Chapter 3: Business Environment

Exercises — Exercises

Q1 What is meant by business environment?

Business environment means the sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but that may affect its performance. It includes external forces such as consumers, competitors, governments, courts, media, and economic, social, political, technological and legal conditions that operate outside a business enterprise yet influence its working.

Q2 How does understanding of business environment help in improving performance of a business?

Many studies reveal that the future of an enterprise is closely bound up with what is happening in the environment. Enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period. Understanding the environment enables managers to identify opportunities and threats, tap resources effectively, cope with rapid changes, and formulate better plans and policies.

Q3 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).

Increased life expectancy of people and increased awareness for health care have increased the demand for many health products and services like soft drinks, fat-free cooking oil, and health resorts. New health products and services have, in turn, changed people's life styles. This illustrates how social environment (health awareness, life expectancy) and economic environment (consumer spending) are closely inter-related, affecting each other and shaping new business opportunities.

Q4 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).

Two impacts of changes in business environment on Krishna Furnishers Mart are: (i) Increase in competition — new entrants in the furniture field eroded the firm's market share, forcing it to rethink its strategy; and (ii) Market orientation — the firm now needs to study and analyse market trends and design products accordingly, shifting from a production-driven approach to a customer and market-driven approach.

Q5 Name any two Specific forces of business environment affecting business.

Two specific forces of business environment are: (i) Customers — they directly and immediately affect the day-to-day working of an enterprise by determining demand for its goods and services; and (ii) Competitors — rival firms directly influence the market share, pricing, and strategies of an enterprise.

Q6 Why it is important for business enterprises to understand their environment? Explain.

Understanding business environment is important for the following reasons: (i) Identifying opportunities and getting first mover advantage — early identification lets firms exploit opportunities before competitors, as Maruti Udyog did with small cars. (ii) Identifying threats as early warning signals — environmental awareness helps managers identify threats in time and take corrective action. (iii) Tapping useful resources — businesses draw inputs (finance, raw materials, labour) from the environment and must understand it to secure these resources. (iv) Coping with rapid changes — in a dynamic environment characterised by turbulent markets and intense global competition, understanding the environment helps managers develop suitable courses of action. (v) Assisting in planning and policy formulation — since the environment is a source of both opportunities and threats, its analysis helps in planning and policy decisions. (vi) Improving performance — firms that continuously monitor their environment and adapt accordingly improve present performance and continue to succeed over the long term.

Q7 Explain the following terms: a. Liberalisation b. Privatization c. Globalisation

a. Liberalisation: The economic reforms introduced as part of the New Industrial Policy 1991 were aimed at liberalising Indian business and industry from all unnecessary controls and restrictions, signalling the end of the licence-permit-quota raj. It involved abolishing licensing requirements in most industries, freedom to decide the scale of business activities, removal of restrictions on movement of goods and services, freedom in fixing prices, reduction in tax rates, simplifying import and export procedures, and making it easier to attract foreign capital and technology.

b. Privatisation: The new set of economic reforms aimed at giving a greater role to the private sector in the nation-building process and a reduced role to the public sector. The government redefined the role of the public sector, adopted planned disinvestment of public sector enterprises, and decided to refer loss-making and sick enterprises to the Board of Industrial and Financial Reconstruction. Disinvestment means transfer of ownership from the public sector to the private sector; if government ownership is diluted beyond 51 per cent, ownership and management pass to the private sector.

c. Globalisation: Globalisation means the integration of the various economies of the world leading towards the emergence of a cohesive global economy. Through the 1991 policy, the government moved India towards globalisation by liberalising imports, promoting exports through rationalisation of the tariff structure, and reforming foreign exchange. Globalisation involves an increased level of interaction and interdependence among nations so that physical, geographical or political boundaries no longer remain barriers for businesses to serve customers in distant markets.

Q8 National Digital Library of India (NDL India) work 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.

The case of NDL India highlights two dimensions of business environment: (i) Technological environment — the use of digital technology to create a virtual repository with a single-window search facility represents scientific improvements and innovations that provide new methods of delivering services; and (ii) Social environment — by supporting all academic levels including differently-abled learners free of cost, NDL India reflects society's values of equality of opportunity, social justice, and concern for the quality of life, which are key elements of the social environment.

Q9 State the impact of demonetization on interest rates, private wealth and real estate.

According to the chapter, the impact of demonetisation was as follows: (i) Interest rates/Money — cash transactions declined, bank deposits increased, and financial savings increased; lower interest rates became possible as banks had more funds to lend. (ii) Private wealth — private wealth declined since some high-denomination demonetised notes were not returned and real estate prices fell. (iii) Real estate — real estate prices declined, as a significant part of real estate transactions previously involved unaccounted (black) money, which was eliminated by demonetisation.

Q10 How would you characterize business environment? Explain with examples, the difference between general and specific environment.

Business environment can be characterised as follows: (i) Totality of external forces — it is the sum total of all things external to business firms and is aggregative in nature. (ii) Specific and general forces — it includes both. (iii) Inter-relatedness — different elements are closely inter-related. (iv) Dynamic nature — it keeps changing in terms of technology, consumer preferences, and competition. (v) Uncertainty — future happenings are difficult to predict. (vi) Complexity — it consists of numerous interrelated and dynamic forces from different sources. (vii) Relativity — it differs from country to country and region to region.

Difference between general and specific environment: Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working. For example, a supplier raising prices immediately affects a firm's production cost. General forces (such as social, political, legal and technological conditions) have an impact on all business enterprises at the same time and may affect an individual firm only indirectly. For example, a change in government tax policy affects all businesses, not just one. Another example: scientific research discovering an energy-efficient light bulb affects all firms in the lighting industry (general), whereas a specific customer's decision to switch to a competitor affects only that enterprise (specific).

Q11 How would you argue that the success of a business enterprise is significantly influenced by its environment?

The success of a business enterprise is significantly influenced by its environment for the following reasons:

(i) Identifying opportunities for first mover advantage: The environment provides numerous opportunities. Early identification helps the enterprise exploit them before competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognise the need for small cars given rising petroleum prices and a large middle-class population in India.

(ii) Identifying threats: The environment is also a source of many threats. Environmental awareness serves as an early warning signal. For instance, if an Indian firm learns that a foreign multinational is entering the market with new substitutes, it can prepare by improving quality, reducing costs, or engaging in aggressive advertising.

(iii) Tapping resources: A business enterprise draws inputs like finance, machines, raw materials, labour, power and water from its environment. Understanding the environment helps the enterprise design policies to secure the resources it needs.

(iv) Coping with change: Today's business environment is increasingly dynamic with turbulent market conditions, rapid technological changes, and intense global competition. Firms that understand their environment can effectively cope with these changes.

(v) Planning and policy: Since the environment is a source of both opportunities and threats, its analysis provides the basis for planning and policy formulation.

(vi) Improving performance: Many studies reveal that the future of an enterprise is closely bound up with what is happening in the environment. Enterprises that continuously monitor and adapt to their environment improve performance and continue to succeed in the long term.

Q12 Explain, with examples, the various dimensions of business environment.

The various dimensions of business environment are:

(i) Economic Environment: Includes interest rates, inflation rates, changes in disposable income, stock market indices and the value of rupee. For example, low long-term interest rates benefit construction companies and automobile manufacturers as consumers buy more homes and cars on borrowed money. High inflation rates increase costs of raw materials, machinery and wages, constraining business enterprises.

(ii) Social Environment: Includes social forces like customs, traditions, values, social trends and society's expectations from business. For example, the celebration of Diwali, Eid, Christmas and Guru Parv provides significant financial opportunities for greetings card companies, confectionery manufacturers and tailoring outlets. The health-and-fitness trend has created demand for organic food, gyms, bottled water and food supplements.

(iii) Technological Environment: Includes forces relating to scientific improvements and innovations that provide new ways of producing goods and services. For example, advances in computers and electronics have changed how companies advertise their products through information kiosks and World Wide Web multimedia pages. Shifts from vacuum tubes to transistors, from typewriters to computer-based word processors, have created new businesses while making older ones obsolete.

(iv) Political Environment: Includes political conditions such as general stability and peace in the country and attitudes of elected government representatives towards business. Political stability builds confidence among business people to invest in long-term projects. On the other hand, political instability and threats to law and order create uncertainty for business activities.

(v) Legal Environment: Includes various legislations, administrative orders issued by government authorities, and court judgments. For example, the advertisement of alcoholic beverages is prohibited; packets of cigarettes carry the statutory warning 'Cigarette smoking is injurious to health'; and advertisements of baby food must inform buyers that mother's milk is the best. Non-compliance with these regulations can land a business enterprise in legal problems.

Q13 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. This step resulted in a substantial increase 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.

a. Dimensions of business environment highlighted:
(i) Economic environment — the demonetisation of 500 and 1,000 notes directly affected money supply, interest rates, bank deposits, financial savings, real estate prices, and government tax revenue.
(ii) Technological environment — the increase in awareness and use of Point of Sale (PoS) machines, e-wallets, digital cash and other cashless transaction modes reflects the role of technological innovation in changing how business transactions are conducted.
(iii) Legal environment — the government's announcement through legislation made certain currency notes cease to be legal tender with immediate effect, imposing legal obligations on citizens and businesses to comply.
(iv) Political environment — demonetisation was a policy decision by the elected government reflecting its political will to curb corruption and black money, which directly affected business activities.

b. Features of Demonetisation:
1. It is viewed as a tax administration measure — those with unaccounted wealth had to declare it and pay taxes at a penalty rate.
2. It signals that tax evasion will no longer be tolerated or accepted.
3. It channelises savings into the formal financial system — deposits in banks provide a base for loans at lower interest rates.
4. It aims to create a less-cash or cash-lite economy by channelling more savings through the formal financial system and improving tax compliance, even though digital transactions require cell phones for customers and PoS machines for merchants with internet connectivity.

Q14 What economic changes were initiated by the Government under the Industrial Policy, 1991? What impact have these changes made on business and industry?

Economic changes under the Industrial Policy, 1991:
The Government of India announced a New Industrial Policy in July 1991 as part of economic reforms. The broad features were: (a) Reduction in industries under compulsory licensing to six; (b) Dereservation of many industries earlier reserved for the public sector — the role of the public sector was limited to four industries of strategic importance; (c) Disinvestment carried out in case of many public sector industrial enterprises; (d) Liberalisation of policy towards foreign capital — share of foreign equity participation increased and 100 per cent FDI was permitted in many activities; (e) Automatic permission granted for technology agreements with foreign companies; and (f) Foreign Investment Promotion Board (FIPB) set up to promote and channelise foreign investment in India. In essence, this policy sought to liberate industry from the licensing system (liberalisation), drastically reduce the role of the public sector (privatisation), and encourage foreign private participation in India's industrial development (globalisation).

Impact on business and industry:
(a) Increasing competition — firms now face competition both from domestic and foreign companies;
(b) More demanding customers — with more choices available, customers have become more quality-conscious and demanding;
(c) Rapidly changing technological environment — technology upgradation is essential to remain competitive;
(d) Necessity for change — firms must continuously innovate and change to keep pace with the dynamic environment;
(e) Need for developing human resources — quality manpower with up-to-date skills is essential;
(f) Market orientation — firms have shifted from production orientation to customer and market orientation;
(g) Loss of budgetary support to the public sector — public sector enterprises now face the challenge of operating without government protection and competing on their own merit.