the mandatory recommendation of the Birla Committee on Corporate Governance for an Audit Committee for company, with powers to investigate any activity within its terms of reference and to seek information from any employee. The major role of the Audit Committee is the oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

13.12 INVESTIGATION

Central Govt. may investigate into the affaire of the company under Sections 235 and 237 or into the ownership of shares of a company under Section 247 of the Act. Central Govt. and Company Law Board has been empowered to consider such application and cause an investigation to be made by the Central Govt. Action on the report of inspector also vest in the Central Govt.

Who can apply for Investigation

The following can apply for the investigation of affaire of a company:

i) ***On the report of Registrar:*** On the report of Registrar Central Govt. may appoint one or more competent persons as inspectors to investigate the affairs or a company and to report thereon in such manner as the Central Govt. may direct.

ii) ***Shareholders:*** The Companies Act, 1956 empowers the Company Law Board (now Tribunal) to consider an application from a specified number of shareholders and to declare that an investigation be conduct into the affairs of the company.

iii) The Company By Passing Special Resolution (Section 237(a)(i)).

iv) ***The Court by Order:*** Court by order can declare that the affairs of the company ought to be investigated by inspector appointed by the Central Govt.

Action

On the receipt of the report of the inspector appointed, the Central Govt. may take one or following actions:

i) Prosecute the person found guilty for any Criminal offence

ii) Present a petition to the Court (now Tribunal) for winding up of the company.

iii) Make an application to the Court (now Tribunal) under section 397 or 398 (sec. 243)

iv) Bring proceedings for fraud or misappropriation of the company's property.

Inspection

Section 209A(1) provides that the books of account and other books and papers of every company shall be open to inspection during business hour:

i) by the Registrar

ii) by such officer of Government as may be authorized by the Central Govt. in this behalf

iii) by such officers of the SEBI as may be authorized by it.

13.13 WINDING UP OF COMPANIES

Winding up of a company is the process where by its life is ended and its property administered for the benefit of its creditors and members. The object of winding up a company is to realize the assets and pay the debts of the company expeditiously in a fair manner in accordance with the law.

13.13.1 Modes of Winding up

Company may be wound-up in any of the following three ways:

i) By the court (now Tribunal) making a winding-up order (Compulsory Winding-up)

ii) By the passing of a appropriate resolution for voluntary winding up at a general meeting of members (can be of two type):

    a) Members' voluntary winding-up

    b) Creditors' voluntary winding-up

iii) Winding up subject to supervision of the Court

i) ***Compulsory Winding up:*** It is primarily the High Court, which has the jurisdiction to wind up companies in relation to the place at which registered office of the company is situated. However, the Central Government may empower on any District Court to exercise that jurisdiction, only in respect of small companies with the paid-up capital of not more than Rs. one lakh of rupees and having their registered office within that district. The High Court may regulate the conduct of such proceedings before the District Court. It may even direct a District Court to retain and continue winding up proceedings, which that District Court had no jurisdiction to handle. It may also withdraw any winding up process in a District Court from that Court and proceed with the winding by itself, or transfer it to another District Court.

ii) ***Voluntary Winding up:*** Winding up by the members or creditors without any intervention of the Court is called 'Voluntary Winding up'.

iii) ***Winding up subject to the provision of Court:*** At any time after a company has passed a resolution for voluntary winding up the court may make an order that the voluntary winding up should continue subject to the supervision of the Court (Section 522). The application for such intervention of the Court may be made by a creditor, contributory or the voluntary liquidator, when there are irregularities or frauds in the voluntary winding up.

13.13.2 Buy Back of Shares

The Companies (Amendment) Act, 1999 has inserted new Section 77A, 77AA and 77B relating to a company's powers to purchase its own shares. Buy back of its own shares by a company is nothing but reduction of share capital. It is nothing but a process which enables a company to go back to the holders of its shares and offer to purchase from them the shares that they hold.

13.14 COMPANIES (AMENDMENT) ACT, 2000

Following are the major highlights of the Companies (Amendment) Act, 2000:

1. Penalties have been increased by almost ten times for non-compliances.
2. The minimum paid up capital for a private company would be Rs. 1,00,000/- and for a public company would be Rs. 5,00,000/- or higher capital as prescribed. A private company shall not invite or accept deposits from persons other than its members, directors or their relatives. A public company shall include a private company which is the subsidiary of a public company. (Section 3)
3. The private company cannot automatically become a public company on account of turnover or shareholding criteria [Section 43A(11)] A public company now becoming private company has to inform ROC that it has become a private company and necessary alteration in the certificate of incorporation is required to be done within 4 weeks from the date of application made by company
4. SEBI has been conferred power to deal exclusively with listed companies and companies proposed to be listed in connection with the matters related to issue, transfer of securities and non-payment of dividend (Section 55A)
5. The concept of Shelf Prospectus and Information Memorandum has been introduced. `Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of securities and `Information Memorandum' means memorandum issued to the public along with the shelf prospectus filed at the stage of the first offer of securities under which such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities. (Section 60A & 60B)

6. The offer of any securities to more than 50 people in one financial year will be treated as a public offer. This provision is not applicable to NBFC's and public financial institutions. [Section 67(3)]
7. Every listed public company making an initial offer of securities of more than Rs. 10 crores is to be in the dematerialised form only (Section 68B).
8. Equity capital of the company can be now issued either with voting rights or with differential rights as regards to dividends, voting rights or otherwise (Section 86).
9. Provisions relating to Debenture Trust Deed, Debenture Redemption Reserve, Debenture Trustee has been inserted.
10. The concept of postal ballot has been introduced to pass resolution instead of transacting the business in general meeting. Under these provisions members are required to send their assent/dissent in writing on a postal ballot within 30 days from the date of posting the letter (Section 192A).
11. The concept of interim dividend has been included in the provisions.
12. In addition to the Central Government, SEBI has now been authorized to carry out inspection of books of account and other books in connection with listed companies. (Section 209A).
13. The Board Report should also include Directors Responsibility Statement requiring the disclosure of various information and making the directors responsible for the disclosures. (Section 217).
14. Disqualification for appointment of auditor includes such auditors who holds security carrying voting rights after a period of one year from the date of commencement of the amended act. (Section 226)
15. The observations or comments of the auditors which has adverse effect on the functioning of a company should be written in thick type or in italics in the Auditors' Report (Section 227)
16. The public limited company which has paid up capital of at least Rs. 5 crores and having at least 1,000 small shareholders should have at least one director elected by such small shareholders (Section 252).
17. Disqualification of Directors includes a person who is already a director of a public company which has not filed annual accounts and annual returns for continuous 3 financial years or more or has failed to repay its deposits or interest or redeem its debentures on due date or pay dividend and such failure continues for at least one year. (Section 274)
18. The maximum number of companies in which a person can be a director has been reduced from 20 to 15. (This excludes directorships of private companies, unlimited companies, non profit associations and companies in which the person is an alternate director). [Section 275]
19. The concept of audit committee consisting of at least 3 directors has been introduced for such public companies having paid up capital of at least Rs. 5 crores. (Section 292A)
20. A company which is incorporated or is to be incorporated outside India is allowed to offer Indian Depository Receipts under the rules framed by the Central Government. (Section 605A)
21. In case of Government companies, auditors will now be appointed only by the Comptroller and Auditor General of India. (Section 619)
22. Registrar of Companies, Shareholders and persons authorized by the Central Government can make a complaint in writing to a court against the offences

committed by a company against the provisions of any Act. SEBI has also been authorized to make such complaints relating to issue, transfer of securities and non-payment of dividend. (Section 621)

Check Your Progress 4

Fill in the blanks:

1. The company legislation in India owes its origin to the _________ company law.
2. Company has a ______________, which is used as a substitute for its signature.
3. A ______________ is one which is incorporated by a Special Act of the Legislature.
4. _____________ refers to the entire process by which a company is brought into existence.
5. The ________ contain the rules and regulations of the internal management of the company.
6. ___________ means that part of the share capital of the company, which are not preference shares.

13.15 COMPANY LAW TRIBUNAL (ERSTWHILE COMPANY LAW BOARD)

Company Law Tribunal is responsible for the administration of the company Law.

1. ***Members:*** The Company Law Tribunal shall consist of such number of judicial and technical members, not exceeding fourteen, as the Central Government deems fit.
2. ***Constitution of benches:*** The powers of the Company Law Tribunal may be exercised by benches, out of which one shall be a judicial member and another shall be a technical member. There are five regional benches and one Principal Bench at New Delhi presided over by the President or Vice-President.
3. ***Powers of benches:*** Every Bench constituted have powers of a Civil Court while trying a suit, under the Code of Civil Procedure, 1908 (5 of 1908), in respect of the following matters, namely:
   (a) discovery and inspection of documents or other material objects producible as evidence;
   (b) enforcing the attendance of witnesses and requiring the deposit of their expenses;
   (c) issuing of commissions;
   (d) compelling the production of documents or other material objects produced as evidence and impounding the same;
   (e) appointing Committees for the investigation of any matter, including the giving of any expert opinion or advice on any matter specified by it;
   (f) examining witnesses on oath;
   (g) granting adjournments;
   (h) reception of evidence on affidavits.
4. ***Power to punish for contempt:*** The Company Law Tribunal shall have the same jurisdiction, powers and authority in respect of its own contempt as the High

Court has and may exercise for this purpose the provisions of the Contempt of Courts.

13.16 LET US SUM UP

Based on the report of the Bhabha Committee, Companies Act, 1956 was introduced in Parliament in 1952. Since then Companies Act has been amended several times.

Companies can be of many types such as Private and Public Company, Limited and Unlimited Company, Holding and Subsidiary Companies, Government Companies Foreign Companies, Statutory Companies, Registered Companies.

The whole process of formation of a company can be divided into three stages: - Promotion, Registration, Commencement of Business. Promotion refers to the entire process by which a company is brought into existence. If the company is to be formed as a public company, any seven or more persons associated for any lawful purpose may form the company be getting it registered with Registrar of Companies. A private company or a company having no share capital can commence its business immediately after it has been incorporated.

There should be proper auditing of the Company Accounts. Besides auditing the accounts should be investigated by the Audit Committee. Central Govt. may investigate into the affaire of the company under Sections 235 and 237 or into the ownership of shares of a company under Section 247 of the Act. Central Govt. and Company Law Board has been empowered to consider such application and cause an investigation to be made by the Central Govt. Action on the report of inspector also vest in the Central Govt.

Winding up of a company is the process where by its life is ended and its property administered for the benefit of its creditors and members. Company may be wound-up in any of the following three ways: Compulsory Winding Up, by the passing of a appropriate resolution for voluntary winding up at a general meeting of members and winding up subject to supervision of the Court.

Company Law has given many rights to Central Govt. and Company Law Board to check the Oppression and Mismanagement of company. Companies (Amendment) Act 2000 brought many significant changes to the companies Act. Company Law board which used to look after the administration of Company Law is replaced by the Company Law Tribunal by the Companies (Second Amendment) Act,2002

13.17 LESSON END ACTIVITIES

1. Prepare a project on the changes brought in Company Law in last fifteen years, to make it suitable in changed situation.
2. Form a virtual company according to the Company Law.

13.18 KEYWORDS

Shareholders: Person having the shares of company.

Company: Company Act states that "a 'company' means a company formed and registered under Companies Act".

Separate Legal Entity: In law company is regarded as an artificial legal person having its own name and its own seal, its assets and liabilities are separate and distinct from those of its members.

Limited Liability: The liability of the members of the company is limited to contribution to the assets of the company up to the face value of shares held by him.

Common Seal: It has a common seal, which is used as a substitute for its signature.

Promotion: In Companies Act, Promotion refers to the entire process by which a company is brought into existence.

Memorandum of Association: It is the charter of the company. It prescribes the name of the company, its registered office, objects and capital and also defines the extent of its powers.

Articles of Association: The Articles of Association (AA) contain the rules and regulations of the internal management of the company.

Unlimited Company: The liability of members of an unlimited company is unlimited.

Board of directors: The directors of a company collectively are referred to as the "Board of directors.

Qualification shares: Qualification shares are the minimum number of shares a person must own, as provided in the articles of the company, in order to qualify to become a director of the company.

Winding Up: Winding up of a company is the process where by its life is ended and its property administered for the benefit of its creditors and members.

Buy Back of Shares: process which enables a company to go back to the holders of its shares and offer to purchase from them the shares that they hold.

Preference Shares: preference share capital has priority both in repayment of dividend as well as capital.

Subscribed Capital: means that part of the issued capital at nominal or face value which has been subscribed or taken up by purchaser of shares in the company and which has been allotted.

Nominal, authorized or registered capital: means the sum mentioned in the capital clause of Memorandum of Association.

Paid-up capital: means the total amount of called up share capital which is actually paid to the company by the members.

13.19 QUESTIONS FOR DISCUSSION

1. Describe various types of company and their characteristics.
2. Briefly describe the process of formation of company according to the company law.
3. What is Board of Directors? What are the powers of Board of Directors?
4. Describe various mode of Winding up of companies.
5. Write Short Notes on: Capital, Membership, Disqualification of Director, Audit Committee, Company Law Tribunal (Erstwhile Company Law Board), Companies (Amendment) Act, 2000,

Check Your Progress: Model Answers

CYP 1

1. The word 'Company' is an amalgamation of the Latin word 'Com' meaning "with or together" and 'Pains' meaning "bread". Originally, it referred to a group of persons who took their meals together. A company is nothing but a group of persons who have come together or who have contributed money for some common person and who have incorporated themselves into a distinct legal entity in the form of a company for that purpose.

Contd…

2. Important needs:
   (a) Incorporation of Companies
   (b) Allotment of shares and share capital
   (c) Membership in Companies
   (d) Borrowing by companies and registration of charge
   (e) Management and administration of companies
   (f) Winding up of Companies

CYP 2

1. A company limited by guarantee is a registered company having the liability of its members limited by its memorandum of association to such amount as the members may respectively thereby undertake to pay if necessary on liquidation of the company.
2. A statutory company is one which is incorporated by a Special Act of the Legislature (i.e. by the Act of the Parliament or State Legislature). The statutory companies are also known as 'corporations'.

CYP 3

1. Promotion refers to the entire process by which a company is brought into existence. It starts with the conceptualization of the birth a company and determination of the purpose for which it is to be formed. The persons who conceive the company and invest the initial funds are known as the promoters of the company.
2. Any transaction which is outside the scope of the powers specified in the objects clause of the MA and are not reasonable incidentally or necessary to the attainment of objects is ultra-vires the company and therefore void.

CYP 4

1. English, 2. Common Seal, 3. Statutory Company,
4. Promotion, 5. Articles of Association 6. Equity shares

13.20 SUGGESTED READINGS

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LESSON

14

COMPETITION BILL, 2001

CONTENTS

14.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the reasons of introducing the Competition Bill
- Explain the concept of Competition Bill
- Know the role of Competition bill in regulating business
- Learn the role and powers of Competition Commission of India

14.1 INTRODUCTION

The Central Government constituted a High Level Committee on Competition Policy and Law. The Committee submitted its report on the 22nd May, 2000 to the Central Government. The Central Government consulted all concerned including the trade and industry associations and the general public. The Central Government after considering the suggestions of the trade and industry and the general public decided to enact a law on Competition.

The Competition Bill, 2001 seeks to ensure fair competition in India by prohibiting trade practices which cause appreciable adverse effect on competition in markets within India and, for this purpose, provides for the establishment of a quasi-judicial body to be called the Competition Commission of India (hereinafter referred to as CCI) which shall also undertake competition advocacy for creating awareness and imparting training on competition issues.

The Bill aims at curbing negative aspects of competition through the medium of CCI.

The Bill confers power upon the CCI to levy penalty for contravention of its orders, failure to comply with its directions, making of false statements or omission to furnish material information, etc.

The Competition Bill aims at repealing the Monopolies and Restrictive Trade Practices Act, 1969 and the dissolution of the Monopolies and Restrictive Trade Practices Commission. The Bill provides that the cases pending before the Monopolies and Restrictive Trade Practices Commission will be transferred to the CCI [Competition Commission of India] except those relating to unfair trade practices which are proposed to be transferred to the relevant for established under the Consumer Protection Act, 1986.

It has following provision:

14.2 PROHIBITION OF AGREEMENTS

No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.

Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which:

1. directly or indirectly determines purchase or sale prices;
2. limits or controls production, supply, markets, technical development, investment or provision of services;
3. shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers

   It prohibits any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including:

   (a) *Tie-in Arrangement:* includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

   (b) *Exclusive Supply Agreement:* includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

   (c) *Exclusive Distribution Agreement:* includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods;

   (d) *Refusal to Deal:* includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought;

   (e) *Resale Price Maintenance:* includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged; shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition.

Things which are not contained in the Act shall refer to following:

1. "copyright" under the Copyright Act, 1957;
2. "patent" or "exclusive right" granted under the Patents Act, 1970;
3. "collective mark", "permitted use", "registered proprietor", "registered trade mark" or "registered user" under the Trade Marks Act, 1999;
4. "homonymous geographical indication" or "geographical indications" registered under the Geographical Indications of Goods (Registration and Protection) Act, 1999;
5. "design" registered under the Designs Act, 2000;
6. "layout-design" registered under the Semi-conductor Integrated Circuits Layout-Design Act, 2000;
7. the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

Check Your Progress 1

Describe, in brief, the following:

1. Exclusive supply agreement.

   ……………………………………………………………………………………….

   ……………………………………………………………………………………….

2. Refusal of deal.

   ……………………………………………………………………………………….

   ……………………………………………………………………………………….

14.3 PROHIBITION OF ABUSE OF DOMINANT POSITION

The organizations enjoying dominant position in the market are prohibited by the Act to use their strength to affect its competitors or consumers or the relevant market in its favour.

14.4 REGULATION OF COMBINATIONS

Regulation of combinations regulates the mergers and acquisitions. Any person or enterprise, who or which proposes to enter into a combination, may, at his or its option, have to give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within seven days of:

(a) approval of the proposal relating to merger or amalgamation, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

The Commission shall, after receipt of notice under sub-section (2), deal with such notice in accordance with the provisions.

14.5 COMPETITION COMMISSION OF INDIA

For the purpose of this act Govt. established a commission to called as Competition Commission of India.

Sub-clause (1) of clause 8 of the Bill provides that the Commission shall consist of a Chairperson and not less than two and not more than ten other Members to be appointed by the Central Government.

14.6 DUTIES, POWERS AND FUNCTIONS OF COMMISSION

Subject to the provisions of this Act, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers, and ensure freedom of trade carried by other participants, in markets in India.

The Commission may inquire into any alleged contravention of the provisions either on its own motion or on:

(a) receipt of a complaint from any person, consumer or their association or trade association; or

(b) a reference made to it by the Central Government or a State Government or a statutory authority.

The Commission can enquire whether an agreement has an appreciable adverse effect on competition. The Commission can enquire whether an enterprise enjoys a dominant position or not, The Commission can enquire that whether any combination is likely to cause an appreciable adverse effect on competition in India, or any other violation of the Act.

14.7 THE JURISDICTION, POWERS AND AUTHORITY OF THE CCI

On receipt of a complaint or a reference from the Central Government or a State Government or a statutory authority or on its own knowledge or information, under section 19, if the Commission is of the opinion that there exists a prima facie case, it shall direct the Director General to cause an investigation to be made into the matter. The Director General submits its report in a specified period.

Where after inquiry the Commission finds that any agreement or action, of an enterprise in a dominant position, is in contravention of section 3 or section 4, as the case may be, it may pass all or any of the following orders, namely:

(a) Direct any enterprise or association of enterprises or person or association of persons, as the case may be, involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case may be;

(b) Impose such penalty, as it may deem fit which shall be not more than ten per cent. of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse;

(c) Award compensation to parties in accordance with the provisions contained in section 34;

(d) Direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;

(e) Direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any;

(f) Recommend, to the Central Government for the division of an enterprise enjoying dominant position;

(g) Pass such other order as it may deem fit.

The Commission shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government, the Commission shall have powers to regulate its own procedure including the places at which they shall have their sittings, duration of oral hearings when granted, and times of its inquiry. The Commission shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination witnesses or documents,

(e) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office;

(f) dismissing an application in default or deciding it ex parte;

(g) any other matter which may be prescribed;

(h) Every proceeding before the Commission shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purposes of section 196 of the Indian Penal Code and the Commission shall be deemed to be a civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Check Your Progress 2

Fill in the blanks:

1. The _____________ aims at repealing the Monopolies and Restrictive Trade Practices Act, 1969.
2. ____________ includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;
3. _______________ or "exclusive right" granted under the Patents Act, 1970;
4. The _________________ shall not be bound by the procedure laid down by the Code of Civil Procedure.
5. The Commission shall have, the same powers as are vested in a civil court under the Code of ________________, 1908.

14.8 PENALTIES

1. Without prejudice to the provisions of this Act, if any person contravenes, without any reasonable ground, any order of the Commission, or any condition or restriction subject to which any approval, sanction, direction or exemption in relation to any matter has been accorded, given, made or granted under this Act or fails to pay the penalty imposed under this Act, he shall be liable to be detained in civil prison for a term which may extend to one year, unless in the meantime the

Commission directs his release and he shall also be liable to a penalty not exceeding rupees ten lakhs.

2. The Commission may, while making an order under this Act, issue such directions to any person or authority, not inconsistent with this Act, as it thinks necessary or desirable, for the proper implementation or execution of the order, and any person who commits breach of, or fails to comply with, any obligation imposed on him under such direction, may be ordered by the Commission to be detained in civil prison for a term not exceeding one year unless in the meantime the Commission directs his release and he shall also be liable to a penalty not exceeding rupees ten lakhs.

3. If any person fails to comply with a direction given by the Commission, the commission shall impose on such person a penalty of rupees one lakh for each day during which such failure continues.

The Competition bill repealed the MRTP Act which was not relevant in the changed situation. The Competition bill is more pragmatic and an effective tool in curbing unhealthy competition or checking big firm to take undue advantage of their strength. Not only in India such type of laws are in force even in USA and Europe. As there is a probability that big firms may affect supplier , consumer, and competitor in their favour and in a duopoly or Oligopoly market situation firms establishes cartel and tries to influence the market in their favour. Competition bill works in the interest of nation and to provide level playing field.

14.9 LET US SUM UP

The Competition Bill aims at repealing the MRTP. The Bill provides that the cases pending before the Monopolies and Restrictive Trade Practices Commission will be transferred to the CCI. CCI prohibits any agreements which restrict production, supply, distribution, or indulge in storing, which have an adverse effect on competition within India. Agreement can be as Tie-in Arrangement, Exclusive Supply Agreement.

The organizations enjoying dominant position in the market are prohibited by the Act to use their strength to affect its competitors or consumers or the relevant market in its favour. CCI regulates the combinations , mergers and acquisitions. The Commission shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government.

14.10 LESSON END ACTIVITY

Prepare a project on impact of competition Bill on Indian industry after its execution.

14.11 KEYWORDS

Competition Commission of India (CCI): It is a quasi-judicial body. Established under The Competition Bill, 2001. It aims at curbing negative aspects of competition

Tie-in Arrangement: It includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.

14.12 QUESTIONS FOR DISCUSSION

1. Discuss the type of agreement which competition bill prohibits.
2. Briefly discuss the functions and power of Competition Commission of India.
3. Discuss how competition bill of India is better than that of MRTP.

Check Your Progress: Model Answers

CYP 1

1. Exclusive Supply Agreement includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;
2. Refusal to Deal includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought;

CYP 2

1. Competition Bill, 2. Tie-in Arrangement, 3. patent
4. Competition Commission, 5. Civil Procedure

14.13 SUGGESTED READINGS

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LESSON

15

FOREIGN EXCHANGE MANAGEMENT ACT

CONTENTS

15.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the reasons for introducing FEMA in place of FERA
- Know the concept of FEMA
- Discuss the executing body of FEMA
- Learn the role of RBI in implementing FEMA

15.1 INTRODUCTION

Foreign Exchange Management Act (FEMA), 1999 has been enacted as part of liberalization. The Act is implemented w.e.f. 1st June, 2000.

Foreign exchange control was first introduced in September, 1939 under Defense of India Rules. Foreign exchange regulation act was introduced in 1947. This was later replaced with 'the Foreign Exchange Regulation Act, 1973 (FERA)'. Which was further replaced by FEMA which came into effect from 1st June 2000.

15.2 DIFFERENCE BETWEEN FERA AND FEMA

The object of FEMA is bill is to consolidate and amend the law relating to foreign exchange with the object of facilitating external trade and payment and for promoting the orderly development and maintenance of foreign exchange market in India. The main difference between FERA and FEMA is as follows:

(a) The object of FERA was to conserve foreign exchange and to prevent its misuse. The object of FEMA is to facilitate external trade and payments and maintenance of foreign exchange market in India.

(b) Violation of FERA was a criminal offence while violation of FEMA is civil offence.

(c) Offences under FERA were not compoundable while offences under FEMA are compoundable.

(d) Citizenship was a criteria to determine residential status of a person under FERA, while stay of more than 182 days in India is the criteria to decide residential status.

(e) Provision in respect of Basic Travel Quota (BTQ) business travel export commission, gifts, donation etc have been considerably enhanced in FEMA.

(f) Almost all current account transactions are free, except a few.

15.3 SCOPE OF FEMA

FEMA provides:

1. Free transactions on current account subject to reasonable restrictions that may be imposed.
2. RBI controls over capital account transactions.
3. Control over realization of export proceeds.
4. Dealing in foreign exchange through authorized persons like authorized dealer/ Money changer/ off shore banking unit.
5. Adjudication of Offences.
6. Appeal provision including Special Director (Appeals) and Appellate Tribunal.
7. Directorate of Enforcement.

15.4 FUNCTIONS OF RESERVE BANK OF INDIA

FEMA envisages that RBI will have key role in management of foreign exchange. The main function of RBI under FEMA as follows:

(a) Control over dealing in foreign exchange by giving general or special permission for dealing in foreign exchange, excluding those cases where specific provision have been made in ACT, rules or regulation – section 3.

(b) RBI cannot impose any restriction on current account transaction.

(c) Specifying conditions for payment in respect of capital account transaction – section 6 (2).

(d) Regulate/prohibit/ restrict the following, by issuing regulations:

(i) transfer or issue of foreign security to resident and Indian security to non-resident.

(ii) borrowing and lending in foreign exchange or to a foreign person.

(iii) Export/Import of currency or currency notes.

(iv) Transfer of immovable property outside India.

(v) Giving guarantee or surety where foreign exchange transaction is involved – section 6(3).

(e) Specify (by regulation) period and manner in which foreign exchange due from export of goods and services should be received – section 8.

(f) To grant exemption from realization an repatriation in cases specified under section 9 [These cover provision in respect of possession of foreign currency or foreign coins, foreign currency accounts, foreign exchange acquired form employment, business, trade, services etc.].

(g) Granting authorization to 'Authorized Person' to deal in foreign exchange to give direction to them and to inspect the authorized person – section 10, 11 and 12.

(h) To make regulation – section 47.

Today rupee is convertible on current account, this means all current income (including rent, dividend, interest, salary etc.) is repatriable, even in cases where principle amount is not repatriable. Today many currencies like Dollars (USA), Pound Sterling, Euro, DM, Yen, Lira etc. are freely convertible, all this limits the role of FEMA. As now to deal in Forex is not so cumbersome and any authorized person or agency can deal in any currency.

Authorized Person to deal in foreign exchange and foreign securities – RBI

RBI delegate its power to authorized person to deal in foreign exchange with suitable guidelines:

Authorised Person

Section 2(c) states that 'authorised person' means an authorised dealer, money changer, off-shore banking unit or any other person authorized under section 10(1) to deal in foreign exchange and foreign securities. Generally all nationalised banks, and foreign banks are appointed as 'Authorised Dealers' to deal in foreign exchange.

Money changer are authorized by RBI only to purchase foreign currency in form of traveler's cheques, notes or coins or sale foreign currency in form of coins and notes.

Check Your Progress 1

What do you mean by authorised person?

………………………………………………………………………………………

………………………………………………………………………………………

15.5 EXPORTS OF GOODS AND SERVICES

Regulation relating to export of goods and services from India are contained in Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.

Every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal, and Bhutan, shall furnish to the specified authority, a declaration in one of the forms set out in the Schedule. Declaration should be submitted with in 21 days from exports.

15.6 POSSESSION AND RETENTION OF FOREIGN CURRENCY

Under FEMA restriction are only for physical possessions and retention of foreign currency and not in respect of the foreign currency kept in permissible account with authorized dealers (banks).

Limits for Possessions and Retention of Foreign Currency or Foreign Coins:

1. An authorized person can retain and possess foreign currency and coin within the scope of his authority without any limit;
2. Any person can possess foreign coins without limit;
3. A person resident in India can retain foreign currency notes, bank notes and foreign currency travelers' cheques up to a limit as prescribed by RBI;
4. A person resident it India but not permanently resident therein may possess without limit foreign currency in the form of currency notes, bank notes and travelers cheques if such foreign currency was acquired, held or owned by him when he was resident outside India and has been brought into India in accordance with the regulation made under the Act i.e. after making declaration when required.

15.7 REALIZATION AND REPATRIATION OF FOREIGN EXCHANGE

A person resident in India to whom any account of foreign exchange is due or has accrued shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the RBI .

15.8 CAPITAL ACCOUNT TRANSACTION

Section 2(e) states that 'Capital Account Transaction' means:

- A transaction which alters the assets or liabilities, including contingent liabilities outside India of person resident in India.
- A transaction which alters the assets or liabilities in India of person's resident outside India.
- Transfer or issue of any foreign security by a person resident in India.
- Transfer or issue of any security by a person resident outside India.
- Transfer or issue of any security or foreign security by any branch, office or agency in India or a person resident outside India.
- Any borrowing or lending in foreign exchanges in whatever form or by whatever name called.
- Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India.

Deposits between person's resident in India and person resident outside India.

- Export, import or holding or currency or currency notes.
- Transfer of immovable property outside India, other than lease not exceeding five years, by a person resident in India.

- Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.
- Giving of guarantee or surety in respect of any debt, obligation or other liability incurred # by a person resident in India and owed to a person resident outside India or # By a person resident outside in India.

15.8.1 Regulation of Capital Account Transaction

Subject to the provision of sub-section (2) any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction.

The RBI may, in consultation with the central Government specify:

(a) any class or classes of capital account transaction which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transaction.

Provided that the RBI shall not impose any restriction on the withdrawal of foreign exchange for payments due on account of amortization of loans for depreciation of direct investment in the ordinary course of business.

Without prejudice to the generality of the provision of sub-section (2) the Reserve Bank may by regulations, prohibit, restrict or regulate the following:

(a) Transfer or issue of any foreign security by a person resident in India.

(b) Transfer or issue of any security by a person outside India.

(c) Transfer of issue of any security of foreign security by any branch, office or agency in India of a person resident outside India.

(d) Any borrowing or lending in foreign exchange in whatever form or by whatever name called.

(e) Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India.

(f) Deposits between persons resident in India and person resident outside India.

(g) Export, import or holding of currency or currency notes.

(h) Transfer of immovable property outside India, other than lease not exceeding five years, by a person resident in India.

(i) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years by a person outside India.

(j) Giving a guarantee or surety in respect of any debt, obligation or other liability incurred –

   1) By a person resident in India an owed to a person resident outside India; or

   2) By a person resident outside India.

A person resident in India may hold, own transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency , security or property was acquired , held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Without prejudice to the provision of the section, the RBI may, by regulations prohibit, restrict or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

Some Words Used in FEMA

Convertible Currency / Hard Currency:

Some currency are freely convertible i.e. one can exchange these currencies with any other currency without any restriction. Major among these are : Dollars(USA), Pound Sterling, Euro, DM, Yen, Franc, Lira, etc. This is often called 'hard currency'.

Rupee Trade

India has rupee trade with Nepal and Bhutan i.e. payment in respect of trade with Nepal an Bhutan is made in Indian Rupees.

Currency

Currency includes all currency notes, postal notes, postal orders, money orders, cheques, drafts , traveller's cheques, letter of credit, Bill of Exchange and Promissory notes, credit cards or such other similar instruments as may be notified by RBI. RBI has notified 'debit cards', ATM cards or any other instruments by whatever name called that can be used to create a financial liability' as 'currency'.

Foreign Exchange

Foreign exchange means foreign currency and includes (i) deposits, credits, and balances payable in any foreign currency. (ii) drafts, traveller's cheques, letter of credit or bill of exchange expressed or drawn in Indian currency but payable in foreign currency. (iii) drafts, traveller's cheques letter of credit or bill of exchange expressed drawn by bank, institutions or person outside India, but payable in Indian currency.

Overseas Corporate Bodies

OCB means any overseas company, partnership, firm, society, and other corporate body predominantly owned directly or indirectly to the extent of at least 60% by NRIs. It also includes overseas trust in which at least 60% beneficial interest is irrevocably held by NRIs.

Check Your Progress 2

Define the following:

1. Convertible currency

   …………………………………………………………………………………….

   …………………………………………………………………………………….

2. Rupee Trade

   …………………………………………………………………………………….

   …………………………………………………………………………………….

15.9 CURRENT ACCOUNT TRANSACTION

FEMA has eased the regulation over transactions in foreign exchange and security. Transaction in current account are made restriction free:

No restriction on Current account transaction unless specified: Any person can sell or draw foreign exchange to or from authorized person if such sale or withdrawal is a current account transaction. Reasonable restriction on current account transaction can b imposed by central government in public interest, in consultation with RBI.

Current Account Transaction: Section 2(j) states that current account transaction means a transaction other than a capital account transaction. It includes following:

1. Payment due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course of business.

2. Payment due as interest on loans as net income from investment.
3. Remittances for living expenses of parents, spouse and children residing abroad
4. Expense in connection with foreign travel, education and medical care of patents, spouse and children.
5. The definition is ‘inclusive’ i.e. besides of aforesaid expenses, any expenditure which is not a ‘capital account transaction’ will be current account transaction e.g. own expenses on foreign travel, education, and medical care are covered as ‘current account transaction’ even not specified above.
6. Any person may sell or draw foreign exchange to or from an authorized person if such sale or drawl is a current account transaction.

Foreign currency/security/property by resident: A person resident in India may hold, own transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. [Section 6(4)]

Indian currency/security/property by non-resident: A person resident outside India may hold, own transfer or invest in Indian currency, security or any immovable property situated in India, if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India. [Section 6 (4)]

Restrictions on branches, offices of non-resident: RBI prohibit , restrict or regulate establishment of branch, office or other place of business by a person resident outside India; for carrying on any activity relating to such branch, office or other place of business. [Section 6(6)]

15.10 ENFORCEMENT AND PENALTIES

15.10.1 Directorate of Enforcement

Directorate of Enforcement has been formed to ensure that the provision of the Act are followed. Directorate of Enforcement Additional Director, Special Director, an Assistants Directors of Enforcement are appointed by Central Government (section 36).

These officers can investigate contraventions of FEMA. The officers have powers similar to those conferred on Income Tax authorities under Income Tax Act. These powers can be exercised subject to limitation laid down under Income Tax Act. (Section 37)

Following powers are available under the Income Tax Act: Powers to requisition books of accounts etc. Power to call for information, Power to inspect registers of companies [Section 131 to 136 of Income Tax Act].

Penalties under the Act: An Adjudicating Authority appointed by Central Government under FEMA can impose penalty for violating of any provision of Act or contravention of any rule, regulation, direction or order issued under power conferred by the Act.

Departmental Adjudication: Central Government can authorize certain officers as ‘Adjudicating Authority’ u/s 16(1). There jurisdiction will be prescribed by Central Government [Section 16(2)]. They can adjudicate cases in respect of violation of FEMA. These are quasi judicial. They have to follow principle of natural justice by giving opportunity of making representation. The Adjudicating Authority can hold enquiry only on receiving a complaint from an authorized officer. [Section 16 (3)]

Powers of adjudicating and appellate authorities: The adjudicating authority, Special Director (Appeals) and Appellate Tribunal have following powers:

They have following power of civil court:

1. Summoning witnessing and enforcing attendance of any person and examining him on oath.
2. Requiring discovery and production of any document.
3. Receiving evidence on affidavits.
4. Requisition any public record or document or copy of such record/document from any office (subject to section 123 and 124 of Indian Evidence Act)
5. Reviewing its decisions.
6. Dismissing a representation of default or deciding it *ex parte*.
7. Setting aside any order of any representation for default or any order passed by it *ex parte*.
8. Any other matter as may be prescribed by Central Government.

15.10.2 Penalties

If any person contravenes any provision of Act he shall be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakhs rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.

Any adjudicating authority adjudging any contravention under sub-section (1) may if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

Check Your Progress 3

Fill in the blanks:

1. Foreign exchange control was first introduced in September, 1939 under ________________.
2. The object of ____________ was to conserve foreign exchange and to prevent its misuse.
3. Violation of ___________ is civil offence.
4. __________ controls over capital account transactions.
5. Today rupee is convertible on ____________.
6. India has ____________ trade with Nepal and Bhutan.

15.11 LET US SUM UP

Foreign exchange regulation act was introduced in 1947. This was later replaced with ‘the Foreign Exchange Regulation Act, 1973’(FERA). Which was further replaced by FEMA which came into effect from 1st June 2000.

The object of FEMA is to consolidate and amend the law relating to foreign exchange with the object of facilitating external trade and payment and for promoting the orderly development and maintenance of foreign exchange market in India. FEMA envisages that RBI will have key role in management of foreign exchange. RBI delegate its power to authorized person to deal in foreign exchange with suitable guidelines.

FEMA allows Free transactions on current account subject to reasonable restrictions that may be imposed. It also ease the regulation regarding the capital account transaction.

Regulation relating to export of goods and services from India are contained in Foreign Exchange Management (Export of Goods and Services) Regulations 2000. Under FEMA restriction are only for physical possessions and retention of foreign currency and not in respect of the foreign currency kept in permissible account with authorized dealers (banks).

FEMA has eased the regulation over transactions in foreign exchange and security. Directorate of Enforcement has been formed to ensure that the provision of the Act are followed.

15.12 LESSON END ACTIVITY

Prepare a report on the impact of FEMA on the trade in India.

15.13 KEYWORDS

Authorized Person: Authorized Person means an authorized dealer, money changer, off-shore banking unit or any other person authorized under section 10(1) to deal in foreign exchange and foreign securities.

Current Account Transaction: Section 2(j) states that current account transaction means a transaction other than a capital account transaction.

15.14 QUESTIONS FOR DISCUSSION

1. Describe the scope of FEMA and discuss the difference between the FERA and FEMA.
2. Discuss the role of RBI in enforcing FEMA.
3. What is Capital Account Transaction? Discuss the role of FEMA in regulating Capital Account and Current Account Transaction.
4. Discuss how Directorate of Enforcement, enforces the FEMA.

Check Your Progress: Model Answers

CYP 1

Section 2(c) states that 'authorized person' means an authorized dealer, money changer, off-shore banking unit or any other person authorized under section 10(1) to deal in foreign exchange and foreign securities.

CYP 2

1. Some currency are freely convertible i.e. one can exchange these currencies with any other currency without any restriction. Major among these are: Dollars (USA), Pound Sterling, Euro, DM, Yen, Franc, Lira, etc. This is often called 'hard currency'.

Contd…

2. India has rupee trade with Nepal and Bhutan i.e. payment in respect of trade with Nepal and Bhutan is made in Indian Rupees.

CYP 3

1. Defense of India Rules,	2. FERA,	3. FEMA,
4. RBI,	5. Current Account,	6. Rupee

15.15 SUGGESTED READINGS

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LESSON

16

CONSUMER PROTECTION

CONTENTS

16.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to understand:

- Origin of Consumer Rights
- Various agencies of India for consumer treatment
- Process of safeguarding consumer interest

16.1 INTRODUCTION

“The purpose of any business is to create a customer. It is the customer who determines what a business is. It is the customer and he alone, who, through being willing to pay for a good or services, convert economic resources into wealth, thing into goods. What a business thinks it produces is not of first importance – especially not to the future of the business and to its success. What the customer thinks he is buying – what he consider value, is decisive; it determines what a business is, what it produce and whether it will prosper”. (Peter F. Drucker)

Business is about creating customers, business is about satisfying customer, business is about creating value for customer, business is about delighting customer all this are the buzzword of marketing but for some people business becomes about deceiving customer, for them business is all about making money by exploiting and deceiving customer. For them there is law, in India it is Consumer Protection Act, 1986.

16.2 CONSUMER RIGHTS

Every year the 15th march is observed as the “world consumer right day” the significance of this day is that on this day in 1962, John Fitzerald Kennedy, the then president of USA declared four consumer rights. Later International Organization of Consumers Union (IOCU) added three more rights to the list. The government of India too included these rights in its 20-point programme. These have also been incorporated in the United Nations Charter of Human Rights. These are:

(1) Right to Safety
(2) Right to be Informed
(3) Right to Choose
(4) Right to be Heard

Mentioned by President Kennedy

(5) Right to Redress
(6) Right to Healthy Environment
(7) Right to Consumer Education

Added by International Organization of Consumers Union (IOCU)

In our country too the Government has been adding impetus to this movement through various schemes and measures. Late Prime Minister Indira Gandhi ascribed 17th point to her 20 point programme to consumer protection. The first step in the direction was the setting up for National Consumer Council at Delhi. To promote the formation of voluntary consumer organizations the state and central Government have also provided for the dispersal of funds. The Central Government has encouraged the growth of certain units in various departments, which are concerned with consumer awareness.

Check Your Progress 1

What are the consumer rights incorporated in the UN charter of Human Rights?

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………………………………………………………………………………………...

16.3 CONSUMER PROTECTION ACT, 1986

Consumer

The term consumer is defined in Section 2(d) of the Consumer Protection Act, 1986 in two parts, one in reference to a consumer who purchases goods and the second in reference to a person who hires services.

“Consumer” means any person who:

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of differed payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose*; or

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary or such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person.

[* For the purpose of sub clause of (i) “commercial purpose” does not include use by a consumer of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment.]

Thus for a person to be treated as a consumer under the Act he may either be purchaser of goods (or used thereof) or be a hirer of services (or avail or thereof). In first category there is sale or agreement to sale, while in the latter category there is either hiring of services of agreement for availing the services. The word ‘hire” means to acquire the temporary use of a thing or the services of a person in exchange for payment, to engage the temporary use for a fixed sum to procure the use of services of, at a price; to grant temporary use for compensation. This is the plain meaning in reference of which the word has been referred in the Act.

16.4 AIMS AND OBJECTIVE OF ACT

The main objective of the Act (as per preamble to the Act) is to provide for better protection of interest of consumers. Consumer councils and other authorities are provided for settling the consumers’ disputes and other matters. The objective of the Act, 1986 is as follows:

1. The foremost objective of Consumer Protection Bill is to provide for better protection of the interest of consumer and for that purpose, to make provision for the establishment of Consumer Protection Councils and other authorities for the settlement of consumer disputes and for matters connected therewith.

2. ***Rights of Consumer:*** The act is intended to protect following rights of the consumers [Section 6]:

    (i) The right to be protected against marketing of goods which are hazardous to life and property,

    (ii) The right to be informed about the quality, quantity, potency, purity, standard and price of goods to protect the consumer against unfair trade practices,

    (iii) The right to be assured, whether possible, access to a variety of goods at competitive prices,

    (iv) The right to be heard and to be assured that consumers’ interest will receive due consideration at appropriate forums,

    (v) The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers, and

    (vi) The right to consumer education.

3. To provide speedy and simple redressal at minimum expenses to consumer disputes, a quasi-judicial body is to be set up at the district, state and central levels.

    Various short coming were witnessed in the Act and as such various amendment were advocated. In Various Amendment Act were introduced in 1993

Amendment Act to make it more effective in protecting the customer. The 1993 bill seeks to provide for following:

(a) To enlarge the scope of the Act so as to enable the consumers to file class action complaints where such consumers have a common interest and to file complaints relating to restrictive practices adopted by trader;

(b) To enable the consumers who are all self-employed to file complaints before the redressal agencies where goods bought by them exclusively for earning their livelihood, suffer from any defect;

(c) To add services relating to housing construction;

(d) To enable filing of class action complaints on behalf of groups of consumer having the same interest;

(e) To provide for the constitution of selection committees for the selection of non-judicial members of various redressal agencies;

(f) To increase the monetary jurisdiction of District forum/State Commissions/ National Commission;

(g) To confer additional powers on the redressal agencies by way of awarding costs to the parties for ordering removal of defects or deficiency form the services and for empowering the recall of goods likely to endanger the safety of the public etc.;

(h) To impose punishment on the complainant in cases of frivolous or vexatious complaints;

(i) To provide for a limitation period of one year for filling complaints.

Check Your Progress 2

Define 'Consumer' as per the Consumer Protection Act, 1986.

………………………………………………………………………………………..

………………………………………………………………………………………..

16.5 GROUNDS FOR APPEAL FOR THE JURISDICTION TO REDRESSAL FORUMS

Consumer can appeal for the jurisdiction to the Consumer Redressal forums upon any of the five grounds as follows:

16.5.1 Consumer Act and Unfair Trade Practices

CP Act recognizes only those practices as unfair, which are covered under ambit of Section 36-A of the MRTP Act. Specific categories of Unfair Trade Practices recognized by the Act are:

False Representation

The practice of making any statement, whether oral or written or by verbal representation which:

1. Falsely suggest that the goods are of a particular standard, quality, grade, composition, style or model.
2. Falsely suggest that the services are of a particular standards or quality or grade.
3. Falsely suggest any rebuilt, second hand, renovated or reconditioned or old goods as new goods.

4. Represent that the goods or services has sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services so not have.
5. Represent the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier doesn't have.
6. Make a false or misleading representation concerning the need for or usefulness of any goods or services.
7. Gives a warranty or guarantee as to the durability, performance or efficacy of the goods which is not based upon adequate or proper test; the burden of proof will lie upon him to show that the goods were adequately and properly tested.
8. Makes to the public a representation in a form that looks like a guarantee or warranty, or a promise to replace, maintain or repair the goods until they achieve a specified result, and the representation is materially misleading or there is no reasonable prospect that the guarantee, etc contained in he representation shall be carried out.
9. Materially misleads the public about the prices at which such goods or services are available in the market.
10. Gives false or misleading facts disparaging the goods, services or trade of another person.

False Offer or Bargain Price

The second category is in clause (2). It includes the publication of an advertisement in a newspaper or otherwise by which goods or services are offered at a bargain price when in fact this is not the intention or they are not intended to be offered at that price for a reasonable a reasonable period or reasonable quantity. The bargain price for the purposes of this provision means the price stated in the advertisement in such manner as suggests that it is lesser than the ordinary price or a price which the person coming across the advertisement would believe to be better that the price at which such goods are ordinarily sold.

Offering of Gifts Prize etc and Conducting Promotional Contests

Clause (3)(a), of section 36-A of MRTP Act and of section 2 (r) CP Act:

Section 36 (3) prohibits, "offering of gifts, prizes, or other items with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge, when it is fully or partly covered by the amount charged in the transaction as a whole. "

Product Safety Standards

(Clause (4) of section 36-A MRTP Act and of Section 2(r) CP Act, 1986)

The objective of the clause is to protect the consumer from unreasonable risks associated with Consumer products. There are certain laws which prescribes the standards regarding the performance, composition, contents, design etc. Which are necessary to be followed to reduce the risk of injury to the consumer. This clause is regarding the sale or supply of goods intended to be used or is of a kind likely to be used by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions , finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods.

Hoarding or Destruction of Goods Act

[Clause (5) of section 36-A MRTP Act and of section 2(r) CP Act, 1986]

This Act restrict the hoarding or stocking of goods, thus creating artificial scarcity, and reaping the benefits of price rise. Provision of Essential Commodities Act, 1955 do cover such cases, but only with respect to commodities declared essential under Act. Clause 5 of section 36-A prohibits the hoarding and destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those to other similar goods or services.

Box 16.1: UN Guidelines for Consumer Protection, 1986 – General Principles

1. Governments should develop, strengthen or maintain a strong consumer protection policy, taking into account the guidelines set out below. In so doing, each Government must set its own priorities for the protection of consumers in accordance with the economic and social circumstances of the country, and the needs of its population, and bearing in mind the costs and benefits of proposed measures.
2. The legitimate needs, which the guidelines are intended to meet, are the following:
   (a) The protection of consumers from hazards to their health and safety;
   (b) The promotion and protection of the economic interests of consumers;
   (c) Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs;
   (d) Consumer Education;
   (e) Availability of effective consumer redress;
   (f) Freedom to form consumer and other relevant groups or organizations and the opportunity of such organizations to present their views in decision-making processes affecting them.
3. Governments should provide or maintain adequate infrastructure to develop, implement and monitor consumer protection policies. Special care should be taken to ensure that measures for consumer protection are implemented for the benefit of all sections of the population, particularly the rural population.
4. All enterprises should obey the relevant laws and regulations of the countries in which they do business. They should also conform to the appropriate provisions of international standards for consumer protection to which the competent authorities of the country in question have agreed.
5. The potential positive role of universities and public and private enterprises in research should be considered when developing consumer protection policies.

Source: Department of International Economic and Social Affairs.

16.5.2 Restrictive Trade Practice

Section 2(1) (nn) of the Act provides that , “restrictive trade practice” means “any trade practice which requires a consumer to buy, hire or avail of any goods or , as the case may be , services as a condition precedent for buying, hiring or availing of other goods or services”.

According to above definition sale or purchase of a product or service id made conditional on the sale or purchase of one or more other products and services, it amounts to restrictive trade practice. These type of sale are called ‘tie up sale’. The effect is that the purchaser of goods is compelled to purchase some goods or services with the purchase of some goods. As buyer may be compelled to buy gas stove with the purchase of gas cylinder.

Goods and Defect [Section 2 (1)(i)&(f)]

Goods: The consumer protection act doesn’t define the term ‘Goods’ It says that – ‘Goods’ means goods as defined in he Sale of Goods Act, 1930. Section 2(7) of the Sale of Goods Act, defines goods as “Goods means every kind of movable property other than actionable claims and money, and includes stock and shares, growing crops, grass, and things attached to or forming part of land which are agreed to be severed before sale or under the contract of sale".

Defect: Under section 2(1)(f) of the Act 'defect' means: "any fault, imperfection or shortcoming in quality potency, purity or standard which is required to be maintained by or under any law, for the time being in force or as is claimed by the trader in any manner whatsoever in relation to the goods."

Deficiency in Services [Section 2(1)(o)& (g)]

Service: According to CP Act "Service means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance transport, processing, supply of electrical or other energy, board of lodging or both, housing construction, entertainment, amusement, or the purveying a news or other information, but does not include the rendering of any service free of charge or under a contract of personal service."

Deficiency in Service: According to Act "deficiency means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service."

Charging of excessive price over that fixed by law or displayed

A complaint may be made against a trader who has charged a price in excess of the price:

1. Fixed by or under any law for the time being in force, or
2. Displayed on the goods, or
3. Displayed on any package containing the goods.

Hazardous Goods

The consumer protection act in spite of recognizing the right of consumer to be protected against marketing of goods, which are hazardous to life and property, did not provide any preventative mechanism in favor of the consumer. The term 'Hazardous goods' has not been defined in the Act. The person can make complain if he is not informed about the hazardous nature of the goods but the same is not true in case of the hazardous services.

Check Your Progress 3

Define the following:

1. Bargain price

   ………………………………………………………………………………

   ………………………………………………………………………………

2. Deficiency in service

   ………………………………………………………………………………

   ………………………………………………………………………………

16.6 WHO CAN FILE COMPLAINT [SECTIONS 2(B) AND 12]

A complaint in reference to any goods sold or delivered or services rendered may be filed by any of the following:

(a) By consumer himself to whom such goods have been sold or delivered or such service rendered.

(b) Any voluntary consumer association registered under Companies Act, 1956 or under any other law for the time being in force, or

(c) One or more consumers, where there are numerous consumers having the same interest.

(d) The Central and State Government.

In addition to above following are also considered as a consumer and hence they may file a complaint:

Beneficiary of Goods/Services, Legal representative of the deceased consumer, Legal heirs of the deceased consumer, Husband of the Consumer, A Relative of Consumer, and Insurance Company.

Relief available against complaint [Sections 14 and 22]

If the firm is convinced that the goods were really defective or that the complaint about the service is proved, the forum shall have to order any of the following things to be done by the opposite party:

(a) To remove the defect pointed out by the appropriate laboratory for the goods in question;

(b) To replace the goods with new goods of similar description which shall be free form any defect;

(c) To return to the complaint the price or as the case may be the charges paid by the complainant;

(d) To pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party;

(e) To remove the defects or deficiencies in the services in question;

(f) To discontinue the unfair trade practice or the restrictive trade practice or not to repeat it;

(g) Not to offer the hazardous goods for sale;

(h) To withdraw the hazardous goods from being offered for sale;

(i) To provide for adequate costs to complainant.

16.7 CONSUMER PROTECTION COUNCILS

These councils work towards the promotion and protection of consumers. The Consumer Council are created to advice and assist the consumers in seeking and enforcing their rights. We have consumer protection councils both at Center level and State level.

16.7.1 Central Consumer Protection Council

The Central Government was authorized to establish by notification Central Council has come to existence w.e.f. 15th April 1987 through the framing of the (Central) Consumer Protection Rules, (1987).

Composition [Section 2 and rule 3]

Member of the councils are selected from various areas of consumer interest, who are when possible, leading members of statewide organizations representing segments of the consumer public so as to establish a broadly based and representative consumer council. The council shall consist of following member namely:

(a) the Minister in charge of he Department of Food an Civil supplies in the Central Government, who shall be its chairman; and

(b) Such members of other official or non-official members representing such interest as may be prescribed.

The Central Government has provided that the Central Council shall consist of the following members not exceeding, 150 namely:

1. The Chairman shall be the Minister-in-Charge of the Department of Civil Supplies;
2. The Vice Chairman shall be the Minister of State (where he is not holding independent charge) or Deputy Minister I the Department of Civil supplies;
3. The Minister of Food and Civil Supplies or Minister –in –Charge of consumer Affairs;
4. Eight members of parliament – five from Lok Sabha and three from Rajya Sabha;
5. The commissioner of Scheduled Casts and Tribes;
6. Representatives of the Central Government Department [and] autonomous organizations concerned with consumer interest- not exceeding twenty;
7. Representatives of the Consumer Organization or consumer- not less than thirty five;
8. Representative of women- not less than ten;
9. Representatives of farmers, trade industries-not exceeding twenty;
10. Person capable of representing consumer interest not specified above-not exceeding 15;
11. Secretary in the Department of Civil Supplies shall be the member secretary to the Central Council.

The term of council is for three years.

A member can resign by submitting his written resignation to the Chairman. The vacancy would be filled from the category to which the resigning member belonged and also only for the period for which he would have continued.

16.7.2 State Consumer Protection Council

Under section 7 of the Act, State Government are required to establish their respective protection councils. Rules as to composition etc. are to be prescribed by the State Government. The objects of the State Consumer Protection Council are described in section 7 to be the same as those of the Central Council, namely, the points enumerated in Section 6.

Working Groups

Central Government may constitute from amongst the members of the Council a standing Working Group, under Chairmanship of the Member Secretary of the council. The Standing Working Group shall consist of not exceeding 30 members and shall meet and when considered necessary by the Central Government.

16.8 CONSUMER DISPUTES REDRESSAL, AGENCIES UNDER CONSUMER PROTECTION ACT, 1986 (CDRA)

Under the Act, Consumer Disputes Redressal Agencies have been established. The Consumer Protection Act provides for a 3-tier approach in resolving consumer disputes. These three levels are:

1. A consumer Disputes Redressal Forum to be known as the "District forum". This is to be established by the State Government in each district of the State by means of a notification. More than one can also be established in one district.
2. A Consumer Disputes Redressal Commission to be known as the "State Commission". This has also to be established by the State Government in the State by means of notification.
3. A National Consumer Disputes Redressal Commission to be established by Central Government by means of notification.

The Act thus envisages a hierarchy of three Redressal Forums:

1. District Forum
2. State Forum
3. National Forum.

District Forum (Section 10)

Each District forum should consist of:

(a) A person who is or has been or is qualified to be a district judge, who shall be its president.

(b) Two other member who shall be person of ability, integrity an standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problem relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

Appointment Authority: Every appointment under have to be made by the State Government on the recommendation of a Selection Committee consisting of the following, namely:

- The President of State Commission – Chairman,
- Secretary, Law Department of the State – Member,
- Secretary in Charge of the Department.

Members of the District Office remain in the office for a term of five years, or up to the age of 65, which ever is earlier, members are not liable for reappointment Forum created under the Act are judicial authorities and proceedings before them are legal proceedings.

State Commission: (Section 16)

State commission consists of a president and two members one of whom is to be a woman. President is a person who is or has been a judge of a High Court, and the members are person of ability, integrity and standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Appointing Authority: President of the State Commission is appointed by State Government after consultation with the chief justice of High Court. Others members of the commission are made by the State Government on the recommendation of a selection committee consisting of the following, namely:

- President of State Commission –Chairman
- Secretary of Law Department of the State – Member
- Secretary in charge of Department dealing with consumer affair in the State-Member.

Member of the State Commission hold the office for five years or up to the age of 67 year whichever is earlier and he shall not be eligible for re-appointment.

National Commission (Section 20)

The National Commission consists of a president and four other members (one of whom is to be a woman). The president should be the one who is or has been judge of the Supreme court, and the members should be the persons of ability, integrity and standing and have adequate knowledge or experience of , or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Appointing Authority: The President is appointed by the Central Government after consultation with the Chief Justice of India;

The other members of the Commission are made by the central Government on the recommendation of a Selection committee.

The selection committee consists of following:

- A person is a judge of Supreme Court, to be nominated by the Chief Justice of India – Chairman.
- The Secretary in the Department of Legal Affairs in the Government of India – Member.
- Secretary of the Department of Legal Affairs in the Government of India – Member.

Every member of National Commission has to hold office for a term of five years or up to the age of seventy which ever is earlier and is not eligible for re-appointment.

Check Your Progress 4

State whether the following statements are true or false:

1. The purpose of any business is to create a profit only.
2. John Fitzerald Kennedy, the then president of USA declared four consumer rights.
3. The word ‘hire” means to acquire the temporary use of a thing or the services of a person in exchange for payment.
4. Cases having a claim exceeding 5 lakhs but up to the limit of Rs. 20 Lakhs can go to District Commission.
5. Territorial Jurisdiction of the National Commission is whole of India except the State of Jammu & Kashmir.

16.9 JURISDICTION

The question has to be considered with reference to the value, place, and nature of the subject matter:

District Forum

District forum deals the cases where the value of claim is up to Rs. 5 lakhs.

Territorial Jurisdiction: A case is supposed to fall within the purview of District Council when at the time of the institution of the complaint:

(a) The party against whom the claim is made actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area, or

(b) Where there are more than one opposites party, each such party actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area, or

(c) Where there are more than one opposite party, and any such party actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area; provided the other parties not so residing or working agrees, or the district Forum gives permission in this regard,

(d) The cause of action, wholly or in part, arises in that area.

State Commission

Cases having a claim exceeding 5 Lakhs but up to the limit of Rs. 20 Lakhs can go to State Commission.

The Consumer Protection Act does not specifically provide for the territorial jurisdiction of the State Commission. Broadly these are on similar lines on which the territorial jurisdiction of District Forum is based.

National Commission

National Commission is the highest level of Consumer Forums; it may entertain all the matters where the value of claim exceeds Rs. 20 Lakhs. Territorial Jurisdiction of the National Commission is whole of India except the State of Jammu & Kashmir.

Orders of the Consumer Forum are like orders of the Civil Court and are enforceable like decree of the court. The decree of a junior Forum is appealable with senior Forum, and when no appeal is instituted, the order is final. Every order made by the District Forum, or State Commission, or the National Commission may be enforced in the same manner as if it were a decree of the court (Section 25).

16.10 LET US SUM UP

Right to Safety, Right to be informed, Right to Choose Right to be Heard, Right to Redress Right to Healthy Environment, Right to Consumer Education are considered to be the rights of consumers which should be protected. To safeguard the interest of consumers the Consumer Protection Act 1986 was enacted.

The foremost objective of Consumer Protection Bill is to provide for better protection of the interest of consumer and for that purpose, to make provision for the establishment of Consumer Protection Councils and other authorities for the settlement of consumer disputes and for matters connected therewith.

Consumer can appeal for the jurisdiction to the Consumer Redressal forums against Unfair Trade Practices, False Offer or Bargain Price, insufficient product safety Standards, charging high price, defective goods etc. This act restricts the hoarding or stocking of goods, thus creating artificial scarcity. If consumer forum is convinced with the pleas of the consumer then it can give orders to give relief to consumer.

Under the Act, Consumer Disputes Redressal Agencies have been established. The Consume Protection Act provides for a 3 tier approach. The Act thus envisages a hierarchy of three Redressal Forums they are District Forum, State Forum, National Forum.

16.11 LESSON END ACTIVITY

Prepare on the present status of consumer movement in India.

16.12 KEYWORDS

Consumerism: This term is related to the modern consumer movement.

IOCU: International Organization of Consumers Union.

Consumer Council: These are created to advice and assist the consumers in seeking and enforcing their rights.

District forum: Consumer Disputes Redressal Agencies at district level deals the cases where the value of claim is up to Rs. 5 lakhs.

State Commission: Consumer Disputes Redressal Agencies at State level deals the cases where the value of claim exceeding 5 Lakhs but up to the limit of Rs. 20 Lakhs.

National Commission: It is the highest level of Consumer Forums, it may entertain all the matters where the value of claim exceeds Rs. 20 Lakhs.

16.13 QUESTIONS FOR DISCUSSION

1. Define consumer. Discuss the role of consumerism in consumer protection.
2. Discuss the factors responsible for evoking consumer protection movement in India.
3. Briefly describe the Consumer Protection Act, 1986.
4. Discuss the role of Consumer Protection Council in consumer protection.
5. Briefly describe the Consumer Disputes Redressal Agencies established under the Consumer Protection Act 1986

Check Your Progress: Model Answers

CYP 1

(a) Right to Safety

(b) Right to be informed

(c) Right to Choose

(d) Right to be Heard

(e) Right to Redress

(f) Right to Healthy Environment

(g) Right to Consumer Education

CYP 2

For a person to be treated as a consumer under the Act he may either be purchaser of goods (or used thereof) or be a hirer of services (or avail or thereof). In first category there is sale or agreement to sale, while in the latter category there is either hiring of services of agreement for availing the services.

Contd…

CYP 3

1. The bargain price for the purposes of this provision means the price stated in the advertisement in such manner as suggests that it is lesser than the ordinary price or a price which the person coming across the advertisement would believe to be better that the price at which such goods are ordinarily sold.
2. Deficiency means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

CYP 4

1. False , 2. True, 3. True, 4. False, 5. True

16.14 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books

Bedi Suresh (2006) *Business Environment*, Excel Books

Mishra, Puri (2006) *Economic Environment of Business*, Himalaya Publications House

Spiro George W. (1993) *The Legal Environment of Business*, Englewood Cliffs, NJ Prentice Hall

Starling, Grower (1996) *The Changing Environment of Business*, Cincinnati, OH, South Western College Publishing

Weidenbaum, Marray L. (1999) *Business and Government in the Global Market Place*, Upper Saddle River, NJ Prentice Hall.

LESSON

17

INTELLECTUAL PROPERTY RIGHTS (PATENTS)

CONTENTS

17.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the concept of copyrights and patents
- Understand various types of Patents
- Know the difference between product and process patents
- Know how interest of pubic is protected in patents

17.1 INTRODUCTION

National patent laws have a history of over 500 years beginning with the Venetian Patent Law in 1474. The first international agreement, the Paris Convention was agreed upon in 1883. The Paris Convention gave Member States considerable flexibility in enacting their national legislation on Intellectual Property Rights (IPRs).

17.2 PATENT

In India intellectual property rights fall under item 49 of list I – Union List – of Seventh Schedule to Constitution. The items read – Patents, inventions and designs; copyright; trademark; and merchandise marks, Thus patent is a Union subject. Patent protection was first introduced in 18th century. Formal patent protection in Indian was introduced by Patent Act, 1911.

A patent is a grant of property right by the government to an inventor. Patent are exclusive property rights that can be sold, transferred, willed licensed, or used as collateral much like other valuable assets. Patent law stipulates broad categories of what can and cannot be patented, and in the words of the statute, any person who "invents or discover any new and useful process, machine, manufacture or composition or matter, or any new and useful improvement thereof, may obtain a patent."

17.2.1 What can be Patented?

Patentable subject matter can be broadly classified into four broad categories:

1. ***Process:*** The word process as used in patents refers to new methods of manufacturing or new technological procedures that can be validated as unique. As a new method of gene splitting can be patented, or a new patent of manufacturing a drug can be patented.
2. ***Machine:*** The word machine in patent law means that the patent application is for a specific physical item. It has to be new and useful, not merely a work of art or some curiosity.
3. ***Manufacture:*** The word manufacture refers to physical items that have been fabricated through new combination of materials or technical applications. In most instances the application must explain how the product is made, including material, manufacturing processes, and additional modification that the inventor wants to include for protection under the patent grant.
4. ***Composition of Matter:*** The law also permits patenting composition of matter. This category is related to compounds such as synthetic material, medicines, cosmetics, fertilizing agents, and biogenetic catalyst. Simply having a mixture of ingredients, however, does not constitute a patentable composition.

17.2.2 Type of Patent

The patent law provides three categories of Patents: utility patents, design patents and plant patents.

1. ***Utility Patents:*** A utility patent is granted for a new product process machine methods of manufacturing, and composition of matter. This category excludes most botanical creations related to plant and agriculture use.
2. ***Design Patents:*** Design patents are granted for any new or original ornamental design for an article of manufacture. A design patents protect the appearance of the article not the article itself. An inventor can easily register both a utility patent and a design patent.

   Design as per Design Act: Section 2(5) of Design Act defines that 'design' means only the features of shape, configuration, pattern or ornament applied to any article by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction of anything which is in substance a mere mechanical device, and does not include any trademark defined in section 2(1)(v) of Trade and Merchandise Marks Act or property mark as defined in section 479 of Indian Penal Code.

   The highlights of definition are:

   a) Design Deals with external experience only.
   b) It relates to features of shape, configuration, pattern or ornamental decoration to any article.
   c) Application of shape, configuration etc. to an article should be by an industrial process or means.

d) In the finished article, it should appeal to and judged solely by the eye.

e) It does not include any mode or principle of construction.

f) It does not include any trademark.

3. ***Plant Patent:*** In botanical term, any new variety of plant that has been asexually reproduced can be granted a plant patent. The new plant must not exist in nature or in an uncultivated state. Therefore new plants, mutants, hybrids, and seedlings may be patented, provided the inventor can satisfy the Patent Office that the new plant did not evolve from nature.

Besides Patent IPR (Intellectual Property Rights) includes following things:

1. ***Trademarks:*** Trademarks "includes any word, name, symbol, or distinguishing device, or any combination thereof adopted and used by a manufacturer or merchant to identify his goods as distinguish them from those manufactured or sold by others." Trademarks can be name used in commerce, such as Coke, clearly trademarked by Coca-Cola Corporation. A trademark can be a symbol, such as Apple Computer Corporation's unusual apple with a bite in he side. Distinguishing device can be artistic renderings of corporate products , such as the wild mustang horse for the Ford automobile, the intricate shield and insignia designed NFL football team.

   Besides trademarks organization can also get Service Marks. Service Marks are unique characters or slogans, often quite similar to trademarks, that provide protection for brand images and creative properties that enhances a company's marketability. AS Onida has a familiar service mark "neighbor's envy owner's pride".

   Trademark law is also applicable on Internet as it is in the physical world. This gives the protection to "domain name" in the same manner as to trademark.

2. ***Copyrights:*** Copyrights are similar to patents in establishing ownership and protection for creative endeavor, but they pertain to intellectual property. A copyright extends protection to authors, composers, and artists, and it relates to the form of expression rather than the subject matter. This distinguishing is important because most intellectual property has proprietary information in terms of subject matter, and if that property cannot be patented, the copyright only prevents duplicating and using original matter. The probation does not prevents another person from using the "subject matter" and them rewriting the material. For example the concept of an electronic spreadsheet is not protected; however the software program devised to create the spreadsheet (form of expressive) is protected by copyright.

   Virtual matters under copyright protection are photographs, paintings, sculptures, poems, articles, stories, books, music, sound recordings, motion pictures, audiovisual works, periodicals, computer punch cards, microfilms, pantomimes, an choreographic works. These can be accurately differentiated from similar works. Copyright law extends to literary and dramatic efforts, so that performance and recording rights also can be protected. In some instances new copyright can be obtained for old material, if the new use represents a new form of expression.

   Works in which copyright subsist-

   Section 13(1) of Copyright Act provides that copyright subsist in (a) original literary, dramatic, musical and artistic works (b) cinematograph films and (c) sound recording.

3. ***Layout Design for Integrated Circuit:*** The scope of layout design for integrated circuit is to protect the chip and also the articles incorporated on it. An innocent

infringer is free from liability, but once he has received the notice of infringement he is liable to pay a reasonable royalty.

4. ***Trade Secrets and Undisclosed Information:*** This provide protection to persons/institutions on information which is lawfully under their control from being disclosed to, acquired by or used by others without their consent in a manner contrary to commercial practices so long as the information is secret and has commercial value because it is secret. It is expected that person/institution has taken reasonable steps to keep information secret.

5. ***Geographical Indicators:*** This tool gives protection to goods that can be identified as originating or manufactured in he territory of a country, or a region or locality in that territory where a given quality, reputation or other characteristics of such goods is essentially attributable to its geographical origin.

6. ***Anti-Competitive Practices in Contractual Licenses:*** It is accepted that some licensing practices related to IPR, which restrains competition may have an adverse impact on trade and impede transfer for technology.

Coca Cola has taken five IPRs for its product as follows:

Trademark: For its Logo

Design Patent: For the design of its bottle

Copyright: For its slogan “Thanda matlab Coco-Cola”

Secret Patent: For its formula

Check Your Progress 1

Define the following:

1. Trademarks

   ……………………………………………………………………………………

   ……………………………………………………………………………………

2. Copyrights

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   ……………………………………………………………………………………

17.3 NEW PATENT LAW [PATENT (AMENDMENT) ORDINANCE, 2005]

In January 2005 with the amendment of Indian Patent Act, 1970, through a midnight ordinance on December 31, 2004, the India entered in a new a phase of Product Patent.

Some of the important provisions and their legal implications in respect of product patents are as follows:

1. ***Patentable Subject Matter:*** According to new ordinance whatever falls within the purview of the definition of ‘invention’ will be patentable in India. The amendment to the Act in 2002 defines invention as “A new product or process involving inventive step and capable of industrial application” Thus if product satisfies the tests of patentability, viz., novelty, inventive step(non-obviousness) and industrial application (utility) it can be patented in India.

   The second requirement of a patentable invention, that of novelty, requires that the invention was not known to the public before the patent application was lodged. The novelty of an invention is determined by the patent examiner conducting a search of literature in the relevant field, to determine what the state of the art was at the date of patent application being filed.

The novelty requirement also necessitates that the invention has not been disclosed publicly by the person applying for the patent. An example of the application of that rule is that the application must not have offered the product for sale before applying for a patent. The requirement of novelty is not actually as strict a limitation as one might suppose.

There is certain exception to it. As under section 3(j) "Plants and animals in whole or any part thereof (other than micro organism) including seeds, varieties and species and essentially biological process for the production of plants and animals – cannot be patented" This is in line with Article 27.3 of TRIPS. Under section 3(d) of the Act, the mere discovery of any new property or new use for a known substance or new use for a known substance is not patentable.

a) *Farm Sector:* The new amendment has not categorically excluded seeds developed by novel means. The third amendment has extended the product patent regime, which includes seeds developed by novel means, particularly the transgenic seeds.

(b) *Software:* Software would now be patentable if embedded with hardware. Currently the intellectual property rights (IPRs) protection with regard to software are limited to copyrights. This means that software embedded in hardware application like mobile phones, TVs and computers are patentable.

c) *Micro-Organism and Microbiological Process:* The TRIPs Agreement has not defined micro-organism and microbiological process. The question is whether the micro organism, existing freely, are patentable or their mere isolation in pure form are patentable or human intervention, in establishing a level of novelty in the discovered micro – organism, I needed for patenting.

   The next question is whether a product produced by a micro-organism, which is known can be patentable or the process is patentable. In absence of clear definition of micro-organism and micro biological process in the TRIPs Agreement.

   In the absence of clarity in the third amendment, claims in gene patent applications may pertain to genes or partial DNA sequence, proteins encoded by these genes, vectors used for transfer of genes, genetically modified micro-organism, cells, plants and animals and the process of developing a transgenic product. All these may lead to multiple rights, owned by multiple actors, called patient thickets over a final product. Hence there are problem of not only patent thickets but also of royalty staking and reach through claims.

d) *"Mere" new use:* Earlier 'new use for a known substance' could not be patented. However new Ordinance provides that "mere new use for a known substance " cannot be patented. The insertion of a single word 'mere' would open the floodgates for pharmaceutical product patents. The word 'mere' restrict the scope of non-patentable subject matter and widens the scope of patentability. The effect is that new pharmaceuticals use of known substance itself is known and comprises part of the state of the art would be patentable.

   Infringement

   A person who infringes a patent by making or using a patented invention without permission can be sued by the patent holder for damages. Perhaps the most distinctive feature of patents in comparison to copyright law, is that it is possible to infringe a patent unintentionally, and that this makes no difference to liability for damages.

2. ***Mail Box Application:*** The Mail box application for product patents that were filed from January 1, 1995 until December 31, 2004 will now be examined for grant of patents rights. Nearly 12,000 patents applications, majority of them from multinational Parma companies, would be opened by the Government on 1st January as the Government has complied it with WTO obligations. (The Economic Times, 28th December 2004).

   Only upon the actual grant of patent will the patentee be able to prevent others from exploiting his invention. The grant of patent will typically take anywhere between 1 and 3 years for now depending on the backlog of work in various branches of the patent office. The product which are patented abroad, but for which no corresponding patent applications were filled in India, will continue to be open for exploitation in India. Patent term of 20 years will be calculated from the date of the application and not from the day the patent was granted.

   Due to the existence of bolar provision in Section 107A of the Act, organization will be able to make , use sell or import the patented product for uses related to development and submission under Indian or foreign law.

3. ***Exclusive Marketing Right (EMR):*** Product patent was also applicable to those applications, which that were made since 1995 using the “mailbox” provisions. The “mailbox” provision were introduced in the Patent Act through the first amendment undertaken in 1999 in order to fulfill the condition imposed in Article of the TRIPs Agreement (The so called Transitional Arrangement) The “Transitional Arrangement” required India to introduce two provisions in its Patent Act. Article 70.8 of the TRIPs Agreement required India to provide “a means” by which product patent application can be filed from 1 January 1995. If the products figuring in these applications were granted a patent in any of the WTO member countries and the product were granted marketing approvals in any of the WTO member countries, then according to Article 70.9, five years Exclusive Marketing Rights (EMR) have to be granted by India before the patent on the product was either granted or rejected in India.

   According to new ordinance holders of EMRs will continue to enjoy their EMR till the patent is granted or rejected.

4. ***Compulsory License:*** Article 31 of TRIPs provide the provision of Compulsory license which means a situation where a government allows an agent to produce a patented product without the consent of the original patent owner. If attempts to obtain right to produce a patented product from patentee fails and if a compulsory license is issued, then adequate remuneration will paid to the original rights holder. These requirements are waived or diluted when these are issued for public and non commercial use or for other circumstances of extreme urgency.

   Chapter XVI of the Act deals with the provision of compulsory license in India. Section 92A allows the grant of compulsory license to manufacture and export a patented product to any country having insufficient or no manufacturing capacity in the pharmaceutical sector to address public health problems, provided a compulsory license has been granted in that country.

   Provision of compulsory license can be implemented after payment of adequate remuneration to the patent holder.

5. ***Pre-versus Post Grant Opposition:*** Before the introduction of new ordinance India followed a system of Pre Grant Opposition. Erstwhile section 25 of the Patent Act provided for initiation of proceedings for opposition the grant of a patent which could be launched within four months from the date of advertisement of the acceptance of complete specification. The Grant of patents could be opposed on the grounds included:

i) the invention for which the patent has been claimed was publicly known or publicly used in India,

ii) the invention is obvious and does not involve an inventive step,

iii) the invention is not patentable under the Patent Act 1970,

iv) the complete specification wrongly mentions the source or geographical origin of biological material used in the invention, and

v) the invention on which the patents is claimed forms part of the traditional knowledge whether in India or elsewhere.

The 2003 Amendment introduces two sets of changes to the condition relating to opposition to the grant of patents. First the pre- grant opposition of the 1970 Act is proposed to be changed to a pre-grant representation and secondly, the pre grant opposition has been replaced by post-grant opposition. Post Grant opposition, which has been provided in Section 25(3) of the Patents Act, 1970 allows any interested person to oppose the grant of a patent before the expiry of one year from the date of grant of patent. But while change in the system of opposition has been included the ground for opposition has been left unchanged. The grounds for pre grant opposition in the 1970 Act have been retained in the post grant opposition of 2003 Amendment and two sub-clauses (j) and (k) have been added.

17.4 IMPORTANT PUBLIC INTEREST PROVISIONS IN THE PATENT LAW

Union Minister of Commerce and Industry, Shri Kamal Nath has said that the Patent (third) amendment has taken care of public interest, particularly public health and nutrition. He said:

“The law effectively balances and celebrates intellectual property protection with public health concerns and national security. By participating in the international system of intellectual property protection, India unlocks for itself vast opportunities in both export as well as its potential to become a global hub in the area of R&D based clinical research outsourcing, particularly in the area of biotechnology”.

The important public interest provision in the Patent Law announced by Shri Kamal Nath are:

a) ***Conditional grant of Patent (Section 47):*** This empowers the Government to import, make or use any patent for its own purpose. For drugs, it also empowers import for public health distribution.

b) ***Revocation of Patent in Public interest (section 66):*** This empowers the Government to revoke a patent where it is found to be mischievous to the state or prejudicial to the public.

c) ***Grant of Compulsory License (Section 82 to 94):*** Chapter XVI deals with the general principles and circumstances for grant of compulsory licenses in order to protect public interest particularly public health and nutrition. These provision check the abuse of patent rights. They can be invoked if the reasonable requirement of the public with respect to patented inventions have not been satisfied, and the patented inventions is not available for public at a reasonably affordable price, and if the patented inventions is not worked in the territory of India.

d) ***Acquisition of Invention and Patent for Public purpose (Section 102):*** This empowers the Government to acquire a patent to meet national requirements.

e) ***Bolar Provision [Section 107 (A) (a)]:*** This facilitates production and marketing of patented products immediately after expiry of term of patent protection by permitting preparatory action by non-patentees during life of patent.

f) ***Parallel import [Section 107 (A)(b)]:*** This provides for import so that patented product can become available at the lowest international price. (PIB Press Release, 27th December 2004).

Check Your Progress 2

Fill in the blanks:

1. The first international agreement, the ________ Convention was agreed upon in 1883.
2. Patent is a _________ subject.
3. Formal patent protection in Indian was introduced by Patent Act, ________
4. Since 1970 till the new amendment India has followed a _____________ patent.
5. The word _________________ refers to physical items that have been fabricated through new combination of materials or technical applications.
6. Besides trademarks organization can also get ___________ Mark.

17.5 THE SALIENT FEATURES OF THE THIRD AMENDMENT OF THE PATENT LAW

- Extension of product patent protection to all fields of technology (i.e. drugs, food, and chemicals).
- Deletion of the provisions relating to Exclusive Marketing Rights (EMR) and introduction of a transitional provision for safeguarding EMRs already granted.
- Introduction of provision for enabling grant of compulsory license for export of medicines to countries which have insufficient or no manufacturing capacity, to meet emerging public health situations (in accordance with Doha Declaration on TRIPS and Public Health).
- Modification in the provision relating to opposition procedures with a view to streamlining the system by having both pre – grant and post grant opposition in the Patent office.
- Addition to a new provision to circumscribe rights in respect of mailbox applications so that patent rights in respect of the mailbox shall be available only from the date of grant of patent, and not retrospectively form the date of publication.
- Strengthening the provisions relating to national security to guard against patenting abroad of dual use technologies.
- Clarification of the provision relating to patenting of software related to patenting of software related inventions when they have technical application to industry or are in combination with hardware.
- Rationalization of provision relating to time-lines with a view to introducing flexibility and reducing the processing time for patent application and simplifying and rationalizing procedures.
- Government has the power to acquire a patent for national requirement.
- Polymorphs new form of older drugs are patentable.

- Parallel imports are allowed.
- Local production is mandatory.
- Earlier provision of ‘new use’ criteria is modified to ‘mere new use’.
- Transfer of cases from High Courts to the Appellate Board (S.117G.).

17.6 LET US SUM UP

In India intellectual property rights fall under item 49 of list I – Union List – of seventh Schedule to Constitution. Formal patent protection in Indian was introduced by Patent Act, 1911.

A patent is a grant of property right by the government to an inventor. Besides Patent IPR (Intellectual Property Rights) includes following things: - Trademarks, Copyright, Layout Design for Integrated Circuit, Trade Secrets and Undisclosed Information, Geographical Indicators, Anti Competitive Practices in Contractual Licenses.

On December 31, 2004, the India entered in a new phase a phase of Product Patent. According to new ordinance whatever falls within the purview of the definition of ‘invention’ will be patentable in India. To secure the interest of public the provisions in the Patent Law are Conditional grant of Patent, Revocation of Patent in Public interest, Grant of Compulsory License, Bolar Provision, Acquisition of Invention and Patent for Public purpose, Parallel import etc.

17.7 LESSON END ACTIVITIES

1. Prepare a report on impact of New Patent Law on Indian Pharmaceutical Industry.
2. Prepare a project on strategies of medium level pharma companies like Matrix Lab, Divi Lab in new patent regime.

17.8 KEYWORDS

Utility Patents: A utility patent is granted for a new product process machine methods of manufacturing, and composition of matter.

Design Patents: Design patents are granted for any new or original ornamental design for an article of manufacture.

Plant Patent: In botanical term, any new variety of plant that has been asexually reproduced can be granted a plant patent.

Trademarks: Trademarks “includes any word, name, symbol, or distinguishing device, or any combination thereof adopted and used by a manufacturer or merchant to identify his goods as distinguish them from those manufactured or sold by others.

Copyrights: Copyrights are similar to patents in establishing ownership and protection for creative endeavor, but they pertain to intellectual property.

Bolar Provision: This facilitates production and marketing of patented products immediately after expiry of term of patent protection by permitting preparatory action by non-patentees during life of patent.

Incrementally Modified Drugs (Evergreening): Incrementally Modified Drugs (IMDs), includes new formulations, new combinations of active ingredients or new salts or esters of approved compound.

Generic Drug: Once the patent on a drug expires it is termed as generic.

Compulsory License: Article 31 of TRIPs provide the provision of Compulsory license which means a situation where a government allows an agent to produce a patented product without the consent of the original patent owner.

17.9 QUESTIONS FOR DISCUSSION

1. What is IPR describe the various component/type of IPR.
2. Describe in brief new patent law.
3. Discuss the various measures, which were in New Patent Law to protect consumer interest.
4. Discuss the various strategies which the Indian Pharmaceutical Industries can follow to change the New Patent Law into a Opportunity from a threat.
5. Write short notes on:
    a) Pre-versus Post Grant Opposition,
    b) Third amendment of the Patent Law,
    c) Compulsory License,
    d) Exclusive Marketing Right (EMR),
    e) Mail Box Application.

Check Your Progress: Model Answers

CYP 1

1. Trademarks "includes any word, name, symbol, or distinguishing device, or any combination thereof adopted and used by a manufacturer or merchant to identify his goods as distinguish them from those manufactured or sold by others".

2. Copyrights are similar to patents in establishing ownership and protection for creative endeavor, but they pertain to intellectual property. A copyright extends protection to authors, composers, and artists, and it relates to the form of expression rather than the subject matter.

CYP 2

1. Paris,	2. Union,	3. 1911,
4. Process,	5. Manufacture,	6. Service

17.10 SUGGESTED READINGS

Mittal Vivek (2007) *Business Environment*, Excel Books

Bedi Suresh (2006) *Business Environment*, Excel Books

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LESSON

18

STOCK EXCHANGE AND SEBI

CONTENTS

18.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the functions of Securities and Exchange Board of India
- Learn the powers of SEBI
- Know the guidelines issued by SEBI

18.1 INTRODUCTION

According to CICA Act Companies had to take prior approval for any new issue, and for pricing or public and right issue. It gives powers to GOI to regulate the timing of new issues by private sector companies, the composition of securities to be issued, interest rates which can be offered on debentures and preference shares, the timing and frequency of bonus issues, the amount of prior allotment to promoters, floatation costs, and the premium charged on securities. Now this Act has been repealed by Capital Issues (Control) Repeal Act, 1992.

A major development in the Indian Stock market took place in 1988 when Securities and Exchange Board of India (SEBI) was established through an administrative order, on the lines of the Securities and Investment Board of the U.K. But it became really powerful organization in 1992 when CICA was repealed and the office of Controller of Capital Issues was abolished and The Securities and Exchange Board Act of 1992, provides for the establishment of a Board to protect the interest of investors and to promote the development and regulation of securities market. The Board of SEBI consist of six members comprising the chairman, two members from the amongst the official of the ministries of the central government dealing with fiancé and law, two members who are professional and have expertise or special knowledge relating to securities market, and one member for the RBI.

18.2 FUNCTIONS OF SEBI

SEBI is entrusted with following function (objective):

1. regulating the business in stock exchanged and any other securities market;
2. registering the regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities market in any manner;
3. Registering and regulating the working of collective investment schemes including mutual funds;
4. Promoting and regulating self-regulatory organization;
5. Prohibiting fraudulent and unfair trade practices relating to securities market;
6. Promoting investors' education and training of intermediaries of securities market;
7. Prohibiting insider trading in securities;
8. Regulating substantial acquisition of shares and take-over and mergers of companies;
9. Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchange and intermediaries and self- regulatory organization in the securities market;
10. Levying fees or other changes for carrying out the above purposes.

18.3 DEPARTMENT AT SEBI

SEBI has five operational departments, besides it, it has two more department the legal department and the investigation department. The department and there scope is as follows:

The Primary Market Policy, Intermediaries, Self-Regulatory Organizations (SROs), and Investor grievances and Guidance Department: It looks after all policy matters and regulatory issues in respect of primary market, registration, merchant bankers, portfolio management services, investment advisers, debentures trustees, underwriters, SROs and investor grievances, guidance, education and association.

The Issue Management and Intermediaries Department: It is responsible for vetting of all prospectuses and letters of offer for public and right issues, for coordinating with the primary market policy, for registration, regulation and monitoring of issue-related intermediaries.

The Secondary Market Policy, Operation and Exchange Administration, New Investment Products and Insider Trading Department: It is responsible for all policy and regulatory issues of secondary market and new investment products, registration and monitoring of members of stock exchanges, administration of some of the stock exchanges, market surveillance and monitoring of price movement s and insider trading, and EDP and SEBIs data base.

The Secondary Market Exchange Administration, Inspection and Non-member Intermediaries Department: It looks after the smaller stock exchange of Guwahati, Indore, Mangalore etc. It also responsible foe inspection of all stock exchanges, registration, regulation and monitoring or non-member intermediaries such as sub-brokers.

Institutional Investment, Mergers and Acquisition, Research and Publication, and International Relations and IOSCO Department: It looks after policy, registration and monitoring of Foreign Institutional Investors (FIIs), domestic mutual funds, merger and substantial acquisition of shares, and IOSCO (International Organization of Securities Commissions) membership, and research, publication and Annual Report of SEBI.

Legal Department: This department looks after all legal matters under the supervision of the General Counsel.

Investigation Department: This department carries out inspection and investigation under the supervision of the Chief of Investigation.

SEBI has its regional offices at Calcutta, Chennai, and Delhi. SEBI has also formed two non statutory advisory committees, the Primary Market Advisory Committee and Secondary Market Advisory committee with the members from market player, recognized investors associates and other eminent persons. SEBI is also a member of International Organization of Securities Commissions (IOSCO).

18.4 POWERS AND SCOPE OF SEBI

Functional area of SEBI is very wide it is the rule maker, it is custodian, it is watch dog of the security market. In brief it has the power to regulate: (i) depositors and participants, (ii) custodians, (iii) debentures trustees and trust deeds, (iv) FIIs (v) inside traders, (vi) mutual fund, (vii) portfolio manager, (viii) investment advisers, (ix) merchant bankers, (x) registrars to issue and share transfer agents, (xi) stock brokers and sub-brokers, (xii) underwriters, (xiii) venture capital funds, and (xiv) bankers to issue.

The SEBI can issue guidelines in respect of following:

- Information disclosure, operational transparency, and investor protection
- Development of financial institutions
- Priding of issues
- Bonus issues
- Preferential Issues
- Financial Instruments
- Firm allotment and transfer of shares among promoters.

SEBI is empowered to register any agency or intermediary who may be associated with the securities market, except under and in accordance with the conditions of a certificate of registration issued by the SEBI.

After the suspension of CICA (Capital Issues Control Act, 1947), SEBI is now authorized to govern all he matter related to issue of capital. SCRA also authorizes the SEBI to conduct inquiries into the working of the stock exchange, they are required to submit their annual reports to the SEBI and requires the approval of SEBI for amending their rules and bye laws; SEBI can direct them to amend their bye-laws and rules including reconstitution of their governing boards/councils; and it is empowered to license security dealers operating outside their jurisdiction.

SEBI has been empowered to demand explanation, to summon the attendance and call for documents from all categories of market intermediaries in order to enable it to investigate irregularities, impose penalties, and initiate prosecution. The SEBI is also empowered to notify its regulations and file complaints in courts without the prior approval of the GOI.

Check Your Progress 1

What are the regulatory powers of SEBI?

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18.5 CERTAIN GUIDELINES AND REFORMS INTRODUCED BY SEBI

18.5.1 Primary Securities Market

1. The issues of capital no longer requires any consent from any authority for making issue and for pricing it.
2. SEBI raised the standards of disclosure in public issues and enhanced the transparency.
3. The offer document is now made public even at the draft stage.
4. Companies without track record making first issue can price the issue at par only. At the first issue companies are free to price its securities, provided it has shown net profits in the immediately preceding 3 years, subject to its fulfilling the existing disclosure requirements.
5. Companies with 3 years track record or companies without track record, but promoted by companies with five years track record are free to price the issues. They can list the shares on a stock exchange.
6. Not less than 20% of equity (issued) should be offered to public.
7. For issues above 100 crore, book building requirement has been introduced
8. The pricing of preferential allotment scheme, a minimum of 50% of the net offer to the public is to be reserved for individual investors applying for securities not exceeding 1000 securities, and the remaining part can be allotted to applications for more than 1000 securities.
9. Draft prospectus will be vetted by the SEBI to ensure adequacy of disclosure.
10. Bankers to an issue and portfolio managers have to be registered with the SEBI.
11. Existing listed companies are allowed to raise fresh capital by freely pricing their further issues. However price should be determined in consultation with the lead managers to the issues. The high and low prices for the last two years should be indicated in the offer document. The draft proposal will be vetted by SEBI to ensure adequacy of disclosure.

18.5.2 Secondary Market and Various Intermediaries

1. The governing body and various committees of Stock Exchanges (SEs) have been recognized, restructured and broad based.

2. Inspection of all 22 SEs has been carried out to determine, *inter alia*, the extent of compliance with the directives of the SEBI.
3. Corporate membership of SE is now allowed, encouraged, and preferred. THE Articles of Association of SEs have been amended so as to increase their membership.
4. All the SEs have been asked to established wither a clearing house or a clearing corporation.
5. The BSE have been asked to reduce trading period or settlement cycle from 14 to 7 days for B group's shares.
6. All the recommendations of the Dave committees for improving the working of the OTCEI have been accepted.
7. In accordance with the recommendations of G.S. Patel Committee, BSE has been allowed to introduce a revised carry forward system (CFS) of trading. Other SEs can introduce forward trading only with the prior permission of the SEBI.
8. Brokers are required to segregate the client and its own account.
9. The capital adequacy norms of 3% for individual brokers and 6% for corporate brokers introduced.
10. Both the Brokers and the Sub brokers have been brought within the regulatory fold for the first time now; and the concept of the dual registration of stock brokers with the SEBI and the SEs has been introduced.
11. Panel action can now be taken directly by the SEBI against any member of a stock exchange for violation of any provision of the SEBI Act.
12. It has been mandatory for stockbrokers to disclose the transaction price and brokerage separately in the contract notes issued by them to their clients.
13. Compulsory audit of the brokers' books and filling of the audit reports with the SEBI has now been made mandatory.
14. Insider trading has been prohibited and such trading has been made a criminal offence punishable in accordance with the provision of SEBI.

18.5.3 Investment Protection Measures

The SEBI has introduced an automated complaints handling system to deal with investor complaints. To create an SEBI issues fortnightly press releases, disclosing names to the companies against whom maximum number of complaints have been received. A representative of SEBI now supervises the allotment of share process. Besides many other measures it also issues advertisement frequently to make investor aware of various issues to the securities market and of their rights and remedies.

18.5.4 Classification of Complaints

The complaints received by the SEBI are categorized in five types:

Type I: Non-receipts of refund orders/allotment letters/ stock investment

Type II: Non-receipt of dividend

Type III: Non-receipt of share certificates/bonus shares.

Non IV: Non-receipt of debentures certificate/interest on debentures/redemption amount of debentures/interest on delayed payment of interest.

Type V: Non-receipt of annual reports, right issue forms/interest on delayed receipt of refund orders/dividends.

18.6 INSIDER TRAINING

Insider training in securities is prohibited by SEBI under Insider Trading Regulations 1992. Insider training can be defined as the sale or purchase of securities by persons who possess price sensitive information about the company, on account of their fiduciary capacity involving confidence or trust. SEBI Insider Regulations, 1992 defines he insider as any person who is or was connected with company and who is reasonably expected to have access by virtue of such connection to unpublished price sensitive information with respect to the securities of the company, or who has received or has had access to such unpublished price sensitive information. Broadly insider can be of two type:

(a) Primary Insider e.g. Directors, stock exchanges, merchant bankers, registrars, brokers of the company, top executives, auditors, banks etc. (b) Secondary insider e.g. dealers, agents, other employees, etc, (c) others having access to price sensitive information due to their proximity with the company.

The SEBI Insider Regulations, 1992 prohibits the insider trading and lays down that no insider should:

(i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicate any unpublished price sensitive information to any person, with or without his or her request for such information except as required in the ordinary course of business or under any law; or

(iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.

Check your Progress 2

State True and False for the following statements:

1. A major development in the Indian Stock market took place in 1988 when Securities and Exchange Board of India (SEBI)
2. According to CICA Act Companies did not require any prior approval for any new issue, and for pricing or public and right issue.
3. The Board of SEBI consists of 10 members.
4. SEBI raised the standards of disclosure in public issues and enhanced the transparency.
5. The offer document is now made public even at the draft stage.
6. A representative of SEBI now supervises the allotment of share process.
7. Insider training in securities is allowed by SEBI under Insider Trading Regulations, 1992.

18.7 UNDERWRITING

Underwriter makes a commitment to get the underwritten issue subscribed either by others or by themselves. They agree to take unsubscribe portion of the issue. They render this service for a commission agreed upon between the issuing company and the underwriter subject to the ceiling under the Companies Act.

Underwriter service are available from brokers, investment, companies, commercial, banks and term lending institutions. Only such person (an individual, firm or a company) who has obtained certificate of registration from SEBI, can act as underwriter. Merchant bankers and stock brokers already having a valid certificate from SEBI for working as underwriters.

18.8 LET US SUM UP

The Securities and Exchange Board of India Act, 1992 provides for the establishment of the Securities and Exchange Board of India (SEBI) to protect the interest of securities and to promote the development of and to regulate the securities market. A major development in the Indian Stock market took place in 1988 when Securities and Exchange Board of India (SEBI) was established SEBI is now authorized to govern all he matter related to issue of capital. SCRA also authorizes the SEBI to conduct inquiries into the working of the stock exchange, they are required to submit their annual reports to the SEBI and requires the approval of SEBI for amending their rules and bye laws; SEBI can direct them to amend their bye-laws and rules including reconstitution of their governing boards/councils; and it is empowered to license security dealers operating outside their jurisdiction.

18.9 LESSON END ACTIVITIES

1. Prepare a report on the performance of SEBI since its inception.
2. Prepare assignment on the functions and powers of SEBI in case of any Merger and Acquisition of a listed companies.

18.10 KEYWORDS

Bull: A bull is a buyer in the stock market. He is optimistic about the security prices.

Bear: Bear is a seller of securities. His expectation is that the market would go down.

Derivatives: These are financial instruments that are valued according to the expected price movements of an underlying assets, which may be a commodity, currency or a security.

Insider Trading: Insider training can be defined as the sale or purchase of securities by persons who possess price sensitive information about the company, on account of their fiduciary capacity involving confidence or trust.

Underwriter: Underwriter make a commitment to get the underwritten issue subscribed either by others or by themselves.

18.11 QUESTIONS FOR DISCUSSION

1. Describe briefly the development of Stock Exchange in India.
2. Discuss the function and powers of SEBI.
3. Critically evaluate the guidelines and reform SEBI introduced.
4. Write short notes on: Badla System, Carry Forward Transactions, Derivatives, Insider Trading, Underwriting

Check Your Progress: Model Answers

CYP 1

Functional area of SEBI is very wide it is the rule maker, it is custodian, it is watch dog of the security market. In brief it has the power to regulate: (i) depositors and participants, (ii) custodians, (iii) debentures trustees and trust deeds, (iv) FIIs (v) inside traders, (vi) mutual fund, (vii) portfolio manager, (viii) investment advisers, (ix) merchant bankers, (x) registrars to issue and share transfer agents, (xi) stock brokers and sub-brokers, (xii) underwriters, (xiii) venture capital funds, and (xiv) bankers to issue.

Contd…

CYP 2

1. True, 2. False, 3. False,
4. True, 5. False, 6. True, 7. False

18.12 SUGGESTED READINGS

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Bedi Suresh (2006) *Business Environment*, Excel Books

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LESSON

19

EXCISE, CUSTOMS AND SALES TAX

CONTENTS

19.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the nature of various states and central taxes
- Know the role of customs in Indian economy
- Explain the concept of Excise and its implementation in India
- Know the sales tax and how it is replaced by VAT

19.1 INTRODUCTION

India has a well developed tax structure with a three-tier federal structure, comprising the Union Government, the State Governments and the Urban/Rural Local Bodies. The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution. The main taxes/duties that the Union Government is empowered to levy are Income Tax (except tax on agricultural income, which the State Governments can levy), Customs duties, Central Excise and Sales Tax and Service Tax. The principal taxes levied by the State Governments are Sales Tax (tax on intra-State sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions & Callings. The Local Bodies are empowered to levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities like water supply, drainage, etc.

Since 1991 tax system in India has under gone a radical change, in line with liberal economic policy and WTO commitments of the country. Some of the changes are:

- Reduction in customs and excise duties
- Lowering corporate Tax
- Widening of the tax base and toning up the tax administration

The present lesson discusses the Customs, Excise, and Sales Tax.

19.2 CUSTOMS

Customs Duty is a type of indirect tax levied on goods imported into India as well as on goods exported from India. Taxable event is import into or export from India. Import of goods means bringing into India of goods from a place outside India. India includes the territorial waters of India which extend up to 12 nautical miles into the sea to the coast of India. Export of goods means taking goods out of India to a place outside India.

In India, the basic law for levy and collection of customs duty is Customs Act, 1962. It provides for levy and collection of duty on imports and exports, import/export procedures, prohibitions on importation and exportation of goods, penalties, offences, etc.

The Constitutional provisions have given to Union the right to legislate and collect duties on imports and exports. The Central Board of Excise and Customs is the apex body for customs matters. Central Board of Excise and Customs (CBEC) is a part of the Department of Revenue under the Ministry of Finance, Government of India. It deals with the task of formulation of policy concerning levy and collection of customs duties, prevention of smuggling and evasion of duties and all administrative matters relating to customs formations. The Board discharges the various tasks assigned to it, with the help of its field organisations namely the Customs, Customs (Preventive) and Central Excise Zones, Commissionerate of Customs, Customs (preventive), Central Revenues Control Laboratory and Directorates. It also ensures that taxes on foreign and inland travel are administered as per law and the collection agencies deposit the taxes collected to the public exchequer promptly.

Customs duties currently comprise the following:

Basic Customs Duty (BCD): Current general peak rate is 15 per cent.

Countervailing Duty (CVD): This duty is equivalent to central excise duty leviable on a like product manufactured in India. Current rate applicable to majority of the industrial products is 16 per cent plus 2 per cent education cess, taking the effective rate to 16.32 per cent. This duty is calculated on the value of product + basic customs duty.

Additional Duty of Customs (ADC): This duty is levied to countervail the sales tax, value-added tax, local taxes and other charges leviable on the like goods on their sale or purchase or transportation in India. Presently, this duty is levied at 4 per cent on certain items viz. items bound under the Information Technology (IT) Agreement and on specified inputs/raw materials for manufacture of electronic/IT goods. This duty is levied on value of product +basic customs duty + countervailing duty.

Education Cess: This cess is levied at 2 per cent on the amount of BCD + CVD.

In addition, government also levies anti-dumping and safeguard duties on specified products for specified periods. "Value" for the purpose of levy of customs duty is "transaction value" in the course of international trade in arm's length unrelated party transaction.

Import of goods into and export from India is regulated by the Foreign Trade Policy (the Policy) issued from time to time by Government of India. The Policy remains in force for five years and is amended from time to time. The Policy currently in force is for tax year 2004-09. Majority of goods are now freely importable.

Recently, the special duty exemption scheme has released the importers from the burden of paying import duty for those import items which will facilitate production of export goods.

Certain input norms and output norms have been developed for approximately 4,200 items and these norms have been formulated to decide the quantity of duty-free inputs to be imported for the production of a specific export item. The Export Promotion Capital Goods Scheme (EPCG) is the latest addition in the import tax structure which serves to provide deductions in import duty on capital goods. But the deductions under the Export Promotion Capital Goods (EPCG) Scheme are available only after conforming with the export obligations like providing a statement of exports as per Appendix-10 C of the scheme and the statement is required to be certified by a Chartered accountant.

Import Tax in India also includes tariffs that are applied to foreign goods. Tariffs are charged by customs official to allow the landing of the imported goods in the port. The purpose behind levying tariffs is mainly to protect the domestic industries from foreign competition. Tariffs serve to protect the domestic industries through-the revenue tariffs and the protective tariff. The revenue tariffs contain certain set rates to apply on the imports to increase the revenue earning of the government. Whereas protective tariffs serve to superficially amplify the cost of the imported goods so that the buyer has to pay more money for the purchase of an imported good which can be purchased at a lesser price from an indigenous manufacturer.

Indian tariffs are categorized as per the Harmonized Commodity Description and Coding System. The Customs Act acts as the guideline for the application of tariffs on imported goods and also for formulating rules for the valuation of customs. The Customs Tariff Act provides guidance as to the rates of tariffs, anti-dumping, as well as countervailing duties.

India levies import tax on a wide range of articles and some of the significant commodities are as follows:

Table 19.1

Category	Commodity
Metals	Copper, Aluminum, Zinc , Lead, Tin etc.
Iron & Steel Products	Iron and Non Iron alloy steel, Stainless steel etc.
Machine tools	Roller bearings, motor parts, electrical machinery, cinematographic measuring instruments, optical instruments, surgical instruments, man made filaments etc.
Chemicals	Both Organic and inorganic chemicals
Oils	Crude oils, Petroleum oils etc.
Cash Crops	Coffee, Tea, Rubber etc.

Check Your Progress 1

Describe, in brief, the following:

1. Countervailing duty

   ……………………………………………………………………………………….

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2. Additional duty on customs

   ……………………………………………………………………………………….

   ……………………………………………………………………………………….

19.3 EXCISE TAX

Excise Tax is more commonly known as Excise Duty and is one of the most well-known forms of taxation in India. Any manufacturer of excisable products is liable to pay this tax and is levied on a wide variety of commodities manufactured in India.

Central Excise Duty (CENVAT) is levied on goods manufactured and produced in India. It is levied under the authority of the Central Excise Act, 1944 at the rates prescribed in the First Schedule and Second Schedule to the Central Excise Tariff Act, 1985 as amended by Central Excise Tariff (Amendment) Act, 2004. In addition, education cess at 2 per cent on excise duty amount is levied by Finance (No. 2) Act, 2004. The effective rates may be lower pursuant to general/specific notifications issued by the government granting whole or partial exemption from duty. The duty, in most cases, is levied on the basis of value of the excisable goods.

Value, for this purpose, with effect from 1st July 2000 is the "transaction value" which is:

- For delivery at the time and place of removal;
- Where buyer is not a related person; and
- Price is the sole consideration.

For the Indian central government this duty is an important source of revenue. The Excise Tax is required to be paid before the goods leave the factory, as a result of which the small-scale industries do not pay Excise Tax up to the specified value of goods cleared from the factory. The state governments are liable to levy excise duty on a few commodities including liquor, provided the central government fails to do so. At times when the manufactured goods are exported excise drawback is available.

19.3.1 Rates of Excise Tax

The rates of the Excise Tax vary depending on the nature of commodity. Sometimes, even for the similar commodity the tax rates are different depending on circumstances. Factors like end-use and taxability of inputs are responsible for this. The Excise Tax rates are notified in the Central Excise Tariff Act but can be revised accordingly by the annual Finance Acts. However, the former Acts should be considered to determine the applicable excise duty rate for any commodity. According to the Central Excise Tax provisions, such excise duty can be imposed on any goods either produced or manufactured, although the payment can be done during the time of removing the goods.

19.3.2 Importance of Central Excise Tax in India

In India, the revenue from the Excise Tax is the biggest single financial source. The main objective of the central Government is to achieve different socio-economic policies by making suitable adjustments regarding the scope, nature, and quantum of levy of the Central Excise Tax. Such schemes of the Excise Tax taken by the central government modifies and serves various purposes of price control, adequate supply of essential commodities, promotion of small scale industries and industrial growth.

19.3.3 Types of Excise Taxes

In India, the three types of Central Excise Taxes being collected include the Basic Excise Duty, Additional Duty of Excise, and Special Excise Duty.

The Basic Excise Duty is charged under the Section 3 of the Central Excises and Salt Act, 1944. According to this all excisable goods other than salt produced or manufactured in India, has to pay the rates given in the schedule to the Central Excise Tariff Act, 1985.

As per the Section 3 of the Additional Duties of Excise Act, 1957 it is authorized that only the goods described in the Schedule to this Act are liable for Excise Tax payments. Generally these are imposed under different categories like medicinal and toilet preparations, sugar and other industries development.

The Special Excise Duty following the Section 37 of the Finance Act, 1978 was imposed on all excisable goods that are also subjected to Basic excise Duty under the Central Excises and Salt Act, 1944. However, the Finance Act provisions regarding the said fiscal year specify the levy and collection of the Special Excise Duty.

CENVAT is payable by the manufacturer but is, ordinarily, recovered from the buyer as a part of consideration for sale of goods. To reduce the cascading effect of CENVAT, a scheme known as MODVAT was introduced in 1986, which has now been renamed as CENVAT (effective 1st April, 2000). Under the CENVAT Scheme, a manufacturer can avail of the credit of the central excise duties or additional duties of customs (i.e. CVD) paid on specified inputs and capital goods used in the manufacture of excisable goods and also service tax paid on eligible input services and utilize it in discharging central excise duty on finished excisable goods.

The State has been also empowered to levy the duties of excise on:

1. alcoholic liquors for human consumption and
2. opium, Indian hemp and other narcotic drugs and narcotics manufactured in the State by the powers enshrined in the Constitution of India.

19.4 SALES TAX

Sales tax is levied on the sale of movable goods. Most of the Indian States have replaced. Sales tax is the most important source of revenue to the states and is imposed on virtually all sales of goods. It is primarily the liability of the seller, who generally recovers it from the purchaser. Each state has its own sales tax act under which tax is imposed at different rates. Sales of imported items and sales by way of export are generally exempt from sales tax. Luxury goods are normally taxed at a higher rate than other commodities. The sales tax acts of certain states provide for certain additional levies, i.e., works contracts tax (imposed on a contractor for manufacture, erection, repairs, etc.), turnover tax (imposed on the value of turnover exceeding a certain limit) and purchaser tax (imposed on the value of goods purchased from suppliers that are not registered under the sales tax laws).

The Central Sales Tax Act covers interstate sales. A concessional rate of sales tax is applicable if the buyer is registered with the Sales Tax authorities.

Most of the state sales tax has been on a First Point basis, though some states, notably Kerala, Karnataka and Tamil nadu of late have a Multi-point system of taxation covering certain limited commodities. In view of the independence of the States to frame their Sales tax systems, every state had its own system, with no uniformity or coordination with other states, and used the power to tax, purely as a revenue raising exercise with no regard for economic efficiency. Generally the following adverse characteristics marked the State Sales tax regime:

1. Multiplicity of rates
2. Numerous exemptions for commodities.
3. Wide spread between the rates, resulting in classification difficulties and attendant legal issues.
4. Incentive schemes such as Tax Holidays and Tax deferrals for New Industrial.
5. Undertakings with a view to promote industrialisation, even at loss of revenue.

These features resulted in difficulty in compliance and administration; excessive litigation on classification; and unhealthy competition among states to corner new investments by offering all sorts of tax holidays and deferrals, resulting in what is called as the 'race to the bottom'.

Government of India has introduced a Value Added Tax (VAT) system to bring uniformity in tax system

19.4.1 Value-Added Tax/Sales Tax

Sales tax with a new Value Added Tax (VAT) from April 1, 2005. VAT is imposed on goods only and not services and it has replaced sales tax. Other indirect taxes such as excise duty, service tax etc., are not replaced by VAT. VAT is implemented at the State level by State Governments. VAT is applied on each stage of sale with a mechanism of credit for the input VAT paid. There are four slabs of VAT:

- 0% for essential commodities
- 1% on bullion and precious stones
- 4% on industrial inputs and capital goods and items of mass consumption
- All other items 12.5%
- Petroleum products, tobacco, liquor etc., attract higher VAT rates that vary from State to State.

A Central Sales Tax at the rate of 2% is also levied on inter-State sales and would be eliminated gradually.

Check Your Progress 2

State True and False for the following statements:

1. India has a well developed tax structure with a three-tier federal structure.
2. Customs Duty is a type of indirect tax levied on imports only.
3. The Constitutional provisions have given to States the right to legislate and collect duties on imports and exports.
4. Central Excise Duty (CENVAT) is levied on goods manufactured and produced in India.
5. In India, the revenue from the Excise Tax is the biggest single financial source.
6. Sales tax is primarily the liability of the seller, who generally recovers it from the purchaser.
7. Sales tax has been replaced by VAT

19.5 LET US SUM UP

India has a well developed tax structure with a three-tier federal structure, comprising the Union Government, the State Governments and the Urban/Rural Local Bodies. The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution. Customs Duty is a type of indirect tax levied on goods imported into India as well as on goods exported from India. The Constitutional provisions have given to Union the right to legislate and collect duties on imports and exports. Central Excise Duty (CENVAT) is levied on goods manufactured and produced in India. It is levied under the authority of the Central Excise Act, 1944. Sales tax is levied on the sale of movable goods. Most of the Indian States have replaced. Sales tax is the most important source of revenue to the states and is imposed on virtually all sales of goods.

19.6 LESSON END ACTIVITIES

1. Consult your nearest shopkeeper and analyze the changes he has to bring to follow the VAT.
2. Prepare a brief report on the changes brought in rates of customs in the recent past.

19.7 KEYWORDS

CENVAT: Central Excise Duty.

VAT: Value Added Tax.

MODVAT: Modified Value Added Tax.

EPCG: The Export Promotion Capital Goods Scheme.

WTO: World Trade Organizations.

19.8 QUESTIONS FOR DISCUSSION

1. Discuss the taxes on Import and Export in India.
2. Briefly describe the taxes on the production in India.
3. Discuss that why sales tax has been replaced by the VAT

Check Your Progress: Model Answers

CYP 1

1. This duty is equivalent to central excise duty leviable on a like product manufactured in India. Current rate applicable to majority of the industrial products is 16 per cent plus 2 per cent education cess, taking the effective rate to 16.32 per cent. This duty is calculated on the value of product + basic customs duty.
2. This duty is levied to countervail the sales tax, value-added tax, local taxes and other charges leviable on the like goods on their sale or purchase or transportation in India. Presently, this duty is levied at 4 per cent on certain items viz. items bound under the Information Technology (IT) Agreement and on specified inputs/raw materials for manufacture of electronic/IT goods.

CYP 2

1. True, 2. False, 3. False, 4. True,
5. True, 6. True, 7. True

19.9 SUGGESTED READINGS

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Bedi Suresh (2006) *Business Environment*, Excel Books

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