

# Unit – I

## Lesson 1

### Introduction of Business Environment

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**Business:**

An organized effort of enterprises to supply goods and services to the consumers is business. Business is called a system because it is created to satisfy the needs and desires of the consumers.

Business is an economic pulse of a nation because it strives to increase society's standard of living where profits are always counted as primary mechanism for motivating business activities.

Profit is the main incentive for starting a business and it is necessary to succeed.

**Environment:**

Environment generally relates to variety of the internal and external forces which have a bearing on the functioning of business.

Environment includes different factors related to outside the firm which can lead to opportunities for or threats to the firms.

**Factors which influence the business environment-** on one end survival and success of any individual depends on his innate capability as physiological factors to cope up with the environment and the extent to which the environment is conducive to the development of the individual.

On the other end, survival and success of a business firm depends on its innate strength – resources at its command, including physical resources, financial resources, human resources skill and organization and its adaptability to the environment and the extent to which the environment is favorable to the development of the organization.

In prevailing environment the survival and success of a firm depends on 2 factors-

- (i) The Internal factors – Internal environment
- (ii) The external factors – external environment

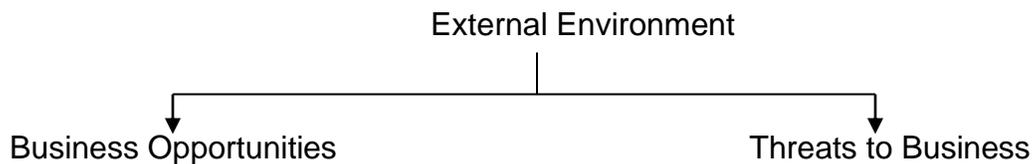
Business Environment often relates to the external factors.

**What is meaningful organization:** Meaningful organization is that which always indicates certain mission objective(s) and goals (s) and a strategy to achieve them.

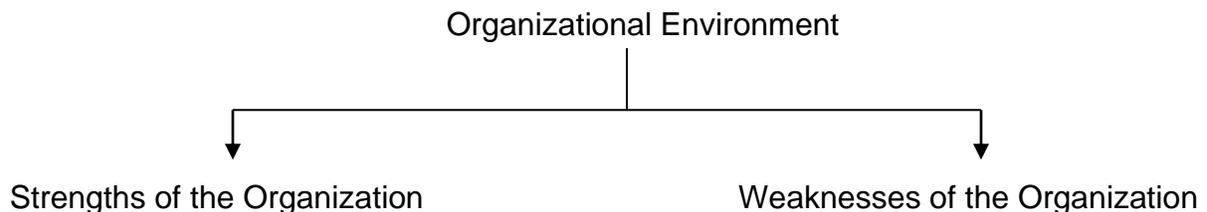
Formulation of strategy indicates the proper fitness of firm's of environment.

Setting up of Mission/objective/goals of any enterprise is based on the assessment of external environment and organizational environment.

**(A)** External Environment broadly indicates two components –



**(B)** Organizational Environment indicates two components –



## STRATEGY FORMULATION

Strategy formulation is pitting the organizational factors (internal environment) against the opportunities and threats in the external environment or in other words, business decisions are based on two main sets of factors i.e. internal environment and the external environment.

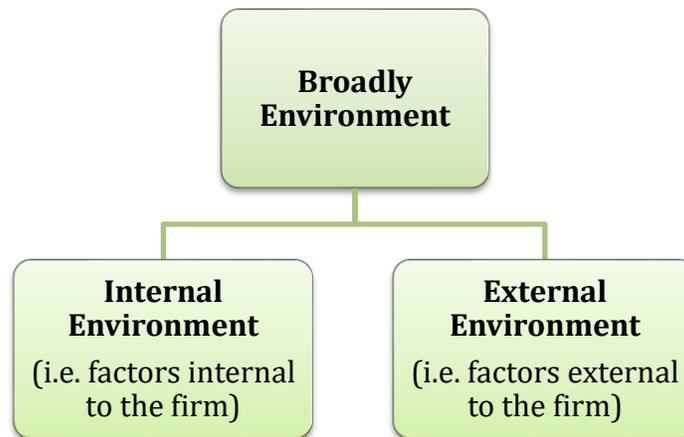


In the business area SWOT analysis i.e. (analysis of strengths and weakness of the organization and opportunities of threats in the environment) is first important step in the strategic management process.

### **Types of Environment:**

On the basis of closeness with the firm the environmental factors may be classified in different levels.

Broadly environment is connected to two areas:

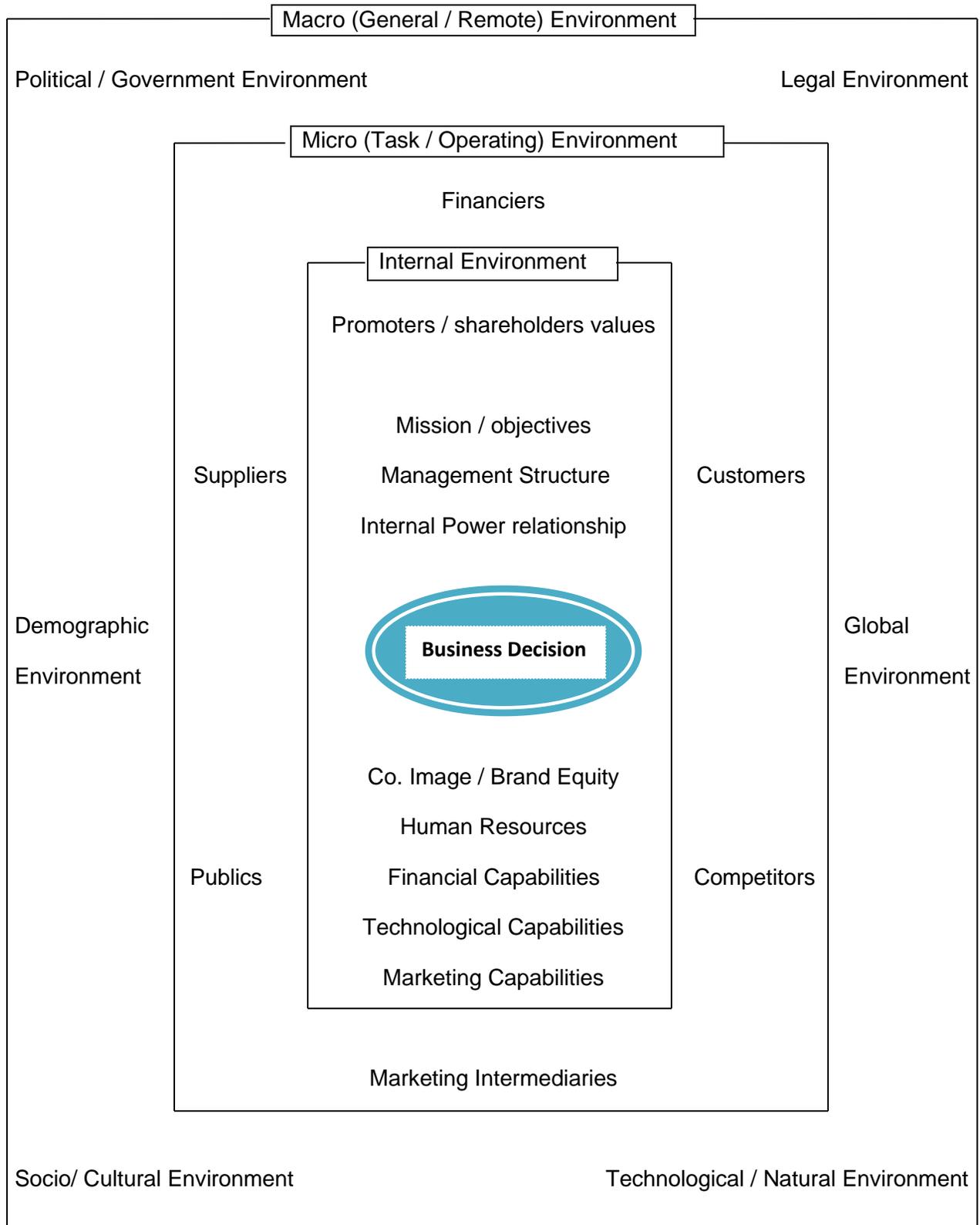


Internal factors of any business are generally controllable factors because company can easily control over different factors and alter or modify of its personnel physical facilities, organization and functional means (like marketing mix) to suit the environment.

Whereas, external factors are not easily controllable factors and are connected with economic, social, cultural, government, legal, demographic, as they are generally beyond the control of the company.

Some external factors like suppliers and distributors of the firm have a direct and intimate impact on the firm covered under micro environment known as task environment and operating environment and other external factors like Industrial policy, demographic factor etc., also affect an industry and come under macro environment. Thus, the external environment can also be classified into two broad categories- macro and micro.

### Business Environment



External factor of the firm like suppliers and distributors have a direct and intimate impact on the firm, these are covered under micro environment known as task environment and operating environment other external factors like industrial policy, demographic factor also affect the industry and are enumerated in the macro environment.

### **Levels of Business environment**

- (i) Internal environment
- (ii) Micro environment/Task/Operating environment
- (iii) Macro environment/general/remote environment

### **Internal Environment**

Internal factors which have bearing on the strategy and other decisions.

### **Value system:**

The value system of the founders those at the helm of affairs has important bearing on the choice of business mission and objectives of the organization, business policies and practice.

Value system shared by all in the organization is an important factor contributing to success.

Voluntary incorporation in the articles of association is social and moral responsibility to consumers, employees, shareholders, society and the people.

Value system and ethical standards among the factors are evaluated in companies by selection of suppliers, distributors, collaborators etc.

### **Mission and Objectives**

Business domain of the company, priorities, direction of development, business philosophy, business policy etc are guided by the mission and objectives of the company.

E.g.: Arvind Mills' mission:

To achieve global dominance in selected business build around core competencies through continuous product and technical innovation, customer orientation and focus on cost effectiveness.

### **Management structure and nature:**

Organizational structures, the composition of BOD and extent of professionalization of management etc. are important factors influencing business decisions.

Some management structures and styles delay decision making which depends upon physical assets.

BOD is the highest decision making body which sets the direction for the development of the organization. The quality of board is a critical factor for the development and performance of a company. Private sector in India presents extreme cases in this connection.

The share holding pattern could have important managerial implications.

In large companies like Wipro majority of the share is held by the promoters and large firms like Tata Group of Companies where the promoters' position is very vulnerable.

**Internal Power Relationship:-** the top management enjoys support from different levels of employees, shareholders and Board of Directors have important decisions and their implementation.

Relationship between the members of Board of Directors and between the chief executive and the Board are also critical factors.

**Company Image Brand Equity:-** Image of company matters in care of raising, forming joint venture are other alliances, solidities marketing intermediaries, entering purchase or sale contracts, launching of new products. Brand equally is also relevant in different same cases.

**Human Resources:** different characteristics of HR are skill, quality, morale, commitment, attitude etc. which generally contribute to the strength and weakness of an organization.

Some organizations face difficulty to carry out restructuring or modernization because of resistance by employees whereas they are smoothly done in some other organization. Initiative of people at different levels may vary from organization to organization. The organizational culture and over all environmental depends on them.

**Financial capabilities-** basically financial capabilities affect the business performance, strategies and decisions based on financial policies, financial position and capital structure.

**Technological Capabilities:** - technological capabilities are important for business because they influence the competitiveness of a firm and facilities like production capacity, teleology and efficiency of the productive apparatus, distribution logistics.

**For example-** Quality is important in the pharmaceuticals industry particularly for a global player in case of healthcare not only no compromise on quality but the company also makes the quality norms.

Strictly than international or relevant standard and quality maintenance imbibed throughout the organization.

**Marketing capabilities-** company's ability to innovate and complete depend on research and development and other technological capabilities.

**Marketing resource-**Marketing resources like organization for marketing, quality of the marketing men, brand, equity and distribution network directly affect on marketing efficiency. They are also important for brand extension, new product introduction etc.

**External Environment:** consist of micro environment and macro environment.

**Micro:** - this is known as task environment or operating environment because this environment's forces directly effect on the operation of the firms.

Micro environment consists of companies' immediate environmental factors that affect the performance of the companies. These include suppliers, marketing intermediaries, competitors, customers and public.

Marco environment consists of large societal forces which affect all the factors in the company's micro environment like demographic economic, natural, technical and cultural forces.

Micro environment forces are more internally linked with the company than macro factor. Micro forces need not necessarily affect all the firms in a particular industry in the same way. Some micro factors associated with a firm are-

**1. Suppliers:** These are important part of micro environment of a company who supply inputs like raw materials and components. Reliable supply of resources to ascertain the smooth functioning of business is necessary. Uncertainly regarding supply often compels companies to maintain high inventories due to increase in cost. In India factories maintain indigenous stock of 3-4 months and imported stock of nine months against average hours of two weeks. In case of sensitivity of the supply many companies give high importance to vendor development. Vertical integration where feasibility helps to solve the supply problem.

It is very risky to depend on a single supplier because strike, lockout or other production problem with the supplier may seriously affect the company. Similarly change in the attitude or behavior of supplier may also affect the company.

So multiple sources of supply, help in reducing the supply risk.

Supply management assumes more importance in scarcity environment. Company purchasing agents learn how to obtain favorable treatment during the period of shortage; that means purchasing department might have to market itself to suppliers.

Because of critical importance of the supply factor companies resorting to partnering/relationship marketing partnering are becoming more and more international and this provides challenging opportunities for Indian suppliers because international players.

**2. Customers:** - Customer often extorts so the major task of business is to create and sustain customers. Any business exists only because of its customers so, monitoring customers' sensitivity is first required for the success of business.

### **CATEGORY OF CUSTOMERS**

Company may have different categories of customer like-

Individuals

House holds

Industries & other Commercial establishment

Government & other Institution

E.g. - Customers of tyre company

Individual Automobile owner

Automobile manufacture

Public Sector Transport Undertaking

**Private business:** other transport operators

Single customer is often too risky because it may place the company in a poor bargaining position, apart from the risk of losing business consequent to the winding up of business by the customers.

The choice of customers segments should be based on -

- Relative profitability
- Dependability
- Stability of demand

- Growth prospects
- The extent of completion

### 3. Competitors

Competitors include not only other firms of market of the same or similar products but also those who compete for the discretionary income of the consumers.

E.g. Competition for a television company may come not only from other TV manufacturers but also from two wheelers, refrigerators, cooking ranges and even stereo sets and others and from the firms offering savings and investment schemes like banks, companies, accepting public deposits or issuing shares or debentures. This competition among different products may be described as desire competition as the primary task is to influence the basic desire of the consumer. This desire of competition is generally very high in countries characterized by limited disposable incomes.

When consumer decides to spend his discretionary income on recreation, he may still be confronted with a number of alternatives like two in one, to choose from TV., Stereo etc. The competition among the alternatives which satisfy a particular category of desire is called as generic competition.

If the consumer decides to go for a TV, the next question will arise that which form of TV is required, black & white or colored with remote control or without it. It means there is a product form competition. Finally the consumer encounters the brand competition i.e. the competition between different brands of the same product form.

So in implication of different demands a marketer should strive to create primary and selective demand for his products.

**Marketing Intermediaries** – It is an immediate environment of company which consists a number of intermediaries where firms which assist the company in promoting, selling and distributing its goods to final buyer.

These include middle men as agents and merchants. The role of middle men is to find customers or close sales with them. Physical distribution firms usually assist the company in stocking and moving goods from their origin to their destination as ware houses and transportation firms.

Marketing service agencies assist the company in targeting and promoting its products to the right markets as advertising agencies, marketing research firms, media firms and consulting firms, and financial intermediaries which finance marketing activities and insure business risks.

**4. Financier:-**

Financier of a company is an important micro environmental factor. Besides financing capabilities, the policies and strategies, attitudes (including attitude towards risk) ability to provide non financial assistance is important.

**5. Public:**

Company may encounter certain public in its environment .Public is any group that has are actual or potential interest in or impact on an organization's ability to achieve its interest.

Examples-Media Publics, citizen action publics and local publics.

In India usually leading companies are attacked by the media public particularly by bringing down the share prices of the company by tarnishing its image. Companies are also affected by local publics. Environmental pollution is the issue taken up by local publics to suspend operation and/or take pollution abatement measures.

Particularly in developed countries non-government organizations have been mounting up protests against held labour, sweat labour, cruelty against animals, environmental problems resulting from imports. Exports of developing countries are affected by these developments.

Some businessmen regard consumerism as an opportunity for the business. The media public may be used to disseminate useful information.

Similarly co-operation between company and the local public may be established for mutual benefit of the company.

**SELF CHECK QUESTIONS****LONG ANSWER TYPE QUESTIONS:**

1. What do you mean by business environment? Discuss its internal factors.
2. What is mean by business environment? Discuss the operating factors of business in present scenario.

**SHORT ANSWER TYPE QUESTIONS:**

1. What do you mean by customer? Discuss its classification.
2. What is meaning full organisation? Discuss the purpose of SWOT analysis.

**OBJECTIVE TYPE QUESTIONS:**

1. High capital intensive nature of the industry is an entry barrier to \_\_\_\_\_  
(a) Co- operative Firms      (b) Small Firms      (c) Large Firms  
(d) Medium Firms      (e) None of these

**Ans: (b)**

2. Strategic management relates to \_\_\_\_\_  
(a) Determination of the basic long term goals and objective of any firm  
(b) Determination of elementary short term goals and objective of any firm  
(c) Determination of long term and short term goals and objective of any firm  
(d) None of these

**Ans: (a)**

3. Concentric diversification relates to the process of \_\_\_\_\_  
(a) Adding old products      (b) Adding new products  
(c) Adding old and new products      (d) None of these

**Ans: (b)**

4. Success of strategic business unit depends upon \_\_\_\_\_  
(a) Managerial level strategy      (b) Administrative level strategy  
(c) Functional level strategy      (d) None of these

**Ans: (c)**

# Lesson 2

## MACRO ENVIRONMENT OF BUSINESS

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A company and its micro environment forces operate the macro environment forces which shape opportunities and pose threats to the company. This environment is known as general and remote environment.

Generally Macro forces are more uncontrollable than micro forces. When macro environment is uncontrollable the success of a company depends on its adaptability to the environments.

The cost of the imported components increases substantially because of the depreciation of the domestic currency, the solution may be their domestic manufacturers.

### **Important macro environment factors**

- 1. Socio-culture environment-** this environment is influenced by different factors which are beyond company's gate like-
- a) People's attitude to work and wealth.
  - b) Role of family marriage
  - c) Religion and education ethical issues.

This environment is closely relevant to business unit because this environment produces a variety of goods and the type of employees.

- 2. Economic Environment-** this environment relates to different forces which generally link to economic parts of business like-
- i) Industrial Production
  - ii) Agriculture
  - iii) Planning
  - iv) Basic economic philosophy
  - v) Infrastructure
  - vi) National Income
  - vii) Money supply
  - viii) Price level

- ix) Population
- x) Savings
- xi) Stages in the economic development
- xii) Trade cycle

These are major factors which make up the total economic environment. Business always relates to economic environment to obtain all its needed inputs from economic environment and absorbs the output of business unit in the environment.

### **3. Political /Legal environment.**

This is influenced by three political institutions i.e.

- i) Legislature
- ii) Executive
- iii) Judiciary

Which shape, direct, develop and control business activities controls.

**Legislature** decides on a particular course of action

**Executive** is called government which implements whatever is decided by the parliament.

**Judiciary** plays the watch dog role to ensure that both the legislature and executive functions are in public interest and within the boundaries of the constitutions. The political environment is indispensable for business growth.

### **4. Technological environment**

This environment exercises basically on considerable influence on business. Technology is the systematic application of scientific or other organized knowledge to practical tasks.

Technology reaches people through business. Businessmen should be ever alert to adopt changed technology to their business.

Business is the product of technological, political- legal, economic, socio –cultural, global and natural factors amidst which it functions.

**Common features in the relationship between business and its environment:**

1. Symbiotic relationship between business and its environment and among the environmental factors.  
(I.e. Business is influenced by its environment to a certain degree and it influences the external forces. Similarly political-legal environment influences economic environment and vice-versa.
2. Environmental factors are dynamic; they keep on changing as years roll by business.
3. A particular business firm may not be in a position by itself to change its environment by itself, but along with other firms business will be in a position to mould the environment in its favor to a large extent.

**5. Demographical**

Demographic factor relates to a variety of study like-age, income, literacy, employment, business material etc.

**Natural environment**

This environment covers different issues like-

1. Manufacturing depends on physical inputs
2. Mining and drilling depends on natural deposits
3. Agriculture depends on nature
4. Trade between two regions depends on geographical factors.
5. Transportation and communication depend on geographical factors.

**Global environment**

Global environment covers all those global factors relevant to business as world trade organization- its principles and agreements, other international convention/agreements, declaration/protocols, economic and business conditions/sentiments in other countries etc.

Similarly certain developments are like development in the crude oil price which has global impact.

- The WTO principles and regulations are important implications for Indian business. The import and investment liberalization mandated by WTO have substantially changed the competitive environment in India.

- Economic conditions in other countries may affect the business ex-if economic conditions in a company's export markets are very good.

### **GLOBALIZATION**

means several things, to several people – it's a new paradigm – a set of – fresh beliefs, working methods and economic political and socio-cultural realities in which the previous assumptions are no longer valid.

- *For developing countries :-*

It means integration with the world economy globalization refers to a process of integration of the world into one huge market. Globalization calls for removal of all trade barriers among countries.

### **FEATURES OF GLOBAL COMPANY**

- It is a cluster of multiple units (located in different parts of the globe) but all linked by a common ownership.
- Multiple units draw on a common pool of resources, as money, credit, information, trade name and control system.
- The units respond to some common strategy.

#### **Common entry barriers:**

##### **Government Policy:**

In many cases government policy and regulations are important entry barriers. In India prior to the economic liberalization government dictated entry barriers like reservation of industries/products for public sector and small scale sector, industrial licensing, regulations under MRTP Act, restrictions on foreign capital and technology, import restrictions.

##### **Economics of Scale:**

Can deter entry in two ways -

1. It keeps out small players
2. Discourages even potentially large players because of risk of large stakes

##### **Product differentiation:**

It relates to brand image, customer loyalty, product attributes which may form entry barriers forcing new entrants to depend heavily to overcome this barrier.

##### **Monopoly Elements:**

Proprietary product/technology monopolization/effective control over raw material supplies, distribution channels are entry barriers which are difficult to overcome.

##### **Capital requirement:**

High capital intensive nature of the industry is an entry barrier to small firms. Risk of huge investment could be a discouraging factor for other firm.

**Bargaining Power of Buyers:-**

Buyer possesses different degrees of bargaining power. Buyers compete with the industry by forcing down prices, bargaining for higher quality or more services at the expenses of industry profitability. Important determinants of the buyers power.

1. Volume of purchase relations to the total sale of the seller.
2. Importance of the product to the buyer in terms of the total cost.
3. The extent of standardization or differentiation of the product
4. Switching costs
5. Importance of the industry's product with respect to the quality of the buyers product or services.
6. Extent of buyers information

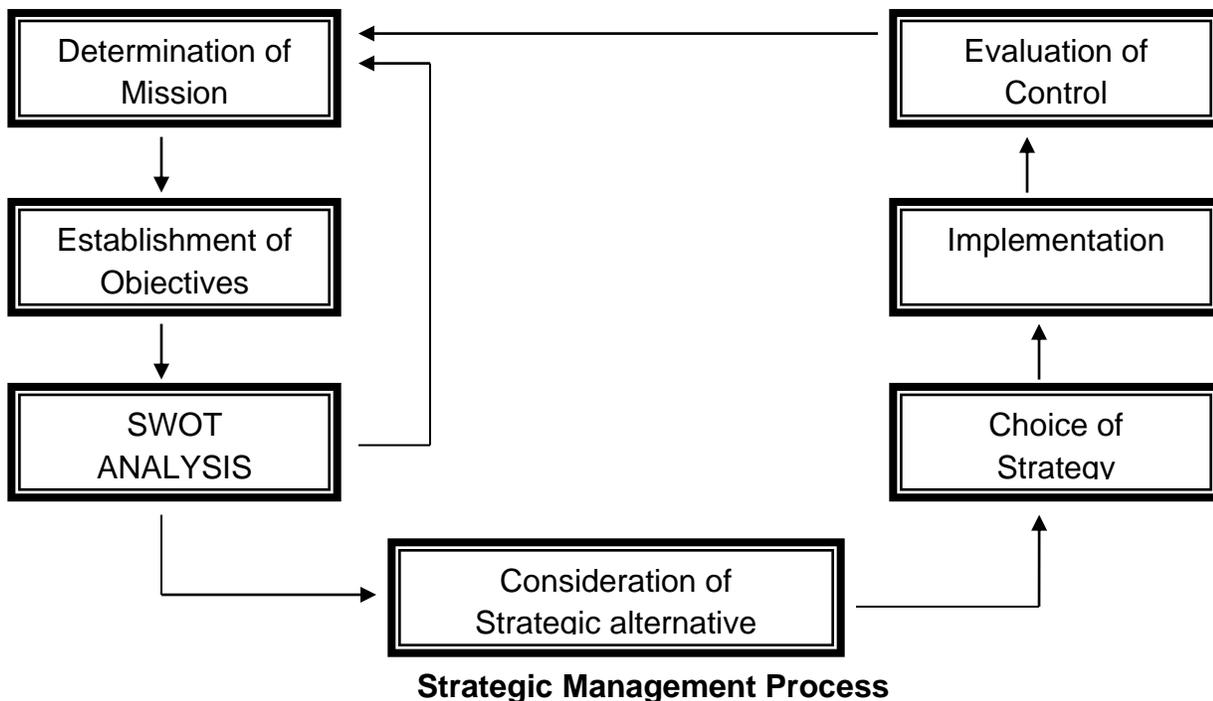
**Bargaining Power of Suppliers:**

Determinants of supplier's power

1. Extent of concentration and domination in the supplier industry,
2. Importance of the product to the buyer
3. Importance of the buyer to the supplier
4. Extent of substitutability of the product
5. Switching costs
6. Extent of differentiation or standardization of the product
7. Potential for forward integration by suppliers.

**Environmental analysis and strategic management:-**

Analysis of SWOT (i.e. strength and weakness of the company and opportunities and threats in the environment) plays an important role in the strategic management or business policy.



Strategic Management process makes the importance of external internal factors.

**Strategy:** Strategy is a unified, comprehensive and integrated plan relating the strategic advantages of the firm to the challenges of the environment. It is designed to ensure that the basic objectives of the enterprise are achieved.

**Strategic Management:** relates to the sets of decisions and actions which lead to the development of an effective strategy or strategies to help in achieving corporate objectives.

Strategic Management is the determination of the basic long term goals and objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to carry out these goals.

### **Areas where strategic management involves**

1. Wider rainification
2. Involves long time perspective
3. Use critical resources towards perceived opportunities or threats in a changing environment

### **Formulation of Mission and Objective**

First step in the strategic management process is determining the mission and objectives of the company. A strategy is a means to achieve the ends or objectives. So objectives should not be static but they should be dynamic, i.e. changes in the environment or changes in the organizational strength and weakness may call for modification to the objectives. Dynamic companies conduct audit of their objectives and reformulate or reorient the objectives if desirable to ensure that the company's objectives are most appropriate records. What information is necessary to formulate clear the objectives necessary to record definite answer.

- What business the company is in?
- What should the Company's business be?
- What will the Company's business be?

“Objective helps define the organization in its environment”.

Environmental analysis help to find answer for what should the Company's business be? “If what should be the business is different from” what the business is, and then certainly there is a need for redefining the business by matching the company resources to the environment.

**SWOT Analysis**

Identification of the threats and opportunities in the environment and the strength and weakness of the firm is the cornerstone of business policy formulation; these factors determine the course/courses of action to ensure the survival and or growth of the firm.

Environment might present different opportunities but company might not have the strength to exploit the opportunities. Similarly a firm may not have the strength to meet the environmental threats.

If a company finds that it will not have the competence to survive in a particular line of business, it prudent to concentrate on a business or business for which the firm is most competent,

Many companies which exited different business are concentrating on their core business eg: - Ceat exited four non tyre businesses (Glass, fiber, electronics, photocopiers and Nylon Code) and decided to concentration on core business like – tyres, funds obtained by the divestment have been used.

The environmental opportunities and threats should be evaluated in the light of the strength and weakness of the internal factor comprising of finance, technology and skill, production facilities, personnel and marketing capabilities. Capability of a company to exploit the environmental opportunities or to meet the challenges depends upon the strength of there factors.

**Strategic Alternatives and choice of strategy**

After the identification of the environmental opportunities and threats and the organizational strength and weakness, the next tasks in this process are consideration of strategic alternatives and choice of the most appropriate strategies.

A company may be confronted with different alternative as

1. Should the company continue in the same business or shut it down.
2. If it should continue in the same business should it grow by expanding the existing units, establishing new units or by acquiring other units in the industry
3. If it should diversify, should it diversify into related areas or related areas
4. Should it grow by vertical integration

Company that plans to market its products in foreign markets may have different alternatives-

1. Manufacture the product completely in the home country and export it to the foreign market.
  2. Establish manufacturing facility in a free area as export processing zones and make exports from there.
  3. Establish manufacturing facility in the foreign country and undertake the complete manufacturing of the product there .
  4. Manufacture the components at home and assemble the product in the foreign market.
  5. Contract some foreign firm for manufacturing the product and do only the marketing of it
  6. Enter into licensing/franchising agreement with a firm in the foreign market
  7. Establish a joint venture abroad for manufacturing and marketing the product
- choice of strategy should be based on evaluation of different alternatives.

**Implementation:**

Good strategy is not sufficient but its effective implementation is important. In this connection it is necessary to formulate a detailed plan to achieve the objectives by the chosen strategy.

Implementation encompasses also the formulation of the plan to implement the strategy.

In a multi-unit business, formulation of different levels of strategies is an essential and important aspect of implementation.

**SELF CHECK QUESTIONS**

**LONG ANSWER TYPE QUESTIONS:**

1. What is meant by Macro environment of business? Discuss the factors which generally influence the business environment.
2. Differentiate between micro and macro environment of business.

**SHORT ANSWER TYPE QUESTIONS:**

1. Discuss the important features of modern business.
2. Discuss the common entry barriers of business.

**OBJECTIVE TYPE QUESTIONS:**

1. Marketing intermediaries generally includes \_\_\_\_\_  
(a) Middlemen as agents and merchants      (b) Middlemen as agents  
(c) Middlemen as agents and employees      (d) None of these  
**Ans: (a)**
  
2. For developing countries globalization means \_\_\_\_\_  
(a) Integration with the world economy      (b) Integration with the country's economy  
(c) Integration with the foreign economy      (d) None of these  
**Ans: (a)**
  
3. Business policies are always guided by \_\_\_\_\_  
(a) Articles of company      (b) Reputation of company  
(c) Mission and objectives of the company      (d) None of these  
**Ans: (c)**
  
4. Adding new and unrelated products or services relates to \_\_\_\_\_  
(a) Conglomerate diversification      (b) concentric diversification  
(c) Conglomerate and concentric diversification      (d) None of these  
**Ans: (a)**

# Lesson 3

## ECONOMIC PHILOSOPHIES OF BUSINESS

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### Levels of strategies for multiunit business –

#### 1. Corporate level strategy.

This is a master strategy to achieve the overall corporate objectives; other levels of strategies are designed to implement the corporate strategy. They are formulated with reference to the corporate strategy.

#### 2. SBU Level Strategy

This strategy is concerned to achieve the specific objective of the strategic business unit which helps to achieve the overall corporate objectives.

SBU is an operating division of a firm which serves a distinct product/market segment or well defined set of customers and or a geographic area.

The SBU is known as operating division.

#### 3. Functional Level Strategy:

The ultimate success of the SBU strategy depends on the effectiveness to management functions like marketing, finance, production, R & D. If some SBU level objectives are to be achieved by introducing a new product then R & D, Production, finance and marketing departments are important to gear up of this task.

In a single unit business there are only two levels of strategies corporate level and the functional level.

So implementation of task involves mobilization and development of resources including personnel, organizing and assigning tasks to different elements of organization.

Motivation and high morale of people from top to bottom of the organization are essential for the successful implementation of the strategy besides their potential capability.

Evaluation of strategy is that phase of strategic management process in which top managers determine whether their strategic choice for implementation is meeting the objectives of the enterprise.

### Reasons why business fails to achieve the results-

1. Improper implementation of the strategy
2. Environmental changes which were not anticipated while formulating the strategy.
3. Inappropriate strategy.

1. Improper implementation of strategy may due to:
  - i. Inappropriateness of the implementation of the strategy.
  - ii. Inefficiency and lack of commitment of the personnel in charge of implementation.
  - iii. Wrong assignment of the tasks
  - iv. Inadequacy of resources.

Environmental changes can increase in competition, changes in consumers preferences or attitudes, technological changes which could not be anticipated while formulating the strategy.

Inappropriate strategy: result of wrong diagnosis (environmental threats and opportunities or the internal strengths and weaknesses) or wrong strategic choice resulting from the faulty evaluation of the alternatives.

So the success of business depends on effective utilization of the company's resources (resources means not only existing resources but also the additional resources it can mobilize and augment for any specific task). This involves the evaluation of the company's strength and weaknesses in the light of environmental threats and opportunities or to combat the threats and formulation of strategic accordingly. Companies which fail to do so are often doomed to fail.

So constant monitoring of the environment and timely and appropriate steps to tap the opportunities and to meet the challenged are essential for success.

### **ECONOMIC SYSTEM**

The political philosophies are covered in :

1. Democracy
2. Totalitarianism.

The economic philosophies are distinct in there ways like:-

1. Capitalism
2. Socialism
3. Communism

### **CAPITALISM**

System of capitalism relates to the philosophy of "individualism believing in private ownership of all agents of production, in private sharing of distribution process that determine the functional rewards of each participant and in individual expression of consumer choice through a free market place. In its political manifestation, capitalism may fall in a range between extreme individualism and no government (anarchism) and the acceptance of some state sanctions.

Welfare concept developed in recent years in India as modification of modern capitalism which provides for an increasing degree of state regulations which certain deficiencies appear in the economy. These limitations placed on the free market operations as workmen's compensation law, provision for social security, laws regulating industrial relations or direct state financial aid to housing and agriculture are accepted as a result of the members of democracy becoming dissatisfied with certain conditions that prevailed or might prevail without these measures.

Welfare state is a sort of state socialism, in which the public ownership is not sanctioned of the activities that are regulated.

Some experts comment that the acceptance of certain welfare state objectives is necessary to provide flexibility for capitalism otherwise it might become static and be destroyed because of certain faults welfare actions modify within the framework that constitute the basic fundamental conditions of capitalism. USA is the example of capitalism.

### **SOCIALISM**

Under socialism the tools of production are organized, managed and owned by the government, with the benefit to proceed to the public. A strong public sector agrarian reform, control over private wealth and investment and national self-reliance are other socialism planks.

Socialism does not involve an equal division of existing wealth among the people but it believes in providing employment to all and emphasizes suitable rewards to the efforts put in by every worker called as Fabian socialism. This philosophy is followed in India and other social democratic countries.

### **COMMUNISM**

This goes to abolish all private property and property rights to income. States own and direct all instruments of production. No scope of relationship to private property especially in sharing and distribution process is there as this right does not exist. This is alternatively called Marxism. Communism is followed in Russia, china and East-European countries.

**Comparison between three economic systems**

<b>Characteristic</b>	<b>Capitalism</b>	<b>Socialism</b>	<b>Communism</b>
Eco-market	Freedom to compete the right to invest	Limited competition with state owned industries	Absence of competition with state owned markets and industries
Individual incentives	Profits and wages in relation to one's ability and willingness to work	Profits recognize wages fairly in relations to efforts	Projects not allowed. Workers urge to work for the glory of the state
Capital sources	Capital invented by owners who may also borrow on credit. Capital may be reinvented from profit. Depreciation is legal	Obtained from owners and from state issued bonds for state owned industries	State provides all resources to start business owned by the state. No depreciation is legal
Labor	Workers are free to select and employer and an occupation	Workers are allowed to select occupation state planning encourages employment	The state determines one's employers and employment.
Management	Managers are selected on the basis of ability. They have freedom to make decision	Managers in state owned industries are answerable to the state.	The manager must be partly members. Absence of freedom to make decision.
Business ownership	Individuals have the right to own a business and to contract with others	State own the basic industries other business may exist	State owns all productive capacity including communes
Risk Assumption	Losses ,may be assumed by owners, may transfer business risk to other business through insurance	People assume risks of state owned industries. Losses taken from taxes	Economic production owned by the state. Risks assumed by the state. Losses reduce standard of living.

The term socialism and communism are used interchangeably. The east European countries are called socialist countries as they follow Marxist ideologies.

### **Reasons of inherent weakness of communism-**

1. The major weakness of Marxism is the denial of individual freedom. Essential requirement of humans is freedom to work, to learn, to express, to choose and to indulge in expenditure in one choice. The freedom is denied to people. Marxism followers believe that the ideology would guarantee individual freedom.
2. Communism assumes total commitment of people to work and to country's welfare. In the communist countries people work more or less same as they work under capitalism. The fact is more slackness and more pilfering on the part of the workers and probably more corruption on the part of the management than in the capitalist societies is there.
3. Communist economics fail to achieve significant economic growth. The rate of growth has been markedly lower than the economies relying on market forces. Most failure of state or collective ownership has been in agriculture where a super power Soviet Union possessing one sixth of the land surface of the globe but unable to feed its people even after 70 years of revolution.
4. Communism has been obsessed with rights of workers. This obsession has led to the tendency to strike work, often on unjustifiable ground.
5. Followers of communism seem to have different contradictions which are too conspicuous in the attitude towards religion.
6. Finally communism collapsed because of its inherent weaknesses, lack of flexibility. Capitalism survives because of its flexibility.

Socialism is the position between capitalism and communism partaking the strong points of both the philosophies and avoiding their weaknesses at the same time. For this reason different developing countries of Asia, Latin America and Africa have adopted socialistic philosophy. But different countries experience that people's untidy lives could be improved by government management. So they set up bureaucracies to regulate every aspect of life.

So mixed economy selection is a midway between capitalism and communism as economic philosophy of our country. Closely resembling socialism, the concept of mixed economy relates to the existence of private enterprises along with public ownership.

Under mixed philosophy the economic set up may be split into three parts:-

1. Sector in which both production and distribution are entirely managed and controlled by the state to complete exclusion of private enterprise.

2. Sector in which the state and private enterprise jointly participate in production as well as in distribution.
3. Sectors in which the private enterprise has complete approach subject only to the general control and regulation of the state.

Mixed economy has guided our economy for the past three and half decades and will probably continue to do so in the years to come.

### **Economic System**

Scope of private business depends on the economic system which indeed is rooted in political philosophy. At one end there are free enterprises/market economics or capitalist economies, on the other end are centrally planned economies or communist countries. In between the two – the mixed economies are there. Mixed economic system itself defined a wide variation. Freedom of private enterprise is the greatest in mixed economy, which is characterized by different assumptions:-

1. The factors of production (Labour, land capital) are privately owned and the production occurs at the initiative of the private enterprise.
2. Income is received in monetary form by sale of services of the factors of production and from the profit of the private enterprise.
3. Freedom of choice in consumption, occupation, savings and investment relates to the members of free market economy.
4. Free market economy is not planned controlled or regulated by the government. Government satisfies community or collective wants but does not compete private firms nor does it tell the people where to work or what to produce.

However, free market economy is completely an abstract system rather than a real one. Today market economies are subject to number of government regulations.

The communist countries have a centrally planned economic system. Under rule of a communist or authoritarian socialist government, state owns all the means of production, determines the goals of production and controls the economy according to a central master plan. The consumption pattern in a centrally planned economy is dictated by the state.

Countries like China, East Germany, Soviet Union, Poland, Hungary etc had centrally planned economies. However several of these countries have discarded communist system and have moved toward market system.

In between capitalist system and centrally planned system the mixed economy system situates. Under which public and private sectors co-exist, like in our country participation of state widely varies between the mixed economies. However in many mixed economies the strategic and other nationally important industries are fully owned or dominated by state.

So the economic system is a very important determinant of the scope of private business. The economic system and policy are important external constraint on business.

**Change** - Modern business is dynamic. New technologies herald the arrival of new products leaving behind the old ones. Today's growth product may be tomorrow's earthen pot.

Incandescent lamps put off kerosene lamps, Luna, TVS 50, Hero Honda and others mopeds have made vicky, one time popular two wheelers, disappear from the market. Dot pens have allowed ink pens to drying. Hand winding time-pieces are pushed aside by quartz watches. This type of change makes the business people spend vast sums on R & D and ever vigilant in adopting new technologies. As we go into future, business is going to be more complex. Especially business is going to be knowledge based.

**Vastness** - Mass production and mass marketing are the order of the day. Machines are gradually replacing manual labor in the manufacturing process. Production in bulk has become possible through machine operating. Marketing activities are being stepped up to match massive production. New channels of distribution, super bazaars, discount houses and trade fairs are important to meet the challenges of mass production. But Indian industries are in experience in implementing rapa project.

In India this is because of high interest and finance cost as companies have to reckon and even control inconsistency and immature industrial policies and growing environmental movement.

### **Diversification**

Today business is characterized by diversification. The product portfolio of any medium or large business house reads like who is who. The Tata group premier business house has already different businesses like-iron and steel, fertilizers, light, commercial vehicles, power, chemicals, tea-textile, shipping, hotel services electronics, printing, oil and consultancy under its belt. Now they are also into the areas of passenger cars computers bio-technology, housing development activities.

So diversity may be distinguished between

1. Concentric
2. Horizontal
3. Conglomerate

1. Concentric diversification relates to the process of adding new but related products or services. Hindustan lever is example for concentric diversification. In one line the company has different brands. For example in soaps it has Liril, Pears, Rexona, Lux and Lifebouy.

2. Adding new, unrelated products or service called horizontal diversification. Ex. – Sony Corporation's purchase of Columbia pictures Entertainment Company.
3. Conglomerate diversification relates to adding new and unrelated products or services. Tata and JK group typically conglomerate diversification. Here two companies are involved in the diversification.

### **How to avoid failure**

Different ideas to avoid failure can be-

1. If business is not big enough then the company should not try for diversification.
2. If business lack staying power stay clear of imposing of diversification
3. If possible be the first in the race
4. Where feasible float a new company
5. Check the availability of marketing skills necessary in the new business
6. Be ready to accept the limitations and compromises
7. In case of a small player it is better to have a small ego.
8. It is no crime to remain undiversified.

Companies often follow mergers and acquisitions to route for diversification.

### **Globalization:**

Going international is another quality of modern business where there are no barriers regarding political boundaries to business. Production facilities are being set up in different countries and products are being sold worldwide. Globalization is becoming imperative for modern business due to technological innovations, crumbling trade barriers, global flow of capital and technology, information explosion, intensity of market competition, changing life style and the demand for new products.

The success achieved by Japan and other Asian countries has demonstrated that imaginative and supportive economic and trade policies – domestic and accent on technological innovation, product design, quality price, marketing strategy and infrastructure back up, play a vital role in carving a niche in international business arena.

### **Science:**

The development of atomic power, advances in metallurgy and allied field, accomplishment relating to the space – age programme, application of mathematics in managerial decision making and progress in miniaturization are contributors being made to business by science.

**Information:**

Area of information including data processing, information systems analysis and preparation of effective records and reports has achieved a major status. The vital reason for progress in the area is availability of computer and electronic devices which help in quick and accurate gathering, processing and distributing information. Information technology (IT) itself is subject to revolutionary changes. As business gets globalised, online communication across the world is highly useful.

**Government Interference:**

Interference of government in business was on the top priority up to 1980's. During 1950, 1960s and 1970s there was a broad consensus that government must intervene directly and play active role in economic development.

During late 1980 s and early 1990 s the scenario changed drastically. By the beginning of 1990 s it was sharp swing faith in government as an agent of economic development government began to be seen as bottlenecks in development.

**International institutions**

Economic experts and other agencies advocating that govt. must keep away from economic activities. No economy is totally free from govt. role, the degree of government's interference has come down but nevertheless the involvement is there.

**Competition**

Businessmen are expected to stand on their feet to eliminate inefficiencies, cut down costs and improve productivity.

Competition is beneficial to the competing firms besides benefiting the consumers.

How competition benefits consumer is obvious "Companies benefit from having strong domestic competition".

Aggressive home based suppliers and demanding local suppliers competing domestic competition will keep each other honest in obtaining government support. Companies are less interested to get government contracts or creping industry protection.

**Different roles played by government in business****Economic roles of Government**

Government plays an important role in almost every national economy of the world. Even in the countries having capitalist economics or market economics "a substantial share of the nation's products goes to satisfy public wants. A substantial part of the private income originates in the public budget and public tax, and transfer payments significantly influence the state of private income distribution. The budget policy affects the level of employment and prices in the private sector.

Besides socio-political ideological reasons if any, in the predominantly private enterprises, economic government interference is necessitated because in the market mechanism alone cannot perform all economic functions. Public policy is needed to guide, correct and supplement it in certain respects.

It is important to realize that the proper size of the public sector is a significant degree, a technical rather than ideological issue.

State control of economy is a universal phenomenon so the extent and nature of the control varies between nations, depending upon the nature and stage of development of the economy, the behavior of the private sector, the political philosophy, social attitudes, administrative etc.

### **Government normally plays 4 important roles in an economy**

1. Regulation
2. Promotion
3. Entrepreneurship
4. Planning.

### **Regulation:**

Government regulation of the business may cover extending from entry into business to the final results of a business.

The reservation of industries to small scale public and co-operative sectors, licensing system etc. regulate the entry.

Regulation of product mix, promotional activities etc. amount to regulation of the conduct of business.

Results of business operations may be regulated by measures as ceiling on profit margins, dividend etc,

The state may also regulate the relationship between enterprises. For e.g.: - restrictions on intra-corporate investments, interlocking of directors and appointment of sole selling agents.

Government regulation of the economy may be divided into direct controls and indirect controls.

Indirect controls are through different fiscal and monetary incentives and disincentives or penalties. Activities may be encouraged or discouraged through monetary and fiscal incentives and disincentives.

For instance, a high import duty may discourage imports and fiscal and monetary incentives may encourage the development of export oriented industries.

Direct administrative or physical controls are more drastic in effect. Characteristic of direct control is discretionary in nature. They can be applied selectively from firm to firm and industry to industry at the discretion of the state.

Regulation of the business has been rampant in the developing countries. Since late 1980's, a deregulation trend has set in. This has drastically transformed the competitive environment and has given an impact to globalization.

### **Promotional Role**

This role played by government is important in developed countries and also in the developing countries.

In developing countries where the infrastructural facilities for development are inadequate and entrepreneurial activities are scarce, the promotional role of the government assumes special significance.

State have to assume direct responsibility to build up and strengthen the necessary development infrastructures as power, transport, finance, marketing, institutions for training and guidance and other promotional activities.

Promotional role of state also encompasses the different fiscal, monetary and other incentives, including coverage of certain risks, for the development of certain priority sectors and activities.

### **Entrepreneurial Role**

Government is connected to establish and operate business enterprises and bearing the risks. Factors like socio-political ideologies, dearth of private entrepreneurship, neglect of certain sectors like unprofitable sectors by the private entrepreneurs, absence or inadequate competition in certain segments and the resultant exploitation of consumers have contributed to the growth of state owned enterprises in many countries.

### **Planning Role**

The importance of planning the less developed economy was emphasized by Pt. Jawahar Lal Nehru, chief architect of Development Planning in India to less developed economy. He rightly observed "Whatever it may be in other countries, in developing countries like ours, which have to develop fairly rapidly, the time element is important and the question is how to use our resources to the best advantage. If our resources are abundant it will not matter how they are used. But where one's resources are limited one has to see that they are directed to be right purpose to build up whatever one is aiming at".

## SELF CHECK QUESTIONS

### LONG ANSWER TYPE QUESTIONS:

1. Write an essay on Economic System.
2. What is Socialistic Economic System? Discuss its features and Workability.

### SHORT ANSWER TYPE QUESTIONS:

1. Discuss the limitations of mixed economy in India.
2. Discuss the roles played by government in business.

### OBJECTIVE TYPE QUESTIONS:

1. Strategic business unit is known as \_\_\_\_\_  
 (a) Electronic division (b) Remote division (c) Operating division (d) None of these

**Ans: (c)**

2. Board of Directors set the direction for \_\_\_\_\_  
 (a) The benefit of socio-cultural environment (b) The development of the organization  
 (b) The coordination between companies (d) The success of leadership

**Ans: (b)**

3. Human resource generally contribute \_\_\_\_\_  
 (a) Strength and weakness of an organization (b) Opportunity and threats  
 (c) Reputation of different institutions (d) None of these

**Ans: (a)**

4. Customer may be categorized as \_\_\_\_\_  
 (a) Household (b) Individual (c) Government and other industries  
 (c) All of these (e) None of these.

**Ans: (d)**

5. Executive is called as \_\_\_\_\_  
 (a) Implementation whatever decided by top level  
 (b) Implementation whatever decided by Government  
 (c) Implementation whatever decided by operational level  
 (d) None of these

**Ans: (a)**