

# Chapter 3 - Business Environment

## Very Short Answer Type

### Question 1:

What is meant by business environment?

### Answer:

Business environment refers to all the external forces that affect the performance of a business organisation. Such forces can be economic, social, political, technological or legal. Thus, individuals, consumers, government, legal matters all compose business environment. For example, change in taste and preferences of the consumers, change in government policies, change in political scenario, change in legal policies, all make up business environment. An organisation cannot control such forces but they affect its performance either positively or adversely. For example, a change in consumer's tastes in favour of a firm's product, increases demand for its product. Similarly, an introduction of a new technology leaves the technology used by the firm obsolete and its products comparatively inferior. Thus, it can be said that everything that is outside the purview of an organisation but affects its performance composes business environment.

### Question 2:

How does understanding of business environment help in improving performance of a business?

### Answer:

Organisations that carefully study their business environments and accordingly adopt suitable plans and policies are better able to improve their performance in the long run. The enterprises which keep a check on the environment not only perform well in the present scenario but also continue to succeed in the future.

### Question 3:

Give an example to show that a business firm operates within numerous inter related factors constituting the business environment. (Hint: example highlighting the inter relatedness of dimensions of business environment).

### Answer:

Business organisations work in a complex environment consisting of numerous interrelated and dynamic conditions. For example, ABC Ltd is an automobile company. Its performance is affected by the following factors:

Economic: Global recession

Social: Changed consumption habits of people due to the improved standard of living of customers

Technological: Advanced technology leading to automation in manufacturing

Legal: 28% GST levied on automobiles

**Question 4:**

Krishna Furnishers Mart started its operations in the year 1954 and emerged as the market leader in the industry because of their original designs and efficiency in operations. They had a steady demand for their products but over the years, they found their market share declining because of new entrants in the field. The firm decided to review their operations and decided that in order to meet the competition, they need to study and analyze the market trends and then design and develop their products accordingly. List any two impacts of changes in business environment on Krishna Furnishers Mart's operations. (Hint: increase in competition and Market orientation).

**Answer:**

The impacts of changes in business environment on Krishna Furnishers Mart's operations are:

1. Increased competition
2. Necessity for change
3. Market orientation
4. Innovation in designs (any two)

**Question 5:**

Name any two Specific forces of business environment affecting business.

**Answer:**

Specific forces directly affect individual enterprises in the day to day operations. Examples of specific forces:

1. Investors loyalty
2. Customer tastes and preferences
3. Strategies of Competitors
4. Terms and conditions of the Suppliers (any two)

**Short Answer Type****Question 1:**

Why it is important for business enterprises to understand their environment? Explain.

**Answer:**

Understanding of business environment is of vital importance for successful functioning of an organisation. Any organisation cannot function independently. It's functioning and performance depends on several external forces as well. A continuous evaluation and understanding of the business environment helps a firm to take account of these forces in a better manner and thereby, improve its functioning. The following points highlight the importance of understanding of environment for business enterprises.

**i. Identification of Opportunities:** With a careful analysis of the business environment an enterprise can identify the positive opportunities for business. An early identification of the opportunities helps it in taking first hand advantage in competition.

**ii. Identification of Threats:** Besides positive opportunities, a study of business environment helps an enterprise in the identification of threats or negative signals that may adversely affects its functioning. Thereby, it enables it to take appropriate preventive measures.

**iii. Accumulating Useful Resources:** Environment provides a business various resources or inputs for its functioning such as raw material, machinery, labour, etc. On the other hand, enterprises provide the environment with output in the form of goods and services. That is, environment acts both as a source of resources as well as a source of demand for the products of the enterprises. Thus, it becomes logical for the enterprises to take up those resources from the environment that can be converted into the desired output. This is possible only if the enterprises have an understanding of what the environment desires and what it can offer.

**iv. Adjusting to Changes:** Business environment is dynamic in nature. Changes in technology, consumers taste and preference, government policies take place continuously. A careful analysis and understanding of the environment helps an enterprise in dealing with these changes in a better manner and thereby, take appropriate actions.

**v. Formulating Plans and Policies:** A continuous study of environment helps an organisation in the identification of the opportunities and threats. Thereby, it guides the organisation in framing suitable plans and policies in view of the current scenario.

**vi. Improving Performance:** A continuous analysis of the environment helps the enterprises in framing suitable policies and plans and thereby, improves their performance.

## Question 2:

Explain the following terms:

- (a) Liberalisation
- (b) Privatization
- (c) Globalisation

## Answer:

**(a) Liberalisation:** Liberalisation refers to the removal of unnecessary controls and restrictions of the government in the form of licenses, permits and quotas. India initiated liberalisation of industries in 1991. Liberalisation of industries in India took the following form.

- i. License required for the establishment of industries were abolished.
- ii. Enterprises became free in deciding the scale and size of production and the price of the products
- iii. Restrictions were removed on the movement of goods and services
- iv. Procedures regarding exports and imports were relaxed

**(b) Privatisation:** Privatisation implies according greater role to the private sector and reducing the involvement of public sector. Privatisation was followed in India in the following manner.

- i. Disinvestment of the public sector enterprises

- ii. Establishing Board of Industrial and Financial Reconstruction for the revival of the sick and loss making enterprises.
- iii. Diluting the stake of government in the public sector enterprises.

**(c) Globalisation:** Globalisation refers to the process of integration of various economies of the world. It implies reducing the restrictions on the import and export such as licensing and tariffs. In India the following policies were followed with regard to globalisation.

- i. Removal on restriction on imports
- ii. Abolishing the export duty
- iii. Reducing import duty

### Question 3:

Briefly discuss the impact of government policy changes on the business and industry.

### Answer:

The policies of liberalisation, privatisation and globalisation by the government affect the functioning of the business enterprises. The following points highlight the impact of government policy changes on the business and industry.

- i. Increased Competition:** As a result of the policies such as relaxation of the licensing policy and reduction of import duties, the competition faced by the domestic firms increases. India companies experienced competition in service industry such as telecommunication, banking, insurance, etc.
- ii. Increased Demand:** As competition increases, the choice of goods and services for the consumers also increases. Thus, consumers also gain from quality products and greater variety.
- iii. Change in Business Policies:** The government policies directly impact the functioning of the business enterprises. As a result, they have to alter their policies appropriately.
- iv. Technological Changes:** As competition increases firms tend to find new and innovative ways to survive in the market. In such a scenario, technological improvements become imperative.
- v. Need for Trained Personnel:** Innovations and improvement in product, application of improved technologies requires skilled and trained personnel. Thus, there arises a need for the development of human resources.
- vi. Greater Market Orientation:** With increased competition, the production has become market oriented. That is, the enterprises produce as per the demand market.
- vii. Less Reliance on Budgetary Support by Public Sector Enterprises:** To survive the increased competition, the public sector enterprises must improve efficiency and productivity rather than relying on budgetary support to cover their losses.

### Question 4:

National Digital Library of India (NDL India) is a pilot project initiated by the HRD ministry. It works towards developing a framework of virtual repository of learning resources with a single-window search facility. It provides support to all academic levels including researchers, life-long learners and differently-abled learners free of cost. State the dimensions of business environment highlighted above.

**Answer:**

The business environment highlighted are:

1. Technological dimension: 'It works towards developing a framework of virtual repository of learning resources with a single-window search facility.'
2. Social dimension: 'It provides support to all academic levels including researchers, life-long learners and differently-abled learners free of cost. '

**Question 5:**

State the impact of demonetization on interest rates, private wealth and real estate.

**Answer:**

Impact of demonetization:

1. Interest rates: Cash transactions declined, Bank deposits increased and Increase in financial savings
2. Private wealth: Declined since some high demonetized notes were not returned
3. Real estate: Decline in prices of property

**Long Answer Type****Question 1:**

How would you characterise business environment? Explain, with examples, the difference between general and specific environment.

**Answer:**

Business environment refers to all the external forces such as economic, social, political, technological or legal that affects the performance of a business organisation. In other words, everything that is outside the purview of an organisation but affects its performance composes business environment.

Business environment has the following characteristics.

- Aggregate of External Forces:** Business environment is the total of all the external forces such as individuals, consumers, government, legal matters that affect the performance of an organisation either positively or negatively.
- Interrelation:** Different forces of business environment are closely related to each other. For example, an increase in the income of the consumers increases the demand for consumer durables such as television, refrigerator, etc.
- Ever Changing:** Business environment is dynamic and ever changing in nature. For example, consumer tastes and preferences, technology, government rules and policies keep changing continuously.
- Uncertainty:** Business environment is uncertain. Changes in different forces of the environment cannot be predicted easily. In addition, dynamism of the forces makes it even more uncertain.

**v. *Complex*:** Business environment is the aggregate of different interrelated and dynamic forces. Thus, it becomes difficult and complex to understand. For example, all political, social, economic, technological and legal matters affect the performance of organisation simultaneously. While, it may be easy to understand the individual affect of these forces, their cumulative effect is quite difficult to understand.

**vi. *Relative*:** Business environment is relative in nature. It differs from region to region. For example, political conditions, religious beliefs, government rules and policies differ from one region to another.

### ***Specific Environment and General Environment***

Specific environment refers to those external forces that affect an organisation directly. That is, they are the forces that are specific to a particular organisation or a company. For example, a change in tastes and preferences of consumers towards the products of a company, directly affects its demand. Similarly, a delay in the supply of raw material from the suppliers directly affects the production of a company.

On the other hand, general environment refers to those external forces that affect all the organisations. As against specific forces, general forces do not pertain to a particular organisation, rather they affect the performance of all the organisations. Thus, such forces affect a particular organisation only indirectly. For example, a change in technology affects the quantity and quality of production of all the organisations. Similarly, a change in political conditions affects all companies simultaneously.

### **Question 2:**

How would you argue that success of a business is significantly influenced by its environment?

### **Answer:**

Any organisation cannot function in isolation. Rather, its working and actions are influenced by many external forces such as social and political conditions, technological changes, etc. Such external forces compose environment for an organisation. It is of prime importance for any organisation to have an understanding of the business environment. A continuous study of the business environment enables an organisation to identify the forces that affects it functioning and thereby, helps it in reacting and coping with these forces in an appropriate manner. The following points highlight the importance of environment for the success of a business organisation.

**i. *Identification of Opportunities*:** Changing business environment offers many positive opportunities for business. A careful analysis of the environment enables an enterprise to identify these positive opportunities and take first hand advantage in competition. That is, it enables the organisation to gain maximum benefit and move ahead of its competitors. For example, Tata recognised the demand for a small and economical car in India and thereby, launched the popular Tata Nano at a price of just one lakh. Thus, it became the leader in low cost car in India.

**ii. *Identification of Threats*:** Besides positive opportunities, certain changes in the environment may also affect the functioning of an environment adversely. A study of business environment helps an enterprise in the identification of these threats or negative signals. Thereby, it enables it to take appropriate preventive measures. For example, if a mobile manufacturing company finds that another company is coming up with new and improved features in its product, then it acts a competition for it. An identification of the threats can enable the organisation to take appropriate measures such as improving the quality and features of its mobile, advertising, etc.

**iii. *Accumulating Useful Resources*:** Environment acts a source of inputs or resources such as raw material, machinery, labour, etc. required for the functioning of an organisation. On the other hand,

environment also acts a source of demand for goods and services produced by the organisation. Thus, it is rational for the organisations to take up those resources from the environment that can be converted into the desired output. This is possible only if the enterprises have an understanding of what the environment desires and what it can offer. For example, with a rise in demand for the touch screen technology in mobile phones, manufacturers are accumulating resources required for manufacturing touch screen phones.

**iv. *Adjusting to Changes:*** Business environment is dynamic in nature. Technology, consumers taste and preference, government policies, political conditions change continuously. A careful analysis and understanding of the environment helps an enterprise in dealing with these changes in a better manner and take appropriate actions. For example, by a study of business environment many bakery enterprises have realised the growing demand for sugar-free products and are increasing the production of such bakery products.

**v. *Formulating Plans and Policies:*** With a continuous study of the environment an organisation can identify various threats and opportunities for its business. Accordingly, it can frame suitable plans and policies in view of the current scenario. For example, if on analysing the market for clothes in India, it is found that there is an increasing demand for western wear, then a cloth manufacturing company can frame policies and strategies to incorporate western wear in its production.

**vi. *Improving Performance:*** An analysis of the business environment helps the enterprises in identifying various threats and opportunities that affect its performance. It helps the organisation in dealing with these changes in an appropriate manner. Thereby, it helps it in improving its performance.

### Question 3:

Explain with examples, the various dimensions of business environment.

### Answer:

The following are the dimensions of business environment.

**i. *Economic Environment:*** It comprises of the economic variables such as interest rates, income, stock market indices that affect the functioning of the enterprises. For example, an increase in the income of the consumers increases the demand for goods and services of the enterprises. Similarly, a fall in the interest rates for loans for consumer durables increases the spending capacity and thereby, increases the demand for such products.

**ii. *Social Environment:*** Social environment refers to the social forces such as customs, traditions, social values, social trend etc. For example, religious celebrations provide business opportunities to many enterprises such as those producing sweets, decoration items, etc. Similarly, in India a change in social trend towards western lifestyle has increased the demand for western wear, fast food, etc.

**iii. *Technological Environment:*** Technological environment comprises of the technological changes and improvements. For example, introduction of computers, internet, have changed the way organisations work today. Similarly, continuous improvement and innovations in the technology used in the production improves the quality of production. While on one hand, improvement in technology provides new business opportunities for the enterprises, on the other hand, is a threat for the enterprises using obsolete technology.

**iv. *Legal Environment:*** It refers to the legislation and rules passed by the government such as the Companies Act, Trade union Act, etc. Knowledge of these legislation is essential for enterprises as their

non-compliance can lead to legal trouble for them. For example, an export-import company in India has to follow the rules and regulations as stated under the EXIM policy and the Foreign Trade (Development and Regulation) Act, 1992. Similarly, the refining, processing, distribution, sale of petroleum, petroleum products is governed by the Petroleum and Natural Gas Regulatory Board Act, 2006.

**v. *Political Environment*:** Political environment comprises of political conditions such as peace and stability, law and order, etc. For example, a situation of political unrest such as frequent change in the ruling government implies a change in the rules and policies of the government regarding production and manufacturing. Such a frequent change in the regulations regarding production discourages investment. Similarly, the opening up of our economy under the New Economic Policy in 1991, provided business opportunity to many foreign companies.

#### Question 4:

The government of India announced Demonetization of ₹ 500 and ₹ 1,000 currency notes with effect from the midnight of November 8, 2016. As a result, the existing ₹ 500 and ₹ 1,000 currency notes ceased to be legal tender from that date. New currency notes of the denomination of ₹ 500 and ₹ 2,000 were issued by Reserve Bank of India after the announcement.

The step resulted in a substantial increases in the awareness about and use of Point of Sale machines, e-wallets, digital cash and other modes of cashless transactions. Also, increased transparency in monetary transactions and disclosure led to a rise in government revenue in the form of tax collection.

a. Enumerate the dimensions of business environment highlighted above.

b. State the features of Demonetization.

#### Answer:

a. Dimensions of business environment highlighted above are:

1. Political dimension: 'The government of India announced Demonetization of ₹ 500 and ₹ 1,000 currency notes with effect from the midnight of November 8, 2016. '
2. Legal dimension: 'As a result, the existing ₹ 500 and ₹ 1,000 currency notes ceased to be legal tender from that date.'
3. Technological dimension: 'The step resulted in a substantial increases in the awareness about and use of Point of Sale machines, e-wallets, digital cash and other modes of cashless transactions.'

b. Features of Demonetization are:

1. Measure of tax administration- black money holders had to declare the unaccounted wealth and pay taxes at penalty rates
2. Measure to avoid tax evasion- indicating the government will not tolerate tax evasion
3. Measure of channelizing savings into the financial system- by depositing money in banks
4. Create 'cash-less' or 'cash-lite' economy- for increasing financial savings and reducing tax evasion

#### Question 5:



What economic changes were initiated by the government under the Industrial Policy, 1991? What impact have these changes made on the business and industry?

**Answer:**

Government of India introduced the Industrial Policy, in July 1991. Major highlights of the policy are as follows.

**(i) Abolition of Licensing-** Under the new industrial policy 1991, compulsory licensing system was abolished. In other words, with the industrial reforms the private players were free to start a new venture without the need to obtain a license. However, the system of licensing was retained in six industries namely, liquor, cigarette, defence equipment, dangerous chemicals, industrial explosives, and drugs and pharmaceuticals.

**(ii) Dereservation-** The number of industries exclusively reserved for the public sector was considerably reduced. The private sector was allowed operation in majority of the industries with only 3 industries under the exclusive purview of the government namely, railways, atomic mineral and atomic energy.

**(iii) Augmentation of Production Capacity-** Prior to the policy, industries had to obtain permission from the government in order to expand the scale of production. With liberalisation policy the MRTP companies (companies having assets worth more than Rs 100 crore) were free to expand the scale of their business according to the market conditions.

**(iv) Freedom in Importing Capital Goods-** Under the policy, industrialists were permitted to import capital goods from the foreign countries. 100 percent FDI was allowed in the foreign capital.

**(v) Reforms in the Small Scale Industries-** In India, small scale industries are defined on the basis of maximum investment that is allowed in the unit. With the commencement of reforms the maximum limit has been increased from Rs 5 lakh to Rs 1 crore. This encouraged development and modernisation of the industries. Further, the number of products reserved for the small scale industries was reduced.

**(vi) Disinvestment-** The process of disinvestment was carried out for many public sector enterprises. That is, an increasing share of the assets of the public industrial enterprises was sold to the private sector.

**(vii) Foreign Investment Promotion Board-** This board was set up to encourage and channelise foreign investment in India.

The impact of these changes on the business and industry is highlighted in the following points.

**(a) Increased Competition:** As a result of the policies such as abolition of the licensing policy, dereservation the competition faced by the domestic companies has increased. India companies experienced competition in service industry such as telecommunication, banking, insurance, etc.

**(b) Increased Demand:** With increased competition the choice of goods and services for the consumers has also increased. Thus, consumers also gain from quality products and greater variety.

**(c) Change in Business Policies:** The government policies under new industrial policy directly affected the functioning of the business enterprises. As a result, they altered their policies and operations appropriately.

**(d) Technological Changes:** With the increase in competition, firms tend to find new and innovative ways to survive in the market. They increasingly adopt new technology and engage in further research and development.

**(e) Need for Trained Personnel:** Due to innovations and improvement in product, application of improved technologies, the demand for skilled, trained and competent personnel has increased. Thus, there arises a need for the development of human resources.

**(f) Greater Market Orientation:** With increased competition, it has become imperative for the enterprises to change the production as per the market demand. That is, the production has become market oriented.

**(g) Less Reliance on Budgetary Support by Public Sector Enterprises:** To survive the increased competition, the public sector enterprises have realised the need for improving the efficiency and productivity. They have reduced their reliance on budgetary support to cover their losses.

#### Question 6:

What are the essential features of

- i. Liberalisation
- ii. Privatisation
- iii. Globalisation

#### Answer:

**Liberalisation:** Liberalisation refers to the removal of unnecessary controls and restrictions of the government in the form of licences, permits and quotas. India initiated liberalisation of industries in 1991. Liberalisation of industries in India took the following form.

(i) *Abolition of licenses:* License required for the establishment of industries were abolished. The system of licensing was retained only for six industries namely, liquor, cigarette, defence equipment, dangerous chemicals, industrial explosives, and drugs and pharmaceuticals

(ii) *Augmentation of Production:* Enterprises became free in deciding the scale and size of production and the price of the products. The MRTP companies (companies having assets worth more than Rs 100 crore) were free to expand the scale of their business according to the market conditions

(iii) *Removal of Trade Restrictions:* Various restrictions regarding trade such as quantitative restrictions, customs, duties, tariff, etc. were removed to ease the movement of goods and services

(iv) *Encouragement to Foreign Direct Investment (FDI):* Emphasis was laid to encourage competition in the market and to attract Foreign Direct Investment (FDI) from other countries.

**Privatisation:** Privatisation refers to the gradual transfer of ownership or management of state owned enterprises from the public sector to the private sector enterprises. It implies assigning a greater role to the private sector undertakings. In India, privatisation was followed in the following manner.

(i) *Disinvestment:* For disinvestment, the government adopted two methods. First, selling off a part of the equity of the PSU's and second, strategic sale of PSU's. Under privatisation, a large portion of the equity of the PSU's was sold to the private sector. Also, strategic sale of a number of companies such as Modern Foods India, Bharat Aluminium Company (BALCO), Maruti Udyog Ltd., etc. was undertaken.

(ii) *Establishing Board of Industrial and Financial Reconstruction:* This board was established for the revival of the sick and loss making enterprises.

(iii) *Reducing the Role of Public Sector*: Under privatisation, the number of industries that were exclusively reserved for the public sector was reduced considerably from 17 to 8. At present, only 3 industries are exclusively reserved for the public sector namely, railways, atomic mineral and atomic energy.

(iv) *Navratna Policy*: To improve efficiency, infuse professionalism and to enable PSUs to compete effectively in the market, government awarded the status of ‘*Navaratnas*’ to nine high performing PSUs.

**Globalisation**: Globalisation refers to the process of integration of various economies of the world. It is the process associated with increasing openness, growing economic independence and promoting economic integration in the world economy. In India, the following policies were followed with regard to globalisation.

(i) *Removal on Trade Restriction*: Various barriers on trade such as tariffs, custom duties, quotas, etc. were reduced considerably.

(ii) *Reducing the Export Duty and Import Duty*: Various duties and taxes on import and export were removed to promote free trade.

(iii) *Encouragement to Foreign Capital Investment*: With the aim of encouraging foreign capital investment various steps were taken such as increasing the equity limit of foreign capital, setting up of special economic zones, introduction of Foreign Exchange Management Act (FEMA).