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JAGAT GURU NANAK DEV
PUNJAB STATE OPEN UNIVERSITY, PATIALA

(Established by Act No. 19 of 2019 of the Legislature of State of Punjab)

MASTER OF COMMERCE

Semester-I

MCMM21102T
BUSINESS ENVIRONMENT

Head Quarter: C/28, The Lower Mall, Patiala-147001
Website: www.psou.ac.in

SELF-INSTRUCTIONAL STUDY MATERIAL FOR JGND PSOU

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ਜਗਤ ਗੁਰੂ ਨਾਨਕ ਦੇਵ
ਪੰਜਾਬ ਸਟੇਟ ਓਪਨ ਯੂਨੀਵਰਸਿਟੀ
ਪਟਿਆਲਾ

PREFACE

Jagat Guru Nanak Dev Punjab State Open University, Patiala was established in December 2019 by Act 19 of the Legislature of State of Punjab. It is the first and only Open University of the State, entrusted with the responsibility of making higher education accessible to all, especially to those sections of society who do not have the means, time or opportunity to pursue regular education.

In keeping with the nature of an Open University, this University provides a flexible education system to suit every need. The time given to complete a programme is double the duration of a regular mode programme. Well-designed study material has been prepared in consultation with experts in their respective fields.

The University offers programmes which have been designed to provide relevant, skill-based and employability-enhancing education. The study material provided in this booklet is self-instructional, with self-assessment exercises, and recommendations for further readings. The syllabus has been divided in sections, and provided as units for simplification.

The Learner Support Centres/Study Centres are located in the Government and Government aided colleges of Punjab, to enable students to make use of reading facilities, and for curriculumbased counselling and practicals. We, at the University, welcome you to be a part of this institution of knowledge.

Prof. G. S. Batra
Dean Academic Affairs

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SEMESTER-I

(MCMM21102T): BUSINESS ENVIRONMENT

MAX. MARKS: 100
EXTERNAL: 70
INTERNAL: 30
PASS: 35%
Credits:6

Objective:

To develop basic understanding of the Indian business environment and measurement of various macro-economic variables among learners.

INSTRUCTIONS FOR THE PAPER SETTER/EXAMINER:

1. The syllabus prescribed should be strictly adhered to.
2. The question paper will consist of three sections: A, B, and C. Sections A and B will have four questions from the respective sections of the syllabus and will carry 10 marks each. The candidates will attempt two questions from each section.
3. Section C will have fifteen short answer questions covering the entire syllabus. Each question will carry 3 marks. Candidates will attempt any ten questions from this section.
4. The examiner shall give a clear instruction to the candidates to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated.
5. The duration of each paper will be three hours.

INSTRUCTIONS FOR THE CANDIDATES:

Candidates are required to attempt any two questions each from the sections A and B of the question paper and any ten short questions from Section C. They have to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated

SECTION A

Socio-Political Environment
Unit-1 Dimensions of Business Environment
Unit-2 Socio-Cultural Environment
Unit-3 Social Responsibilities of Business, Political Environment

Legal Environment
Unit-4 Regulatory Policies and Framework
Unit-5 Corporate Laws – I
Corporate Laws – II

Unit-6 Labour Legislation

SECTION B

Regulations of Financial Markets

Unit-7 Financial Markets
Unit-8 Capital Market
Unit-9 Regulation of Capital Market
Investors Protection and Corporate Governance.

Economic Environment

Unit-10 Structure of Indian Economy
Unit-11 Economic Planning
Unit-12 Economic Policies

Suggested Readings:

1. Cherunilam, Francis, "Business Environment", 2011, Himalaya Publishing House, New Delhi.
2. K Ashwathappa, "Legal Environment of Business", Himalaya Publishing House, New Delhi.
3. M. Adhikary, "Economic Environment for Business", Sultan Chand & Sons, New Delhi.
4. K. Ashwathappa, "Essentials of Business Environment", 11th edition (2011), Himalaya Publishing House, New Delhi.
5. Paul Justin, "Business Environment – Text and Cases", 2006, Tata McGraw Hills Publishing
6. Ruddar Dutt and KPM Sundaram, "Indian Economy", 53rd edition, S. Chand and CompanyLtd., New Delhi.
7. Govt. of India, Five Years Plan documents.
8. Govt. of India, Various issues of Annual Economic survey of India.
9. http://swayam.gov.in/
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SEMESTER-I

(MCMM21102T): BUSINESS ENVIRONMENT

COURSE CO-ORDINATOR AND EDITOR: DR. PINKY SRA

SECTION A

UNIT NO.	UNIT NAME
Unit 1	Dimensions of Business Environment
Unit 2	Socio-Cultural Environment
Unit 3	Social Responsibilities of Business, Political Environment
Unit 4	Regulatory Policies and Framework
Unit 5	Corporate Laws – I Corporate Laws – II
Unit 6	Labour Legislation

SECTION B

UNIT NO.	UNIT NAME
Unit 7	Economic Policies
Unit 8	Financial Markets
Unit 9	Regulation of Capital Market
Unit 10	Structure of Indian Economy
Unit 11	Economic Planning
Unit 12	Economic Policies

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SEMESTER 1

COURSE: BUSINESS ENVIRONMENT

UNIT –I: DIMENSIONS OF BUSINESS ENVIRONMENT

STRUCTURE

1.9 Answers to self-check Questions

1.10 Exercise

1.11 Recommended Readings

1.0 OBJECTIVE

The objectives of this chapter are to introduce the reader with the concept of business, business environment, importance of business environment and various dimensions of business environment. The aim of the chapter is to make reader familiar about such Internal and External forces which are an integral part of Business Environment. This unit also give knowledge about the micro and macro environment, which is the integral part of business environment.

1.1 INTRODUCTION

The existence and success of Business enterprise depends upon the various

Factors which affect the functioning of an enterprise. These factors might be internal or external. The Internal factors consist of supplier, customer, competitors, market intermediaries etc. These are more or less controllable by the business enterprise. But some factors are beyond the control of any business, these are external factors. These external Environmental factors which affects the business enterprise most. The success and survival of the business depend much upon the extent on its ability to adopt to the changing environmental factors.

1.2 CONCEPT OF BUSINESS

Business is something related to those activities which are carried out with the objective of earning profits. These activities might relate to production of goods and services, trading of goods and services etc. In earlier days, the Profit maximization was the main objective of business. Social responsibilities of the business towards customers, society and employee were totally ignored. But in recent times the customer has gained a central position. And the objectives of the Profit maximization is achieved through increased customer satisfaction.

1.3 BUSINESS ENVIRONMENT

Business Environment refers to those aspects of the surroundings of business enterprise which have influence on the functioning of business. Business cannot exist in vacuum. Its factors which are in and around the business enterprises influence the working of the business enterprise. These environmental factors can be termed as Business Environment. The Business environment factors are dynamic in nature and goes on changing rapidly. The existence and success of the Business enterprise depends on the ability of the business to adopt the changes in the business environmental factor.

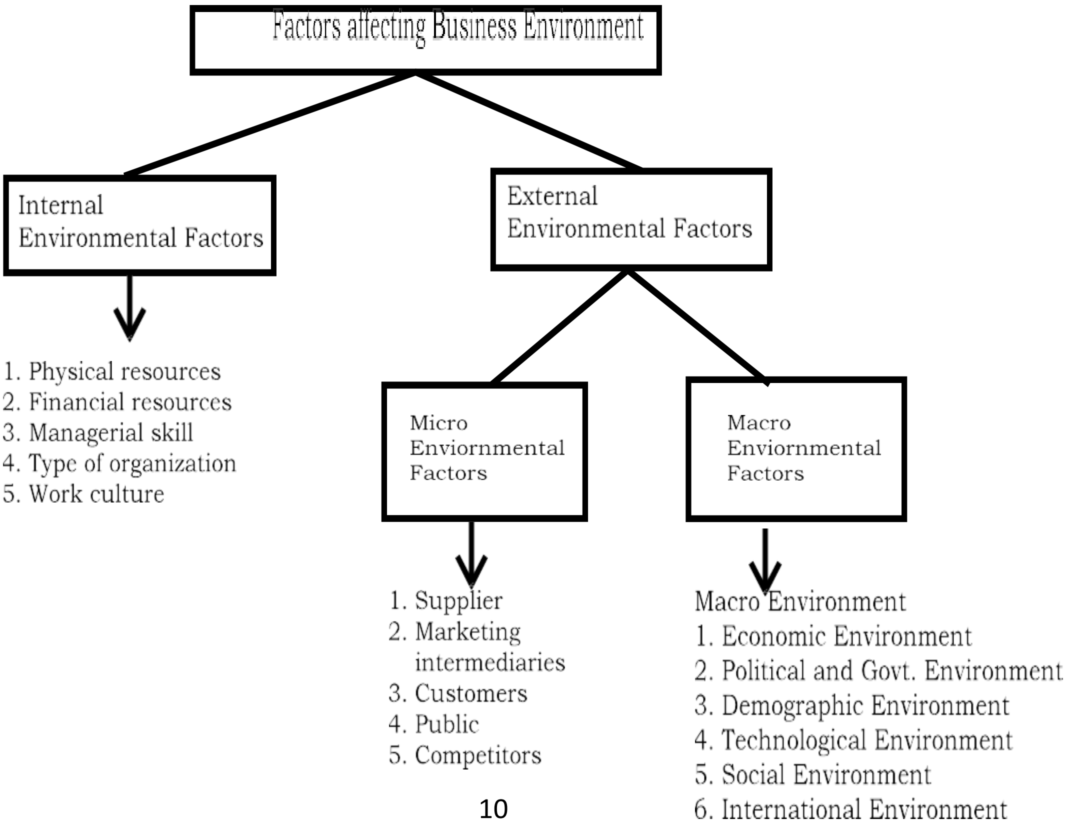
Arthur M. Weimer has defined, "Business Environment encompasses the climate or set of conditions - economic, social, political or institutional - in which business operations are conducted". Several forces operate outside a business and these all form parts of the business environment and are known as dimensions of business environment. These are discussed in this chapter.

The Business Environment can be divided into two parts:

(1) Internal Environment

(2) External Environment

The factors relating to Business Environment has been further discussed with the help of following chart



The Survival and Success of a business firm depends upon Internal as well as External factors. Although the Internal factor such as physical resources, financial resources, skill and organization affects the business but these factors are more or less controllable. It is mainly the external environmental factors which are beyond the control of a firm and the success and survival of the firm will very much depends upon the extent on its adaptability to the environment. The External environmental factors which are regarded as uncontrollable include government and legal factors, demographic factors, Socio cultural factor, geophysical factors etc.

1.3.1 Internal Business Environment: Internal Environment includes internal factors of the business which can be controlled by business. It refers to environment within the organization. Internal Environment includes 5 Ms. i .e. Men, Material Money, Machinery and Management available with business.

1.3.2 External Business Environment: The External Business environment consists of a micro environment and a macro environment. Micro environment

includes the suppliers, marketing intermediaries, competitors, customers and the Public. Whereas the Macro environment consists of such forces which affect all the factors of micro environment namely, the demographic, economic, natural, technological, political and cultural forces. The micro forces need not necessarily affect all the firms in a particular industry in the same way. For example, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When Competing firms in an industry have the same micro elements, the relative success of the firms depend on their relative effectiveness in dealing with these elements.

A Company and the forces in its micro environment operate in a larger macro environment of forces that shapes opportunities and pose threats to the company. The Macro forces such as Economic environment, Political and Government environment, Socio cultural environment, Demographic environment, Physical and Technological environment are more uncontrollable than the micro forces.

Since Independence, Indian Business Scenario has undergone a sea change. Macro environmental factors like incomes are changing, demographic factors like population size are changing. Government conditions are also changing in a positive way, India is on the threshold of business revolution. And now Indian economy is considered as one of the most dynamic economies of the world. Following points will further clarify the present business scenario

1.4 MICRO ENVIRONMENT: The forces which are close to the company and affect its ability to work constitute micro environment. It is known as operating environment of business. It includes suppliers, customers, market intermediaries, competitors and public as explained here:

1.4.1 Suppliers: - Every business enterprise requires a number of suppliers, who supply raw materials and components to the company. So multiple suppliers and reliability on supplier reduce the risk in business.

1.4.2 Customers: - A business exists only because of its customers. A company make several policies to attract and satisfy the customers like research, after sale-service, advertisement etc.

1.4.3 Market Intermediaries: - Every business enterprise may be assisted by market intermediaries which include agents and brokers who help the company to find customers. It is a link between the company and final consumer.

1.4.4 Competitors: - Business has to adjust its various activities according to actions and reactions of competitors. A business unit will have to understand the strategies framed by competitors and respond timely by making counter-strategies.

1.5 MACRO ENVIRONMENT

The term Macro Environment refers to "the forces and institutions outside the organization that can be potentially affect the organizations performance". Following are the elements of Macro Environment:

1.5.1 Economic Environment:

Economic environment of a business consists of Economic Conditions of the country, Economic Policies followed by the government and the overall economic system of the country, the economic conditions of a country, for example, the nature of the economy, the stage of development of the economy, the distribution of income and assets etc. are among the very important determinants of business strategies. In India although at present, the per capita income is not comparable with that of developed countries, but incomes as well as investments are steadily and rapidly rising. Business prospects are generally bright. Although there is a growth in the income but income disparities still exist. Despite these income disparities, lot of demand of goods exists, and thus exist the business opportunities.

Types of Economic Environment

1. Mixed Economy
2. Capitalistic System
3. Socialistic System

India follows the mixed economic system. Private and Public sector co-exist in the mixed economic system. At the time of independence, the responsibility of development of socio-economic structure was entrusted to the public sector. Thus, strategic and core areas were reserved for public sector only. And Private sector was assigned only with non-strategic areas to flourish. But now, sectors which were previously reserved for public sector are being opened up for the Private sector. Thus, providing enormous opportunities for the business to grow. Now only 3 industries are reserved exclusively for the public sector. These are atomic Energy, minerals specified in the schedule to the atomic energy (control of production our use order) 1953 and rail transport. **Indian Mixed economic** system is somewhat a **capitalistic system** with the socialistic **approach** thus, getting the benefits of both the Systems. Economic Policies of the government are directed in such a way so as to further the prosperity of the society as a whole like Promotion and establishment of new industries in the backward area location which may have many disadvantages. However, the government is providing incentives for units located in these backward areas, which may compensate them for these disadvantages, at least to some extent. Similarly, now, the government has followed the policy of restriction of concentration of Economic Power by large industrial houses and foreign concerns. But now the restriction regime is the thing of the Past. Economic Policy reforms in July, 1991 have opened up new areas for private sector and for foreign concerns. A large number of restrictions have been removed. Now India is marching towards free market economy.

The fully free market economy however is an abstract system rather than a real one. Today, even the so-called market economy is subject to a number of government regulations.

Economic policies of the government are trying to provide a Liberalised Economic system in which foreign capital is invited, and private sector is relieved from the clutches of unnecessary regulations and control so that it can grow to its maximum extent. Now the business firms whether domestic or foreign, are more inclined to invest in such a liberalized developing economy like India rather than

investing in developed countries which are more or less have reached to a saturation

level in certain respects. Now more and more multinational companies are increasing their stake in India.

1.5.2 Political and Government Environment:

Economic Policy, Economic Conditions and Economic system had a close relationship with the Political and government environment. Although Indian government followed the mixed approach but somewhat it has more or less tried to emulate the central planned economic system of socialistic countries. The government till now had followed the policy of Protectionism to Domestic companies from international competition, but now the government has liberalised the Indian economy. Now the Indian Economy is marching towards to be the part of global economy more strongly. Now free market economy forces are playing its role. More and more foreign Collaboration, joint venture, Strategic alliances are taking places. Multinational companies are feeling comfortable while investing in India. The state of multinational companies is increasing in India.

Due to these policies, the Business environment is changing. It is becoming increasingly competitive both locally and at international level. Where these liberalized economic policies are providing enormous opportunities to domestic business firms to grow internationally, at the same place, the domestic business firms are being put at risk of being swallowed by the multinational companies. The policy of protectionism followed by the government has somewhat made the domestic firm inefficient. This has happened due to lack of international competition. But now the Globalisation thrust of the government has put these domestic fi rms to the exposure of competition by the large multinational houses. But it will not be in the interest of the nation in the long run to protect these inefficient units which are eating our precious resources. It will always be in the interest of the nation to promote healthy competition. Now the Indian government is Providing motivation in somewhat other ways to promote the level of Indian companies. Given the proper environment and to become important players in the global market. Japan and Asian Tigers demonstrate that even devastated and developing economies can rapidly grow to become powerful forces to be reckoned with in the global economy.

Moreover, the changing policy environment in India is contributing to the growth of Indian large industrial houses also. Their strength to compete in international market would have been better in the changing condition, e.g., cut in the tariff rate has helped the Indian companies such as Reliance, to garner profits at existing level.

The industry and the government should be very vigilant against the government drawback of such Transformation. The drawbacks like dumping by foreign companies should be taken care of. Moreover, this transformation would have been more smooth if a substantial internal liberalization had proceeded the external liberalization.

1.5.3 Demographic Environment:

Demographic environment consists of population size, growth rate, age composition, sex composition etc. of population, family size, economic stratification of the population, educational level, language, Caste, religion etc. These all factors which represent the characteristics of population are relevant to the success of business .

India is one of the highest populated countries and still its population is growing at a rapid speed. A rapidly increasing population indicates a growing demand for many Products. The income level of large size of Indian population is very low and, moreover a significant size of Indian population is below the poverty line. Even this fact throws open enormous opportunities to the businesslike providing housing facilities, medical facilities, education facilities etc. to the people. One more fact, is the size of Indian middle class which is larger than the total population of any other country except China and U.S.A.

High population growth rate also indicates an enormous increase in labour supply. This is an added advantage to the Business firms operating in India, as compared to developed countries, in which, due to shortage of labour supply, capital intensive techniques are being followed.

Another important fact of the population is that the most of the Indian population lives in of rural areas. This has led to the rapid growth of rural market. Now most of the Business started directing their towards tapping of rural market. This has opened up now opportunities to the business world. Business firms are inventing new products for meeting the demand of rural people.

Now even the financial institutions have increased their sphere of activities to rural areas. More and more banking and credit facilities are being provided to the rural people. They have contributed to the demand of additional goods and thus contributing to additional opportunities to the business. Credit cards, ATM, Credit limits are now not the new names to the rural people. This has revolutionalised the Indian Business scenario.

Occupational structure of the population in the country is changing. This decades, as like any other underdeveloped country, Agriculture sector has remained the primary sector. But now Service sector is growing and throwing open enormous entrepreneurial opportunity in the service sectors. The growth of service sector will help the agriculture sector to shed away the additional labour force i t is accommodating. This will help in rising the income level thus contributing to more demand of Products. This will open up new vaster of opportunities to the business firms.

1.5.4 Technological Environment:

Till decade, the Indian government has followed the policy of Protectionism. It was more like a closed economy thus restricting contracts with the global economy.Imports were restricted which prohibited the free flow of Technology from and to the outside world. Although Technical advancement have been made over the years but still in many industries, Primitive and labour-intensive methods were being followed, perhaps this was due to the availability of abundant labour and lack of international competition.

Now, the Indian economy has been Liberalised Foreign collaboration, merger, acquisition, and Direct investment of foreign capital is also taking place. This has resulted into inflow of foreign Technology. Now Indian business firms can afford advanced Technology and advance equipments, and thus can compete with the foreign firms. These Liberalised import procedures and cut duties have further boosted up the Indian business scenario.

To Promote entrepreneurship in risky and high Technological projects, the government is promoting venture capital. Even now the foreign venture capital firms have been permitted to do business in India but with prior permission from Foreign Capital Promotion Board. Promotion of venture capital firm has added a new dimension to the Indian business firms.

Overall, Indian business firms are not too far behind in the Technological front. And now they are competing with the best in the world.

1.5.5 Social Environment:

Social environment encompasses the social responsibility of the business and the alertness or vigilance of the consumers, and of society at large. In India, more and more consumers and society at large are becoming aware of their rights. Large number of consumer protection societies are cropping up. And even law has been enacted to protect the rights of the consumer. Significant developments have led to the wide acceptance of its social responsibilities by the business. Now the business firms are being entrusted with the responsibility of improving the quality of life in our society. And the business firms are responding to the needs and demands of the society at large.

1.5.6 International Environment:

Due to Liberalisation and globalisation measures, Indian Economy is now closely linked to the trends in the international market. The Indian firms which are

Importing or Exporting to the foreign market are exposed to the risk and opportunities of the global trends. As like depression of 1930 in U.S.A., had started depression in the world market.

1.5.7 Natural Environment:

Geographical and ecological factors such as natural resource endowments, weather and climate global context, part facilities, etc. are all relevant to business. Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influencethe location of certain industries. For example: (1) Industries like cement manufacturing with high material index tend to be located near the raw material source. (2) Climate and weather conditions affect the location of certain industries like the cotton textile industry. (3) Topographical factors may affect the demand pattern.

(4) Textile industry located near coastal area. And now, the depletion of natural resources, environmental pollution and disturbance of the ecological balance have caused great concern.

Self-Check Exercise

Ques.1. Discuss the factors relating to Internal Business Environment.

Ques.2. Discuss the factors relating to External Business Environment.

1.6 CHANGING DIMENSIONS OF BUSINESS ENVIRONMENT IN INDIA

Before 1991, Indian economy was a closed economy, strictly under the control of government and dominated by public sector, leading to lack of competition. During 90's the economy witnessed the worst international financial crisis and the Government of India had to declare liberalization and globalization of the Indian economy to deal with the crisis. This led to significant changes in almost all the sectors of the economy.

1. Changes in the economic environment:

1. Liberalisation i.e., shifting of economy from a closed economy to a free market economy.
2. Shifting from a socialist ideology to a capitalistic ideology.
3. Shifting from protective environment to a competitive business.
4. Free entry and exit of foreign brands in India.
5. Increased inflow of Foreign Direct Investment through incentives and policy liberalization.
6. Shifting from ISI to ISO quality standards.
7. Shifting from public sector to private sector.
8. Greater emphasis on the development and promotion of service sector for the growth of Indian economy.
9. Considering guidelines from WTO, IMF and IBRD while formulating domestic and foreign economic policies.

2. Changes in Legal Environment:

(a) Abolition of all restrictive provisions of MRTP Act (Monopolies and Restrictive Trade Practices).

(b) Replacing FERA (Foreign Exchange Regulation Act) by FEMA (Foreign Exchange Management Act).

(c) Enactment of Consumer Protection Act.

(d) Enactment of Environment Protection Act.

(e) Replacement of Company Act 1956 with a new legislation. Enactment of SEBI.

(f) Abolition of IDRA Act (Industrial Development and Regulation Act).

3. Changing Political Environment:

India is having a multi-party-political system comprising of large number of national and regional political parties. These regional and state level political parties play an important role in the formation of central government of India. All major political parties have their own philosophy for development of the country. The play objectives change every five years depending upon on the current political party in power. Important aspects of changing political environment in India are:

(a) Continuous political uncertainty.
(b) Coalition governments at the centre.
(c) Increasing role of regional and state level political parties in national politics of the country.
(d) Reducing role of government in the economic affairs of the country.
(e) People have become more politically conscious and have developed interest in politics and political processes.
(f) Growing impact of international politics.
(g) Increasing influence of politicians on economic decision-making and policy formulation.

4. Changes in Social and Cultural Environment:

(a) Change in eating habbits, tastes and preferences of the people.
(b) Emergence of a large middle class.
(c) Shifting from a joint family system to nuclear families.
(d) Improvement in standard of living of people.
(e) Improvement in status of women in society because of economic independence.
(f) Change in occupational profiles with larger percentage of people joining service industry.
(g) Birth rate and death rate have decreased.
(h) Growth of education through privatisation.
(i) Declining social values.
(j) Business firms are becoming more socially responsible.
(k) Growing concern for protection of human rights and consumer rights.

5. Changing Technical Environment:

The most major changes in 21st century is in the field of technology. More and more industrial and technological growth has led to improvements in both quality and efficiency of products and services. Even the jobs are becoming more scientific and technical requiring only specialized and skilled personnel.

Significant changes in this direction are:

(a) Complex division of labour.
(b) Specialization in every field.
(c) Increase in competition.
(d) More stress on research and development.
(e) Biological engineering and genetic engineering is gaining importance.
(f) Industry is offering multi-utility products and services.

6. Changing Physical and Natural environment:

The enactment of Environmental Protection Act and increasing role of non- government organisations and society in general has created many problems for the industry. Increasing pollution of air, water and soil has created markets for certain new products such as mineral water, frozen foods, cosmetics etc. Significant changes in this field are:

(a) Ecological imbalance.
(b) Unhealthy living conditions.
(c) Increase in urbanization leading to a fall in the area covered under cultivation.
(d) The judiciary is also actively restraining the corporate sector by giving judgments in favor of preservation of the natural environment.

7. Changing International Environment:

(a) Growing importance of international bodies, WTO, IMF, UNO etc.
(b) Increasing pressure of international politics.
(c) International bodies are framing policies and programs for member countries to follow.

Every businessman has to continuously watch and monitor all these environmental factors in order to frame policies and strategies for the future.

1.7 SUMMARY

At present Indian business scene is full of expectations with the globalization and Liberalization measure. Indian business is becoming more integrated with the global business. Now world level Technology is at its feet. Government is playing a supportive role. And in more Congenial environment, Indian business is making a steady progress. It will help Indian Economy to be one of most dynamic economy of the world.

1.8 GLOSSARY

1. Internal Environment: It covers internal factors of the business which can be controlled by it.
2. External Environment: It consists of external factors which are beyond the control of business.
3. ATM: Automatic teller machine.
4. Business: Activities which are carried on to earn profit.
5. Intermediaries: Distributors, wholesalers, retailers.

1.9 ANSWERS TO SELF CHECK QUESTIONS

Ans.1. Factors affecting internal Business Environment

1. Physical Resources
2. Financial Resources
3. Managerial skill
4. Type / Nature of organization
5. Work culture

Ans.2. External Environment based factors are as mentioned below:

(A) Micro Environment Factors

1 Suppliers
2 Marketing intermediaries
3 Customers
4 Public
5 Competitors

(B) Macro Environmental factors

1. Economic Environment
2. Political and Government Environment
3. Demographic Environment
4. Technological Environment
5. Social Environment
6. International Environment
7. Natural Environment

1.10 EXERCISE

(A) Short Questions:

Q1. What do you mean by micro environment?

Q2. Distinguish between internal and external environment.

Q3 Write a short note on: -

(a) Marketing intermediaries

(b) Demographic Environment

(c) International Environment

(B) Long Questions:

Q1 What is business? How does the business of today differs from that of four or five decades ago?

Q2 "Today a firm can ignore environment at its own Peril". Discuss the statement with the help of example from real business world.

Q3 What do you mean by business Environment? Outline and explain different environmental factors that create a profound impact on business.

1.11 RECOMMENDED READINGS

1. Business Environment By-Francis Cherulinum
2. Essentials of Business Environment By-K Aswathappa.
3. Business Environment By-Rosy Joshi-Sangam Kapoor

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SEMESTER 1

COURSE: BUSINESS ENVIRONMENT

UNIT 2: SOCIO-CULTURE ENVIRONMENT

STRUCTURE

2.0 OBJECTIVE

The objectives of this chapter are to introduce the reader with the concept of socio-culture environment, factors, importance of socio-culture environment and various dimensions of socio culture environment. The aim of the chapter is to make reader familiar about such socio culture forces which are an integral part of Business Environment.

2.1 INTRODUCTION

Social and cultural factor affecting business include belief systems and practices, customs, traditions and behaviours of all people in a country, fashion trends and market activities influencing actions and decisions. Socio-cultural perspective is one of the most important factors influencing decision of marketing managers and strategic goals of companies entering new foreign markets.

2.2 MEANING OF SOCIO-CULTURE ENVIRONMENT

The socio-cultural environment refers to trends and developments in changes in attitudes, behaviour, and values in society. It is closely related to population, lifestyle, culture, tastes, customs, and traditions. These factors are created by the community and often are passed down from one generation to another. Socio-cultural environment continues to be dynamic and changing. Its factors also vary between community groups. Therefore, companies need to monitor these trends and consider their strategic implications. The word 'socio-culture' has been derived from two words society and culture. Society and Culture are **both external factors** (beyond anyone's control) that have a direct effect on business.

2.3 FEATURES OF SOCIO-CULTURE ENVIRONMENT

1. Culture is dynamic and keeps on changing with time.

2. Culture is bounded by rules that the people of a locality, community, region, or nation follows.
3. Culture is also determined by the groups or unit that a person stays in.
4. Culture is also based on the survival of the people over the years.
5. Culture is a reflection of attitudes, values, beliefs, norms etc. that has occupied the people's mind over a long period of time.
6. Culture of the people tends to change over time based on their needs and requirements.

2.4 SOCIO-CULTURE FACTORS

1. Culture: Individual values and habits can change individuals through contact with specific cultures.
2. Habits: that represent how to behave in response to a given situation.
3. Beliefs and values: Belief refers to how we feel about something or someone. Meanwhile, values are relatively long-standing beliefs and serve as guidelines for culturally appropriate behaviour.
4. Number and growth of population: Increasing the population indeed provides more labor and demand for goods and services. On the other hand, it can lead to social problems such as crime and poverty, especially when employment is inadequate.
5. Age composition: In some countries, productive age populations dominate and provide opportunities for economic growth and demand for goods and services. However, countries like Japan, the elderly population dominates. It presents opportunities as well as challenges for the economy and companies there.
6. Geography: Populations may be concentrated in some geographical regions, for example, on arable agricultural land or in industrial areas.
7. Ethnicity: A country, like Indonesia, consists of a variety of different ethnic and ethnic groups. It has implications for various aspects such as language, culture, habits, and tastes.
8. Household and family structure: The population of a community can be broken down based on the number of children.
9. Employment: for example, the composition of white-collar workers vs. blue-collar workers.
10. Wealth and social class: People from different social classes can have different values that reflect their position in society.

2.5 THE SOCIO-CULTURE FACTORS THAT INFLUENCE A BUSINESS

1. Level of income - Level of income of the people is highly dependent on the type of work they do. It is used by the organisations to devise their pricing strategies for the target group of people or customers.

   For example: If a company serves in a country or region with very low levels of income per person, it needs to keep the prices of the goods accordingly so as to create a market for their goods in that country or region.

2. Level of education - Level of education also determines the survival of the business in a culture.

   For example: Print media for advertising is possible in a culture where the people are educated.

3. Demographics - Age group of people in the society helps to know what kind of product is to be sold in a given market.

   For example: A society with more number of infants will serve as a better market for infant products such as baby soap, baby diapers, toys, etc. On the other hand, society with the majority of old-age people will serve as a market for products such as walking sticks, etc., which are needed by old people.

4. Sex Ratio - The number of men and women ratio is also a discriminant factor that is a deciding point for the business about the products that will work well in the market.

   For example: Society with a huge number of men will serve as a good market for men's grooming products. Whereas, if the society has more of the female population it will serve as a better market for beauty products and cosmetics.

5. Religion - Religious beliefs of the people also help the business to make decisions and policies weather to explore the area as a market or not.

   For example: It can be easily seen that coffins are sold more in the area where there are more Christians have the ritual of burying the dead bodies whereas for Hindus bodies are burned after death.

6. Eating habits - The dietary requirements and eating habits of people of a region highly dependent on the geography of the region and this factor also plays a very big role in the sustainability of a business.

For example: If the people of a region largely consume food grains, a company serving that region needs to be very particular about the range of their products. People there probably would not consume processed foods. So a food processing company would not be able to capture the market there. Examples where socio-cultural factor led to important decisions regarding their brand: -

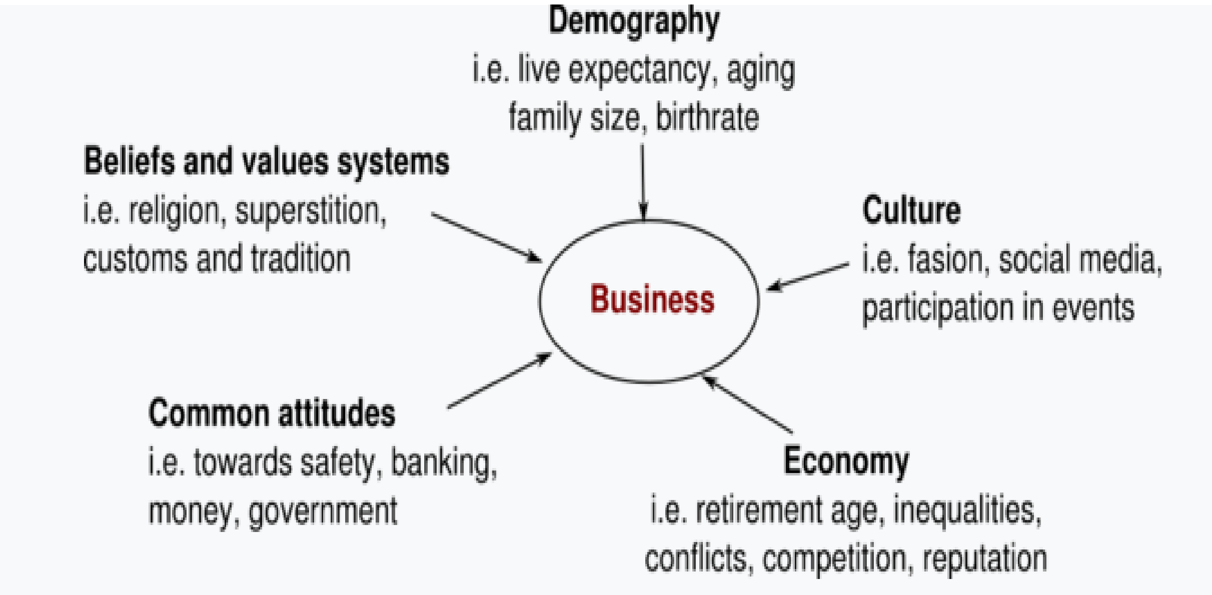
1. McDonald's vegetarian variants were launched only after it was launched in India for it came to know that India is a country with a large proportion of vegetarian customers.
2. Many of the multinational companies outsource their work to India because of the availability of cheap manpower in India that's why a lot of BPO and KPO find their hub in India.

Thus, socio-cultural factors although not in the control of any company, plays a very important role in the decision making and all the companies keep it in mind while making any decision in the business unit.

2.5.1. SOCIAL FACTORS AFFECTING BUSINESS

- social classes and their influence on the society,
- average disposable income level
- wealth of people
- Economic Inequalities
- level of education
- Access to education
- Level and access to health-care
- Health consciousness in society (smoking, drinking, drug use, safe driving, etc.),
- Buying habits and Customer preferences,
- average retirement age
- personality of average customer
- Reputation of company in society,
- conflict within society,

2.5.2. CULTURAL FACTORS AFFECTING BUSINESS



- Fashion trends.
- Lifestyle.
- Social media influence (blogging, etc.) vs traditional media (press, TV, radio).
- Dominant communication technology in social groups.
- Participation in cultural events.
- Willingness to pay for tickets.
- Popular actors, music styles, design forms.
- Creativity of people.
- Relative population of local (folk) artists vs. global imported culture.
- Various other determinants of culture.

2.5.3 SOCIO-CULTURE FACTORS AND DEMOGRAPHY

- population growth rate,
- birth control regulations and incentives,
- age distribution
- life expectancy rate,
- sex distribution (differences between number of men and women in society),
- average family size and family structure,
- relative influence of minorities in society,
- immigration rate,
- emigration rate,

- social diversity (of income, education, race, gender, etc.),

2.5.4. BELIEFS AND VALUE SYSTEMS WITHIN SOCIETY

- majority and minority religions,
- influence of religious leaders on social behaviours,
- role of religion as a binding/dividing factor in society,
- dominant beliefs in society,
- eating habits connected with religion,
- belief in superstitions (Friday 13th, 13th floor in buildings, etc.) and myths,
- role of science in relation to religion,
- customs, traditions during holidays (worship days),

2.5.5. COMMON ATTITUTES IN SOCIETY

- Attitudes toward banking, saving money and investing,
- Attitudes toward ecological products, recycling, global warming, etc.,
- Attitudes toward renewable energy sources, green products,
- Attitudes toward imported products and services, foreign investment etc.
- Attitudes toward work and career, possibility of development,
- Attitudes toward leisure and retirement,
- Attitudes toward learning and self-development,
- Attitudes toward others (diverse people, counties, companies, etc.),
- Attitudes toward safety (police, military, etc.) and privacy,
- Attitudes toward ethical/unethical behaviours and corporate social responsibility.
- Attitudes toward management practices.

2.6. SUMMARY

Changes in several sociocultural factors may take years. However, some of them are changing faster and more dynamically like technological developments. Sociocultural factors continue to change. That has implications for the opportunities and threats that companies face. And finally, these changes also determine the company's strategy that the company must choose. Social and cultural change challenges companies to find more effective ways to adapt to stay ahead of their competitors. For example, changes in age composition affect changes in patterns of demand for goods and services. As the elderly population begins to dominate, the need for health services and pensions increases. Furthermore, changes in age composition also affect recruitment policies. Companies must face more elderly with reduced productivity. Different sociocultural factors also influence business practices, policies, and activities. Culture influences taste and lifestyle.

Therefore, culture also influences the types of products and services that businesses must offer. Also, human resource management may need to overcome cultural differences in recruitment. For example, some ethnic minorities have different body language, which may be difficult for interviewers to interpret.

2.7 GLOSSARY

Socio-culture environment: Social and cultural factor affecting business include belief systems and practices, customs, traditions and behaviours of all people in a country, fashion trends and market activities influencing actions and decisions.

2.8 EXERCISE

Q.1. what do you understand by socio-culture environment?

Q.2. How socio-culture environment affect business environment?

2.9. RECOMMENDED READINGS

- Business Environment By-Francis Cherulinum
- Essentials of Business Environment By-K Aswathappa.
- Business Environment By-Rosy Joshi -Sangam Kapoor

M.COM

SEMESTER-I

COURSE: BUSINESS ENVIRONMENT

UNIT 3: CORPORATE SOCIAL RESPONSIBILITY AND POLITICAL ENVIRONMENT

STRUCTURE

3.0 OBJECTIVE

Corporate Social Responsibility is one of the most important issues in the world. As we are moving forward in our life, we are becoming aware of our responsibilities and rights. A society which provides everything to the organization to prosper is impacted by the actions of the organization. Without a society an organization cannot prosper in their activities because a society provides labour, capital, entrepreneurship and land. So, it is the responsibility of the organization to fulfill the commitments made by them towards the society. This chapter aims at better understanding of responsibility of corporates towards society as well as rights of society. This chapter will help the reader to understand the concept of Corporate Social Responsibility (CSR) and its benefits to the corporates and different views presented by different authors regarding Corporate Social Responsibility.

3.1 INTRODUCTION

Corporate Social Responsibility is a concept where by companies decides to do something good for the betterment of the society. It is a responsibility which a corporate feel towards its society. Because a society is not merely a word but a group of whole worlds which includes our environment, living organisms, and ecosystem. All these things play a very important role in the success of the organization. If any organization has all these things, it means they are enjoying a competitive advantage over those organizations which do not have all these things. So it is the moral responsibility of the organization to pay back to the society by fulfilling the commitments towards them. A corporate has a give and take relationship with the society so if today corporate will invest in the society in future they will get higher returns on their investment. Today India is moving on the path of development but social issues like poverty, hunger, rape, labour exploitation, drought, food adulteration, child labour, pollution, global warming, inflation, hoarding, etc. are increasing at a very faster rate on the other hand. The activities of the corporates affecting the environment in a very negative way that our ecosystem has lost its balance. So if a corporate is responsible for this then corporate should make an efforts for removing these social illness from the society by providing quality products to customers at reasonable price, by providing proper working conditions to employees, by establishment of women harassment cell, opening of schools and colleges, etc. So, our government has made an effort to make realize the corporates for their responsibilities towards the society by introducing mandatory CSR in Companies Act, 2013. Due to this introduction, the focus of corporate has moved from “Single Bottom Line-earning profits” to triple bottom line representing economic profits, social and environmental dimensions. TATA and Birla are some companies which are practicing CSR even before the mandatory introduction of CSR in Companies Act, 2013.

3.2 MEANING AND CONCEPT

Corporate Social Responsibility is the fulfillment of commitments made by the organization towards all the stakeholders which are the part of the organization in some way or other. In other words, the organization has to fulfill its responsibilities not only towards shareholders but also towards employees, supplier, financial institutions, shareholders, customers, etc.

European Commission (2002) defines CSR as "A concept where by companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis, as they are increasingly aware that responsible behaviour leads to sustainable business success."

Carroll (1979) defines "The Social Responsibility of business encompasses the economic, legal, ethical and discretionary expectations that society has of organizations at a given point in time."

Friedman (1962) defines "There is one and only one social responsibility of business- to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

All the definitions talks about the responsibility of corporates towards all its stakeholders which are impacted by the actions of corporates in some way or other.

3.3 APPLICABILITY

The provisions of CSR applies to every company which is satisfying any of the following criteria according to section 135(1) of companies Act, 2013 then it **must spend at least 2% of their average net profits made during the three previous financial year towards CSR in current financial year.** The criteria are as under:

If any company has

Net worth of rupees five hundred crore or more, or
Turnover of rupees one thousand crore or more, or
Net profit of rupees five crore or more.

If any company has not completed the period of three financial years since its incorporation but it satisfies the criteria mentioned in section 135(1) then companies have to spend at least 2 % of the average net profits made during immediately preceding financial years.

*****Profit Before Tax (PBT) is used for computation of net profits under section 135 of the act.

3.4. CSR FRAMEWORK

The composition of the CSR Committee for various types of companies is as under:

Listed Companies: Three or more directors, out of which at least one shall be an independent director.

Unlisted Public Companies: Three or more directors, out of which at least one shall be an independent director.

However, if there is no need of any independent director in the company then two or more directors.

Private Companies: Two or more directors, no need of independent directors.

Foreign Companies: At least 2 persons out of which:

According to clause (d) of sub-section (1) of section 380 of this act.

Another shall be nominated by foreign company.

*If the amount to be spent on CSR by a company is not more than fifty lakh rupees then it is not mandatory for companies to form CSR committee in that case all the functions of CSR committee shall be discharged by the Board of Directors of the company.

3.5. FUNTIONS OF CSR COMMITTEE

- Formulate and recommend CSR policy to the Board.
- Suggest the amount of expenditure should be incurred on CSR activities.
- Monitor the CSR policy time to time.

3.6. RESPONSIBILITIES OF THE BOARD REGARDING CSR PROVISIONS

- Approve CSR policy
- Disclose the content of this policy in the report and ensures the same will be placed on company’s website.
- Ensures the utilization of disbursed CSR funds.
- It will also ensure that the company will spend each year at least 2 % of average net profits made during three immediately preceding financial years regarding CSR.

3.7 DIFFERENT MODES OF INCURRING CSR EXPENDITURE

Activities route: It is a direct route where by companies undertake CSR programmes as per Schedule VII of the act by itself or by an implementing agency.

Contributions to fund routes: It allows the companies to contribute in various funds as specified in Schedule VII of the act like Clean Ganga Fund, Swachh Bharat kosh, PM CARES FUND, etc.

Contribution to incubators and R &D projects: It is specified in Schedule VII of item no. (ix).

3.8 ACTIVITIES PRESCRIBED IN SCHEDULE VII OF COMPANIES ACT, 2013

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:

(i) eradicating hunger, poverty and malnutrition, 2 [promoting health care including preventive health] and sanitation 3 [Including contribution to the Swatch Bharat Kosh set-up by the Central Government for the promotion of sanitation] and making available safe drinking water;

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water 4 [including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents, 5 [Central Armed Police Forces (CAPE) and Central Para Military Forces (CPMF) veterans, and their dependents including windows;

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or 6 [Prime Minister’s Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or] any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs)

(x) rural development projects.

(xi) slum is development. Explanation. — For the purposes of this item, the term ‘slum area’ shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

(xii) disaster management, including relief, rehabilitation and reconstruction activities.

3.9 BENEFITS OF CSR

There are so many benefits available to the corporates by practising CSR activities are as under:

1. **Develop Brand Loyalty:** Corporate Social Responsibility is not an activity towards only shareholders but also towards many stakeholders such as customers, suppliers, environment, financial institutions, etc. A corporate by performing CSR builds a strong relationship with customers which makes the customers fully satisfied and don't let this satisfaction not to switch over the competitor's product and customers are ready to take products even at higher prices for higher quality of products and services. Sales of the companies will increase and they will get their break-even point at an early stage (their fixed cost will be covered early). The elasticity of their products will become inelastic.
2. **Attract low-cost Capital:** By performing CSR activities, a company builds a good reputation in the market which helps the company to take capital from the market even in the depression period. All the financial institutions build a trust on companies and they will arrange capital in case of need of companies at a very lower rate. Companies can take loan from public in the form of public deposits, debentures so that there will be no dilution of ownership.
3. **Smooth supply of Raw Material:** Raw material will be supplied by the supplier smoothly even in the period of shortage of raw material at reasonable rates if a company practice CSR activity regarding suppliers. For example, company will make payment to suppliers on time then company will also get financial benefits such as discounts.
4. **Free Publicity:** A company practicing CSR need not invest more in advertisement campaigns as their activities will be covered by the media themselves. In this way corporate will get the benefit of free advertisement made by media by positive publicity.
5. **Competitive Advantage:** A company practising CSR will attract potential customers as well as customers of competitors which would remove the competition from the market and it leads to increase the sales of the company and profits will also gain momentum. Market size of the company will also increase. So, a company which practice CSR always gain competitive advantage over those who do not practice CSR activities.
6. **Benefit of Economies of scale:** By practising CSR activities, the customers of the company will increase which leads to the demand of products. A company needs to do large production to meet the demands of the customers. Production on large scale use the resources in an optimum manner, no resources will be wasted and in this way a company will get benefits of economies of scale.

7. **Creation of Synergy:** Synergy means when 2 + 2 is not equal to 4 but more than 4. So, if a company practice CSR, then synergy will be created as everything will run in the organisation smoothly. It will lead to increase in the value of firm and goodwill of the company also increases.
8. **Less interference of government:** If a company will practice CSR towards government like they will not evade the taxes and pays their dues on time then government will not interfere in the functioning of the companies and work not be hindered.
9. **Creation of Human Resource Asset:** A company practicing CSR towards its employees then employees will be satisfied and they will be more committed towards the organizational goals. Absentism will be reduced to zero. The performance of the employees will increase. If the employees will be satisfied then a new asset will be created in the organisation that is Human Resource asset. If any organisation has this asset, then no one will compete with that organisation because this asset is the most powerful instrument of the company which can be created by the company itself by providing trainees not by purchasing from the market. Talented persons want to be a part of only those organizations which fulfill their commitments.
10. **Increase in the market price of shares:** A company practicing CSR towards its shareholders will lead to the demand of shares in the market. If the demand of shares is more than the supply of shares then their prices will increase. This will happen if a company pays dividend on time, use their capital in fruitful investments.
11. **Financial Benefits:** A company will get financial benefits like increase in sales, low cost of capital, profits maximization, increase in value of firm, discounts on purchases, etc.

3.10 CHALLENGES FACED BY COMPANIES IN PRACTISING CSR

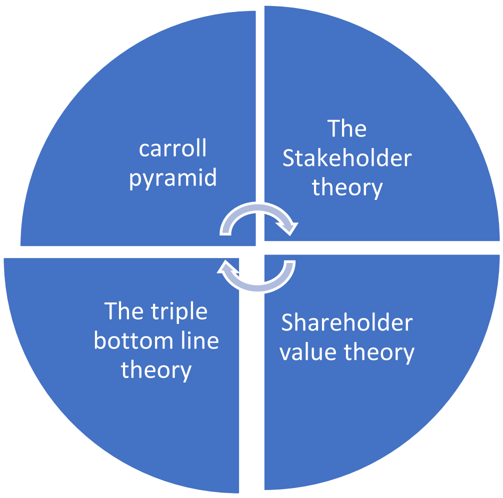
There are some challenges which are faced by companies in implementing CSR practices are as under:

1. **Increase cost:** Not all CSR activities helps in increasing profits as for small companies it leads to increase in their cost which affects the profits in a very negative way. Small organisation can't bear the cost of CSR activities. The cost incurred in CSR towards environment is very high and affects the profitability of the companies.
2. **Lack of interest of NGOs:** Sometimes companies take the help of implementing agencies such as NGOs which further do not take interest in CSR activities, due to this the expected results of CSR activities will not come. It further leads to capital erosion.

3. **Lack of knowledge:** Companies practising CSR do not have proper knowledge regarding CSR guidelines due to this companies make wrong policies of CSR which leads to wastage of time, money as well as resources.
4. **Lack of commitment of Top-level management:** Sometimes Top-Level Management do not take interest in CSR activities as they think it is not a key activity that they should spend their worthy time on it. So to fulfill the requirement of Companies Act, 2013 they pass this responsibility to implementing agencies such as NGOs which further do not take interest in CSR practices. Also, at the time of distributing the funds regarding CSR they will hesitate as they think it is just only the wastage of time, money as well as important resources of the organisation.
5. **Publicity stunt:** Companies practising CSR only for the sake of media coverage not for the betterment of society. Due to this the expected results do not come.

All these are the challenges which comes in the path of implementation of CSR activities on an voluntarily basis but they are performing just due to mandatory introduction of CSR in companies Act, 2013 not voluntarily. So, there should be a motivating factor which remove these challenges and change the perception of companies regarding CSR. For this Seminars, Conferences should be organized in order to explain the importance of CSR activities as well as how to relate them with the objectives of the organisation.

3.11 THEORIES OF CSR



There are different viewpoints regarding CSR which comes in the form of CSR. Some authors support CSR activities and motivates the companies for practising CSR but at the same time there are some authors which do not support CSR practices. So, there are the following theories regarding CSR:

Carroll CSR Pyramid: Carroll has propounded CSR theory by giving a pyramid. According to him Company should practice CSR in a order given by carroll.

Economic Responsibility: According to him first of all a company should fulfill his economic activity before moving to other responsibilities. Companies should make an effort to increase the profits of companies because profits are necessary for the survival and growth of the companies. Without profits, no company can survive in the long run.

Legal Responsibility: It is the second stage of Carroll Pyramid. After fulfilling economic responsibilities, a company should fulfill the legal responsibility. Companies have to prevent themselves for doing illegal activities such as labour exploitation, child labour, food adulteration, hoarding, tax evasion, money laundering, manipulating the accounts of the companies, etc. Companies should obey the rules and regulations prevailing in the country.

Ethical Responsibility: It is the third stage of Carroll Pyramid. According to him company should behave ethically as companies should do something good for the well-being of the society.

Philanthropic Responsibility: It is the last stage of this Pyramid. It is a voluntary activity taken by the companies to participate in the social activities which is not mandatory by law but it is the inner desire to do something for the society as society sacrifices for the companies.

The Triple Bottom Line Theory: The founder of this theory is John Elkington. This theory incorporates three dimensions of performance: Economic, Social and Environmental.

Economic dimension: Companies has to make efforts for not high profits but for continuous profits in the long run. For this companies have to scan the internal and external environment of the business.

Social dimensions: Companies have to pay attention towards the social affairs along with financial affairs. They need to collect data from society regarding the problems of the society such as unemployment, education, poverty, etc. and according to the priorities of the society companies have to work on them.

Environmental dimensions: Companies should focus on the environmental issues as due to the activities of the companies the environment has been impacted negatively. So, companies should use the alternate source of energy like solar energy, wind energy instead of coal for electricity purpose in the industry. Companies should use renewable source of energy instead of nonrenewable source of energy. Equipment must be implemented in the industries for the disposal of waste material so that air and water pollution can be prevented as it leads to global warming. So companies should focus on this dimension also.

The Stakeholder Theory: According to this theory, companies should fulfill the responsibilities towards each and every member of the organisation which is impacted by the actions of the organisation directly or indirectly. They have to take care of all stakeholders like customers, suppliers, financial institutions, employees, directors, women, etc.

Shareholder Value Theory or Fudiciary Capitalism: According to this theory the prime responsibility of the corporates to make profits and gives dividend to shareholders. They only need to fulfill the responsibility towards only shareholders not stakeholders. This theory is inspired by the views of Friedman as according to him the executives of the business is to make higher profits for their owners in the legal framework without any fraud.

3.12 Summary:

Corporate Social responsibility is fulfilling the responsibilities towards each stakeholder. CSR is mandatory for all those companies which fulfills the criteria of Act. There are so many benefits which companies avail by practising CSR as increase in sales, brand loyalty, creation of Human Resource Asset, attract capital, less interference of government, creation of synergy,etc. But there are some challenges which are faced by companies in implementing CSR as lack of knowledge, lack of interest, lack of resources, etc. There are different theories presented by different authors present their different views regarding CSR.

3.13 Glossary:

CSR: Corporate Social Responsibility

Single bottom line: it means focus on earning profits only.

Triple bottom line: profits, social, environment dimensions

Stakeholder: It includes suppliers, employess, customers, shareholders, etc.

3.14 EXERCISE

(A) Short Questions

Q. 1: Explain the concept of Corporate Social Responsibility?

Q.2: Explain the criteria as well as amount spent on CSR according to Companies Act,2013?

Q.3: Explain the functions of CSR committee?

Q.4: Explain the composition of CSR committee for different types of companies?

Q.5: Explain the functions of the Board regarding CSR provisions?

(B) Long Questions

Q.1: Explain the theories of CSR?

Q.2: Explain the benefits and challenges of CSR?

Q.3 : Explain the activities specified in Schedule VII of companies Act, 2013?

Q.4: Explain the different modes of incurring CSR expenditure?

3.15 RECOMMENDED READINGS

- Corporate Social Responsibility in India : By Sanjay Aggarwal
- Corporate Social Responsibility: Doing the : By Philips Kotler
- Most Good for your Company and Your Cause

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SEMESTER-1

BUSINESS ENVIRONMENT

UNIT-4: POLITICAL AND LEGAL ENVIRONMENT OF BUSINESS

STRUCTURE

4.0 OBJECTIVES

Objectives of the chapter are to give knowledge about the political and legal environment which affect the functioning of a business. The legal environment includes the laws passed by the government as well as the decisions rendered by the various commissions and agencies at every level of the government. And the political environment includes the policies of present government. This factor consists of external factors such as political stability and peace in the country. The foresight of the ruling party and its perspective towards business. Needless to say, the political environment is easily the most important dimension of the business environment. After reading the chapter reader will be able to know the political and legal environment which are important factors, which help businessman for survival of any business.

4.1 INTRODUCTION

The Economic Policies have depended upon the political policies of a political party. In this way political environment of a country has great impact on the business houses. Important economic policies such as industrial policy, foreign capital policy, fiscal policy and import policy are often political decisions which established the great impact of political and legal environment on the business houses. A stable and dynamic political environment is indispensable for business growth.

4.2 ELEMENTS OF POLITICAL ENVIRONMENT

The political institutions i.e., legislature, Executive and Judiciary plays important role in economic policies as well as in the development of country whereas the legislature is vested with most vital powers like policy making, budget making and executive control. The decisions of the legislature affect activity of business houses. Legislatures have to check that profit earning is not only justified but also whether the activities of business houses are in a manner beneficial to the society. The other important political institution is the Executives of the actual law and policies enforcing agency. What the legislative made in their chamber actually come in force in the hands of executives. In the way the functions of executive also effect the economic development. Sometimes the legislature makes some policies but there is conflict between the executives and business houses about implementation. In case of such conflicts, the judiciary, the third important political institution resolves the conflicts. It is the power of the judiciary to settle legal disputes that effect business considerably. It is therefore necessary to discuss about the impact of political and legal environment on the economy.

4.3 ECONOMIC ROLE OF GOVERNMENT

Depending upon the nature and stage of development on the economy, the behaviour of the private sector, the political philosophy, social attitudes, administrative system etc., it is a universal phenomenon that state control economy. In the modern era, two most powerful institutions in the society are ‘business’ and ‘government’ which meet on common ground or otherwise together they determine the public policy both foreign and domestic for a nation. But four corner development of a country is only possible if the government plays significant role in the economy of a country. Normally government plays four important roles in an economy i.e.

1. Regulatory Role
2. Promotional Role
3. Planning Role
4. Entrepreneurial Role

1. Regulatory Role: Government regulation of the economy may be broadly into two parts direct and indirect control. The reservation of industries to small scale, public and cooperative sector, licensing system, import and export regulations, the subsidies for different sectors are some examples of regulatory measurements of the governments.
2. Promotional Role: For the development of economy, state/government will have to assume direct responsibility to build up and strengthen the necessary development of infrastructure i.e., transport, power, finance, marketing and institutions for training and guidance along with other promotional activities.
3. Planning Role: A Well-planned economy may lead to a country on the path of development. State especially plays important role in planning economy. How to use resources and achieve the goal within the time frame set etc. are the basic needs for proper development of economy and proper planning is most important tool for the same.
4. Entrepreneurial Role: Sometimes to boost-up the economic development government plays the role of an entrepreneur. It establishes the business enterprises and bear the risks. Dominating trend of public sector is basic

ingredient of under developed countries. But recently many governments have resorted to privatization.

4.4 EFFECT OF POLITICAL PHILOSOPHIES ON ECONOMY

The impact of political parties and their policies in the country may be seen from economic set-up. The dominated role of public sector in India is outcome of Congress Party's policies and adoption of ‘socialist approach by the party’. Likewise, easter Europe and U.S.S.R. with several common characteristics, controlled and role of private sector to a very limited extend with lot of restriction on imports and foreign business. But with the changing era the various countries are running towards the privatization. The communist country like China where communist party is still in power, are on the rapid road of privatization. Impact of coalition/ governments on the economy is of different style. In such a situation if all the allied wings worked with common agenda it leads to lesser problems. But even in coalition governments when all the allied parties want to impose their party's policies it will lead to nowhere. If we discuss about India, since independence except a short span, Congress Party rule the country till 1995, and core sector has been fully dominated by the public sector. But after that, with change of ruling and command in the hands of NDA there started the reformative phase and disinvestment of the various public units was undertaken. In the meantime one of the partner of the NDA government stopped the path of privatization which effect the economic growth of the country. Thus, policies of political parties have a great impact on business houses.

4.5 RELATIONSHIP BETWEEN GOVERNMENT AND BUSINESS

From the above discussion it is clear that the government and business are the one and other side of coin. To accelerate the growth of business, it is foremost for the government to make such policies which are beneficial for the business and economy. But in the same way the business house is also responsible (for some duties) towards the government.

1. Business Responsibilities to Government: Business firms have a number of responsibilities to the government. Business firms must obey

the laws of central, state and local governments. Business should look to the government for support encouragement and guidance. Business leaders must look upon government as a big brother who is wiser, more matured in business. Business has following responsibilities towards government:

(i) 1.Tax Payment: Pay regular taxes on their sale, inputs and income and also deduct, at source, income taxes from salaries and wages of employees and remit the collections to the government.

(ii) Voluntary Programmes: Business Firms cooperate with government agencies on a voluntary basis in connection with various programs such as withholding stated amounts from wages and salaries of employees for the purchase of National Saving Certificates or giving special assistance to local government units in connection with drought relief education, tree planting etc.

(iii) Providing Information: Somet imes political leaders may take certain decisions that may not be in the overall interest of business. The onus then lies with the business leaders to place before the decision makers, the facts and problems, individually or though forums and argue for the modification or change of decisions.

(iv) Government Contracts: Many business firms bid for Government contracts and if successful, carry out the resulting projects with the required specifications and standards.

(v) Government Service: Business offers services of its leaders of the Government. It is not unusual for business executive to lead or accompany delegations to foreign countries for exploring trade and industry prospects.

(vi) Political Activity: Business can make monetary contributions to political parties particularly at the time of elections. The other way of participation is to contest election as independents on party labels. The third way refers to behaviour after election and is concerned with securing legislation in favour of business.

2. Government Responsibilities to Business

Government responsibilities to business are much greater than the obligations of business to Government that have the power, will and resources to decide, shape, guide and control business activities.

(i) Establishment and Enforcement of Law: Government establishes and enforces laws and regulations under which the business functions. Governments is responsible for providing the rule of the game which make the business systems function smoothly and which help to maintain competition.

(ii) Maintenance of Order: Government has the responsibility of maintaining order and protecting person and property. It would be impossible to carry on the business in the absence of a peaceful atmosphere.

(iii)Money and Credit: It is the responsibility of Government to regulate money and credit and protect the integrity of the rupee i.e. to guard against rapid fall in its value.

4.6 LEGAL ENVIRONMENT AND THE ECONOMY

Introduction: The impact of political environment on the development of economics is irresponsible as long as the impact of legal environment is not forgettable. Apart from the direct laws which control investment and related matters. There are number of laws that regulates the conduct of the business- like laws relating to standards of product, packing, promotion, ethics and ecological factors etc.

With the origin of concept of ‘consumerism’ a wide range of laws have been enacted to save those interests of consumers, to remove the unwanted and unhealthy competitions between the companies i.e., the Consumer Protection Act 1986, MRTP Act etc. Various laws have also been enacted in favour of labourers pertaining to labour reform i.e., to control working hours, working conditions, labour charges, child labour etc, these laws named as industrial Dispute Act, Factories Act, Trade Union Act, Workmen Compensation Act etc. The regulatory act to control the business activities subject to foreign exchange, import, export has been made i.e., EXIM Policy, FEMA. Tax collection is most important revenue source of the government and various statutes to collect taxes are in our country like the Central sales Tax, Excise Act and moreover the

Income Tax Act.

In the crowd of these number of enactment and statutes, the impact of legal environment do not require any special detail. The effect of legal system on the business environment is very important. Regulation of business units and their proper management and relation with other enterpreneur when organized and controlled by the statutes, then there remains less chance for frauds and irregularities. Some policies that create opportunities for development of one may lead to threat to others. The policy of liberalization in India has opened up new dimensions to achieve and threats to deceive. But the public interest and benefits of society at large is to be seen while enactment of statute. Thus the changing scenario of legal environment, its impact on business in each and every aspect of the economy is very important. The important statutes relating to business as follows in two broader parts:

1. Pre Independence- E r a : To regulate the business activities from the ancient times certain norms have been put forward to comply by the business houses. It was the British period market by the drain of wealth and certain fundamental laws had been enacted to regulate business and economy.

a) The Indian Contract Act 1872: First step for origin of business is contract law enacted in 1872 provided norms relating to the very basic aspects of contract formation, which is fundamental to any economy.

b) The Partnership Act 1932: Increase in business activity gave birth to partnership and the act regulates the conduct of partners in firms and with outsiders and gives sanction to the institution of partnership.

c) The Sales of Goods Act 1930: The Sales of Goods Act 1930 provide provisions for different types of aspects on the sale, purchase of goods.

The Negotiable Instrument Act 1881: Finance is soul of business and economy, but credit also plays most important role in the economy, thus, negotiable instruments are like blood in veins and Act deals with basic needs of validity of instrument and its enforceability.

2. Post- Independence Era: A variety of statutes have been enacted since the independence. To accelerate the pace of economics as well as to regulate the obstacles that come before government a number of statues have been

made like.

1. The Companies Act 1956: A big chunk of business houses have been hold by companies and to regulate the conduct of companies Act 1956 is being amended from time to time to provide an exhaustive law on regulation of companies incorporated under the act.

2. Labour Laws: India has started its development process with socialistic approach and as such number of statutes has been enacted to improve the conditions of persons involved in commerce and trade or in industry by way of labour. Some important statutes like the Industries Disputes Act, 1947, The Factories Act, 1948, The payment of Wages Act, The Minimum Wages Act, The Workmen Compensation Act, Trade Union Act are basically concerned with the safeguard of labour class and to save the workmen from exploitation of employers on account of less wages, working hours, working conditions, dispute regarding service matters, lock-out etc.

3. The Consumer Protection Act 1986: Drastic changes have been caused in the economy with the intervention of multinational companies and due to poor, illiterate, people of country, it becomes duty of the Government to save consumer interests. With the object to provide better protection to the interest of consumers. The Consumers Councils have been established under the act. The magnacarta of consumer rights, not only recognize the rights but also provide effective agency to redress the consumer grievances.

4. The Securities and Exchange Board of India Act 1992 (SEBI) :

SEBI was established in 1988, to end the director intervention and regulation of Government. SEBI is a statutory body under the act of 1992 and regulate listing, promote the security markets and prohibit the unfair fraudulent practice. And amendment in the year of 1995 has been made to make SEBI more powerful and to keep transparency in the security market transactions.

5. The MRTP Act, 1969: The MRTP Act came into force from 1 June 1970, and has been amended in 1974, 1980, 1982, 1984 and 1991. This act applies in the whole of India except the State of Jammu and Kashmir. The Act had two objectives viz. (1) Controlling monopolistic trade practices, and (2) Regulating restrictive and unfair trade practices. After this the economic

reforms initiated from the beginning of 1990 necessitated a shift in the focus from regulating

monopolies to promoting competition. Hence a Competition Act was conceived in time with the recommendations of the Raghavan Committee, and the MRTP Act was replaced.

6. The Competition Act, 2002: The Competition Act, 2002 was implemented and designed to promote and sustain competition and thereby protect the interests of consumers. The Act seeks to deal with market failures, advancing consumer interest and ensuring the freedom of trade for other participants in markets in India. The Act runs into sixty-six sections, divided into none chapters. It extends to the whole of India except Jammu and Kashmir.

7. The Foreign Exchange Regulation Act and Foreign Exchange Management Act: The Foreign Exchange Regulation Act came into force in India with effect from Ist January, 1974. The primary objective of this Act was to prevent the outflow Indian currency and to see that the foreign exchange legitimately due to India should be received. Keeping in view the changed environment, on 4 August, 1998, the Foreign Exchange Management bill was introduced. The FEMA aims it simplifying, consolidating and amending the law relating to foreign exchange with the objective of facilitating external trade and payments, and for promoting the orderly development and maintenance of foreign exchange markets in India.

4.7 RATIONALE FOR GOVERNMENT INTERVENTION

Pure public goods such as defence, law and order and environmental protection cannot be provided by private markets alone. Because everybody wants them but no one is willing to play for them individually. Government can provide them and imposes their cost on tax payers.

Goods with positive externalities or spillover benefits are worth more to society than to any one consumer. Public health and education, for example, reduce infection rates, add to society's knowledge base and raise productivity. Market's tend to undersupply these goods and complementary public funding or provision can therefore improve efficiency. Natural monopolies such as gas pipelines, local transport networks and other infrastructure services are most efficiently provided by a single firm. Unconstrained, monopoly procedures tend to overprice and undersupply these services. But the public provision or regulation can in principle be efficient.

Imperfect information on the part of either consumers or producers may make markets fail. Private commercial insurers cannot efficiently insure against risks like unemployment, longevity and deteriorating health in old age, because these risks are influenced by characteristics and behaviours of the insured that the insurer can't observe along with the government policy and they affect large part of the population equally and simultaneously. Government can regulate private pensions and insurance and complement them with basic public pensions and

insurance to improve efficiency and fill gaps in coverage.

Role of the Government:

1. Orderly Growth: It means balanced regional development, distributive justice, full employment and protecting the economy against ‘booms and busts.
2. Infrastructure: Business needs for its effective functioning such infrastructural facilities as transportation, power, finance trained personal and civil amenitites.
3. Information: Government should provide information through departments of commerce and industry, labour, health, education, banking, atomic energy and host of others.
4. Assistance to Small Industries: Being small in size, these firm face problems relating to finance, marketing, know-how and infrastructural facilities. It is again the responsibility of Government to provide the required facilities and encourage the small-scale sector to grow.
5. Transfer of Technology: Government owned research establishment transfer their discoveries to the private industry in order to put them to commercial production.
6. Government Competition: Government often competes with private

business firms for the purpose of regulating competition, improving quality or to supplement private activities with Government programmes.

7. Inspection and Licenses: Government agencies conduct inspection activities on foods and drugs for assuring quality products to consumers. Government issues licenses to competent business establishment to carry on different activities.
8. Tariffs And Quotas: These are used by government to project business from foreign competition. Incentives and subsidies are granted by Government to encourage development of home industries.

4.8 SUMMARY

The state (i.e., the Government) plays a very active role in all economies, including the market economies, the extent and nature of state intervention vary widely between nations. The national necessity for proper utilization of scarce resources and prioritization of development objectives and ideological reasons have made the planning role of government an important role in socialist and developing countries. Government interference is also necessary because speedy development of trade and industry depend upon development of infrastructure which is developed by government. The role of Government in India is governed by the principles and provisions of Indian Constitution. The central government's role has declined to a great extent in industrial development because of decentralisation of power and responsibility. Now it is left to states to play an active and independent role in industrial development by creating a conducive environment for development of industries including attracting foreign investment.

4.9 EXERCISE

(A) Short Questions:

Q.1. What are the various elements of political environment of an economy?

Q.2. What do you mean by the Governmental responsibilities towards business?

Q.3. Why the Promotional role of the government for the development of economy is required?

(B) Long Questions:

Q.1. What is the legal environment and its basic elements?

Q.2. How does political environment affect the economy of a country?

Q.3. How does legal environment affect the economy of a country?

4.10 SUGGESTED READINGS

1. Business Environment (Text & cases)

By: Francis Cherunilam

2. Business Environment

By: Rosy Joshi, Sangam Kapoor

3. Essentials of Business Environment By: K. Aswathapka

M.COM

SEMESTER I

BUSINESS ENVIRONMENT

UNIT 5 CORPORATE LAWS- I, CORPORATE LAWS –II

Structure

Corporate Law 2

5.1 INTRODUCTION

The Companies Act, 2013 was passed to consolidate and amend the law relating to the companies. Owing to changes in the national and international economic environment and to enable growth, The Central Government decided to substitute the Companies Act, 1956 with a new legislation. The Companies Act, 2013 aims to improve corporate control, simplify rules, strengthen the interests of stakeholders and for the first time legislates the role of whistle-blowers and provisions relating to class action suit. It extends to the whole of India

5.2 APPLICABILITY OF THE COMPANIES ACT 2013:

The provisions of act shall apply to: -

- Companies incorporated under this Act or under any previous company law.
- Insurance companies (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)
- Banking companies (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)
- Companies engaged in the generation or supply of electricity (except where the provisions of the above Act are inconsistent with the provisions of the Electricity Act, 2003)
- Any other company governed by any special Act for the time being in force.
- Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

5.3 COMPANY: MEANING AND ITS FEATURES

Section2(20) of the Companies Act, 2013 defines the term ‘company’. “Company means a company incorporated under this Act or under any previous company law”.

Following are the main features of the company: -

i. **Separate Legal Entity**: - A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are supplied by the shareholders, the company becomes the owner of its capital and assets. A member does not even have an insurable interest in the property of the company. No members can either individually or jointly claim membership rights in assets of the company during the existence of the company or on its winding up.

ii. Perpetual Succession: - Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act. The shares of the company may change hands significantly but that does not affect the presence of the company. Since a company is an artificial person created by law, law alone can bring an end to its life. Its existence is not affected by the death or insolvency of its members.

iii. Limited Liability: - The liability of members of a company is limited either by shares or guarantee. Limited liability means that the liability of its members is limited to the unpaid amount on the shares that they are holding plus the premium they had agreed to pay. In case the company is limited by guarantee the liability of the members extends to the amount each one has guaranteed to pay in the event of winding up of the company.

iv. Artificial Legal Person: - A company is a person created by a procedure other than natural birth. It is thus called artificial. Since it is formed by law it is an artificial legal person having all rights of an individual. A company is invisible, intangible, immortal, but not fictitious. A company can do anything which any natural person can do except that it cannot appear in the court, cannot be sent to jail nor can it marry or divorce.

v. Common Seal: - Common seal is the official signature of a company, which is affixed by the officers and personnel of the company on its every document. The common seal is a seal used by a company as the symbol of its incorporation. Any document bearing the common seal of the company and duly witnessed by at least two persons (with authority) will be binding on the company.

5.4 FORMATION OF COMPANY (SECTION 3). —

(*1*) A company may be formed for any lawful objective by—

(*a*) seven or more persons, where the company to be formed is to be a public company;

(*b*) two or more persons, where the company to be formed is to be a private company; or

(*c*) one person, where the company to be formed is to be One Person Company that is a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

(*2*) A company formed under sub-section (*1*) may be either—

(*a*) a company limited by shares; or

(*b*) a company limited by guarantee; or

(*c*) an unlimited company.

5.5 MEMORANDUM (SECTION 4)

The memorandum of a company shall state—

(*a*) The Name of the company with Suffix―Limited in the case of a public limited company, or the last words ―Private Limited in the case of a private limited company:

Provided that nothing in this clause shall apply to a company registered under section 8;

(*b*) The State in which the registered office of the company is to be situated;

(*c*) The Objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

(*d*) The Liability of members of the company, whether limited or unlimited, and also state,

(*i*) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any

(*ii*) In case the company is limited by guarantee the liability of the members extends to the amount each one has guaranteed to pay in the event of winding up of the company.

(e) In the case of a company having a share capital: -

(*i*) the amount of share capital with which the company is to be registered and the division of shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and

(*ii*) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name

(*f*) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

5.6 ARTICLES (SECTION 5)

The articles of a company shall contain the regulations for management of the company.

he document containing the articles of association of a company is a business document; hence, it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company.

The articles of association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit. It is important therefore that the auditor should study them and, while doing so he should note the provisions therein in respect of relevant matters.

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with. The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

5.7 INCORPORATION OF COMPANY (SECTION 7). —

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

(1) Filing of the documents and information with the Registrar of the Companies: For the registration of the company following documents and information are required to be filed with the Registrar within whose jurisdiction the registered office of the company is proposed to be situated—

- the Memorandum of Association and Articles of Association of the company duly signed by all the subscribers to the Memorandum.
- a declaration by person who is engaged in the formation of the company (an advocate, a chartered accountant, cost accountant or company secretary in practice) and by a person named in the articles (director, manage or secretary of the company), that all the requirements of this act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.
- a declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that- ¬ he is not convicted of any offence in connection with the promotion, formation or management of any company, or ¬ he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company

under this Act or any previous company law during the last five years, ¬ and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

- the address for correspondence till its registered office is established;
- the particulars (names, including surnames or family names, residential address, nationality) of every subscriber to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
- the particulars (name, including surname or family name, the Director Identification Number (DIN), residential address, nationality) of the persons mentioned in the articles as the first directors and such other particulars including proof of identity as may be prescribed; and
- the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

(2) Issue of certificate of incorporation on registration: The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

(3) Allotment of Corporate Identity Number (CIN): On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

(4) Maintenance of copies of all documents and information: The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its dissolution under this Act.

(5) Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. during incorporation process): If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action for fraud under the Act.

(6) Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation): Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under this section shall each be liable for action for fraud under the Act.

(7) Order of the Tribunal: Where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants—

(a) Pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

(b) Direct that liability of the members shall be unlimited; or

(c) Direct removal of the name of the company from the register of companies; or

(d) Pass an order for the winding up of the company; or

(e) Pass such other orders as it may deem fit

5.8 FORMATION OF COMPANIES WITH CHARITABLE OBJECTS (SECTION 8).

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed:

1. To promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

2. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members.

5.9 PUBLIC OFFER AND PRIVATE PLACEMENT (SECTION 23). —

(*1*) A public company may issue securities—

(*a*) to public through prospectus; or

(*b*) through private placement; or

(*c*) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder.

(*2*) A private company may issue securities—

(*a*) by way of rights issue or bonus issue in accordance with the provisions of this Act; or

(*b*) through private placement by complying with the provisions of Part II of this Chapter

5.10 MATTERS TO BE STATED IN PROCPECTUS (SECTION 26).

Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state the following information, namely: —

(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees if any, underwriters and such other persons as may be prescribed.

(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time.

(iii) details about underwriting of the issue.

(iv) consent of the directors, auditors, bankers to the issue, expert 's opinion, if any, and of such other persons, as may be prescribed.

(v) procedure and time schedule for allotment and issue of securities.

(vi) capital structure of the company in the prescribed manner.

(vii) main objects and present business of the company and its location, schedule of implementation of the project.

(viii) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash.

5.11 SHELF PROSPECTUS (SECTION 31).

Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new changes created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus

5.12 RED HERRING PROSPECTUS (SECTION 32). —

A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

5.13 ALLOTMENT OF SECURITIES BY COMPANY (SECTION 39). —

"Allotment" means the appropriation out of previously un-appropriated capital of a company, of a certain number of shares to a person. Section 39 contains provisions in respect of allotment of securities when there is a public offer.

1)Receipt of Minimum Amount is a must: -The prospectus must state the minimum amount to be subscribed. Such minimum amount must be received from the subscribers or investors at the time of making application.

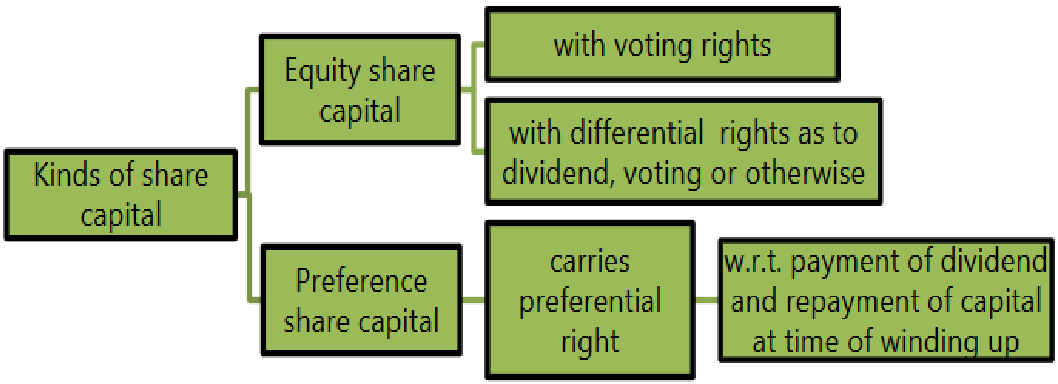
2) Quantum of Amount Payable on Application: - The amount payable on application on every security shall not be less than five per cent of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

3) Consequences if minimum amount is not subscribed: - If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus or such other period as specified by SEBI then the application money shall be repaid within a period of fifteen days from the closure of the issue.

4) Return of Allotment: -Where company makes an allotment of securities shall file a return of allotment within 30 days with the registrar.

5) Punishment for Default: - In case of default Company shall pay penalty of Rs 1000 for each day during which such default continues, or Rs 1 lac whichever is less.

5.14 KINDS OF SHARE CAPITAL (SECTION 43). —



KINDS OF SHARE CAPITAL (fig 1.1)

The share capital of a company limited by shares shall be of two kinds, namely: —

♦ Equity share capital: - Shares which are not preference shares are termed as equity shares.

There are two types of Equity shares namely: -

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

♦ Preference share capital: - The Act defines preference share capital as instruments which have: -

1) Preferential right to dividend payment (absolute/fixed or ad-valorem/ %) and

2) Preferential repayment during winding up of the company.

These shareholders can also participate in equity pool post the preferential entitlements.

The shares or debentures or other interest of any member in a company shall be movable property transferable in the manner provided by the articles of the company. Every share in a company having a share capital shall be distinguished by its distinctive number. Provided that nothing in this section shall apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

5.15 CERTIFICATE OF SHARES (SECTION 46): -

A certificate of shares is required when shares are issued in physical form: -

1) A certificate, specifying the shares held by any person, shall be *prima facie* evidence of the title of the person to such shares.

(*2*) A duplicate certificate of shares may be issued, if such certificate —

(*a*) is proved to have been lost or destroyed; or

(*b*) has been defaced, mutilated or torn and is surrendered to the company.

(*3*) Notwithstanding anything contained in the articles of a company, the manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

(*4*) Where a share is held in depository form, the record of the depository is the *prima facie* evidence of the interest of the beneficial owner.

(*5*) If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447

5.16 ISSUE OF SWEAT EQUITY SHARES (SECTION 54): -

Issue of 'sweat equity shares': Section 54 mentions the provisions which need to be adhered to by a company if it desires to issue sweat equity shares.

Conditions: According to Section 54 (1), a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(a) the issue is authorised by a special resolution passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

5.17 ISSUE AND REDEMPTION OF PREFERENCE SHARES (SECTION 55)

(1) No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.

(2) A company limited by shares may issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.

(3) Provided further that—

(a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

(b) no such shares shall be redeemed unless they are fully paid.

(c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account.

(d) (*i*) in case of such class of companies, as may be prescribed the premium, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

(*ii*) in a case not falling under sub-clause

(*i*) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

5.18 ISSUE OF BONUS SHARES (SECTION 63): -

A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

(*i*) its free reserves;

(*ii*) the securities premium account; or

(*iii*) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless: -

*(*a) it is authorised by its articles;

(*b*) it has, on the recommendation of the Board, been authorised in the general meeting of the company;

(*c*) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(*d*) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(*e*) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

(*f*) it complies with such conditions as may be prescribed.

5.19 DEBENTURES (SECTION 71): -

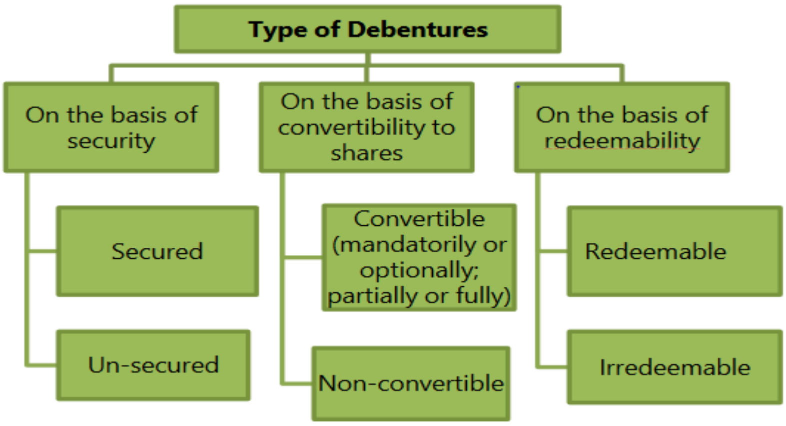
As per Section 2(30), debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

- A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

  Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

- No company shall issue any debentures carrying any voting rights.
- Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.
- Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.
- A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.
- A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.
- If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term

which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.



TYPES OF DEBENTURES (fig 1.2)

5.20 PROHIBITION ON ACCEPTANCE OF DEPOSITS FROM PUBLIC (SECTION 73): -

According to section 73 (1) of the Act, no company can accept or renew deposits from public unless it follows the manner as prescribed under Chapter V of Companies Act 2013.

Exempted companies under section 73 are: -

(1) Banking Companies

(2) Non-Banking Financial Company (NBFC)

(3) Housing Finance Company (HFC)

(4) other companies as specified by the Central Government, in consultation with RBI.

Any company may accept or renew deposits from its members by following the provisions as set out below: -

- Passing of a Resolution: - A company is required to pass a resolution in general meeting for acceptance of deposits from its members [Section 73 (2)].
- Issuance of a Circular containing Statement: - The company is required to issue a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in the prescribed form and manner. The circular may be published in English

language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

- Filing of Circular: - The company is required to file a copy of the circular containing the statement with the Registrar within 30 days before the date of issue of the circular.
- Requirement of Deposit Repayment Reserve Account: - The company is required to deposit, on or before 30 th of April each year, at least 20% of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account.
- Certification as to No default in Repayment: - The company needs to certify that it has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits.
- Provision of Security: - The company may provide security, if any, for the due repayment of the amount of deposit or the interest thereon. Further, if security is provided, the company shall take steps for the creation of charge on the property or assets of the company.

CORPORATE LAW 2

MANAGEMENT AND ADMINISTRATION

5.21 REGISTER OF MEMBERS (SECTION 88): -

- Every company shall keep and maintain the following registers in such form and in such manner as may be prescribed, namely: -

(*a*) register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India;

(*b*) register of debenture-holders; and

(*c*) register of any other security holders.

- Every register maintained shall include an index of the names included therein.
- Register index of beneficial owner to be maintained of a depository: The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act,

1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

- Maintenance of foreign register: A company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country. The register may be referred as “Foreign Register”.

- If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

5.22 ANNUAL RETURN (SECTION 92): -

Provisions with regard to Annual Return are contained in section 92. Every company shall prepare a return in the prescribed form containing the particulars as they stood on the close of the financial year regarding: -

(*a*) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(*b*) its shares, debentures and other securities and shareholding pattern;

(*c*) its indebtedness;

(*d*) its members and debenture-holders along with changes therein since the close of the previous financial year;

(*e*) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

(*f*) meetings of members or a class thereof, Board and its various committees along with attendance details;

(*g*) remuneration of directors and key managerial personnel;

(*h*) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(*i*) matters relating to certification of compliances, disclosures as may be prescribed;

(*j*) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them.

Every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified. If a company fails to file its annual return before the expiry the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

5.23 ANNUAL GENERAL MEETING (SECTION 96): -

- Every company other than a One Person Company shall in each year hold in addition to any other meetings, a general meeting as its annual general meeting and shall specify the meeting as such in the notices calling it, and not more than fifteen months shall elapse between the date of one annual general meeting of a company and that of the next.
- In case of the first annual general meeting, it shall be held within a period of nine months from the date of closing of the first financial year of the company and in any other case, within a period of six months, from the date of closing of the financial year.
- The Registrar may, for any special reason, extend the time within which any annual general meeting, other than the first annual general meeting, shall be held, by a period not exceeding three months.
- Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate.

5.24 CALLING OF EXTRA ORDINARY GENERAL MEETING (SECTION 100):

The Board may, whenever it deems fit, call an extraordinary general meeting of the company at the requisition made by, —

(*a*) in the case of a company having a share capital, such number of members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

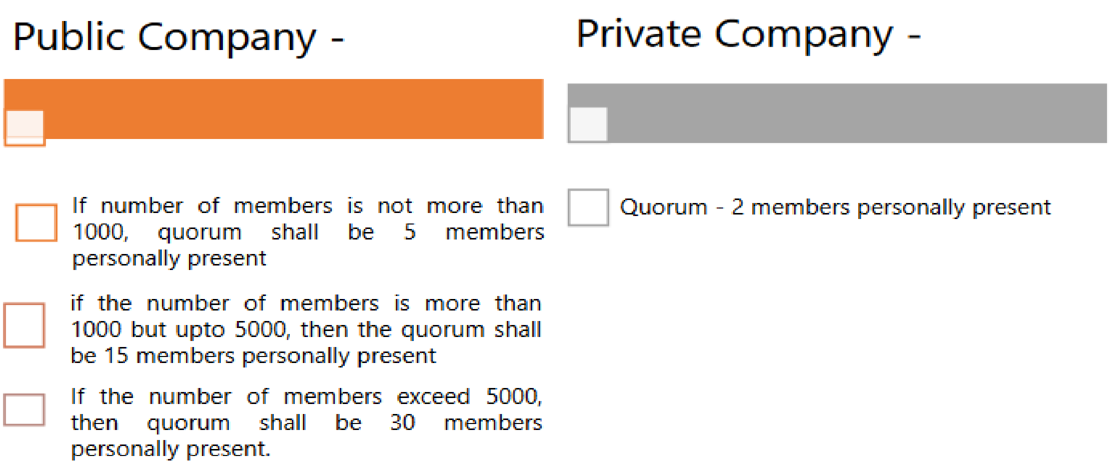
(*b*) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

The requisition shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.

If the Board does not, within twenty-one days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than forty-five days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves within a period of three months from the date of the requisition.

5.25 QUORUM FOR MEETINGS (SECTION 103): -

Quorum means the minimum number of members who must be present in order to constitute a valid meeting.



MINIMUM NUMBER OF MEMBERS REQUIRED TO FORM QUORUM (fig 2.1)

Adjourned Meeting due to want of Quorum: –

If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company—

(a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or (b) the meeting, if called by requisitionists under section 100, shall stand cancelled:

Provided that in case of an adjourned meeting or of a change of day, time or place of meeting under clause (a), the company shall give not less than three days' notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated. If at the adjourned meeting also, a quorum is not present within half-an-hour from the time appointed for holding meeting, the members present shall be the quorum.

5.26 CHAIRMAN OF MEETINGS (SECTION 104): -

Unless the articles of the company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act and the Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the meeting

5.27 PROXIES (SECTION 105):

- Appointment of a proxy is an important right of a member of the company. Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf. However, a proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll.

- A person appointed as proxy shall act on behalf of such member or number of members not exceeding fifty and holding in aggregate not more than 10 per cent of the total share capital of the company carrying voting rights.

- It needs to be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument should be under its seal or be signed by an officer or an attorney duly authorised by the body corporate.

- A proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period. Every member entitled to vote at a meeting of the company, or on any resolution to be moved there at, shall be entitled during the period beginning twenty-four hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at any time during the business hours of the company, provided not less than three days' notice in writing of the intention so to inspect is given to the company.

5.28 MINUTES (SECTION 118): -

The minutes of each meeting shall contain a fair and correct summary of the proceedings that took place at the concerned meeting.

In the case of a Board Meeting or a meeting of a committee of the Board, the minutes shall also contain–

- The names of the directors present at the meeting; and
- In the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.

The minutes kept in accordance with the provisions shall serve as the evidence of the proceedings therein.

5.29 DECLARATION OF DIVIDEND (SECTION 123): -

According to Section 123 (1), the dividend for any financial year shall be declared or paid from the following sources.

(a) Profits of the current financial year- Profits arrived at after providing for depreciation in accordance with Schedule II.

b) Profits of any previous financial year or years- Profits of any previous financial year(s) arrived at after providing for depreciation in accordance with Schedule II and remaining undistributed i.e. credit balance in profit and loss account and free reserves. It is to be noted that only free reserves and no other reserves are to be used for declaration or payment of dividend.

Final Dividend

♦ When the dividend is declared at the Annual General Meeting of the company, it is known as 'final dividend'.

♦ The rate of dividend recommended by the Board cannot be increased by the members.

Interim dividend may be declared by the Board of Directors at any time during the period from closure of financial year till holding of the annual general meeting. The declaration of interim dividend is done out of profits before the final adoption of the accounts by the shareholders and therefore, interim dividend is said to be declared and paid between two AGMs.

The sources for declaring interim dividend include:

•Surplus in the profit and loss account; or

• Profits of the financial year in which such dividend is sought to be declared; or
• Profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.

5.30 UNPAID DIVIDEND ACCOUNT (SECTION 124): -

Section 124 of the Act contains the provisions relating to Unpaid Dividend Account (UDA). These are as follows:

➢ Where a dividend has been declared by a company but has not been paid or claimed within thirty (30) days from the date of declaration, the company shall, within seven (7) days from the expiry of the said period of 30 days, transfer the total amount of unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account (UDA). The UDA shall be opened by the company in any scheduled bank.

- Within 90 days of transferring any amount to the Unpaid Dividend Account, the company shall prepare a statement containing the names, last known addresses and the amount of unpaid dividend to be paid to each person and place such statement on its web-site, if any, and also on any other web-site approved by the Central Government for this purpose.
- All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund (IEPF) along with a statement containing the prescribed details.
- Any claimant of shares so transferred to IEPF shall be entitled to reclaim the 'transferred shares' from Investor Education and Protection Fund in accordance with the prescribed procedure and on submission of prescribed documents.

5.31 INVESTOR EDUCATION AND PROTECTION FUND (IEPF) (SECTION 125): -

Credit of Specified Amounts to the Fund: Following specified amounts shall be credited to the Fund:

- Amount given by the Central Government- The amount given by the Central Government by way of grants after due appropriation made by Parliament
- Donations by the Central Government- Donations given by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;
- Income from Investments- The interest or other income received out of investments made from the Fund;
- Matured Deposits- Matured deposits with companies other than banking companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);
- Matured Debentures- Matured debentures with companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);
- Amount received from Sale Proceeds- Amount received from sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years.

The Fund shall be utilized for refund of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon. The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him. Such audited accounts together with the audit report thereon shall be forwarded annually by the Authority to the Central Government.

5.32 BOOKS OF ACCOUNTS, ETC., TO BE KEPT BY COMPANY (SECTION 128): -

Every company must prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. Provided all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide.

Where such a decision is taken by the Board the company shall within seven days thereof file with the registrar a notice in writing in form AOC-5 giving full address of that other place.

Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed. The summarised returns of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and kept open to directors for inspection.

The books of accounts, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year.

5.33 FINANCIAL STATEMENT (SECTION 129): -

- The financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III. Provided further that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

- At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

- Where a company has one or more subsidiaries, it shall, in addition to financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under.

- Where the financial statements of a company do not comply with the accounting standards the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

5.34 APPOINTMENT OF AUDITORS (SECTION 139): -

Every company shall appoint an individual or a firm as an auditor of the company at the first annual general meeting (AGM). If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the AGM. If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement. Before the appointment is made, the written consent of the auditor to such appointment and a certificate shall be obtained from the auditor.

Listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or re-appoint—
(1) an individual as auditor for more than one term of five consecutive years; and
(2) an audit firm as auditor for more than two terms of five consecutive years.

First auditor shall be appointed by the BOD within 30 days of the date of registration to hold office until the conclusion of the first AGM.

If there is a casual vacancy the Board may fill casual vacancy in the office of an auditor within 30 days but where such vacancy is caused by the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and

Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

5.35 COMPANY TO HAVE BOARD OF DIRECTOR (SECTION 149): -

Every company shall have a Board of Directors consisting of individuals as directors and shall have: -

(*a*) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

(*b*) a maximum of fifteen directors.

Provided that a company may appoint more than fifteen directors after passing a special resolution. Provided further that such class or classes of companies as may be prescribed, shall have at least one-woman director.

Every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year.

Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director, —

(*a*) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(*b*) (*i*) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(*ii*) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(*c*) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(*d*) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to

- two per cent. or more of its gross turnover or
- total income or fifty lakh rupees or such higher amount as may be prescribed,

whichever is lower, during the two immediately preceding financial years or during the current financial year.

(*e*) who, neither himself nor any of his relatives—

(*i*) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year.

(*ii*) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year.

(iii) holds together with his relatives two per cent. or more of the total voting power of the company.

(*iv*) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company.

5.36 MEETING OF BOARD (SECTION 173): -

Every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation and thereafter hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than one hundred and twenty days shall intervene between two consecutive meetings of the Board.

A meeting of the Board shall be called by giving not less than seven days 'notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. The participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, which are capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

Every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of twenty-five thousand rupees.

A One Person Company, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days.

5.37 MODES OF WINDING UP (SECTION 270): -

(*1*) The winding up of a company may be either—

(*a*) by the Tribunal; or

(*b*) voluntary.

(*2*) Notwithstanding anything contained in any other Act, the provisions of this Act with respect to winding up shall apply to the winding up of a company in any of the modes specified under sub-section (*1*).

5.38 CIRCUMASTANCES IN WHICH COMPANY MAY BE WOUND UP BY TRIBUNAL (SECTION 271): -

A company may be wound up by the Tribunal, —

(*a*) if the company is unable to pay its debts;

(*b*) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(*c*) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(*d*) if the Tribunal has ordered the winding up of the company under Chapter XIX;

(*e*) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(*f*) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(*g*) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

A company shall be deemed to be unable to pay its debts: -

- If a creditor to whom the company is indebted for an amount exceeding one lakh rupees and creditor has served a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty-one days after the receipt of such demand.
- If any execution or other process issued on a decree or order of any court or tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part.
- If it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company

5.39 CIRCUMSTANCES IN WHICH COMPANY MAY WOUND UP VOLUNTARILY (SECTION 304): -

A company may be wound up voluntarily, —

(*a*) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved; or

(*b*) if the company passes a special resolution that the company be wound up voluntarily.

5.40 WINDING UP OF UNREGISTERED COMPANIES (SECTION 375): -

*(*1) Subject to the provisions of this Part, any unregistered company may be wound up under this Act, in such manner as may be prescribed, and all the provisions of this Act, with respect to winding up shall apply to an unregistered company, with the exceptions and additions mentioned in sub-sections (*2*) to (*4*).

(*2*) No unregistered company shall be wound up under this Act voluntarily.

(*3*) An unregistered company may be wound up under the following circumstances, namely:

(*a*) if the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;

(*b*) if the company is unable to pay its debts;

(*c*) if the Tribunal is of opinion that it is just and equitable that the company should be wound up.

(*4*) An unregistered company shall, for the purposes of this Act, be deemed to be unable to pay its debts—

(*a*) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding one lakh rupees then due, has served on the company, by leaving at its principal place of business, or by delivering to the secretary, or some director, manager or principal officer of the company, or by otherwise serving in such manner as the Tribunal may approve or direct, a demand under his hand requiring the company to pay the sum so due, and the company has, for three weeks after the service of the demand, neglected to pay the sum or to secure or compound for it to the satisfaction of the creditor;

(*b*) if any suit or other legal proceeding has been instituted against any member for any debt or demand due, or claimed to be due, from the company, or from him in his character as a member, and notice in writing of the institution of the suit or other legal proceeding having been served on the company by leaving the same at its principal place of business or by delivering it to the secretary, or some director, manager or principal officer of the company or by otherwise serving the same in such manner as the Tribunal may approve or direct, the company has not, within ten days after service of the notice,—

(*i*) paid, secured or compounded for the debt or demand;

(*ii*) procured the suit or other legal proceeding to be stayed; or

(*iii*) indemnified the defendant to his satisfaction against the suit or other legal proceeding, and against all costs, damages and expenses to be incurred by him by reason of the same;

(*c*) if execution or other process issued on a decree or order of any Court or Tribunal in favour of a creditor against the company, or any member thereof as such, or any person authorised to be sued as nominal defendant on behalf of the company, is returned unsatisfied in whole or in part;

(*d*) if it is otherwise proved to the satisfaction of the Tribunal that the company is unable to pay its debts.

5.41 TEST YOUR KNOWLEDGE

i. What is the meaning of the company and discuss its features?

ii. What is Memorandum of Association?

iii. Discuss the steps involved in formation of a company.

iv. Discuss briefly about types of prospectuses.

v. What are the legislation stated in The Companies Act 2013 for issue of debentures?

vi. Discuss about the conducting of Annual General Meeting as per The Companies Act 2013.

vii. Write a brief note on proxies as per The Companies Act 2013.

viii. What is Investor Education and Protection Fund and when it is created?

ix. What are the steps involved in appointment of an auditor of the company under The Companies Act 2013?

x. Explain when a company can be wound up by the Tribunal

M.COM

SEMESTER I

BUSINESS ENVIRONMENT

UNIT 6: LABOUR LEGISLATION

STRUCTURE

6.1 INTRODUCTION

THE CONCEPT OF LABOUR LEGISLATIONS

Law comes into being to provide the growing needs of society, which may be due to technological, economic, political, social changes. Law is a dynamic concept. Law is like a citadel which needs consistent updating. "Life and Laws have moved together in history and it must do in future". It is in this perspective that the Labour Legislations have to be studied.

6.2 INDUSTRIAL REVOLUTION AND THE NEED FOR LABOUR LEGISLATIONS

The industrial culture created too much exploitation of the working classes by the employer who took benefit of the individual dispensability of the employee and wanted to increase its profit on the investment. The ideal rule of capitalism that "Risk and Right" go in sync and afforded them with privileges to "hire and fire". The other legal recourse then available were those of Master and Servant and carrot and stick etc. The code of common law was in operation. The law of contract was in vogue to rule the relation between worker and the employer, which mostly not in favour of the workers. Extended hours of work, extremely low wages, no safety and welfare facilities, without any insurance and the exploitation was at large.

Government was not supportive and following the course of action of Laissez-faire (let not interfere) and employers ill-treated workers, taking benefit of the situation. Every civilization on its onwards march, revises, reviews, revamps and reinvents its legal perception and civilised means of living. The changes caused by the industrial revolution formed some gaps and it turn out to be the duty of the social order to fill-up those gaps. Society manage to develop certain social strategies to fill up those gaps, which are known as labour legislation. The labour legislations are the outcomes of Industrial Revolution and they have come into being to take care of the abnormalities created by it. They are diverse from general legislations, as they came in to being to relieve special disorders formed by specific situations. So, they are specific and not general in orientation, philosophy and concept.

6.3 FACTORS INFLUENCING LABOUR LEGISLATIONS IN INDIA

The issues examined above are the common factors motivating the shape of labour legislation. There are precise factors, unique to India which have influenced labour legislations.

A) Influence Of Colonial Rule

Most of the early labour regulation came into being due to the pressure from the industrialists of Lancashire and Birmingham; as labour working in industrial unit and mills in India were very inexpensive in comparison to their British counterpart. No doubt, these regulations were positive to Indian workers but this advantage was subsidiary to the main purpose i.e. the safety of the interests of British Capitalists. The British Civil Servants carried with them the British tradition of democracy and pragmatism. The Workman Compensation Act, 1923, the Indian Trade Unions Act, 1926, the Payment of Wages Act, 1936 etc. followed British pattern.

B) The Struggle for National Liberation and Adoption of Indian Constitution

The Manufacturing work force got backing from the freedom struggle and pro-independence leaders who made diligent struggles to get protective labour legislations enacted. The Indian Trade Unions Act, the appointment of Royal Commission on Labour etc. came in to being due to the stress from freedom struggle. The leaders of the national movement had assured the formation of an improved and just social order after independence; which was eventually embodied in the Preamble, Fundamental Rights and Directive Principles of State Policy of the Indian Constitution.

6.4 OBJECTIVES OF THE LABOUR LEGISLATIONS

DIFFERENT OBJECTIVES

Labour legislation in India has try to find to accomplish the following objectives:

(1) Formation of justice- Social, Political and Economic

(2) Providing opportunities to all workers, regardless of caste, creed, religion, beliefs, for the growth of their character.

(3) Safety of unprotected segment in the community.

(4) Preservation of Industrial Peace.

(5) Creation of environments for economic growth.

(6) Protection and upgradation of labour standards.

(7) Shielding workers from exploitation:

(8) Assuring right of workmen to syndicate and form association or unions.

(9) Safeguard the right of workmen to negotiate jointly for the advancement of their service conditions.

(10) Make government interfere as guardian of social wellbeing than to remain a spectator.

(11) Ensure human rights and human dignity

6.5 PRINCIPLES OF LABOUR LEGISLATION

There are various principles of labour legislations such as:

- Principle of Protection
- Principle of Social Justice
- Principle of Regulation
- Principle of Welfare
- Principle of Social Security
- Principle of Economic Development
- Principle of International Obligation

There are two main principles, i.e. social justice and social equity. There are other principles too.

PRINCIPLE OF SOCIAL JUSTICE

The principle of social justice fundamentally affirms that all social groups must be considered in the same manner, no matter what ever may be the case. It intends to eradicate social disparity, as it can be undoubtedly perceived that certain groups have been expose to social infirmity in terms of work or labour. It intends to offer identical employment chance to all irrespective of social standing of a person.

SOCIAL EQUITY

This principle is basically grounded on maintenance of regulations which is based on social impartiality of labour. Laws are to be revised from time to time, situations are not everlasting, they keep on varying from time to time, hence there is a need to bring modifications in the law correspondingly. This interference by the government for making amendments or alterations, to match the changed circumstances are entered upon the principle of social equity. To summarise, Social equity is setting up of impartial standards for all by means of legislative stipulations and obligations to do so.

NATIONAL ECONOMY

This principle affirms that, while passing a labour regulation, the general economic condition of the nation must be taken into account. As in any country the state of national economy is an important factor in affecting labour legislation.

SOCIAL SECURITY

From the view point of, “Principles of Labour Legislation and Industrial Jurisprudence, Dr. Soumitra Kumar Chatterjee” stated that it is the concept of social security and is a vital part of social justice. It is established on the notions of human self-respect and social justice. It basically means that government must shield every national which in any way adds to the advancement of the country’s welfare. Its measures are important from two perspectives:

First, they set up an important step on the way to the goal of a welfare state;

Second, they empower workers to turn out to be more efficient and hence increases the industrial power and potential.

6.6 DIFFERENT LABOUR LAWS ENACTED IN INDIA.

- The Workmen’s Compensation Act, 1923.
- The Trade Union Act, 1926.
- The Industrial Employment (Standing Orders) Act, 1946.
- The Payment Wages Act 1936
- The Industrial Disputes Act, 1947.
- The Minimum Wages Act, 1948.
- The Employees State Insurance Act, 1948.
- The Factories Act, 1948.
- Maternity Benefits Act, 1961.

6.7 GROWTH OF LABOUR LEGISLATION IN INDIA

In the eighteenth-century, India was not only a great agricultural country but also a great industrial country. Both the European and Asian markets were mostly sustained because of the looms supplied by India. British government in India, as a matter of strategy restrained Indian manufacturers, so that they might promote new companies of England. Their main policy was to ensure that Indian community mainly grow the raw materials. The British domination in India sustained for some time, which led to the evolution of Indian nationalism. In the twentieth century, the national movement took a new turn and hence there was a pressure for Indian goods. A non-cooperation movement, which is recognized as Swadeshi movement, was started, which pressed the people to use the goods which were made in India and to refuse the goods which were foreign- made.

In India, the plantation industry in Assam was the first one to attract the legislation. Numerous new statutes were passed from 1863 onwards for the regulation of recruitments. These statutes had additional focus on the safeguard of interests of the businesses rather than protection the interest of the workers. Although, The Factories Act was passed in 1881 and the Mines Act was passed in 1901. But the most important Act which was passed to protect the interests of the workers was The Workmen's Compensation Act, 1923. Some of the other significant social security legislations are: The Employees State Insurance Act, 1948, The employees Provident Funds Act, 1952 etc.

Laws were also made to regulate the labour management relations. Some of them are: The Industrial Disputes Act, 1947. The Trade Unions Act, 1926, and The Industrial Employment (Standing Orders) Act, 1946. Labour laws guaranteeing labour welfare and minimum standards were also enacted. Some of them are: The Factories Act, 1948. The Minimum Wages Act, 1948. The Payment of Wages Act, 1936, and The Payment of Bonus Act, 1965.

6.8 SOME OF THESE ACTS ARE BRIEFLY DISCUSSED AS BELOW:

6.8.1 THE WORKER'S COMPENSATION ACT, 1923

Every worker has the entitlement to claim compensation for the damages that he/she suffered in the course of his/her employment. Can we visualize a factory where no measures are adopted for the employee's welfare? The answer would be no, nonetheless over the years' numerous incidents ranging from industrial mishaps to diseases acquired during the occupation has emerged, but for such misfortunes, suitable provision is there and that provides for compensation to the workers. Prior to 1923, no such act or regulation was present which rendered them to feel pain from countless adversities, disabilities and accidents. As the nation progressed, the industrialisation also increases and with that the hazards faced by the workmen. They were susceptible to to ailments and various work-related dangers which the then regulations failed to address. It was only in 1921 that the Government noticed the common need for regulations guarding the workers and therefore the Workmen's Compensation Act, 1923 came into being. The Act was amended in the year 2009 modifying the title from Workmen's Compensation Act to Employees Compensation Act and replacing the word "workman" or "workmen" to "employee" or "employees" wherever it was believed to be needed along with some other changes. This Act came into force from the 1st of July 1924 and was applied to the whole of India.

Objective

The Workmen's Compensation Act, 1923 came into being to enforce a constitutional responsibility upon the employer so that it fulfils his moral duty when the workers suffer from any such injuries. This Act was one of the most basic labour wellbeing laws to have been approved with the main objective of giving compensation to the workers on the occurrence of an accident in the course of the employment. The Worker's Compensation Act, 1923 recognizes itself as social security regulation which points at providing compensation to even those dependants including daughter or a son who has not reached the age of 18 years, a widow, and others who has been included u/s 2(1)(d) of the Workmen's Compensation Act. 1923. It prioritises the fast-paced compensational procedure with an object of the negligible rate at which the dispute can be disposed of.

Scope of this Act

As has been previously stated, this Act applies to the whole of India and covers all such persons including a railway servant, construction workers, factory workers, loading & unloading work on a ship, maintenance and repairs of roads and bridges, circus and other employments which have been listed under Schedule II of the Workmen's Compensation Act, 1923. Upon the modification of the Workmen's Compensation Act in the year 1995, the Act widened its scope to the employees of newspaper organisations, drivers, cleaners, motor vehicle workers, persons engaging in horticultural occupations and many other mechanical jobs. An individual who has been working through contract is also eligible to receive compensation under this stated Act. Therefore, it means that an employee has the right to be reimbursed by the contractor, but the primary obligation lies on the employer.

Employer's Liability under The Workmen's Compensation Act, 1923

Section 3 of The Workmen's Compensation Act, 1923 provides for the situations where an employer would be responsible to pay the compensation:

- If the employee suffered a personal injury
- The injury was due to an accident
- The accident must have arisen in the course of the employment
- The injury must have resulted in the demise of the employee or his/her total or partial disablement for a period exceeding 3 days.

This section, though, specifies the cases when the employer is not liable. They are:

- If the injury did not result in partial/ total disablement of the employer for a period exceeding 3 days
- The employee was under the influence of drugs.
- Employee wilfully violated the order specifically conveyed or framed for the security of the employee.

Subject to this, ***Schedule I*** of this Act provides for the list of injuries under which the employer would be responsible. They are:

1. **Partial disablement**
2. **Total disablement**

Under Partial Disablement, it is divided into two types;

- **Temporary** and **permanent** disablement. Partial disablement lessens the earning capacity of the employee for the reason of the accident which he/she incurred during the course of the employment. Temporary disablement- This type of disablement is short-term in nature which thus decreases the earning capability of the worker because of the accident incurred during the employment.
- **Permanent disablement**- This type of disablement is permanent and lessens the earning capacity of the worker for every employment because of the accident incurred during the employment.
- **Total disablement** refers to incapacitation, whether of temporary or permanent nature which incapacitates the workman for doing all the works which he was earlier capable of doing during the employment.

Conclusion

Workmen’s Compensation Act has been helpful in protecting the rights of the workmen. Such an Act is a blessing for the workers as it delivers numerous benefits for their well-being. A workman adds greatly towards the progress of an employer’s occupation, thus making it towards success.

6.8.2 THE TRADE UNIONS ACT, 1926

A trade union is an alliance which comprises of workers who undertake to help labourers in matters relating to equality in pay, long working hours, a congenial and good working environment and other advantages to which the workers should be entitled. These establishments act as a connection between the employers and the employees. Prior to the development of industrial development on a massive scale, there was a personal arrangement between the workers and managers. In this way, there was no necessity for the development of any mechanism supervising the liaison between the labourer and managers.

But as soon as the industrial development took place, the relationship lost its meaning because of the massive-scale industrial development which enticed managers to reduce the cost of production, in order to survive the fierce competition in the marketplace and capitalize on their profit by using a more technically multifaceted mode of production which brought about the issues of unemployment for those section of labourers who were entirely be contingent on their wages for their survival. This distorted the present employer and employee relation where employees were ill-treated and exploited by their managers. The conflicting condition among labourers and managers, and the suffering of the labourers lead to the development of different trade unions.

HISTORY OF TRADE UNION IN INDIA

In India, the trade unions have developed into an important stage for putting up the requirements of the labourers. They have similarly converted into one of the greatest influential pressure groups and try to influence the Government to bring the regulation which is in favour of the employees without trying to become a part of the Government. Trade Unionism conquered its concrete shape after the end of the First World War. The necessity for an organized trade union was recognized in 1875 by several social workers like Shri Sorabji Shapaji Bengali and Shri N.M. Lokhande whose efforts brought about the development of trade unions like The Printer Union of Calcutta (1905), The Bombay Postal Union (1907), etc. The first labour association of India was The Bombay Mill-Hands Association, which was created by N.M. Lokhande in 1890. After this, numerous other trade unions were formed like the Madras Labour Union, Ahmedabad Textile Labourers Association, etc.

EMERGENCE OF THE TRADE UNION LAW

Labour law has an influence on the development of industrial relations in India. The basis of social equity has been the foundation of all the labour regulations in India. The foundation of the International Labour organization to raise the status of the worker all over the place in the world gave further boon to the requirements for well-framed labour legislations making in the nation. Another internal factors like the Swaraj Movement of 1921-24 and the Royal Commission on labour furthermore put pressures on the government for the enactment of new labour laws and include them in the Constitution, which will benefit the workers. Labour is a part of the concurrent list and consequently both the centre and state can make laws identified with it. The Trade Union Act, 1926 is one of the several labour legislations in the country.

The Trader Union Act, 1926 is related with the registration and protection of the trade unions. Following are the objectives of the act:

1. To safeguard the workers against exploitation by employers
2. To speak for the grievances of employees on behalf of them to the management
3. To protect and safeguard the rights of the workers provided to them under the employment clause or labour laws.
4. To enlarge involvement for decision making
5. To take punitive action against the workers doing in-disciplinary acts.

Let us look at some important concepts covered by this act-

1. **Trade Dispute [Section 2 (g)]**– A trade dispute means any dispute between 1) employer and employee, 2) employee and employee, 3) employer and employer and employers concerned with employment or not employment or the working conditions provided.
2. **Registered Trade Unions [Section 2(e)]**– A registered trade union simply means a trade union which is registered under the Trade Union Act, 1926 fulfilling all the clauses of the act. Some registered trade unions are- All India Trade Union Congress (AITUC), National Labour Organization (NLO), etc.

Trade Union Act, 1926 is a Government aided enactment which has been made to safeguard the labourers in both organized and unorganized sectors from cruel treatment and to safeguard their human rights. As such the enactment covers the provisions for the registration, regulation, benefits, and protection of the trade unions which, therefore, benefits the labourers.

6.8.3 THE PAYMENT WAGES ACT 1936

Purpose of the Act

The main intention of the Act is to avoid needless delay in the payment of wages and to put a stop to unlawful deductions from the wages. Every individual employed in any factory, upon any railway or via sub-contractor in a railway and a person working in a manufacturing or other establishment. The State Government may by announcement extend the requirements to any class of persons employed in any establishment or class of establishment. The benefit of the

Act recommends for the regular and timely payment of wages (on or before 7th day or 10th day of after wage period is greater than 1000 workers) and stopping illegal deductions being made from wages and arbitrary fines.

Summary of the provisions of the Act

The provisions of the Act about the imposition of fines on the employed person are as follows such as. The employer must display on his premises a list of acts or omissions for which fines can be levied. Before levying a fine on an employed person he must be given an opportunity of being heard against the fine. The quantum of fine must not exceed 3 percent of the wages. A fine cannot be levied on an employed person who is under the age of 15 years. A fine cannot be recovered by instalments or after 90 days from the day of the act or omission for which it is imposed. The funds received from fines must be used for the welfares of the employed persons.

Subsection 8(3), 10(1-A) & Rule 15} deals with any person wants to impose a fine on an employed person or to make a deduction for damage or loss shall clarify personally or in writing to the said person the act or omission, or damage or loss in respect of which the fine or deduction is proposed to be imposed, and the amount of fine or deduction, which it is proposed to impose, and shall hear his explanation in the presence of at least one other person, or obtain it in writing.

The procedure and Competent authority which deals with employment matters

If disagreeing to the provisions of the Act any deduction has been made from the wages of an employed person or any payment of wages has been delayed, he has to make an application for claiming the same to the Authority appointed under the Act. Such application can be made by the employed person himself or a legal practitioner or an official of a registered trade union. Such application has to be made within a period of 12 months from the date on which the date on which the deduction from the wages was made or from the date on which the payment of the wages was due to be made.

There is a competent Authority to consider and settle any application for payment of subsistence allowance. The subsistence allowance to be paid to an employee placed under suspension pending Departmental Enquiry is covered within the definition of wages given under Section 2(6) of the Act and, therefore, the Authority is competent to entertain and decide an application for payment of subsistence allowance.

The Authority under the Payment of Wages Act is a Court of summary jurisdiction having authority to deal with the simple issue of delay in payment of wages or deduction from wages.

It is not within the preview of the Authority to determine the question of the status of an employed person. The matter is an intricate question of law as also of fact. There is an agreement between an employer and his employees authorizing the deduction of union subscription from the salaries of the employer null and void under Section 23 of the Act, such agreement being beneficial and advantageous to the employees is not null and void under Section 23 of the Act.

Employer's duty

Employer's mandatory required to display the summaries of the Act in his factory or establishment. Every employer must display in his place of work or establishment a notice comprising the abstracts of the Act and the rules made thereunder in English and also in the language understood by the majority or the persons.

Conclusion

The Payment of wages Act is a legislation drawn up to safeguard the employee's rights from being disregarded by the employer. The employee should be paid on time and should not be harassed against anything during the employment. It has though given a lot of safeguards to employees and will continue to do so in the future as well.

6.8.4 THE INDUSTRIAL EMPLOYMENT (STANDING ORDERS) ACT, 1946

The Act makes it mandatory for employers of an industrial organisation where 100 or more workers are working to clearly describe the conditions of employment, by way of standing orders/services rules and to make them known to the workers employed. Though, in the N.C.T. of Delhi, the Act applies to an industrial undertaking where 50 or more workers are employed or were employed in the preceding 12 months.

The employer is required to prepare draft standing order, which he propose to adopt and tender the same to the Certifying Officers for certification. The employer is required to act in compliance with the certified standing orders in dealing with the day today affairs of the workers. Certified standing orders have the force of the law like any other enactment.

Administrative Machinery

All Deputy Labour Commissioners of the Labour Department have been employed Certifying Officers for the purpose of certification of the proposed standing orders of the respective areas under their control. Industrial Tribunal-I is the Appellate authority under the Act.

Penalty

The Act stipulates that in case the employer fails to submit the draft standing orders, a fine up to Rs. 5,000/- can be imposed and in case of contravention of the standing orders, a fine up to Rs. 100/- and in case of continuance of the offence, further fine up to Rs. 25/- for each such day can be imposed.

6.8.5 THE INDUSTRIAL DISPUTES ACT, 1947

Introduction

Irrespective of the level of economic growth, rules governing dispute resolution form an integral part of the labour law agenda in any nation. This is due to the fact that grievances and conflicts are unavoidable in any working relationship, and the object of policy is meant to provide such tools that address these disagreements successfully and expeditiously. In recent times the use of voluntary systems such as arbitration, conciliation, and mediation has become essential to dispute resolution policy. This is because they lack the confrontational component that ordinary legal action proceedings are symbolised by and thus, have been successful in preserving relationships during the process of dispute resolution.

The Industrial Disputes Act, 1947 is the main regulation governing dispute resolution in India. It was passed to deliver for the investigation and resolution of industrial disputes, to avoid illegal strikes and lockouts, to provide respite to workmen during lay-off or after retrenchment or unlawful removal from the work. It also provides for the systems of conciliation, arbitration, and adjudication to encourage measures for mutually advantageous relations between employers and employees.

Applicability & Scope of the Act

To recognize the scope of the Industrial Disputes Act, 1947 it is significant to appreciate the meaning and import of the terms *'industrial dispute'* and *'industry'* as defined in the statute. Section 2(k) of the Act states *'industrial dispute' as* any dispute or difference between employers and employees, or between employers and workmen, or amongst workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of employment of any person. Section 2(j) of the Act defines the 'industry' as any business, trade, undertaking, manufacture, or calling of employers and includes any calling, service, employment, handicraft, or industrial occupation or avocation of workmen.

Therefore, to attract the function of the Act, a dispute would have to occur in an organisation falling under the definition of industry and would have to include one or more of the interested party stated in the definition of industrial disputes. In other cases, there is no possibility for the governmental intervention and thus the only option is to approach courts or take part in alternate dispute resolution systems.

Industrial disputes may be generally categorized into interest disputes and rights disputes. Interest disputes are typically related to the determination of a revised wage level and other state of affairs of employment. Whereas, rights disputes relate to the understanding and application of existing standards of employment and usually involve an individual worker or group of workers. The Industrial Disputes Act, 1947 has provided for the founding of both internal and external systems to settle industrial disputes. Internal mechanisms include bodies such as the works committee and the grievance redressal committee.

The Industrial Disputes Act, 1947 provides for the following external mechanisms to resolve industrial disputes: –

Board of Conciliation & Conciliation Officers

Section 4 and Section 5 of the Act mention about the conciliation as a instrument for redressal of industrial disputes. The Government Employs Conciliation Officers by way of notification in the Official Gazette. They can be selected to a particular area or industry, for a fixed tenure, and are believed to be acting in an administrative capacity. Their function is to assist in negotiation between the groups so as to help them reach a common understanding.

Court of Enquiry

This court of civil nature under Section-6 of the Act is constituted by the government by way of notification to inquire into matters connected with or relevant to industrial disputes.

Labour Court

They have been established under Section 7 of the Act, containing only one person who is selected by the government to supervise the proceedings of the court. Qualification of such a person is that they must have been/are a High Court Judge, or district judge or additional district judge for at least 3 years or held any judicial office in India for not less than 7 years. Their jurisdiction extends to matters specified under the Second Schedule of the Act.

Industrial Tribunal

They have been created by government notification under Section 7-A of the Act, and one or more of its kind can be constituted. They are a quasi-judicial body; so, they must serve notice upon the parties to the reference by name before making any award. Their jurisdiction extends to matters specified in the Second or Third Schedule.

National Tribunal

This quasi-judicial body is constituted under Section 7-B to resolve industrial disputes at the national level, of national importance. Differences of such kind are taken up at the countrywide level, in which one or more industries in one or more states are affected. The judge presiding this tribunal must not be lesser in position than a High Court Judge, must be less than 65 years, and has the same powers as other preceding tribunals, with respect to the declaration of an award.

Conclusion

Though the Act provides for both internal and external bodies for dispute resolution and prevention of illegal strikes, lockouts and eases the use of unjust labour practices, from a compliance viewpoint. It is significant to have healthy internal systems that address disputes. External systems normally require an excessive degree of effort, expense and time spent which usually leads to a bitter relationship between employer and employee. Thus, having internal means of resolution is better as the possibility of having to trust on adjudication or alternate dispute resolution decreases, by this means a harmonious working relationship can be developed which eventually leads to better productivity.

6.8.6 THE MINIMUM WAGES ACT, 1948.

Minimum Wages Act was first passed by the Central Legislative Assembly in the year a 1948. The main purpose after this Act was to bridge the wage inequality amongst different workers in an employment. This Act fixes the minimum rates of wage in certain types of occupations. Meaning there by that the wages paid for the work done should not be lesser than the amount recommended by the Act.

The Objective of Minimum Wages Act 1948"

The main objective of this Act is to make sure that each employee is paid the minimum amount of wage recommended for the specific job. This, in turn, decreases the likelihoods of employees getting exploited in the hands of their managers. As per the Act, Government has to take the steps to fix the minimum wage rates and modify the same at the specific gap of every five years. Likewise, it has the authority to appoint advisory committees to provide just complaint of the employers as well as employees.

Minimum Wages Act Applicability

The provisions of the Minimum Wages Act are applicable on every occupation that employs more than 1000 workers in a State. Also, it is applicable on all the States of India, except Jammu & Kashmir. Unless specifically consented by the Central Government, the provisions of this Act are not applicable on the employees of the undertaking owned by the Central Government or Railways.

Definition of Wages as per Minimum Wages Act 1948:

The Section 2 of the Act defines the 'wages' as remuneration that is capable of being represented in form of money. This may include the House Rent Allowance, but would exclude the amount paid as the value of house accommodation, supply of water, electricity and medical, travelling allowance, contribution to pension fund, provident fund or insurance, gratuity, or any other special expenses paid by the employer.

6.8.7 THE EMPLOYEES STATE INSURANCE ACT, 1948

Employees' State Insurance Scheme of India, is a multidimensional social security scheme customised to provide socio-economic safeguard to the worker and their dependants covered under the scheme. The wide-ranging and multi-pronged social security programme is managed by a top corporate body called the Employees' State Insurance Corporation.

The announcement of Employees' State Insurance Act, 1948 (ESI Act), by the Parliament was the first most important legislation on social Security for workers in independent India.

The ESI Act 1948, includes certain health related contingencies that the employees are normally exposed to; such as illness, maternity, temporary or permanent disablement, Work-related ailment or death due to employment injury, causing in loss of wages or earning capability total or partial. Social security stipulation made in the Act to counter balance the financial distress or deprivation of the resources due to illness or disablement.

Applicability

Under Section 2(12) the Act is applicable to non-seasonal factories employing 10 or more persons.
Under Section 1(5) of the Act, the Scheme has been extended to shops, hotels, restaurants, cinemas including preview theatres, road-motor transport undertakings and newspaper establishments employing 10* or more persons.
Further under section 1(5) of the Act, the Scheme has been extended to Private Medical and Educational institutions employing 10* or more persons in certain States/UTs.

Finance

ESI Scheme, like most of the Social Security Schemes the world over, is a self-financing health insurance scheme. Contributions are obtained from both employees and their employers as a fixed percentage of wages. The State Governments, as per provisions of the Act, contribute 1/8th of the expenditure of medical benefit within a per capita ceiling of Rs. 1500/- per Insured Person per annum. Any additional spending by the State Governments, over and above the ceiling and not falling within the shareable pool, is borne by the State Governments concerned.

Contribution

E.S.I. Scheme being contributory in nature, all the workers in the factories or establishments to which the Act applies shall be insured in a way provided by the Act. The contribution payable to the Corporation in respect of an employee shall comprise of employer's contribution and employee's contribution at a specified rate. The rates are revised from time to time.

Benefits

The section 46 of the Act envisages following six social security benefits:

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1. **Medical Benefit:** Full medical attention is provided to a protected person and his dependent family members from the day he is covered in the scheme. There is no upper limit on expenses on the treatment of an Insured Person or his family member. Medical care is also offered to retired and permanently disabled insured persons and their spouses on payment of a token annual premium of Rs.120/-.

2. **Sickness Benefit (SB):** Sickness Benefit in the shape of cash reimbursement at the rate of 70 percent of salaries is payable to insured workers throughout the periods of certified sickness for a maximum of 91 days in a year. In order to be eligible for sickness benefit the insured worker is required to contribute for 78 days in a contribution period of 6 months.

3. **Maternity Benefit (MB):** Maternity Benefit for pregnancy is to be paid for Twenty-Six (26) weeks, which is extendable by additional one month on medical advice at the rate of full wage subject to contribution for 70 days in the preceding Two Contribution Periods.

4. **Disablement Benefit**

   - **Temporary disablement benefit (TDB:** From day one of entering insurable employment & irrespective of having paid any contribution in case of employment injury. Temporary Disablement Benefit at the rate of 90% of wage is payable so long as disability continues.

   - **Permanent disablement benefit (PDB):** The benefit is paid at the rate of 90% of wage in the form of monthly payment depending upon the extent of loss of earning capacity as certified by a Medical Board

5. **Dependants Benefit (DB):** DB paid at the rate of 90% of wage in the form of monthly payment to the dependants of a deceased Insured person in cases where death occurs due to employment injury or occupational hazards.

6. **Other Benefits:**

   - **Funeral Expenses:** An amount as prescribed in the Act is to be paid to the dependent relative or to the person who performs last rites from day one of entering insurable employment.

   - **Confinement Expenses:** An Insured Women or an I.P. in respect of his wife in case confinement occurs at a place where necessary medical facilities under ESI Scheme are not available.

6.8.8 THE FACTORIES ACT, 1948

There has been noticeable rise of large-scale industry in India in the latter half of nineteenth century. The Factories Act 1934 was approved substituting all the earlier legislation in regard to factories. This act was outlined in the light of the suggestions of the Royal Commission on Labour. This Act has also been amended suitably from time to time.

The understanding of working of the Factories Act, 1934 had exposed number of flaws and fault which have obstructed efficient administration of the Act, and the necessity for extensive amendment of the act to expand its protective provisions to the large number of smaller industrial establishments was felt.

Consequently, the Factories Act, 1948 amalgamating and modifying the law connecting labour in factories, was passed by the Constituent Assembly on August 28, 1948. The Act received the assent of Governor General of India on 23 September 1948 and came into force on April 1, 1949.

Objective of Factories Act ,1948

The chief objectives of the Indian Factories Act, 1948 are to regulate the working conditions in factories, to regulate health, safety welfare, and annual leave and pass exclusive provision in respect of young persons, women and children who work in the factories.
1. Working Hours: As per the provision of working hours of adults, no adult employee shall be needed or permitted to work in a place of work for more than 48 hours in a week. There should be a weekly holiday.

2. Health: For safeguarding the health of workers, the Act lays down that every manufacturing works shall be kept clean and all required provisions shall be taken in this regard. The factories should have proper drainage system, adequate lighting, ventilation, temperature etc. Suitable arrangements for drinking water should be made. Enough latrine and urinals should be provided at suitable places. These should be easily accessible to workers and must be kept cleaned.

3. Safety: In order to provide safety to the employees, the Act provides that the equipment should be fenced, no young person shall work at any dangerous machine, in confined spaces, there should be provision for manholes of adequate size so that in case of emergency the workers can escape.

4. Welfare: For the wellbeing of the workers, the Act provides that in every factory sufficient and appropriate amenity for washing should be provided and maintained for the use of workers. Facilities for storing and drying clothing, facilities for sitting, first-aid appliances, shelters, rest rooms and lunch rooms, crèches, should be there.

5. Penalties: - The provisions of The Factories Act, 1948, or any rules made thereunder the Act, or any order given in writing under the Act is violated, it is treated as an offence. The following penalties can be imposed:

(a) Imprisonment for a term which may extend to one year;

(b) Fine which may extend to one lakh rupees; or

(c) Both fine and imprisonment

Applicability of Factories Act, 1948

The Act is applicable to any manufacturing works whereon ten or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or whereon twenty or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on; but this does not include a mine, or a mobile unit belonging to the armed forces of the union, a railway running shed or a hotel, restaurant or eating place.

Importance of Factories Act, 1948

The Factories Act, 1948 is a beneficial legislation. The purpose and object of the Act is basically to protect the interests of workers, stop their exploitation and take care of their safety, cleanliness and welfare at their places of work. It casts numerous responsibilities, duties and accountabilities on the owner of a factory and also on the factory manager. Amendments to the Act and court decisions have further extended the nature and scope of the concept of occupier, especially vis-a-vis hazardous process in factories.

6.8.9 THE MATERNITY BENEFITS ACT, 1961

Half of the working population are women and these are the crucial part of the workforce. It is the need of the humanity and employment that there should be a balance between work and child-bearing and child-rearing responsibilities. The Constitutional structure provide equality to women in all walks of life. For extending this pursuit, The Maternity Benefit Act, was enacted which is similar to the lines of the International Labour Organisation, intentions to permit maternity protection to women. The Maternity Benefit Act of 1961 and the extremely current modification of law ensure active contribution in trade and industry activities post maternity. Hence, the Maternity Benefit Act safeguards a woman and has equal protection to occupation during pregnancy so that it does not affect women, their productivity or economic growth.

Scope and need for the legislation

The central aim of the Act is to eliminate the obstacles that women come across when they progress on the journey of motherhood. The Act has the main intention of empowering women to combine work and not compromise on their choice of having a child. Going back to history, Germany had started the idea of giving maternity allowance by the end of the 19th century. International Labour Organisation go along with the thought and came up with the Maternity Protection Convention. In the Indian state of affairs, the need to have a maternity benefit regulation was acknowledged by N.M Joshi as back as 1929, when he presented the Maternity Benefit Bill (No. 31 of 1924) in the Central Legislature. Before this, Women's Association India had by now led a mission requiring maternity rights in the Jamshedpur steel industry in 1920. After that, the Central Government took efforts by presenting the Mines Maternity Benefit Act 1941, Employees State Insurance Act 1948, and Plantations Labour Act 1951, which ultimately paved the way for the Maternity Benefit Act of 1961, which was passed by the Parliament with the single object to regulate the employment of women for a specific period before and after child-birth. The causes that forced the codification could be seen in the inconsistencies with regard to the different periods of maternity leave as well as the qualifying period of service of entitlement for maternity benefit. Thus, satisfying a comprehensive object of defending self-respect attached with motherhood by providing full and wholesome maintenance of woman and her child during the period when she is not working. Recently our Honourable Prime Minister Shri Narendra Modi has given approval to some amendments to the Maternity Benefit Act, 1961. In the Parliament, The Maternity Benefit (Amendment) Bill, 2016 was introduced. The modification introduced in the Parliament will help more than 2 million women presently employed in the businesses.

Applicability of the Maternity Benefit Act 1961

The Maternity Benefit Act is applicable to all the organizations including the factories, plantations, mind, government organizations, legislative organizations, shops or any other organization that is centred by the central government.

Eligibility required availing the benefits of the Maternity Benefit Act 1961

According to the facts available, women employed in any organization for a minimum of 80 days in the last year are entitled to get the Maternity Benefit. The amount given to the pregnant women will be based upon the daily wages that they receive while working.

Latest Changes in the Maternity Benefit Act 1961

As specified above that there are numerous modifications announced by our Honourable Prime Minister in the Parliament. After the introduction of the amendment following are the changes in the Maternity benefits act for working women.

The period of maternity vacation has been increased from 12 weeks to 26 weeks for the women working in the private sector.

Amendment to the Maternity Benefit Act 1961 is applicable for women having two surviving children. That indicates that women having two alive children will be entitled to get 26 weeks of leave and women having more than two kids will get 12-week leave from their working. Also according to the latest modification, if any women adopt a child then she will also get 12-week long maternity leave.

Changes in Organizations Rules

The most recent modification in the Maternity Benefit Act has also required the crèches in the organizations where 50 or more workers are working. Furthermore, the organizations are also asked to facilitate work from home for the women.

To conclude, for every child, it is important to have proper maternal care. Having suitable maternal care is very imperative for the growth and development of a child.

Let Sum Up

Law comes into being to provide the growing needs of society, which may be due to technological, economic, political, social changes. Law is a dynamic concept. Law is like a citadel which needs consistent updation. Most of the early labour regulation came into being due to the pressure from the industrialists of Lancashire and Birmingham; as labour working in industrial unit and mills in India were very inexpensive in comparison to their British counterpart. The basic objectives behind the labour legislation are Principle of Social justice, Social equity, National Economy., Social Security. Number of laws were passed by the parliament to provide security, safety and to avoid exploitation by the employer at work. Specific acts were passed for guaranteeing the minimum wages, to resolve the disputes at work place, to provide the medical treatment at affordable price. For working women special act was passed for child-bearing and child-rearing responsibilities. With these legislations the job security and welfare of the workers was ensured.

6.10 Test your knowledge

i. What are the factors Influencing Labour Legislations in India?

ii. What are the objectives achieved in India by labour legislation?

iii. Discuss the There are various principles of labour legislations.

iv. Discuss why the Worker’s Compensation Act, 1923 enacted.

v. Explain the salient features of The Payment Wages Act 1936.

vi. Why The Industrial Disputes Act, 1947 came in to being discuss its applications?

vii. Discuss the Objective of Factories Act ,1948.

viii. Explain why The Maternity Benefits Act, 1961 was passed and discuss its different features.

M.COM

SEMESTER I

BUSINESS ENVIRONMENT

UNIT 7 – FINANCIAL MARKETS

STRUCTURE

7.0 OBJECTIVES

After studying the Unit, students will be able to

- Define the Meaning of financial markets.
- Explain the functions of financial markets.
- Explain the structure of the financial system.
- Discuss financial market types.
- Explain the nature of the financial market.

7.1 INTRODUCTION TO THE FINANCIAL MARKETS

Financial managers and investors don’t operate in a vacuum; they make decisions within a large and complex financial environment. This environment includes financial markets and institutions, tax and regulatory policies, and the state of the economy. The environment both determines the available financial alternatives and affects the outcomes of various decisions. Thus, it is crucial that investors and financial managers have a good understanding of the environment in which they operate. History shows that a strong financial system is a necessary ingredient for a growing and prosperous economy. Companies raising capital to finance capital expenditures as well as investors saving to accumulate funds for future use require well-functioning financial markets and institutions.

A **financial system** (within the scope of finance) is a system that allows the exchange of funds between lenders, investors, and borrowers. Financial systems operate at national, global, and firm-specific levels. They consist of complex, closely related services, markets, and institutions intended to provide an efficient and regular linkage between investors and depositors. Money, credit, and finance are used as media of exchange in financial systems. They serve as a medium of known value for which goods and services can be exchanged as an alternative to bartering. A modern financial system may include banks (operated by the government or private sector), financial markets, financial instruments, and financial services. Financial systems allow funds to be allocated, invested, or moved between economic sectors. They enable individuals and companies to share the associated risks.

7.2 FUNCTIONS OF THE FINANCIAL MARKET

The financial system performs the following functions:

1. **Provision of liquidity**: The provision of money and monetary assets for the creation of goods and services is the primary purpose of the financial system. Money for profitable projects should not be in short supply. Money and monetary assets are referred to as liquidity in financial terms. As a result, all actions in a financial system are linked to liquidity, either as a source of liquidity or as a means of trading liquidity.
2. **Mobilisation of savings:** Mobilizing funds and channelling them into productive activities is another fundamental function of the financial system. The financial system should provide proper incentives to encourage people to save and invest their money in more productive endeavours. As a result, the financial system makes it easier for savings to be converted into investment and consumption. In this activity, financial intermediaries must take the lead.
3. **Maturity transformation function:** The maturity transition function is another feature of the financial system. Financial intermediaries collect deposits from the public in various

maturities based on their liquidity preferences and lend them to borrowers in various maturities based on their needs, thereby promoting a country's economic activities.

4. **Risk transformation function:** With their little savings, the majority of small investors are risk cautious. As a result, people are hesitant to invest in the stock market directly. Financial intermediaries, on the other hand, take money from individual savers and disperse them among various investment units using their extensive knowledge and skills. As a result, the risks for individual investors are spread out. This risk transformation function aids in the development of the industry. Furthermore, the financial system provides a variety of risk-mitigation techniques, such as hedging, insurance, and the usage of derivatives, among others.

7.3 STRUCTURE OF THE FINANCIAL SYSTEM

The financial system or financial sector of any country consists of specialised and non-specialised financial institutions, of organised and unorganised financial markets, of financial instruments, and services that facilitate the transfer of funds. Procedures and practices adopted in the markets, and financial interrelationships are also parts of the system. These parts are not always mutually exclusive; for example, financial institutions operate in financial markets and are, therefore, a part of such markets.

Financial System is a combination of financial institutions, financial markets, financial instruments, and financial services to facilitate the transfer of funds. The financial system provides a payment mechanism for the exchange of goods and services. The structure of the financial system is represented in Figure 1:

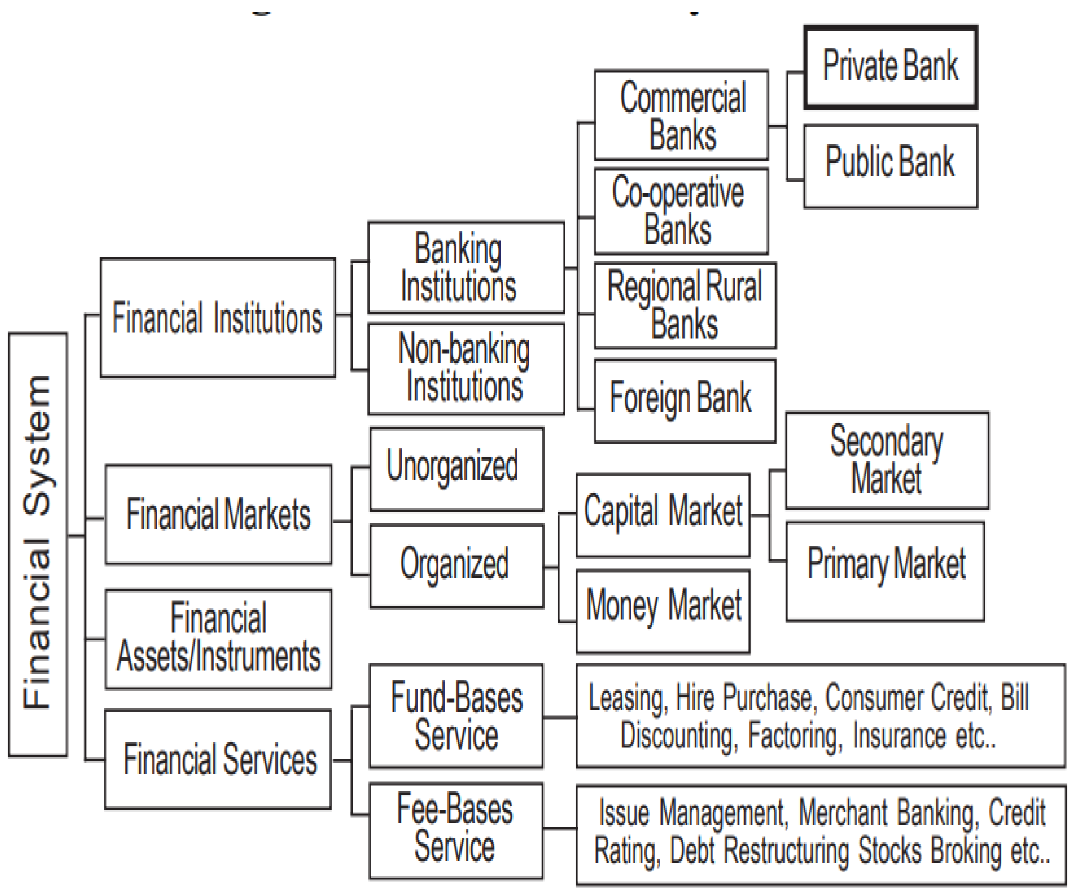

Figure 1: Structure of the financial system

7.3.1 Financial institutions/ Intermediaries: A financial intermediary is an institution that connects the deficit and the surplus. The best example of an intermediary can be a bank that transforms bank deposits into bank loans. The role of a financial intermediary is to channel funds from people who have an extra inflow of money i.e., the savers to those who do not have enough money to fulfill their needs or to carry out the basic activities i.e. the borrowers.

Functions of Financial Intermediaries are basically classified into three parts which are as follows:

- *Maturity transformation* – Deals with the conversion of short-term liabilities to long-term assets.
- *Risk transformation* – Conversion of risky investments into relatively risk-free ones.
- *Convenience denomination* – The way of making the unmatched matching which is matching small deposits with large loans and large deposits with small loans.

The financial intermediary may be in the organised sector or in the unorganised sector. This may also be classified into two:

(i) *Capital market intermediaries:* These intermediaries mainly provide long-term funds to individuals and corporate customers. They consist of term lending institutions like financial corporations and investing institutions like LIC.

(ii) *Money market intermediaries:* Money market intermediaries supply only short-term funds to individuals and corporate customers. They consist of commercial banks, co-operative banks, etc Financial institutions may be Regulatory, Intermediaries, Non-Intermediaries, and Others.

Financial institutions may be Regulatory, Intermediaries, Non-Intermediaries, and Others. Regulatory institutions are those which regulate the Financial Institutions. For example, RBI is the regulatory institution of the money market and SEBI is the regulatory institution of the capital market in India. Intermediaries are those institutions that intermediate between savers and investors. They are classified into Banking Financial Intermediary (BFI) and Non-Banking Financial Intermediary (NBFI). Banking Financial Intermediaries are the creators of credit. They accept deposits and give loans and advances. E.g. Commercial Banks (Public and Private), Co-op. Banks, RRBs. On the other hand, Non-Banking Financial Intermediaries are mere suppliers of credit. They have no credit creation capacity- E.g., LIC, GIC, UTI. Non-Intermediaries do the loan business but their resources are not directly obtained from savers. They came into existence because of a governmental effort to provide for specific purposes, sections, and regions-E.g., IDBI, IFC, NABARD. Other intermediaries are unorganised financial institutions. They include Money Lenders, Indigenous bankers, Traders, Pawn Brokers, Land Lords, etc.

7.3.2 Financial Instruments: The variety of financial instruments available in the system can be used to determine the level of development of the Financial System. It is a written legal agreement between two parties to transfer anything of value, usually money, to the other party at a later period and under specified conditions. The obligation's enforcement is critical. Financial instruments bind one party (a person, a firm, or the government) to make a transfer to another. Payment will be paid at a later date, according to financial instruments. Financial instruments stipulate the terms under which payment will be paid. Can be classified generally as –

1. Equity-based, representing ownership of the asset,
2. Debt-based, representing a loan made by an investor to the owner of the asset.
3. Foreign exchange instruments comprise a third, unique type of instrument

Features of Financial instruments

1. Easily transferable
2. Have a ready market
3. Possess liquidity
4. Can be used as a security for raising loan
5. Some have tax saving

Financial instruments can also be called financial securities. Financial securities can be classified into:

(i) Primary or direct securities: These are securities directly issued by the ultimate investors to the ultimate savers, e.g., shares and debentures issued directly to the public.

(ii) Secondary or indirect securities: These are securities issued by some intermediaries called financial intermediaries to the ultimate savers, e.g., Unit Trust of India and Mutual Fund's issue securities in the form of units to the public, and the money pooled is invested in companies.

Again, these securities may be classified on the basis of duration as follows:

(i) Short-term securities.

(ii) Medium-term securities.

(iii) Long-term securities.

Short-term securities are those which mature within a period of one year, e.g., Bill of Exchange, Treasury Bill, etc. Medium-term securities are those which have a maturity period ranging between one to five years, e.g., Debentures maturing within a period of five years. Long-term securities are those which have a maturity period of more than five years, e.g., Government Bonds maturing after ten years.

7.3.3 Financial Services: Financial service is part of the financial system that provides different types of finance through various credit instruments, financial products, and services. Financial Services is also the term used to describe organizations that deal with the management of money. Examples are banks, investment banks, insurance companies, credit card companies, and stock brokerages. In financial instruments, we come across cheques, bills, promissory notes, debt instruments, letters of credit, etc. While in financial products, we deal with different types of mutual funds which extend various types of investment opportunities.

In addition, there are also products such as credit cards, debit cards, etc. But in services we have leasing, factory, hire purchase finance, etc., through which various types of assets can be acquired either for ownership or on lease. There are different types of leases as well as factoring too. Thus, financial services enable the user to obtain any asset on credit, according to his convenience and at a reasonable interest rate. Financial Services are generally not limited to the field of deposit-taking, loan and investment services, but is also present in the fields of insurance, estate, trust and agency services, securities, and all forms of financial or market intermediation including the distribution of financial products. That is the financial services include all activities connected with the transformation of savings into investment. The important financial services include lease financing, hire purchase, installment payment systems, merchant banking, factoring, forfaiting, etc.

7.3.4 Financial Markets: Financial markets are the centers or arrangements that provide facilities for buying and selling of financial claims and services. The corporations, financial institutions, individuals, and governments trade in financial products in these markets either directly or through brokers and dealers on organised exchanges or off-exchanges. The participants on the demand and supply sides of these markets are financial institutions, agents, brokers, dealers, borrowers, lenders, savers, and others who are interlinked by the laws, contracts, covenants, and communication networks. Financial markets are sometimes classified as primary (direct) and secondary (indirect) markets. The primary markets deal in the new financial claims or new securities and, therefore, they are also known as new issue markets. On the other hand, secondary markets deal in securities already issued or existing, or outstanding. The primary market mobilises savings and supplies fresh or additional capital to business units. Although secondary markets do not contribute directly to the supply of additional capital, they do so indirectly by rendering securities issued on the primary market’s liquid. Stock markets have both primary and secondary market segments. Very often financial markets are classified as money markets and capital markets, although there is an essential difference between the two as both perform the same function of transferring resources to the producers. This conventional distinction is based on the differences in the period of maturity of financial assets issued in these markets. While money markets deal in the short-term claims (with a period of maturity of one year or less), capital markets do so in the long-term (maturity period above one year) claims. Contrary to popular usage, the capital market is not only co-existence with the stock market; but it is also much wider than the stock market. Similarly, it is not always possible to include a given participant in either of the two (money and capital) markets alone.

Commercial banks, for example, belong to both. While treasury bills market, call money market, and commercial bills markets are examples of money market, stock market and government bonds markets are examples of the capital market.

Financial Market serves the following basic functions:

a) Borrowing and Lending: Financial markets perform the essential economic function of channelling funds from households, firms, and governments that have saved surplus funds by spending less than their income to those that have a shortage of funds because they wish to spend more than their income. Those who have saved and are lending funds, the lender-savers, are at the left, and those who must borrow funds to finance their spending, the borrower-spenders, are at the right.

b) Price Determination: The financial commodities traded in a financial market get their prices from the rules of demand and supply. The investors or the household are the suppliers of the funds, and the industries are the ones demanding them. The interaction between the two and other market factors will help determine the prices.

c) Information aggregation and Coordination: FM acts as collectors and aggregators of information about financial asset values and the flow of funds from lenders to borrowers.

d) Risk Sharing: FM allows a transfer of risk from those who undertake investment to those who provide funds for investment.

e) Liquidity: The instruments sold in the financial market tend to have high liquidity. This means at any given time the investors can sell their financial commodities and convert them to cash in a very short period. This is an important factor for investors who do not want to invest long-term.

f) Efficiency: Channelling of funds from savers to spenders is so important to the economy because the people who save are frequently not the same people who have profitable investment opportunities available to them, the entrepreneurs. Without financial markets, it is hard to transfer funds from a person who has no investment opportunities to one who has them. Financial markets are thus

7.4 TEST YOUR UNDERSTANDING

1. Differentiate between financial institutions and financial instruments.

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2. Discuss various types of banking institutions.

7.5 FINANCIAL MARKET TYPES

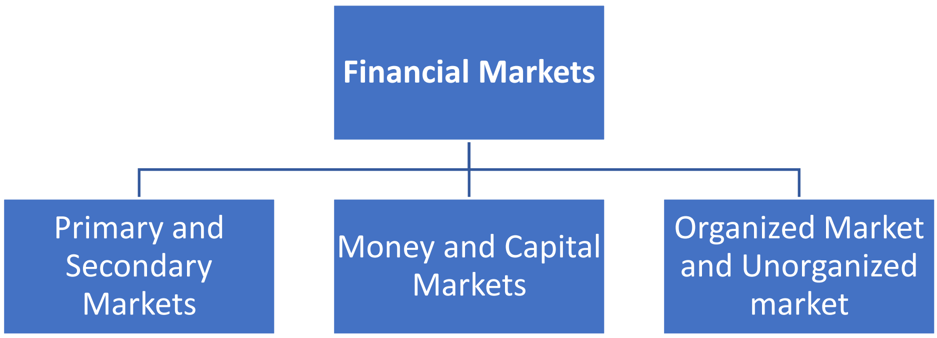

Figure 2: Types of Financial Market

i) Primary and Secondary Markets: A primary market is a financial market in which new issues of security, such as a bond or a stock, are sold to initial buyers by the corporation or government agency borrowing the funds. A secondary market is a financial market in which securities that have been previously issued can be resold. The primary markets for securities are not well known to the public because the selling of securities to initial buyers often takes place behind closed doors. An important financial institution that assists in the initial sale of securities in the primary market is the investment bank. It does this by underwriting securities: It guarantees a price for a corporation's securities and then sells them to the public.

The New York Stock Exchange, NASDAQ (National Association of Securities Dealers Automated Quotation System), Bombay Stock Exchange (BSE), and National Stock Exchange (NSE) in which previously issued stocks are traded, are the best-known examples of secondary markets, although the bond markets, in which previously issued bonds of major corporations and the government are bought and sold, actually have a larger trading volume. Other examples of secondary markets are foreign exchange markets, futures markets, and options markets. Securities brokers and dealers are crucial to a well-functioning secondary market. Brokers are agents of investors who match buyers with sellers of securities; dealers link buyers and sellers by buying and selling securities at stated prices. When an individual buys a security in the secondary market, the person who has sold the security receives money in exchange for the security, but the corporation that issued the security acquires no new funds. A corporation acquires new funds only when its securities are first sold in the primary market. Nonetheless, secondary markets serve two important functions. First, they make it easier and quicker to sell these financial instruments to raise cash; that is, they make the financial instruments more liquid. The increased liquidity of these instruments then makes them more desirable and thus easier for the issuing firm to sell in the primary market. Second, they determine the price of the security that the issuing firm sells in the primary market. The investors who buy securities in the primary market will pay the issuing corporation no more than the price they think the secondary market will set for this security. The higher the security's price in the secondary market, the higher the price that the issuing firm will receive for new security in the primary market, and hence the greater the amount of financial capital it can raise. Conditions in the secondary market are therefore the most relevant to corporations issuing securities. It is for this reason that books like this one, which deals with financial markets, focus on the behaviour of secondary markets rather than primary markets.

ii) Money and Capital Markets: Another way of distinguishing between markets is on the basis of the maturity of the securities traded in each market. The money market is a financial market in which only short-term debt instruments (generally those with an original maturity of less than one year) are traded; the capital market is the market in which longer-term debt (generally with an original maturity of one year or greater) and equity instruments are traded. Money market securities are usually more widely traded than longer-term securities and so tend to be more liquid. In addition, short-term securities have smaller fluctuations in prices than long-term securities, making them safer investments. As a result, corporations and banks actively use the money market to earn interest on surplus funds that they expect to have only temporarily. Capital market securities, such as stocks and long-term bonds, are often held by financial intermediaries such as insurance companies and pension funds, which have little uncertainty about the amount of funds they will have available in the future.

iii) Organized Market and Unorganized market: Organized market is that part of the financial market, which operates under a defined set of rules, regulations, and legal provisions, and the statutory authorities such as the Central Government, the Central Bank the Exchange Commission (such as SEBI in India), etc. The organized market may also be called the official or formal market. Unorganized is that part of the financial markets, which is not standardized and is outside the preview of government control. In India, the rural money lenders and traders form the unorganized market. The basic features of an unorganized market are high-interest rates, fluctuating and varying interest rates, absence of precise rules, upfront payment of interest, unsystematic arrangements, etc.

7.6 CONSTITUENTS OF THE INDIAN FINANCIAL MARKET

The Indian financial market comprises, in the main, the:

• **Credit market**: The credit market is the predominant source of finance. As the Indian capital market is relatively underdeveloped, firms or economic entities depend largely on financial intermediaries for their fund requirements. In terms of sources of credit, they could be broadly categorised as institutional and non-institutional. The major institutional purveyor of credit in India are banks and non-banking financial institutions, i.e., development financial institutions (DFIs) and other financial institutions (FIs) and non-banking financial companies (NBFCs) including housing finance companies (HFCs). The non-institutional or unorganised sources of credit include moneylenders, indigenous bankers, and sellers for trade credit. An important aspect of the credit market is its term structure, viz., (i) short-term credit, (ii) medium-term credit, and (iii) long-term credit. While banks and NBFCs predominantly cater to short-term needs, FIs provide mostly medium- and long-term funds.

Banks*:* Banks in India can be broadly classified as commercial banks and cooperative banks. In terms of ownership and function, commercial banks can be grouped into three categories — public sector banks, regional rural banks, and private sector banks (both domestic and foreign). These banks have a very large member of branches spread wide across the country. After the initiation of financial sector reforms, competition in the banking sector has increased. As a result of the removal of restrictions on project financing, the share of term loans as a percentage of total bank loans went up considerably. An important development in the financial sector in the recent years has been the diversification and growth of para-banking activities such as leasing, hire purchase, factoring, etc. The reasons for banks entering para-banking activities include the need for diversifying earnings, maximising economies of scale and scope, making profits, and also the desire to have leading market positions in financial services. Following the erstwhile UK model, in India, these diversified financial activities are undertaken mostly by subsidiaries of banks. Merchant banking is an important area where subsidiaries of banks have made their presence felt. Merchant banking includes services such as pre-issue, management of the public issue, etc., and as such is dependent on the conditions in the stock market. Dealing in government securities is another area where banks have been fairly active. Venture capital is a new area where banks have entered. Many banking subsidiaries are also quite active in the field of housing finance. Banking subsidiaries are also operating in the credit card business. There is a shared responsibility between the Reserve Bank and SEBI in the regulation of para-banking activities of banks. In India, a prudential regulatory framework based on capital adequacy is in place in the case of para-banking subsidiaries as well.

Financial Institutions*:* A large variety of financial institutions has come into existence over the years to perform a variety of financial activities. While some of them operate at all-India level, others are state-level institutions. All-India financial institutions (AIFIs) consist of all-India development banks, specialised financial institutions, investment institutions and refinance institutions. The state-level institutions, on the other hand, comprise a number of State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs). All-India development banks (IDBI, IFCI, ICICI, SIDBI, and IIBI) occupy an important position in the financial system as the main source of medium- and long-term project finance for the industry. Besides, specialised financial institutions are also operating in the areas of export-import (EXIM Bank, infrastructure (IDFC), tourism (TFCI), and venture capital (IVCF, ICICI Venture). Investment institutions in the business of mutual funds (UTI) and insurance activity (LIC, GIC, and its subsidiaries) have also played significant roles in the mobilisation of household sector savings and their deployment in the credit and the capital markets. In the agriculture and rural sector and the housing sector, the NABARD and NHB respectively, are acting as the chief refinancing institutions. Both of them are also vested with certain supervisory functions. Besides providing direct loans (including rupee loans, and foreign currency loans), financial institutions also extend financial assistance by way of underwriting and direct subscription and by issuing guarantees. Recently, some development financial institutions (DFIs) have started extending short-term/working capital finance, although term-lending continues to be their primary activity.

Non-banking Financial Companies (NBFCs): Non-banking financial companies (NBFCs) are financial intermediaries engaged primarily in the business of accepting deposits and making loans and advances, investments, leasing, and hire purchases, etc. NBFCs are a heterogeneous lot. NBFC sector is characterised by a large number of privately owned, decentralised, and relatively small-sized financial intermediaries. NBFCs are of various types, such as, loan companies (LCs), investment companies (ICs), hire purchase finance companies (HPFCs), equipment leasing companies (ELCs), mutual benefit financial companies (MBFCs) also known as Nidhis, miscellaneous non-banking companies (MNBCs) also known as Chit Funds and residuary non-banking companies (RNBCs). Loan companies, investment companies, hire purchase finance companies, and equipment leasing companies are defined on the basis of the principal activity of their business. Although NBFCs in India have existed for a long time, they shot into prominence in the second half of the eighties and in the first-half of the nineties, as deposits raised by them grew rapidly. Customer orientation, concentration in the main financial centers, and attractive rates of return offered by them are some of the reasons for their rapid growth. Primarily engaged in the area of retail banking, they face competition from banks and financial institutions.

Housing Finance Companies (HFCs): In India, investment in housing is mainly financed by own sources or from the informal credit market. The formal housing finance institutions contribute only a small percentage of housing investments in the country. However, within the formal housing finance sector, the conventional sources of housing finance in India have been the public sector institutions. Over the years, they were found to be grossly inadequate to meet the requirements of the new investments and maintenance of housing and habitat systems. Accordingly, since the mid-eighties, efforts have been directed at the development of housing finance institutions to meet the large resource gap that exists for housing finance in the country. A policy shift to encourage private and cooperative sectors in housing could be discerned and the necessary legal and regulatory changes are being effected in this regard. The formal segment of housing finance includes funding provided by the Central and State Governments and funds from financial institutions like GIC, LIC, commercial banks, specialised housing finance institutions, and cooperative banks. HUDCO was set up in April 1970 as an apex techno-finance organisation in order to provide loans and technical support to state and city level organisations. The State Governments are responsible for implementing social housing schemes. Almost all the States have set up Housing Boards in order to facilitate the implementation of the social housing schemes. Cooperative banks have been financing housing schemes. Cooperative banks cater to economically weaker sections, low and middle-income groups as well as cooperative or group housing societies. The second formal tier of housing finance consists of insurance corporations, commercial banks, and housing finance companies. In recognition of the need for developing a network of specialised housing finance institutions in the country, the National Housing Bank was set up in July 1988 as a wholly-owned subsidiary of the Reserve Bank under the National Housing Bank Act, 1987, to function as an apex bank for the housing finance. NHB regulates HFCs, refinances their operations, and expands the spread of housing finance to different income groups all over the country, while functioning within the overall framework of the housing policy. It has also helped in diverting increasing proportions of annual provident fund accumulations for housing finance through housing-linked savings schemes for provident fund subscribers.

***Foreign Exchange Market*:** The foreign exchange market in India comprises customers, authorised dealers (ADs), and the Reserve Bank. With the transition to a market-determined exchange rate system in March 1993 and the subsequent gradual but significant liberalisation of restrictions on various external transactions, the forex market in India has acquired more depth. The Indian forex market has grown in depth in the 1990s as a result of the implementation of a number of recommendations of three important committees, viz., the High-Level Committee on Balance of Payments (Chairman: Dr. C. Rangarajan), the Report of the Expert Group on Foreign Exchange Markets in India (Chairman: Shri O.P. Sodhani) and the Committee on Capital Account Convertibility (Chairman: Shri S.S. Tarapore).

Since the unification of the exchange rate in March 1993, several measures have been introduced to widen and deepen the forex market. First, banks have been given the freedom to: (i) fix net overnight position limits and gap limits (with the Reserve Bank formally approving the limits), (ii) initiate a trading position in the overseas markets, (iii) determine the interest rates of NRI deposits (linked to LIBOR in the case of FCNR(B) deposits) and maturity period [minimum maturity of one year in the case of FCNR(B) deposits]. Secondly, inter-bank borrowings have been exempted from statutory pre-emptions. Thirdly, banks have been permitted the use of derivative products for asset-liability management. Fourthly, in order to facilitate the integration of domestic and overseas money markets, ADs have been allowed to borrow abroad. However, as a prudential measure, their external borrowings have been related to their capital base. Fifthly, corporates have been provided significant freedom in managing their foreign exchange exposures. They are permitted to hedge anticipated exposures, though this facility has also been temporarily suspended after the Asian crisis. Exchange Earners' Foreign Currency (EEFC) account entitlement has also been rationalised. Risk management strategies like the freedom to cancel and rebook forward contracts have been allowed to corporates. Other risk management tools like cross-currency options on a back-to-back basis, lower-cost option strategies like range forwards and ratio range forwards, and hedging of external commercial borrowing (ECB) exposures have been allowed subject to prudential requirements.

• **Debt market:** The domestic debt market comprises two main segments, viz., the Government securities and other (mainly corporate) securities comprising private corporate debt, PSU bonds, and DFIs' bonds. The government securities market is predominant, while the other segment is not very deep and liquid. Government Securities Market: The size of the Government securities market is large and growing. The Government securities market witnessed a significant transformation in the 1990s. Its development was constrained mainly by a lack of definite limits on the automatic monetisation of the Central Government budget deficits and by relatively low coupon rates offered on the Government securities. The artificially low yield on Government securities had an impact on the entire yield structure of financial assets in the system. Both these factors were corrected during the nineties. As regards the secondary market, there was not much activity which was hindered by low bond yields and the predominance of captive investors. The secondary market activity increased following the introduction of auction-based yields. The activity in the secondary market could further pick up once bond yields are better aligned and investors, other than institutions (banks and insurance companies) start actively transacting in the market. As a part of developing money market instruments, a variety of Treasury bills, viz., 14-day, 91-day, 182-day, and 364-day maturities have been introduced. Innovations have also been introduced with respect to long-term bonds, which include zero-coupon bonds, floating-rate bonds, and capital indexed bonds. The main investors in the Government securities market in India are commercial banks, cooperative banks, insurance companies, provident funds, financial institutions (including term-lending institutions), mutual funds especially the gilt funds, primary dealers, satellite dealers, non-bank finance companies, and corporate entities. The Reserve Bank also absorbs the primary issuance of Government securities, either through private placement or devolvement. Though banks have traditionally been the dominant investors in the Government securities due mainly to SLR requirements, they have, in recent years, found it advantageous to invest in the Government securities beyond the statutory requirements partly because of the better risk-return characteristic of such securities in the context of adherence to capital adequacy requirements and partly because of relatively sluggish demand for commercial credit. A large participant base reduces the borrowing cost for the Government, reduces market volatility, and imparts competition in the market. A market with adequate depth and liquidity for participants with different perceptions and liquidity requirements should emerge; this is also essential to avoid unidirectional movements in the market. The present structure of the Government securities market is predominantly institutional, while the household participation is negligible or nearly absent. Foreign Institutional Investors (FIIs) are also permitted to invest in the dated Government securities and Treasury bills, both in the primary and secondary markets, within the overall debt ceilings. A crucial issue in the development of the Government securities market is the need for a well-functioning secondary market, which requires: (i) a transparent system of trading; (ii) a secure system of settlement of transactions; (iii) an institutional structure whereby the market players have divergent perceptions about liquidity and interest rates; and (iv) a liquid market with a matured system of price determination. To develop the secondary market for the Government securities, the following measures were initiated.

Secondary Market Window: The central banks often play the role of market makers providing two-way quotes through their sales window to infuse liquidity in the secondary market for the Government securities. Generally, two approaches are adopted for operating the secondary market window by the central banks: (i) fixing buying and selling prices and announcing them to the market, and (ii) using a dynamic approach whereby the secondary market window pricing is continuously adjusted in response to the market dynamics. During the initial stages of market development, the Reserve Bank used to announce the sale and purchase prices of securities. In the recent period, however, the Reserve Bank has offered a select list of securities for sale, depending upon supply and demand conditions. A few securities are also included in the purchase list, with a view to improving liquidity through select securities. The sale/purchase prices and the securities offered on sale are frequently revised. Discount House Arrangements: The DFHI was originally set up in April 1988 for developing the money market. It was also allowed to participate in Treasury bills and dated securities. Further, for developing an efficient institutional infrastructure for an active secondary market in Government securities and public sector bonds, the Securities Trading Corporation of India (STCI) was set up in May 1994. Both DFHI and STCI later transformed themselves into PDs. Primary Dealer System: The primary dealer system was evolved and made functional in 1996 with the objective of strengthening the securities market infrastructure and bringing about improvement in the secondary market trading, liquidity, and turnover in Government securities as also encouraging their voluntary holding amongst a wider investor base. PDs have ensured maximum participation in the auctions of Government securities. In the secondary market, they act as market makers by providing continuous two-way quotes thereby ensuring liquidity and support to the success of primary market operations. The system also creates appropriate conditions for open market operations of the Reserve Bank and facilitates the transfer of market-making activities from the Reserve Bank to the market agents. Satellite Dealers: With a view to broadening the market with a second tier of dealer system in trading and distribution and imparting greater momentum in terms of increased liquidity and turnover, a system of SDs was put in place in December

1996. The network of satellite dealers provides retail outlets thereby encouraging voluntary holding of Government securities among a wide investor base. The SDs are also given limited liquidity support from the Reserve Bank. Gilt Funds: The Reserve Bank also encouraged setting up of mutual funds dealing exclusively in gilts, called gilt funds with a view to encouraging schemes of mutual funds dedicated to Government securities and creating a wider investor base for them. Mutual funds dedicated exclusively to invest in Government securities are also provided liquidity support by the Reserve Bank by way of reverse repos in Central Government securities outstanding at the end of the previous calendar month. The market efficiency is significantly influenced by the transaction costs or costs of trading. The transaction costs are, in turn, determined by the type of trading, clearing and settlement system existing in a market. A well-developed market in Government securities requires a system of transparent pricing and allotment, which, in a special sense, refers to information needs. In turn, such a system would imply active market-making activity and broad-based participation. The National Stock Exchange (NSE) introduced a transparent screen-based trading system in the wholesale debt market, including Government securities in June 1994. The trading system known as National Exchange for Automated Trading (NEAT) is a fully automated screen-based trading system. The Over-the-Counter Exchange of India (OTCEI) also started trading in Government securities in July 1997. However, a major part of government securities transactions in the secondary market is operated through over-the-counter negotiated deals. The brokers, who are members of the NSE and OTCEI, can transact business on behalf of commercial banks. The OTCEI and NSE markets complement each other. As announced in the Mid-term Review of Monetary and Credit Policy for 2000-01, the Reserve Bank has taken an in-principal decision to move over in due course to order-driven screen-based trading in Government securities on the stock exchanges. The screen-based trading system would be applicable to all stock exchanges on which banks and FIs can operate.

• **Derivatives market:** Financial derivatives in the Indian financial markets are of recent origin barring trade-related forward contracts in the forex market. Recently, over-the-counter (OTC) as well as exchange-traded derivatives have been introduced, marking an important development in the structure of financial markets in India. Forward contracts in the forex market have also been liberalised. Exchange-traded derivatives tend to be more standardised and offer greater liquidity than OTC contracts, which are negotiated between counterparties and tailored to meet the needs of the parties to the contract. Exchange-traded derivatives also offer centralised limits on individual positions and have formal rules for risk and burden-sharing.

7.7 NATURE OF THE FINANCIAL MARKET

Financial markets are the center that facilitates buying and selling of financial instruments, claims, or services. Financial markets are critical for producing an efficient allocation of capital, allowing funds to move from people who lack productive investments opportunities to people who have them. It caters to the credit needs of individuals, firms, and institutions. The financial market deals with the financial assets or instruments of different types such as currency deposits, cheques, bills, bonds, etc. the main participants in the financial markets are financial institutions, agents, brokers, dealers, borrowers, savers, lenders, and others who are interconnected by law, contract and communication networks. The important role performed by a financial market is described below.

- They generate and apportion credits.
- They serve as intermediaries in the process of mobilization of savings.
- They provide convenience and benefits to the lender and borrowers. They promote the economic development through a balanced regional and sectoral allocation of investible funds.

7.8 REVIEW QUESTIONS

1. What are financial markets? Explain their basis.
2. Explain the constituents of financial markets.
3. State the functions of financial markets.
4. Differentiate between capital market and money market.
5. Discuss the nature of the financial market.

7.9 FURTHER READINGS

1. Shashi K Gupta, Nisha Agarwal & Neeti Gupta, “Financial Institutions and Market”, Kalyani Publishers, New Delhi.
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4. David S. Kidwell, David W. Blackwell, David A. Whidbee, and Richard W. Sias, " Financial Institutions, Markets, and Money", 12th edition, Wiley Publications.
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SEMESTER I

COURSE: BUSINESS ENVIRONMENT

UNIT 8 – CAPITAL MARKETS

STRUCTURE

8.0 OBJECTIVES

After studying the Unit, students will be able to

- Define the Meaning of capital markets.
- Explain the functions of capital markets.
- Explain the structure of capital market system.
- Discuss capital market types.
- Explain the nature of capital market.

8.1 INTRODUCTION TO CAPITAL MARKETS

A good capital market is an essential pre-requisite for the industrial and commercial development of a country. Credit is generally, required and supplied on a short-term and long-term basis. The long-term capital needs are met by the capital market. The capital market is a central coordinating and directing mechanism for the free and balanced flow of financial resources into the economic system operating in a country. The development of a good capital market in a country is dependent upon the availability of savings, proper organisation of its constituent units, and the entrepreneurship qualities of its people.

According to V.K. Bhalla, "Capital market can be defined as the mechanism which channelizes savings into investment or productive use. Capital markets allocate the resources amongst alternative uses. It intermediates flow of savings of those who save a part of their income from those who want to invest it in productive assets".

A capital market is a market for medium- and long-term funds. It includes all organisations, institutions, and instruments that provide long-term and medium-term funds. It does not include the instruments or institutions which provide finance for short period (upto one year). The common instrument used in the capital market are shares, debentures, bonds, funds, public deposits, etc.

8.2 CLASSIFICATION OF THE CAPITAL MARKET

The Capital market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long-term funds are pooled and made available to businesses, government, and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

The Securities Market, however, refers to the markets for those financial instruments/claims/obligations that are commonly and readily transferable by sale. The Securities Market has two interdependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.

The Primary market provides the channel for the sale of new securities. The issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge some obligation.

The Secondary market deals in securities previously issued. The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs.

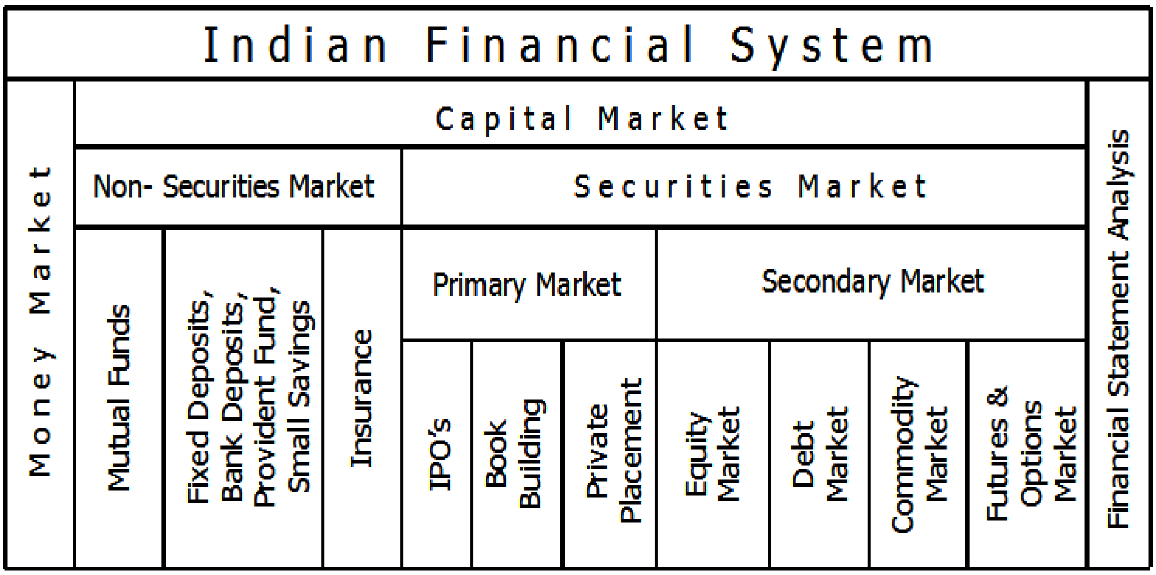
The price signals, which subsume all information about the issuer and his business including associated risk, generated in the secondary market, help the primary market in the allocation of funds.

This secondary market has further two components.

First, the spot market where securities are traded for immediate delivery and payment.

The other is the forward market where the securities are traded for future delivery and payment. This forward market is further divided into Futures and Options Market (Derivatives Markets).

In the futures market the securities are traded for conditional future delivery whereas, in the options market, two types of options are traded. A put option gives the right but not an obligation to the owner to sell a security to the writer of the option at a predetermined price before a certain date, while a call option gives the right but not an obligation to the buyer to purchase a security from the writer of the option at a particular price before a certain date.



8.3 EQUITY MARKET

A market is a location where buyers and sellers come into contact to exchange goods or services. Markets can exist in various forms depending on various factors.

Securities Markets in India: An Overview: The process of economic reforms and liberalization was set in motion in the mid-eighties and its pace was accelerated in 1991 when the economy suffered severely from a precariously low foreign exchange reserve, burgeoning imbalance in the external account, declining industrial production, galloping inflation and a rising fiscal deficit. The economic reforms, being an integrated process, included deregulation of industry, liberalization in foreign investment, regime, restructuring, and liberalization of trade, exchange rate, and tax policies, partial disinvestments of government holding in public sector companies, and financial sector reforms. The reforms in the real sectors such as trade, industry, and fiscal policy were initiated first in order to create the necessary macroeconomic stability for launching financial sector reforms, which sought to improve the functioning of the banking and financial institutions (FIs) and strengthen money and capital markets including securities market. The securities market reforms specifically included:

- Repeal of the Capital Issues (Control) Act, 1947 through which the Government used to expropriate and allocate resources from the capital market for favored uses;
- Enactment of the Securities and Exchange Board of India Act, 1992 to provide for the establishment of the Securities and Exchange Board of India (SEBI) to regulate and promote the development of the securities market;
- Setting up of NSE in 1993, passing of the Depositories Act, 1996 to provide for the maintenance and transfer of ownership of securities in book-entry form;
- Amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA) in 1999 to provide for the introduction of futures and options.
- Other measures included free pricing of securities, investor protection measures, use of information technology, dematerialization of securities, improvement in trading practices, the evolution of an efficient and transparent regulatory framework, the emergence of several innovative financial products and services, and specialized FIs, etc.

These reforms are aimed at creating an efficient and competitive securities market subject to effective regulation by SEBI, which would ensure investor protection.

A Profile: The corporate securities market in India dates back to the 18^{th} century when the securities of the East India Company were traded in Mumbai and Kolkotta. The brokers used to gather under a Banyan tree in Mumbai and under a Neem tree in Kolkota for the purpose of trading those securities. However, the real beginning came in the 1850's with the introduction of joint-stock companies with limited liability. The 1860's witnessed feverish dealings in securities and reckless speculation. This brought brokers in Bombay together in July 1875 to form the first formally organized stock exchange in the country viz. The Stock Exchange, Mumbai. Ahmedabad stock exchange in 1894 and 22 others followed this in the 20th century. The process of reforms has led to a pace of growth almost unparalleled in the history of any country. The securities market in India has grown exponentially as measured in terms of the amount raised from the market, the number of stock exchanges and other intermediaries, the number of listed stocks, market capitalization, trading volumes and turnover on stock exchanges, investor population, and price indices. Along with this, the profiles of the investors, issuers, and intermediaries have changed significantly. The market has witnessed fundamental institutional changes resulting in a drastic reduction in transaction costs and significant improvements in efficiency, transparency, and safety, thanks to the National Stock Exchange. The Indian market is now comparable to many developed markets in terms of a number of parameters.

Structure and Size of the Markets: Today India has two national exchanges, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Each has fully electronic trading platforms with around 9400 participating broking outfits. Foreign brokers account for 29 of these. There are some 9600 companies listed on the respective exchanges with a combined market capitalization near $125.5bn. Any market that has experienced this sort of growth has an equally substantial demand for highly efficient settlement procedures. In India, 99.9% of the trades, according to the National Securities Depository, are settled in dematerialized form in a T+2 rolling settlement The capital market is one environment. In addition, the National Securities Clearing Corporation of India Ltd (NSCCL) and Bank of India Shareholding Ltd (BOISL), Clearing Corporation houses of NSE and BSE, guarantee trades respectively. The main functions of the Clearing Corporation are to work out (a) what counter parties owe and (b) what counter parties are due to receive on the settlement date.

Furthermore, each exchange has a Settlement Guarantee Fund to meet with any unpredictable situation and a negligible trade failure of 0.003%. The Clearing Corporation of the exchanges assumes the counter-party risk of each member and guarantees settlement through a fine-tuned risk management system and an innovative method of online position monitoring. It also ensures the financial settlement of trades on the appointed day and time irrespective of default by members to deliver the required funds and/or securities with the help of a settlement guarantee fund.

Style of Operating: Indian stock markets operated in the age-old conventional style of fact-to-face trading with bids and offers being made by open outcry. At the Bombay Stock Exchange, about 3,000 persons would mill around in the trading ring during the trading period of two hours from 12.00 noon to 2.00 p.m. Indian stock markets are basically quote-driven markets with the jobbers standing at specific locations in the trading ring called trading posts and announcing continuously the two-way quotes for the scrips traded at the post. As there is no prohibition on a jobber acting as a broker and vice versa, any member is free to do jobbing on any day. In actual practice, however, a class of jobbers has emerged who generally confine their activities to jobbing only. As there are no serious regulations governing the activities of jobbers, the jobbing system is beset with a number of problems like wide spreads between bids and offers; particularly in thinly traded securities, lack of depth, and total absence of jobbers in a large number of securities, etc. In highly volatile scrips, however, the spread is by far the narrowest in the world being just about 0.1 to 0.25 percent as compared to about 1.25 per cent in respect of alpha stocks, i.e. the most highly liquid stocks, at the International Stock Exchange of London. The spreads widen as liquidity decreases, being as much as 25 to 30 per cent or even more while the average touch of gamma stocks, i.e. the least liquid stocks at the International Stock Exchange, London, is just about 6 to 7 per cent. This is basically because of the high velocity of transactions in the active scrips. In fact, shares in the specified group account for over 75 percent of trading in the Indian stock markets while over 25 percent of the securities do not get traded at all in any year. Yet, it is significant to note that out of about 6,000 securities listed on the Bombay Stock Exchange, about 1,200 securities get traded on any given trading day.

The question of automating trading has always been under the active consideration of the Bombay Stock Exchange for quite some time. It has decided to have traded in all the non-specified stocks numbering about 4,100 totally on the computer on a quote-driven basis with the jobbers, both registered and roving, continuously keying in their bids and offers into the computer with the market orders getting automatically executed at the touch and the limit orders getting executed at exactly the rate specified.

In March 1995, the BSE started the computerized trading system, called BOLT - BSE on-line trading system. Initially, only 818 scripts were covered under BOLT. In July 1995, all scripts (more than 5,000) were brought under the computerized trading system. The advantages realized are: (a) improved trading volume; (b) reduced spread between the buy-sell orders; c) better trading in odd lot shares, rights issues, etc.

Highlights of the Highly Attractive Indian Equity Market: Two major reasons why Indian securities are now increasingly regarded as attractive to international investors are the relatively high returns compared with more developed global markets as well as the low correlation with world markets.

8.4 TEST YOUR UNDERSTANDING

1. Differentiate between money market and capital market.

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2. Discuss various types of capital markets.

8.5 DEBT MARKET

The National Stock Exchange started its trading operations in June 1994 by enabling the Wholesale Debt Market (WDM) segment of the Exchange. This segment provides a trading platform for a wide range of fixed income securities that includes central government securities, treasury bills (T-bills), state development loans (SDLs), bonds issued by public sector undertakings (PSUs), floating-rate bonds (FRBs), zero-coupon bonds (ZCBs), index bonds, commercial papers (CPs), certificates of deposit (CDs), corporate debentures, SLR and non-SLR bonds issued by financial institutions (FIs), bonds issued by foreign institutions and units of mutual funds (MFs).

To further encourage wider participation of all classes of investors, including the retail investors, the Retail Debt Market segment (RDM) was launched on January 16, 2003. This segment provides for a nationwide, anonymous, order-driven, screen-based trading system in government securities. In the first phase, all outstanding and newly issued central government securities were traded in the retail debt market segment. Other securities like state government securities, T-bills, etc. will be added in subsequent phases. The settlement cycle is the same as in the case of the equity market i.e., the T+2 rolling settlement cycle.

8.6 DERIVATIVES MARKET

The emergence of the market for derivative products, most notably forwards, futures and options, can be traced back to the willingness of risk-averse economic agents to guard themselves against uncertainties arising out of fluctuations in asset prices. By their very nature, the financial markets are marked by a very high degree of volatility. Through the use of derivative products, it is possible to partially or fully transfer price risks by locking-in asset prices. As instruments of risk management, these generally do not influence the fluctuations in the underlying asset prices.

However, by locking-in asset prices, derivative products minimize the impact of fluctuations in asset prices on the profitability and cash flow situation of risk-averse investors.

Derivatives Defined: Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index, or reference rate), in a contractual manner. The underlying asset can be equity, forex, commodity, or any other asset. For example, wheat farmers may wish to sell their harvest at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of this derivative is driven by the spot price of wheat which is the "underlying".

In the Indian context the Securities Contracts (Regulation) Act, 1956 (SC(R)A) defines "derivative" to include –

- A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences, or any other form of security.
- A contract, which derives its value from the prices, or index of prices, of underlying securities.

Derivatives are securities under the SC(R)A and hence the trading of derivatives is governed by the regulatory framework under the SC(R)A.

Products, Participants, and Functions: Derivative contracts have several variants. The most common variants are forwards, futures, options, and swaps. The following three broad categories of participants - hedgers, speculators, and arbitrageurs trade in the derivatives market. Hedgers face risks associated with the price of an asset. They use futures or options markets to reduce or eliminate this risk. Speculators wish to bet on future movements in the price of an asset. Futures and options contracts can give them an extra leverage; that is, they can increase both the potential gains and potential losses in a speculative venture. Arbitrageurs are in business to take advantage of a discrepancy between prices in two different markets. If, for example, they see the futures price of an asset getting out of line with the cash price, they will take offsetting positions in the two markets to lock in a profit.

The derivatives market performs a number of economic functions. First, prices in an organized derivatives market reflect the perception of market participants about the future and lead the prices of underlying to the perceived future level. The prices of derivatives converge with the prices of the underlying at the expiration of the derivative contract. Thus, derivatives help in the discovery of future as well as current prices. Second, the derivatives market helps to transfer risks from those who have them but may not like them to those who have an appetite for them. Third, derivatives, due to their inherent nature, are linked to the underlying cash markets. With the introduction of derivatives, the underlying market witnesses higher trading volumes because of participation by more players who would not otherwise participate for lack of an arrangement to transfer risk. Fourth, speculative trades shift to a more controlled environment of the derivatives market. In the absence of an organized derivatives market, speculators trade in the underlying cash markets. Margining, monitoring and surveillance of the activities of various participants become extremely difficult in these kinds of mixed markets. Fifth, an important incidental benefit that flows from derivatives trading is that it acts as a catalyst for new entrepreneurial activity. The derivatives have a history of attracting many bright, creative, well-educated people with entrepreneurial attitudes. They often energize others to create new businesses, new products, and new employment opportunities, the benefit of which are immense. Finally, derivatives markets help increase savings and investment in the long run. Transfer of risk enables market participants to expand their volume of activity.

Types of Derivatives: The most commonly used derivatives contracts are forwards, futures, and options. Here we take a brief look at various derivatives contracts that have come to be used.

- <u>*Forwards:*</u> A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.
- <u>*Futures:*</u> A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange-traded contracts.
- <u>*Options:*</u> Options are of two types - calls and puts. Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the right, but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date.
- <u>*Warrants:*</u> Options generally have lives of up to one year, the majority of options traded on options exchanges having a maximum maturity of nine months. Longer-dated options are called warrants and are generally traded over-the-counter.

- *LEAPS:* The acronym LEAPS means Long-Term Equity Anticipation Securities. These are options having a maturity of up to three years.
- *Baskets:* Basket options are options on portfolios of underlying assets. The underlying asset is usually a moving average or a basket of assets. Equity index options are a form of basket options.
- *Swaps:* Swaps are private agreements between two parties to exchange cash flows in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. The two commonly used swaps are:

*Interest rate swap*s: These entail swapping only the interest related cash flows between the parties in the same currency and

*Currency swap*s: These entail swapping both principal and interest between the parties, with the cash flows in one direction being in a different currency than those in the opposite direction.

Swaptions: Swaptions are options to buy or sell a swap that will become operative at the expiry of the options. Thus, a swaption is an option on a forward swap. Rather than have calls and puts, the swaptions market has receiver swaptions and payer swaptions. A receiver swaption is an option to receive fixed and pay floating. A payer swaption is an option to pay fixed and receive floating.

8.7 FIXED DEPOSITS

The term "fixed" in fixed deposits denotes the period of maturity or tenor. Fixed Deposits, therefore, pre-suppose a certain length of time for which the depositor decides to keep the money with the bank and the rate of interest payable to the depositor is decided by this tenor. The rate of interest differs from bank to bank and is generally higher for the private sector and foreign banks. This, however, does not mean that the depositor loses all his rights over the money for the duration of the tenor decided. The deposits can be withdrawn before the period is over. However, the amount of interest payable to the depositor, in such cases goes down (usually 1% to 2% less than the original rate). Moreover, as per RBI regulations, there will be no interest paid for any premature withdrawals for the period 15 days to 29 or 15 to 45 days as the case may be.

Other than banks, there are non-banking financial companies and companies that float schemes from time to time for garnering deposits from the public. In the recent past, however, many such schemes have gone bust and it is very essential to look out for danger signals before putting all your eggs in one basket.

Fixed deposits in companies that earn a fixed rate of return over a period of time are called Company Fixed Deposits. Financial institutions and Non-Banking Finance Companies (NBFCs) also accept such deposits. Deposits thus mobilized are governed by the Companies Act under Section 58A. These deposits are unsecured, i.e., if the company defaults, the investor cannot sell the company to recover his capital, thus making them a risky investment option. NBFCs are small organizations, and have modest fixed and manpower costs. Therefore, they can pass on the benefits to the investor in the form of a higher rate of interest. NBFCs suffer from a credibility crisis. So be absolutely sure to check the credit rating. AAA rating is the safest. According to the latest RBI guidelines, NBFCs and companies cannot offer more than 14 per cent interest on public deposits.

8.8 BANK DEPOSITS

When you deposit a certain sum in a bank with a fixed rate of interest and a specified time period, it is called a bank Fixed Deposit (FD). At maturity, you are entitled to receive the principal amount as well as the interest earned at the pre-specified rate during that period. The rate of interest for Bank Fixed Deposits varies between 4 and 6 per cent, depending on the maturity period of the FD and the amount invested. The interest can be calculated monthly, quarterly, half-yearly, or annually, and varies from bank to bank. They are one of the most common savings avenue and account for a substantial portion of an average investor's savings. The facilities vary from bank to bank. Some services offered are withdrawal through cheques on maturity; break deposit through premature withdrawal, and overdraft facility, etc.

INVESTMENT OBJECTIVES

How Suitable are Fixed Deposits for an Increase in Investment?

While a Bank FD does provide for an increase in your initial investment, it may be at a lower rate than other comparable fixed-return instruments. Since capital appreciation in any investment, option depends on the safety of that option, and banks being among the safest avenues, the increase in investment is modest.

Are Fixed Deposits Suitable For Regular Income?

A Bank FD does not provide regular interest income, but a lump-sum amount on its maturity. Since the lump-sum amount depends on the rate of interest, currently between 4 and 6 per cent, Bank FDs are not suitable for regular income.

To What Extent Does a Bank FD Protect the investor against Inflation?

With a fixed return, which is lower than other assured return options, banks cannot guard against inflation. In fact, this is the main problem with Bank FDs as any return has to be calculated keeping inflation in mind.

8.9 PRIMARY MARKETS

Companies raise funds to finance their projects through various methods. The promoters can bring their own money to borrow from the financial institutions or mobilize capital by issuing securities. The funds may be raised through the issue of fresh shares at par or premium, preferences shares, debentures, or global depository receipts. The main objectives of a capital issue are given below:

- To promote a new company
- To expand an existing company
- To diversify the production
- To meet the regular working capital requirements
- To capitalize the reserves

Stocks available for the first time are offered through the primary market. The issuer may be a new company or an existing company. These issues may be of a new type or the security used in the past. In the primary market, the issuer can be considered as a manufacturer. The issuing houses, investment bankers, and brokers act as the channel of distribution for the new issues. They take the responsibility of selling the stocks to the public.

The main service functions of the primary market are origination, underwriting, and distribution. Origination deals with the origin of the new issue. The proposal is analyzed in terms of the nature of the security, the size of the issue, the timing of the issue, and the floatation method of the issue. Underwriting contract makes the share predictable and removes the element of uncertainty in the subscription (underwriting is given in the latter part of this chapter). Distribution refers to the sale of securities to the investors. This is carried out with the help of the lead managers and brokers to the issue.

Only a few years back, any investor worth his salt thought that investing in primary issues was the easiest and simplest way to make money. He scoffed at other "inferior" options like mutual funds and bank deposits because they did not double or triple his money in a few months! Believe it or not, primary markets did that precisely – they posted near indecent returns like 300 to 400% just in two months time. When the common investor benchmarked all other investment options against these phenomenal returns, obviously they stood no chance. Returns apart, investing in primary issues appeared so simple and "risk-free"! All that was required of investors to partake in the manna was to simply put as large an application as possible because the proportionate allotment rule worked to the favor of big investors (small investors were supposed to have gone to mutual funds) and pray for a large allotment. Once they received some shares on the large subscription, they just offloaded their holdings at the listed prices, which were at a hefty premium to the issue price not because of any good fundamentals of the issuing company but simply because demand was far greater than the supply and waited for the next IPO to make another killing.

As profit booking became so simple, money flowed from all directions, some legal and some not so legal – the markets boomed and promoters, brokers, and investors all made merry. "Entrepreneurs" of all sorts mushroomed to float companies with fancy projects and launched IPOs with tall promises to give high earnings and dividends. But no one bothered to check the prospectuses or the credentials of these promoters because there was enough money to be made by everyone or so they thought until the markets crashed like the proverbial nine pins.

What drove the primary markets to these dizzy heights only to collapse later? Those were the early days of liberalization and the foreign institutional investors and mutual funds had no clue as to the levels of transparency or corporate governance absent in the Indian companies. They believed in the picture specially painted for them by the wily promoters, liked it, and invested heavily believing in what was right in the West would be right in the East as well. They were rudely shaken when the promised projects failed to take off because of rampant diversion of money, plain incompetence, and severe change in the economic climate.

Then came, the ice winter of stock market gloom, which lasted for probably the longest period in the near history. As investors lost money and faith in the primary market, they punished all the issuers – IPO after IPO failed to get the desired response from the markets – it almost became impossible for any company to raise money from the stock markets. Genuine companies, which lined up ongoing projects for funds to be raised from the market were driven to desperation and borrowed at usurious rates that broke the back of their balance sheets. The high cost of borrowing made debt servicing difficult and defaults occurred even in corporate organizations known for their high creditworthiness.

The South Asian crisis further made life very difficult for Indian entrepreneurs as their exports failed to take off and money got locked up in huge inventories. This was the perfect recipe for disaster and doomsayers were busy writing the epitaph on the Indian economic revival. As the economy teetered on the verge of collapse, the outlook has changed slowly but surely – the software sector came to the rescue of the markets, a few robust companies lifted the market from their lowest depths to the present peaks of unprecedented highs.

And the Bull Run began all over again. Markets are in frenzy with institutional buying and as the index zoomed to 14500 levels, the primary market issues were back with a bang. Do you see any red herrings here?

Many analysts said investors were climbing up the same learning curve all over again. Some of the 'companies' that came out with IPOs hardly had the right credentials or performance track record to justify the public offer. But the investors starved so long for 'good' issues were merrily lapping up all of them. Happily, so far, they all made money as the scripts listed above their issue prices posted handsome returns in the very short term. But don't the happenings appear so disturbingly familiar?

If you were a discerning investor, you would know speculation and serious investing are very different. As our discursion here deals with the second, we attempt to list the factors that investors should consider as a checklist to guide their primary market investments.

INITIAL PUBLIC OFFER (IPO)

Parties Involved in the IPO

In the sixties and seventies, the company and its personnel managed IPO. But, at present initial public offering involves a number of agencies. The rules and regulations, and the changing scenario of the capital market necessitated the company to seek for the support of many agencies to make the public issue a success. As a student of financial market management, one should know the number of agencies involved and their respective role in the public issue. The promoters also should have a clear idea about the agencies to coordinate their activities effectively in the public issue. The manager to the issue, registrars to the issue, underwriters, bankers, advertising agencies, financial institutions, and government /statutory agencies.

MANAGERS TO THE ISSUE

Lead managers are appointed by the company to manage the initial public offering campaign. Their main duties are:

- Drafting of prospectus
- Preparing the budget of expenses related to the issue
- Suggesting the appropriate timings of the public issue
- Assisting in marketing the public issue successfully
- Advising the company in the appointment of registrars to the issue, underwriters, brokers, bankers to the issue, advertising agents, etc.
- Directing the various agencies involved in the public issue.

Many agencies are performing the role of lead managers to the issue. The merchant banking division of the financial institutions, a subsidiary of commercial banks, foreign banks, private sector banks, and private agencies are available to act as lead managers. Such as SBI Capital Markets Ltd., Bank of Baroda, Canara Bank, DSP Financial Consultant Ltd. ICICI Securities & Finance Company Ltd., etc. The company negotiates with prospective managers regarding its issue and settles its selection and terms of appointment. Usually, companies appoint lead managers with a successful background. There may be more than one manager to the issue. Sometimes the banks or financial institutions impose a condition while sanctioning term loans or underwriting assistance to be appointed as one of the lead managers to the issue. The fee payable to the lead managers is negotiable between the company and the lead manager. The fee agreed upon is revealed in the memorandum of understanding filed along with the offer document.

REGISTRAR TO THE ISSUE

After the appointment of the lead managers to the issue, in consultation with them, the Registrar to the issue is appointed. Quotations containing the details of the various functions they would be performing and charges for them are called for selection. Among them, the most suitable one is selected. It is always ensured that the registrar to the issue has the necessary infrastructure like Computer, Internet, and telephone.

The Registrars normally receive the share application from various collection centers. They recommend the basis of allotment in consultation with the Regional Stock Exchange for approval. They arrange for the dispatching of the share certificates. They hand over the details of the share allocation and other related registers to the company. Usually, registrars to the issue retain the issuer records at least for a period of six months from the last date of dispatch of letters of allotment to enable the investors to approach the registrars for redressal of their complaints.

UNDERWRITERS

Underwriting is a contract by means of which a person gives an assurance to the issuer to the effect that the former would subscribe to the securities offered in the event of non-subscription by the person to whom they were offered. The person who assures is called an underwriter. The underwriters do not buy and sell securities. They stand as backup supporters and underwriting is done for a commission. Underwriting provides an insurance against the possibility of inadequate subscription. Underwriters are divided into two categories:

- Financial Institutions and Banks
- Brokers and approved investment companies.

Some of the underwriters are financial institutions, commercial banks, merchant bankers, members of the stock exchange, Export and Import Bank of India, etc. The underwriters are exposed to the risk of non-subscription and for such risk exposure, they are paid an underwriting commission.

Before appointing an underwriter, the financial strength of the prospective underwriter is considered because he has to undertake and agree to subscribe the non-subscribed portion of the public issue. The other aspects considered are:

- Experience in the primary market
- Past underwriting performance and default
- Outstanding underwriting commitment
- The network of investor clientele of the underwriter and
- His overall reputation.

The company after the closure of the subscription list communicates in writing to the underwriter the total number of shares/debentures under subscribed, and the number of shares/debentures required to be taken up by the underwriter. The underwriter would take up the agreed portion. If the underwriter fails to pay, the company is free to allot the shares to others or take up proceeding against the underwriter to claim damages for any loss suffered by the company for his denial.

BANKERS TO THE ISSUE

Bankers to the issue have the responsibility of collecting the application money along with the application form. The bankers to the issue generally charge commission besides the brokerage, if any. Depending upon the size of the public issue more than one banker to the issue is appointed. When the size of the issue is large, 3 to 4 banks are appointed as bankers to the issue. The number of collection centers is specified by the central government. The bankers to the issue should have branches in the specified collection centers. In big or metropolitan cities more than one branch of the various bankers to the issue are designated as collecting branches. Branches are also designated in the different towns of the state where the project is being set up. If the collection centers for application money are located nearby people are likely to invest the money in the company shares.

ADVERTISING AGENTS

Advertising plays a key role in promoting the public issue. Hence, the past track record of the advertising agency is studied carefully. The tentative program of each advertising agency along with the estimated cost is called for. After comparing the effectiveness and cost of each program with the other, a suitable advertising agency is selected in consultation with the lead managers regarding the issue. The advertising agencies take the responsibility of giving publicity to the issue in the suitable media. The media may be newspapers/magazines/hoardings/press releases or a combination of all.

THE FINANCIAL INSTITUTIONS

Financial institutions generally underwrite the issue and lend term loans to the companies. Hence, normally they go through the draft of the prospectus, study the proposed program for public issues and approve them. IDBI, IFCI & ICICI, LIC, GIC, and UTI are some of the financial institutions that underwrite and give financial assistance. The lead manager sends a copy of the draft prospectus to the financial institutions and includes their comments if any in the revised draft.

MUTUAL FUNDS

Mutual funds are investment companies that use the funds from investors to invest in other companies or investment alternatives. They have the advantage of professional management, diversification, convenience, and special services such as cheque writing and telephone account service. It is generally easy to sell mutual fund shares/units although you run the risk of needing to sell and being forced to take the price offered. Mutual funds come in various types, allowing you to choose those funds with objectives, which most closely match your own personal investment objectives. A load mutual fund is one that has a sales charge or commission attached. The fee is a percentage of the initial investment. Generally, mutual funds sold through brokers are load funds while funds sold directly to the public are no-load or low-load. As an investor, you need to decide whether you want to take the time to research prospective mutual funds yourself or pay the commission and have a broker who will do that for you. All funds have annual management fees attached.

Mutual Fund Schemes may be classified on the basis of their Structure and their Investment Objective. Let us first discuss the classification by Structure:

Open-Ended Mutual Funds

An open-ended mutual fund is one whose units can be freely sold and repurchased by the investors. Such funds are not listed on bourses since the Asset Management Companies (AMCs) provide the facility for buyback of units from unit-holders either at the NAV or NAV-linked prices. Instant liquidity is the USP of open-ended funds: you can invest in or redeem your units at will in a matter of 2-3 days. In the event of volatile markets, open-ended funds are also suitable for investment appreciation in the short-term. This is how they work: if you expect the interest rates to fall, you park your money in an open-ended debt fund. Then, when the prices of the underlying securities rise, leading to an appreciation in your fund's NAV, you make a killing by selling it off. On the other hand, if you expect the Bombay Stock Exchange Sensitivity Index – the Sensex – to gain in the short term, you can pick up the right open-ended equity fund whose portfolio has scrips likely to gain from the rally, and sell it off once its NAV goes up.

8.8 REVIEW QUESTIONS

1. To What Extent Do Open-Ended Funds Protect Me Against Inflation?
2. What Is the Mode of Holding Open-Ended Mutual Funds?
3. What Is the Liquidity of Open-Ended Mutual Funds?
4. Discuss the nature of the capital market?
5. Differentiate between primary market and secondary market?

8.9 FURTHER READINGS

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SEMESTER I

COURSE: BUSINESS ENVIRONMENT

UNIT 9: CAPITAL MARKET AND ITS REGULATION

STRUCTURE

9.0 INTRODUCTION

Often, entrepreneur's savings and donations from friends and relatives are a source of funding for starting a new business or growing an existing business. This may not happen in the case of large projects as the required contribution from the entrepreneur (promoter) will be even greater after receiving a long-term loan; the facilitator may not be able to deliver his or her share (equity capital). So, access to finance can be a major obstacle to establishing or expanding a large-scale business.

However, instead of relying on the limited savings of a small group of friends and relatives, the promoter has the option of raising money for the public across the country by selling (issuing) company shares. For this purpose, the facilitator can invite investment in his work by issuing a donation document which provides full details about the track record, company, project type, business model, expected profit etc.

If you are comfortable with this proposed business, you can invest that way and become a shareholder in the company. In sum, even the smallest amount available for the largest number of people translates into corporate spending. Your small savings, let's say, even `5,000 can contribute to setting, say, ` 5,000 crore Cement or Steel Plant. This way through which companies collect money from the public is called primary markets.

Importantly, if you, as a shareholder, need your money back, you can sell these shares to other or new investors. Such trading does not diminish or change the company's revenue. Stock trading brings such traders and buyers together and makes it easier to trade. Therefore, companies that collect money from the public need to register their shares in the stock market. This method of buying and selling stocks through stock trading is known as secondary markets.

As a shareholder, you are part owner of the company and are entitled to all ownership benefits, including profits (company profits shared with owners). Over the years if a company is doing well, some investors may want to own the company that is doing well by buying its shares. This increase in demand for shares leads to an increase in their price. You will have the opportunity to sell your shares at a higher price than what you bought. So you can increase your wealth, as long as you make the right choice. The opposite is also true!

In addition to stocks, there are many other financial instruments (securities) that are used to raise money. Debentures or bonds are debt instruments that pay interest over the course of their lives and are used by companies to increase medium- and long-term debt. If you prefer a fixed income, you can invest in these tools that can give you a higher interest rate than a fixed bank deposit, due to high risk. Besides, equity and debt, a combination of these instruments, like convertible debentures, preference shares are also issued to raise money.

If you have issues such as time, wherewithal, less money etc. for direct market investment, Mutual Funds (MFs), which are regulated entities, provide an alternative. They raise money from many investors and invest the combined value in the markets in a professional and transparent manner. Benefits from these investment net of management fees are available to you as the owner of the MF unit. MFs offer a variety of schemes, such as those that only invest in equity or debt, index funds, gold funds, etc. to cater to risk appetite of various investors.

Even if you have very small amounts, you can invest in MF programs through a systematic monthly investment plan (SIP).

Institutions, players and mechanism that brings suppliers and users together, is known as the capital market. It allows people to do more with their savings by providing a variety of assets thus enhancing the wealth of investors who make the right choices. At the same time, it enables entrepreneurs to do more with their ideas and talents, making it easier to create funds. Thus capital market mobilizes savings and channelizes it, through securities,into preferred entrepreneurs.

It is not possible for financiers to meet with the user and exchange securities. This is because the securities offered to users may not match the preferences of financiers. There are various mediators who bring the providers and user of funds together to facilitate transactions. The market is regulated by SEBI. It ensures supply of quality securities and non manipulated demand for them . It develops the best marketing practices and takes steps to force miscreants. It maintains good market behavior so that participants can do the job safely.

9.1 Features/Characteristics of Capital Market:

1. **Link between savers and investors** the financial market serves as an important link between savers and investors. The savers are lenders while the investors are borrowers of funds. Savers who do not spend all their income are called "Surplus units" and investors / borrowers are known as "deficit units". The capital market is a means of transfer between surplusl units and deficit units. It is a process in which surplus units lend their accumulated funds to the deficit units

2. **Deals in Long Term fund**: The money market offers long-term and medium-term funds. Not compatible with channelising savings for less than one year.

3. **Utilizes Intermediaries**: Capital market uses various consultants such as brokers, underwriters, depositors etc. These intermediaries serve as active components of the financial market and are very important elements of the financial market.

4. **Capital formation**: Capital market provides incentives to investors in the form of interest or dividends to transfer their surplus funds to deficit units to invest in various businesses. Transfers of funds by surplus units to defecit units lead to capital formation.

5. **Government Rules and Regulations**: The money market operates freely but under the direction of government policies. These markets operate within the framework of

government laws and regulations, e.g., stock trading operates under the rules of SEBI which is a government entity.

An ideal capital market is one:

1. Where funds are available at fair value.
2. Which Facilitating economic growth.
3. Where market operations are free, fair, competitive and transparent.
4. It must provide sufficient information to investors.
5. Must allocate capital productively.

9.2 IMPORTANCE / FUNCTIONS OF CAPITAL MARKET:

The financial market plays an important role in promoting savings and investing in productive investments to boost trade and industry. Thus, the financial market contributes to the capital formation and the growth of the country's economy. We discuss below the importance of the financial market.

1. **Channalising Savings into Busines**s: The capital market serves as an important link between savers and investors. The savers are lenders while the investors are borrowers of funds. Investors who do not spend all their income are called "Surplus units" and investors / borrowers are known as "deficit units". The capital market is a means of transfer between surplus units and deficit units. It is a process in which the surplus units lend their accumulated funds to the deficit units.

2. **Basis for industrialization:** The financial market produces long-term investments, which are essential for industrialization. Therefore, the money market serves as the basis for industrialization.

3. **Accelerating the pace of growth**: Easy and smooth access to long-term financing encourages entrepreneurs to take profitable ventures / businesses in the commercial, industrial, commercial and even agricultural sectors. It leads to economic growth in all areas and accelerates economic development.

4. **Generating liquidity**: Liquidity means conversion to cash . Shares of public companies are transferable, that is, if there is a financial need these shares can be traded on the stock market and the funds can be obtained. This is how the money market generates liquidity.

5. **Increase the national income:** Funds flow into the financial market from individuals and financial advisors who are absorbed by commerce, industry and government. Thus it facilitates the transfer of funds for efficient and profitable use to increase national income.

6. **Capital formation:** Capital market provides incentives to savers in the form of interest or dividend to transfer their surplus fund into the deficit units who will invest in various businesses. Transfers of funds by surplus units to defecit units lead to capital formation.

7. **Productive investment:** The money market provides a way for those who have savings to transfer their savings to those in need of productive investment funds. It diverts resources from wasteful and non-productive channels such as gold, jewelry, conspicuous consumption, etc. to productive investments.

8. **Stabilization of the value of securities:** A well-developed financial market involving professional banks and non-bank intermediaries brings stability to the value of shares and securities. It does this by providing financial assistance to the needy at reasonable interest rates and helping to reduce speculative activities.

9. **Encourages economic growth:** The financial market promotes economic growth. The various institutions operating in the financial market provide quantities and qualitative guidance in the flow of funds and provide a rational allocation of resources. They do this by converting financial assets into tangible assets. This leads to the development of trade and industry through the private and public sector, thereby encouraging economic growth.

9.3 DIFFERENCE BETWEEN CAPITAL MARKET AND MONEY MARKET

The answer to this question in the table below:

1. Short-term securities are traded in the Money Market. Unlike Capital Market, where long-term securities are created and sold.

2. Capital Market is more formal in nature compared to Money Market.

3. Money Market securities are less risky compared to Capital Market securities because they are issued on a short-term basis and involve low volatility.

4. Money Markets are very liquid compared to capital Markets.

5. Money Market helps to meet the short-term credit requirements needs of companies such as operating costs etc. However, Capital Market helps to meet the needs of long-term credit requirements, such as providing a fixed capital to purchase land, building or machinery etc.

6. Return on Investment is higher in the Capital Market compared to the Money Market as Capital Market securities pose a higher risk compared to the Money Market securities.

7. The timeframe of redemption of Money Market securities is less than one year, while Capital Market securities get due after one year or often remains irredeemable in some cases.

Basis of comparison	**Money market**	**Capital market**
Definition	Money market is a place where we invest for the short term on instruments like trade credit, commercial paper, certificate of deposit, treasury bills etc.	Capital Market is a type of financial market in which the company or government securities invest for the long term in the instruments such as bonds, stocks, etc.
Nature	Money markets are casual in nature.	Capital markets are formal or official. It is known for dealing in mutual stocks and bonds.
Instruments	Commercial Papers, Treasury certificates of deposits, Bills, Trade Credit, etc., are included in the money market.	Bonds, Debentures, splits, Asset Secularization, Retained Earnings, Euro Issues, etc., are included in the capital market.
Types of investors	Commercial banks, non-financial institutions, central banks, chit funds, etc., are the primary investor types.	Stockbrokers, insurance companies, Commercial banks, underwriters, etc., are the primary investor types.
Liquidity of market	Money markets are incredibly fluid.	Capital markets are relatively more minor liquid.
Security	Money markets have low risk.	Capital markets have a significant risk in comparison to money markets.

Time	Instrument matures in a year.	Instruments take much time to get mature.

9.4 SEGMENTS OF CAPITAL MARKET:

The stock market has two segments known as the primary market and the secondary market. The primary market is where securities are created. The secondary market is where they are traded.

9.4.1 Primary Market:

The primary market is where securities are first sold by the issuer and bought by investors, before they are available for trading in the stock market.

There are three entities involved in the functions of the primary market:

- A Company
- An underwriter
- Investors

The company issues securities for the first time. The underwriter decides the sale price of the new issue of securities. Lastly, investors are the buyers of the new securities.

Examples of some primary market securities are notes, bills, government bonds, corporate bonds, and company stocks.

9.4.2 Types of Primary Market instruments:

Initial Public Offer (IPO)

IPOs are one of the most popular ways to raise money in primary markets. It is used by companies. Initial Public Offering (IPO) is a process in which a private company goes public with the sale of its stock to the general public. Companies can raise equity capital with the help of IPOs by issuing new shares to the public. Existing shareholders can also sell their shares publicly without raising any fresh capital for the company.

Preferential Issue

When a company issue shares to a few people at a price that may or may not be related to market price, it is called a preferential allotment. This type of issue is one of the fastest ways for a company to raise money. In a preferential allotment, the preference shareholders receive dividends before the regular shareholders. The company determines the basis of the allotment and does not rely on pro-rata or any such mechanism.

Rights Issue

In the case of right issue, a company raises additional capital from existing shareholders by providing more shares at a discounted price in the current market value. Investors have the option to purchase these shares at a discounted price over a specific period of time.

Bonus Issue

In the case of a bonus, the company issues fully paid additional shares to its existing shareholders for free. These shares are a bonus for current shareholders. The issuance of bonus shares does not require fresh capital.

Qualified Institutional Placement

Qualified Institutional Placement (QIP) is a fundraising tool, in which a company raises money by issuing equity shares, fully and partially convertible debentures, or any securities, other than warrants that can be converted into equity shares. Only companies that are eligible to purchase QIPs are Qualified Institutional Buyers (QIBs). These are authorized investors, as defined by the market regulator. Other QIBs are separate investment funds, venture capital investors, mutual funds, pension funds, and scheduled commercial banks.

Why Does a Company Issue Securities in Primary Markets?

Companies issue securities in the primary market to raise money for business growth, business development, infrastructure development, debt relief, and many other reasons. The main source of income is borrowing from banks. However, if a company collects money from banks, it needs to pay interest on it.

On the other hand, when a company raises funds from the public through a primary market, there is no commitment to interest payments. The company pays profits to shareholders in the form of dividend or bonuses. Shareholders are also rewarded when the company’s total stock price is appreciated.

So, now let's look at secondary markets ...

9.4.3 Secondary Market?

The secondary market in which stocks and bonds, previously issued, are bought, and sold. Simply put, in the second market securities are sold after they are initially offered in the primary market.

The Bombay Stock Exchange (BSE), the National Stock Exchange (NSE) and all other stock markets and bond markets are secondary markets. . Securities issued by a company for the first time are offered to the public in the primary market. Once the security has been listed on the exchange, it is available to trade in the secondary market.

The main difference between the two is that in the primary market, the investor receives securities directly from the company through IPOs, while in the secondary market, investors buy securities from other investors who are willing to sell the same. In the secondary market, the price is determined from the demand and supply and in the primary market, the price of the security is fixed from the beginning whereas in the secondary market, the price levels vary with changes in demand and supply.

9.4.4 Secondary market Instruments

Stock Exchanges

Stock exchanges are centralized platforms where trading takes place between buyer and seller. The Bombay Stock Exchange (BSE), the National Stock Exchange (NSE), and the New York Stock Exchange (NYSE) are examples of such platforms.

Here, the exchange is responsible for being a mediator who connects buyers and sellers. As a result, everyone's risk is almost zero as trade is guaranteed.

Over the Counter Market

Over the counter (OTC) market refers to the process by which securities are traded informally. The OTC market is a separate market, consisting of participants who trade between them. The OTC market includes securities that did not meet the requirements to list in the stock markets. It is a bilateral contract in which both parties are involved namely the investor and the seller.

The stocks traded in the OTC market are primarily those of small companies that cannot meet the requirements of the official exchange. Here, the risk is high if there is no regulatory oversight. The price of securities may vary from one seller to another as there is considerable competition in obtaining high volume.

Foreign exchange market (FOREX) is an example of an over-the-counter market.

In addition to the stock exchange and the OTC market, other types of secondary markets include the auction market and the broker market.

Auction Market: The auction market is a platform for buyers and sellers to come to an understanding of the level of collateral to be sold. Price-related information is placed in the public domain, which includes the bidding rate for the offer.

Dealer Market: The merchant market is another type of secondary market where various traders display the prices of certain securities. Foreign exchange bonds and bonds are traded mainly on the stock market.

Importance of Primary and Secondary Markets

The primary markets are new markets, and secondary markets are retail markets. Understanding how these markets work provides investors with a better understanding of where they can find security.

Both financial markets play a major role in raising funds for companies that help move the wheels of the economy. The stock market affects individual businesses in the economy in many different ways. This is because the economy and its stock markets are fundamentally aligned.

When the stock market performs well, it is usually the work of a growing economy. As the economy grows, individual businesses become more productive and generally multiply. In a market economy, the role of the financial market is very important. -Efficient cash market is essential to the modern economy so that there can be an efficient transfer of resources from those who save to those who need money.

9.5 ACTS GOVERNING THE CAPITAL MARKETS

- **The Depositories Act,1996-** The Act regulates deposits in securities. The main purpose of this Act is to ensure the free transfer of securities with speed, accuracy, and security. The law simplifies ownership of the transfer of ownership from one person to another in a simple manner. Provides securities for free transfers in the event of limited Government companies along with the securities.
- **Securities Contract (Regulation) Act, 1956-** Regulatory law applies to all types of matters relating to stock trading. The law aims to make the best use of the stock market. Prevents any kind of defective activity. It is particularly useful in the listing of shares and securities contracts.

- **Security and Exchange Board of India Act,1992-** This Act provides for legal authority in the SEBI. The governing body regulates the market in a variety of ways by protecting shareholders' interests, preventing any kind of market misconduct, and promoting the development of the Securities Market. The Act provides broad and broad mandate for SEBI to effectively and efficiently operate the financial market.

9.6 INSTRUMENTS IN CAPITAL MARKET

1. **Equities:** Equity securities refer to the proprietary portion owned by shareholders in a company. In simple terms, it refers to investing in company shares in order to become the shareholder in an organization. The main difference between shareholders and creditors is that the former does not receive a regular payment, but can make a profit on a large profit by selling shares. Also, equity owners acquire patents and become owners of the company. When a company is facing a liquidity, shareholders can only share the residual interest that remains after the creditors have paid off. Companies also often offer benefits to their shareholders as part of the profits earned from their core business activities.

2. **Debt Securities:** Debt Securities can be classified into bonds and debentures:

1. **Bonds:** Bonds are fixed revenue instruments issued primarily by institution and provincial governments, municipalities, and even companies that finance infrastructure development or other types of projects. It can be termed a mortgage market tool, in which the issuer of a bond is known as the borrower. Bonds usually have a fixed closing time. Therefore, bond issuers must repay the principal amount on the maturity date to the bond owners.
2. **Debentures:** Loans are investment options that are not secured like bonds and are not supported by any collateral. Borrowing is based on trust and, here, investors act as potential creditors of the issuing institution or company.
3. **Derivatives:** The derivative instruments are financial instruments in the financial market whose prices are determined from the underlying assets, such as cash, bonds, stocks, and stock indicators. The four most common types of derivative instruments are forward-looking tools, futures, options and interest rates:
   - **Forward**: Transfer is a contract between two parties where an exchange occurs at the end of the contract at a certain price.
   - **The future**: The future is an outflow of activity that involves the exchange of alternatives for a fixed future date at a predetermined price.

- **Options**: An option is an agreement between two parties in which the buyer has the right to buy or sell a certain number of derivatives at a particular time period.
- **Interest Rate**: An interest rate change is an agreement between two parties that involves exchanging interest rates where both parties agree to pay each other's interest on the loan, with different options, and exchanges

4. **Exchange-Traded Funds:**

Currency trading is a set of multi-investor financial instruments that are used to buy instruments in the various financial markets such as stocks, debt securities such as bonds and other securities. Many ETFs are registered with the Securities and Exchange Board of India (SEBI) which makes them an attractive option for investors with limited expertise with limited stock market experience. ETFs with the characteristics of both stocks and mutual funds are usually traded in the stock market in the form of block-generated stocks. ETF funds are listed on the trading platform and can be purchased and traded on demand during the trading period.

5. **Foreign Exchange Instruments:**

Foreign exchange instruments are financial instruments represented in the foreign market. It mainly contains cash contracts and other transactions. Based on currency agreements, they can be divided into three categories namely location, direct forward and currency exchange.

How to Invest in these Instruments?

The first step that investors need to take in order to invest or trade in these financial instruments in the financial market is to open a trading account with a registered trader. You will then be able to place a buy or sell order from your trading platform to trade or invest in these financial instruments.

9.7 REGULATORY FRAMEWORK OF CAPITAL MARKET IN INDIA

- India has many regulatory structures in the financial sector
- The design has become more complex over time due to: the number of regulatory, equitable, non-manageable structures - but they are still in control; the ambiguity of the ambiguous performance design and its impact.

A brief overview of the Regulatory Framework is as follows:

Regulatory Agencies

- India has smart product controls — the Reserve Bank of India (RBI) controls credit products, savings and remittances; The Securities and Exchange Board of India (SEBI) regulates investment products; The Insurance Regulatory and Development Authority (IRDA) regulates insurance products; and the Pension Funds Regulatory Authority (PFRDA) regulates pension products
- Forward Market Commission (FMC) regulates commodity-based futures (merged with SEBI in late 2015)

Quasi-regulatory Agencies

- Several other government agencies perform similar regulatory functions — the National Bank for Agricultural and Rural Development (NABARD), Small industries Development Bank of India (SIDBI), and the National Housing Bank (NHB).
- NABARD oversees rural regional banks and state and regional co-operative banks.
- The NHB controls housing finance companies, and the SIDBI regulates state financial institutions (SFCs)

Central Ministries

- Certain GoI services are also involved in policy making in the financial system. The Ministry of Finance (MoF) is heavily involved, through its representatives on the boards of SEBI, IRDA and RBI.
- MoF representatives on the boards of public sector banks (PSBs) and Development Financial Institutions (DFIs)

State Governments

▪ Through the Registrar of Co-operatives, which falls under the Department of Agriculture and Cooperatives, regional governments regulate co-operative banking institutions in their respective provinces.

Special Statutes for Certain Financial Intermediaries

- Other key financial services coordinators such as SBI (and its Associated Banks prior to its merger with SBI 2017–18), Public Sector Banks, LIC and GIC are governed by their own rules.
- These rules give these institutions a special status compared to other institutions that perform similar functions

Establishment of FSDC

Over the past few years, significant improvements have been made to regulatory oversight — the establishment of the Financial Sector Development Council (FSDC), which replaced the High Financial Markets Committee.

- The Council is called by the Minister of Finance and has no legislative authority — it is organized as a board of directors, with the Minister of Finance as the chairperson.
- Council resolves disputes between agencies; overseeing the control of financial conferences that fall under the direction of various regulators; and performs multi-product asset management functions

9.8 SECURITIES AND EXCHANGE BOARD OF INDIA

9.8.1 An Introduction

The securities market empowers investment in the economy and enhances the wealth of investors who make the right decisions. Investor confidence is an important factor in the emergence of an effective and efficient financial market. Therefore, the role of the regulator in creating and developing investor confidence is crucial.

Accordingly, the Securities and Exchange Board of India (SEBI) was established by an Act of Parliament of India in April, 1992 with the mandate that

- Protect the interests of investors
- Promoting development and
- Manage securities market

Market regulation

SEBI stipulates that lending companies raise money in the pubic to protect the interest of investors. Extensive disclosure for issuers facilitates informed investment decisions by investors while at the same time ensuring the quality of the issuer. In addition, it has determined the procedures for these companies 'on an ongoing basis' and during the restructuring process (such as earning a lot of money, repaying and removing shares) in order to protect the interests of investors.

To ensure the highest level of service for investors, SEBI only allows eligible and qualified businesses to operate in large markets as mediators. In this regard, it has set out detailed and uniform terms for their registration. In addition, in order to ensure market integrity, it has set the standards for fair market processes that include preventing fraudulent and unfair trade practices and internal trade. Detailed procedures for protecting the interests of investors in secondary markets are also set out. SEBI also describes the operating conditions of integrated investment programs, including Mutual Funds.

Market development:

Going forward, SEBI is initiating measures to expand and deepen security markets by bringing changes to a smaller market and a larger structure. Major market development initiatives by SEBI include moving from a transparent transparency system to a transparent screen based on the line trading system, eliminating visible certification issues by switching to electronic (demat) mode, using a strong stock risk management framework. trading in the market etc. In the past SEBI has launched ASBA (a restricted value-based application) to address issues related to refunds in public affairs.

Major SEBI policy decisions are made through a consultative process that includes expert committees and representatives of industry, academia, and investment organizations. In addition, public opinion is invited before major reforms take place, making the whole process participatory.

Investor protection:

The aforementioned regulatory framework and SEBI market development measures are always intended to protect the interests of investors. In addition, SEBI also has a comprehensive approach to facilitating the resolution of investor complaints. In addition, in line with the belief that an experienced investor is a secure investor, SEBI promotes education and awareness of investors. In addition, dispute resolution (mediating in the stock market) and compensation for investors is also provided.

Enforcement:

SEBI ensures compliance with its procedures by conducting audits of registered consultants, investigations and processing documents, including investor complaints. SEBI is empowered by civil courts to summon information and records, issue summonses, inspect and investigate businesses related to securities markets. In the event of a breach of the procedure, SEBI suspends or cancels the license granted to the coordinators. In addition, SEBI imposes restrictive and restrictive orders against mediators and non-mediators and imposes fines on judicial proceedings.

In addition to these public procedures, SEBI also filed criminal cases against companies for violating regulations. All such SEBI orders are available on the website (www.cali.gov.in), which serves as a warning to potential victims.

9.8.2 Securities and Exchange Board of India and investor protection

The Securities and Exchange Board of India (SEBI) has been established with a strong mandate to protect the interests of securities investors. It is also mandated to promote development, as well as regulate the mortgage market.

An investor is happy to invest, if he (i) knows how to invest; (ii) has full market knowledge; (iii) the market is safe and there are no intruders; and (iv) there are remedial action plans in the event of complaints. Accordingly, SEBI's investment protection strategy has four components.

First, build the capacity of investors through education and awareness so that the investor can make informed investment decisions. SEBI strives to ensure that the investor learns to invest, that is, acquires and applies the information needed to invest, evaluates various investment options to suit his or her specific goals, guarantees his or her rights and obligations to a particular investment, deals with registered intermediaries, and takes appropriate security measures, seek help if there is a complaint, etc.

SEBI has been organizing investor awareness and awareness workshops, and through investment organizations and market participants, and has been encouraging market participants to plan similar programs. It maintains an updated, complete website for educating investors. It publishes various types of warnings through the media. It answers investors' questions by phone, email, letters, and in person to those who visit the SEBI office.

Second, it makes available all the relevant information on public sector investment. SEBI has adopted a regulatory framework based on disclosure. Under this framework, issuers and consultants disclose relevant information about them, products, markets and regulations so that an investor can make informed investment decisions based on that disclosure. SEBI has determined and monitored various initial and ongoing disclosures.

Third, make sure the market has systems and processes that make transactions secure. SEBI has taken various measures such as a screen-based trading system, liquidation of securities, payment of T + 2, and created various rules for regulating coordinators, issuing and trading securities, restructuring of business, etc. to protect the interests of collateral investors. It also ensures that only qualified and qualified people are allowed to operate in the market, every participant is encouraged to comply with the prescribed standards, and that the offender is given exemplary punishment.

Fourth, to facilitate the resolution of investor complaints. SEBI has a comprehensive approach to facilitating the resolution of investor complaints against affiliates and listed companies. It follows companies and consultants who do not address investor complaints, by sending reminders to them and having meetings with them. It takes appropriate enforcement measures as provided under the law (including the delivery of judgments, trials, directives) where the progress of resolving investor grievances is unsatisfactory. It has established a comprehensive arbitration mechanism in stock markets and deposits to resolve investor disputes. Stock markets have investments to protect investors in order to compensate investors if a trader is declared a non-payer. The depository relieves investors of losses due to the negligence of the participants in depositing funds.

9.9. ACTS GOVERNING THE CAPITAL MARKETS

- **The Depositories Act,1996-** The Act regulates deposits in securities. The main purpose of this Act is to ensure the free transfer of securities with speed, accuracy and security. The law simplifies ownership of the transfer of ownership from one person to another in a simple manner. Provides securities for free transfers in the event of limited Government companies and collateral.
- **Securities Contract (Regulation) Act, 1956-** Regulatory law applies to all types of matters relating to stock trading. The law aims to make the best use of the stock market. Prevents any kind of defective activity. It is particularly useful in the listing of shares and securities contracts.
- **Security and Exchange Board of India Act,1992-** This Act provides for legal authority in the SEBI. The governing body regulates the market in a variety of ways by protecting shareholders' interests, preventing any kind of market misconduct and promoting the development of Securities Market. The Act provides broad and broad mandate for SEBI to effectively and efficiently operate the financial market.

9.10 LOOPHOLES AND RECOMMENDATIONS

As the Indian economy is one of the fastest growing economies in the world, many such challenges can hinder growth as certain laws are flawed and there are a number of cases of money laundering, fraud, and money laundering. Market participants use it for unfair trading practices. There is no doubt that in the last few decades the policy makers of the country have promoted the capitalist ideology of the economy and ultimately led to the rapid development of the financial market. Capitalism encourages the accumulation of wealth by a few and they invest more and increase profits to a higher level.

Individual investors can also break market stability by increasing borrowing or borrowing power. Several such cases have demonstrated and identified the need for a more powerful controlling body. Other cases that showed gaps are Harshad S. Mehta vs Central Bureau Of Investigation on October 1, 1992, Harshad S. Mehta vs Central Bureau Of Investigation on September 21, 1998. Harshad Mehta's case shows gaps in the system that finances how they were illegally distributed and used to exploit the stock market. He understood the gap in the money market. There was a similar story of Ketan Parekh's 2001 scam where he took out a loan and invested in the Ketan Parekh vs Securities and Exchange Board of India case on 14 July 2006.

There is also a case for appeal to a special court called the Securities tribunal tribunal and exemplary case Ashwin K. Doshi, Pankaj G. Joshi, and others against the Securities and Exchange Board Of India dated 25 October 2002. These cases and points indicating that there is a problem of financial fraud from major markets that has caused huge losses and reduced investor confidence and created mistrust among people. Such losses force the system to change policies. Another big gap is internal trade and price fraud as if some investors are taking unpublished information and using it to their advantage. Such illegal use has a negative impact on market performance.

The development of regional stocks has been severely affected by large stock exchanges and premiums such as the NSE (National Stock Exchange) and BSE (Bombay Stock Exchange) as investors prefer to invest in securities listed on major stock exchanges. There is also a lack of caution for investors as people are able to move illegal funds into the stock market.

The market is often dominated by a few investors who make the market biased as it reduces the opportunity for new investors. There should be a focus on holding stocks to improve fairness and provide an opportunity for new investors. Most of the financial frauds that occur are caused by private transactions with banks as they have a set of funds so they should be completely banned and a systematic approach to banking management should be developed.

9.11 CONCLUSION

The Indian financial market has undergone many changes after the challenges and irreparable losses it has experienced over the years. There have been major changes and alterations over the years, as well as other significant changes that have reduced the number of cases of financial fraud. There has been a reduction in trade unfair over the years. The financial market has made great strides in building institutions. They transform and improve the lives of investors and market coordinators. The market has been friendly by increasing efficiency and eliminating challenges.

9.12 MEANING: INVESTOR SAFETY

Investor protection is one of the vital elements of a developing securities market. It specializes in making sure that traders are completely informed about their purchases, transactions, company affairs, and updates. diverse procedures, suggestions, policies, and regulations have been issued to guard the investor's proper and repose their self-assurance.

9.13 ROLE OF SEBI IN INVESTOR SAFETY

Buyers are the pillar of the economic and securities marketplace. They determine the level of pastime in the market. They placed the cash in price range, stocks, etc. to assist develop the market and consequently, the financial system. It's therefore very crucial to shield the hobbies of the buyers. Investor safety involves various measures mounted to shield the interests of investors from malpractices. The Securities and exchange Board of India (SEBI) is answerable for rules of the Mutual funds and safeguarding the interests of the traders. Investor protection measures with the aid of SEBI are in place to protect the buyers from the malpractices in shares, the inventory marketplace, Mutual Fund, and so on.

The 2 huge goals of SEBI are given below:

i. Conducive surroundings: SEBI plans to create proper and conducive surroundings for raising cash from the capital marketplace through the guidelines, regulation, exchange practices and suggestions. SEBI regulates stock exchanges and other intermediaries in securities markets such as brokers, sub-agents, service provider bankers, undertaking finances, mutual funds, FII and so on.

ii. Investor safety and training: SEBI aims to shield investors from fraudulent practices and train buyers to lead them to be aware of their rights and accountability.

Measures taken with the aid of SEBI for Investor safety: - SEBI has given out numerous techniques and measures to make sure the investor is protected every now and then. It has published diverse directives, driven many traders focus programmes, installed investor protection Fund (IPF) to compensate the investors. i. issue of law and hints: build the potential of traders through training and awareness to permit an investor to take informed investment decisions. SEBI endeavours to ensure that the investor learns investing, this is, he obtains and uses records required for investing, evaluates various funding options to suit his unique dreams, ascertains his rights and obligations in a specific investment, offers through registered intermediaries, takes important precautions, seeks assistance in case of any unfairness, and many others. SEBI has been organizing investor schooling and attention workshops without delay, and through investor associations and marketplace individuals, and been encouraging market members to arrange comparable programmes. It continues an up to date, complete net web page for schooling of traders. It publishes diverse sorts of awareness through the media. It responds to the queries of traders via cellphone, e-mails, letters, and in person for individuals who visit SEBI workplace. ii. Investor education: Make available every detail applicable for funding in the public domain. SEBI has adopted a disclosure based regulatory regime. Below this framework, issuers and intermediaries expose applicable information about themselves, the goods, the market and the policies in order that the investor can make informed investment choices based on such disclosures. SEBI has prescribed and video display units diverse initial and continuous disclosures. iii. secure transactions: ensure that the marketplace has systems and practices which make transactions safe. SEBI has taken numerous measures along with screen-based totally buying and selling gadgets, dematerialization of securities, T+2 rolling settlement, and framed various guidelines to alter intermediaries, difficulty in buying and selling of securities, corporate restructuring, etc. to shield the hobbies of buyers in securities. It also guarantees that handiest the suit and proper persons are allowed to perform within the marketplace, each participant has incentive to comply with the prescribed standards, and the culprit are offered exemplary punishment. iv. grievance redressal machine: Facilitate redressal of investor grievances. SEBI has a comprehensive mechanism to facilitate redressal of investor grievances towards intermediaries and indexed corporations. It follows up with the businesses and intermediaries who do now redress buyers' grievances, through sending reminders to them and having conferences with them. It takes appropriate enforcement moves as supplied under the regulation (together with release of adjudication, prosecution lawsuits, directions) where development in redressal of investor grievances is not pleasant. It has installed a comprehensive arbitration mechanism in inventory exchanges and depositories for resolution disputes of the investors. The stock exchanges have investor protection price range to compensate traders while a dealer is asserted a defaulter. Depository indemnifies buyers for loss because of negligence of depository or depository participant. v. other measures: SEBI conducts inspection, inquiries and audits of inventory exchanges, intermediaries and self-regulating establishments and takes suitable remedial measures whenever important. in addition it penalises folks that adopt fraudulent and unfair alternate practices.

9.14 INVESTOR'S GRIEVANCES AND REDRESSAL MACHINE OF SEBI

In India funding dangers are very high due to dishonest practices, frauds and unethical investment tradition. traders experience helplessness and insecurity, they hardly have any confidence in financial markets. investors are cheated with the aid of agencies, by using lead managers, by way of agents and through anybody, who's capable of cheating them. The government, the enterprise law Board and the SEBI, in recent years have made efforts to protect the investors. "Buyers protection is an extensive term, it encompasses all the measures designed to guard traders from malpractices of brokers, organizations' managers to trouble, service provider bankers, registrar to problems etc. the principle proceedings are in opposition to brokers of stock exchanges, against listed groups and mutual funds.

GRIEVANCES OF INVESTORS

- in opposition to businesses.
- in opposition to brokers.
- in opposition to depositories.

9.15 TRADITION GRIEVANCES AGAINST ORGANISATIONS

1. Put off in registering transfer of securities. Registration of transfers have to be performed by way of the businesses inside 30 days of receipt of share transfer tool however generally it takes a good amount of time.

2. Non-fee or postpone in charge of dividend. Dividends must be disbursed within 30 days from the date of announcement however with the aid of manipulation of procedures dividends won't be received for months.

9.15.1 TECHNIQUES OF REDRESSAL OF INVESTORS' GRIEVANCES

1. non-reimbursement or delayed repayment of public deposits. Lots of depositors are involved in litigation to get lower back their deposits from organizations.

2. non-receipt of rights problem provided. The letter of provide of rights shares ought to be despatched to all eligible shareholders by means of registered put up and this truth need to be prominently advertised in at least all India newspapers. Shareholders pretty often are not informed of rights issues.

three. Non-receipt of reproduction proportion certificate. An agency is certain to issue duplicate share certificates if the stocks are lost or misplaced by the shareholder, after receiving a request together with the needful rate and on crowning glory of formalities.

four. Transmission of shares. After the demise of a shareholder the possession of shares passes to his legal heirs that's referred to as transmission of stocks. The agency is certain to switch the shares inside the name of the criminal inheritor of the deceased.

5. non-receipt of observation of assembly. Each shareholder whose name appears in the check-in of individuals is entitled to get a hold of 21 days to be aware of the meeting of shareholders. Non-dispatch of awareness of assembly to stakeholders is a common but serious lapse.

9.15.2 GRIEVANCES IN OPPOSITION TO BROKERS

1. Put off or default in price of securities offered. A broker has to make a price to a client who has sold securities through him within 48 hours of payout of finances through clearing residence of stock alternate or the Clearing business enterprise. brokers, more commonly, hold the sale proceed as long as they are able to.

2. delay or default in shipping of purchased protection to the purchaser. A broker has to deliver the purchased securities to his purchaser within 48 hours of payout of securities with the aid of the inventory exchange. It by no means occurs so, in exercise.

3. Non-issue of contract word. brokers need to issue a contract notice in prescribed shape to all their customers within 24 hours of the transaction however they keep away from doing so that you can earn secret income.

4. Charging excess brokerage from customers.

5. Non-passing of company blessings. A dealer is responsible for passing all of the corporate advantages like rights shares, bonus stocks, dividends and so on. to the customer he's managing but, many a times

agents play tricks in this regard.

6. Overcharging. The broker should price or pay the simplest quantity for the sale or buy of securities at He has to not overcharge for purchases or pay less for the income. In exercise, maximum

agents play hints approximately it.

9.15.3 GRIEVANCES AGAINST DEPOSITORY PARTICIPANT

Depository participant is an institution which holds securities both in certificated or uncertificated shape, assists in dematerialization of securities and so forth. of the holder. diverse banks and other establishments are doing this work. Each depository player needs to forward all the dematerialization or materialization requests of his clients to the concerned organization within 7 days of the receipt of the request; however delays are quite not unusual.

Main Depositories are:

- NSDL: National Securities Depositories Limited (1996)
- CDSL: Central Depositories Services Limited (1999)

An investor can seek redressal of his grievances from, the following agencies:

1. Grievance cells in stock exchanges
2. SEBI
3. Company Law Board
4. Courts

1. GRIEVANCE CELL/ INVESTOR SERVICE CELL IN STOCK EXCHANGES

All the acknowledged stock exchanges have mounted investors offering cells to redress the grievances of investors. These cells have played a critical role in settlement of grievances and feature infused self-belief amongst investors. buyers approach these investors' criticism cells to resort to complaints in opposition to agencies and participants of the stock exchange appearing as agents. each BSE and NSE to have their criticism cells.

9.16 METHOD OF REDRESSAL OF GRIEVANCE AGAINST COMPANIES IN INVESTOR SERVICE CELL

1. After receiving the grievance from investors, these are forwarded to the worried organisation which is directed to clear up the matter within 15 days, progress is monitored.

2. If, regardless of reminder, the organisation fails to resolve the complaints and the entire wide variety of pending lawsuits in opposition to the employer exceeds 25 and if these court cases

are pending for extra than forty-five days, the cell issue a show cause be aware of seven days to the business enterprise.

3. If the enterprise still fails to clear up the grievance within 7 days of issue of show motive word the scrip of the enterprise is suspended from trading.

4. investors grievance cell also can switch scrips of defaulting organisation to Z category for non-resolution of buyers complaints.

5. businesses that have an extended history of not resolving investors grievances and have a large wide variety of pending lawsuits are informed to appoint special personnel to clear pending lawsuits on a priority foundation.

9.17 METHOD OF REDRESSAL INVESTORS GRIEVANCES AGAINST STOCK BROKER BY INVESTOR SERVICE CELL

1. When a complaint is lodged with the stock exchange authorities, they forward it to the investor service cell which refers the complaint to the concerned broker and asks him to settle the criticism and send a reply within 7 days.

2. If no response is obtained or the received response is not satisfactory the problem is positioned before the investors grievance Redressal Committee (IGRC) of the stock exchange.

3. This committee hears both, the complainant, the dealer and efforts are made to resolve the matter failing which, it is referred for arbitration that is a quasi-judicial system.

4. A sole arbitrator is appointed if the sum is for less than 25 lakhs, for claims above Rs. 25 lakhs, a panel of 3 arbitrators is appointed.

5. An aggrieved client can file an appeal towards the award given by means of the arbitrator in appropriate court.

OTHER MEASURES TAKEN BY INVESTOR SERVICE CELL

Different measures taken for Investor safety via stock exchanges and solve the grievances of the investors and participants of the exchange are

1. Calling agency representatives to the stock exchange to interact.

2. Calling registrars and transfer agents to the inventory exchange to have interaction.

3. Issuing monthly press releases,

4. List pinnacle 25 agencies towards whom maximum court cases are pending for decision, this is additionally released on the website of the change.

5. Within the case of Bombay stock exchange, it can pursue Mumbai based totally companies to depute their representatives to the exchange to soak up the pending listing of proceedings and solve them at once.

REDRESSAL OF GRIEVANCES THROUGH SEBI

- Complaints arising out of activities that are protected underneath SEBI Act, 1992; Securities Contract Regulation Act, 1956; Depositories Act, 1996 and rules and regulations made thereunder and provisions which can be included underneath section 55A of businesses Act, 1956 are treated through SEBI.
- SEBI has a committed branch viz., Office of Investor assistance and education (OIAE) to obtain investor grievances pertaining to stock agents and depository individuals are taken up with respective stock exchange and depository for redressal and monitored by SEBI through periodic reviews received from them.
- Grievances pertaining to different intermediaries are taken up with them without delay for redressal and are continuously monitored via SEBI.
- Grievances against indexed enterprise are taken up with the respective indexed agency and are continuously monitored. The organisation is required to respond in prescribed layout in the form
- Of Action Taken record (ATR). Upon the receipt of ATR, the status of grievances is updated.
- SCORES (SEBI online complaint redressal device)
- SCORES is a web-based totally centralized complaint redressal machine
- of SEBI. (http://gov.in)
- SCORES is web-enabled and provides online access to 24 x 7.
- Court cases and reminders thereon may be lodged on line at the above internet site at any time from everywhere.
- An e-mail is generated without delay acknowledging the receipt of criticism and shelling out a completely unique grievance registration number to the complainant for future reference and tracking.

- The grievance forwarded online to the entity concerned for its redressal
- The entity concerned uploads an action Taken record (ATR) on the complaint.
- SEBI pursues the ATR and closes the grievance if it is glad that the criticism has been redressed appropriately.
- The worried investor can view the status of the grievance online from the above website by using logging within the specific grievance registration number.

GUIDELINES RELATED TO INVESTORS PROTECTION

- SEBI (Disclosure and Investor Protection) Guidelines, 2000.
- SEBI (Investor Protection and Education Fund) Regulations 2009

9.17.1 REDRESSAL BY COMPANY LAW BOARD

- Corporation law Board which was constituted in may additionally 1991 has been entrusted with many powers which had been previously exercised by using excessive courts. Every bench of the Company Law Board is deemed to be a civil court and every proceeding earlier than it is deemed as judicial proceeding.
- To shield the interests of investors it has the power of inspection of facts and documents and imposing attendance of witnesses.
- An aggrieved investor can follow to the Company Law Board

(i) To analyze the affairs of the organization

(ii) For comfort in case of oppression of management and/or mismanagement

- Investors can also inn lawsuits approximately put off and non-price of constant deposits and interest thereon with the Company Law Board.
- Representations about desired changes inside the companies Act for investors protection also can be made to the Company law Board

9.17.2 REDRESSAL OF INVESTORS GRIEVANCES THROUGH COURTS

- While an investor has tried all different ways of having his criticism settled there is no other way left with him besides to continue in opposition to the organization or the intermediary by way of civil and criminal complaints.

- Suits towards organizations can be filed in the high courts of the states. Each high court has unique designated benches approximately for business enterprise affairs and all proceedings towards organizations in breach of Companies Act are heard there.
- An aggrieved Client can file cases in high courts towards the groups to get justice however the process of law is pretty time consuming and pricey and hence past the reach of small buyers and to offer help to investors with the aid of training.

SECURITIES OMBUDSMAN

It is one of the obligations of SEBI to shield the pursuits of investors in the securities market by taking vital steps as it deems fit. SEBI were receiving complaints from the investors towards listed companies particularly with respect to non-receipt of refund orders, non-receipt of stocks certificate / unit certificate, non-receipt of dividend and plenty of extra topics. The proceedings against intermediaries regarding deficiency of service were in a huge number. For redressal of the investor grievance SEBI has been advising the corporations or the intermediaries to redress the same. The buyers have additionally been claiming damages / compensation / interest and many others. The alternative course of action against the listed company is prosecution or imposition of economic penalty of the erring agencies. The available action against intermediaries is the suspension and cancellation of registration or imposition of monetary penalty. The above does not redress the complaint of buyers or deliver any compensation to the buyers. Therefore, the problem of an alternative redressal mechanism that is cheap, rapid, informal and efficient has been enticing the attention of SEBI. The draft of the SEBI (Ombudsman) regulations, 2003 has been organized considering the hints of the Committee. The notion of Ombudsman for Securities marketplace turned into discussions inside the conferences of the prison Advisory Committee constituted by using the SEBI that is headed by way of Mr. Justice M. N. Venkatachalam, Former chief Justice of India. The Committee has advised the framing of the SEBI (Ombudsman) policies by using SEBI pursuant to its capabilities beneath section 11 of the Securities and trade Board of India, Act, 1992.

“Ombudsman” means any person appointed under section 3 of these guidelines and consists of Stipendiary Ombudsman; “Stipendiary Ombudsman” means a person appointed under regulation 9 for the reason of performing as ombudsman in recognition of a specific matter.

Appointment of Ombudsman:

1. The Ombudsman for Securities market can be appointed by the Chairman, SEBI on the advice of a selection Committee together with three individuals namely a retired high court

judge, an expert of financial market and an Officer of SEBI not below the rank of govt Director.

2. In the initial stages the Ombudsman may be appointed at the top office of the Board and depending on the wide variety of the court cases in a specific vicinity, the Stipendiary Ombudsman can be appointed and the infrastructure available at the regional workplaces of SEBI or the local inventory exchanges may be utilised.

3. With a purpose to make the concept easily number of instances in precise areas relying upon the quantity of court cases received.

4. The Stipendiary Ombudsman shall exercise all powers and features as are vested in the workplace of the Ombudsman.

5. The Stipendiary Ombudsman shall be paid such fees and allowances for the offerings rendered via him as may be decided by the Board from time to time. Such expenses shall be honorary fees or sitting costs.

Qualification, Tenure etc. of Ombudsman:

1. The individual of excessive ethical integrity having at least 40 years of age, having at the least 10 years' experience of service in any regulatory frame or having unique knowledge and experience in law, finance, economics, management and administration or either a retired District judge are qualified to be a District judge can be appointed as an Ombudsman.

2. The individual to be appointed as a Stipendiary Ombudsman has to be a person of excellent social status having served as a judicial or government officer or having experience of at the least 10 years in topics referring to consumer or investor protection or having legal exercise or served for a minimum period of 10 years in any financial organization or a regulatory body.

The different qualifications for each type of Ombudsman is contemplated in view of the distinct status of the two. The Ombudsman has to be set up as a everlasting authority with

monthly profits and has to cope with the topics on a continuous basis. The stipendiary Ombudsman will be appointed for the unique disputes and may be paid sitting prices depending upon the nature of the complaints.

Fees and Allowances -

1. The remuneration and different perquisites payable to the Ombudsman shall be determined through the Board time to time and will be borne through the issuer corporation and the intermediaries in such proportion and in such manner as may be certain by way of the Board from time to time.

2. In terms of section 11 (2) (k) SEBI may for the purposes of protection of the interests of the buyers may also take measures by means of levying charges or different fees. Consequently, it is proposed that the prices and other charges of the Ombudsman can be charged from the listed organizations and intermediaries and the establishment charges, infrastructure charges may be furnished with the aid of the stock exchanges.

Nature of Complaints:

1. The Ombudsman can be empowered to acquire lawsuits towards the listed public organizations, public companies which intend to get their securities listed in a recognised stock exchange, Mutual funds, Collective investment Scheme and the intermediaries in securities market regarding redressal of grievances of traders in securities, claims of any cash in respect of issue or dealing in securities, deficiency in services.

2. The proceedings can be filed both with the Board or Ombudsman on any person or more of the grounds as cited in the draft policies. Such grounds inter alia include non-receipt of refund orders / allotment letters, non-receipt of dividend with the aid of shareholders or unit holders, non-receipt share certificate / unit certificate, debenture certificate and bonus stocks. and many others. or any other matter as may be detailed via the Board.

Manner of Resolution of Dispute

The Ombudsman is empowered to consider such complaints and facilitate resolution via mutual settlement, or mediation and on failure of those to adjudicate any claim towards the listed organization or middleman in respect of buying or selling of or dealing in securities.

Annual Budget

The Ombudsman shall be accountable to draw up an annual budget for its workplace in consultation with the Board and shall incur expenditure in the approved budget. It shall publish an annual file to the Chairman and furnish any information to the board as may be called for.

Power to call for information

For the cause of carrying out his duties the Ombudsman might also name for information or any report referring to the difficulty of the complaint from the listed business enterprise /

intermediary or any other person, organization or authority that is in / his possession. The Ombudsman shall maintain confidentiality of any information and document. procedure for filing grievance

1. The draft rules contemplate a simplified technique. The aggrieved man or woman might also file the complaint in the specified form either himself or via his authorized agent. The proceedings can be filed at once with the Ombudsman or to the Board. The proceedings received by the Board will be forwarded to the Ombudsman or the Stipendiary Ombudsman.
2. The draft rules require that earlier than making the grievance to the Board / Ombudsman shall make certain that he had made a representation to the business enterprise or middleman and the same has been rejected or no response has been acquired within one month and the complaint is not in respect of the same matter which has been settled via the Ombudsman and the grievance is made within 12 months of the purpose of movement.

Re-examination of the award on adjudication

An aggrieved party to an award on adjudication can also make an application to the Board for re-examination of the award. The Board can also pass appropriate orders on such applications within 45 days.

Costs and Interests

The Ombudsman might also decide an award of affordable repayment, fees of the proceedings and stipulate interest to be paid by the party against whom the award has been made till the award is implemented.

Implementation of the award

The award on consent, settlement or the arbitral award with the aid of the Ombudsman or by way of the Arbitral Committee shall be binding on the parties. If any party fails to enforce the award, he will be accountable for action under section 15C of the SEBI Act, suspension of buying and selling or delisting of securities, suspension of trading or delisting of securities, suspension or cancellation of registration etc.

Disclosure of the system by the listed companies and the intermediaries

1. As a matter of disclosure to investor and investor awareness it has been provided that the listed businesses and the intermediaries shall be required to display the name and address of the Ombudsman to whom the proceedings are to be made by the aggrieved party in their workplace premises in this sort of manner that the visiting shareholders and buyers can take

notice. The listed agencies and the intermediaries also are required to reveal if they provide files or customers' settlement the complaint redressal mechanism thru Ombudsman under the rules.

2. The failure to show the facts as above or furnishing records to the Ombudsman as required underneath the rules shall appeal to penalty under section 15A of the SEBI Act.

9.18 CORPORATE GOVERNANCE INTRODUCTION

Company Governance refers to the way an enterprise is ruled. It mimics the technique by using which groups are directed and controlled. It means carrying the enterprise as consistent with the stakeholders' dreams. its miles certainly conducted by means of the board of administrators and the worried committees for the enterprise's stakeholder's gain. it's far all about balancing character and societal goals, as well as, financial and social dreams.

Company Governance is the interplay between numerous members (shareholders, board of directors, and organization's management) in shaping enterprise's performance and the way it's far proceeding in the direction of. the connection between the owners and the managers in an organization should be wholesome and there should be no warfare among the two. The proprietors should see that person's actual performance is consistent with the standard overall performance. These dimensions of corporate governance should no longer be ignored.

Corporate Governance deals with the way the companies of finance assure themselves of having a truthful go back on their investment. Corporate Governance truly distinguishes between the proprietors and the managers. The managers are figuring out authority. In contemporary organizations, the features/ responsibilities of owners and managers ought to be actually described, as an alternative, harmonizing.

Company Governance deals with figuring out approaches to take effective strategic selections. It offers ultimate authority and complete duty to the Board of directors.

In the modern marketplace- oriented economy, the need for company governance arises. Also, efficiency in addition to globalization are enormous elements urging company governance. Company Governance is critical to expand introduced value to the stakeholders. Corporate Governance guarantees transparency which guarantees strong and balanced economic development. This additionally ensures that the hobbies of all shareholders (majority in addition to minority shareholders) are safeguarded. It ensures that every one shareholder is absolutely exercising their rights and that the organisation absolutely acknowledges their rights. Company Governance has a broad scope. It includes both social and institutional aspects. Company Governance encourages an honest, ethical, as well as moral environment.

9.19 DEFINITION OF COMPANY GOVERNANCE

The definition of corporate governance most broadly used is "the gadget by which agencies are directed and managed" (Cadbury Committee, 1992). extra specifically it's far the framework by way of which the numerous stakeholder pursuits are balanced, or, as the IFC states, "the relationships among the management, Board of directors, controlling shareholders, minority shareholders and different stakeholders". Cadbury Committee [1] (U.ok.), 1992 has defined company governance as such

1. "corporate governance is the gadget by which agencies are directed and managed. It encompasses the complete mechanics of the functioning of an enterprise and attempts to put in place a machine of exams and balances between the shareholders, directors, personnel, auditor and the management."
2. "Company governance is the system by which enterprise companies are directed and controlled. The corporate governance shape specifies the distribution of rights and obligations amongst distinctive members in the organisation, such as, the board, managers, shareholders and spells out the rules and approaches for making decisions on company affairs. by way of doing this, it also gives this; it also offers the structure via which the employer targets are set, and the method of attaining the ones targets and monitoring performance."
3. Definition of company governance through the Institute of corporation Secretaries of India is as beneath:

"Corporate Governance is the application of pleasant control practices, Compliance of regulation in proper letter and spirit and adherence to moral standards for effective control and distribution of wealth and discharge of social obligation for sustainable improvement of all stakeholders".

THE OECD STANDARDS OF CORPORATE GOVERNANCE STATES

"Corporate governance includes a fixed relationship between a business enterprise's management, its board, its shareholders and other stakeholders. corporate governance additionally gives the shape via which the objectives of the corporation are set, and the way of attaining the ones targets and monitoring overall performance are decided." whilst the conventional definition of corporate governance acknowledges the lifestyles and significance of 'different stakeholders' they still remain conscious of the traditional debate on the relationship among disconnected proprietors (shareholders) and regularly self-serving managers. certainly, it has been stated, as a substitute ponderously, that corporate governance includes elements:

1. The long-term courting which has to address checks and balances, incentives for manager and communications between control and buyers;
2. The transactional relationship which includes managing disclosure and authority.

This implies an adverse courting among management and investors, and a mind-set of mutual suspicion. This became the basis for a lot of the rationale of the Cadbury report, and is one of the reasons why it prescribed in some element the way wherein the board needed to conduct itself: consistency and transparency toward shareholders are its watchwords. As fundamentally vital as these trends are, we choose to take a alternatively broader view, which places the Cadbury Code and other codes evolved due to the fact (combined Code, Sarbanes-Oxley, King, and many others) in a wider context and shows its hints emerging clearly inside the direction of a organisation's evolution. In an early e book on corporate governance, additionally posted in 1992, one of the creators of this website evolved a definition of corporate governance as which includes 5 elements which the board ought to keep in mind:

- long term strategic goals
- personnel: past, present and future
- environment/community
- customers/providers
- compliance (legal/regulatory)

benefits OF corporate GOVERNANCE

- exact corporate governance ensures company success and economic increase.
- strong corporate governance continues investors' confidence, as a result of which, rporations can enhance capital efficiently and successfully.
- It lowers the capital fee.
- there may be an effective impact on the percentage fee.

- It affords right inducement to the proprietors in addition to managers to obtain targets which are in pursuits of the shareholders and the employer.
- right company governance additionally minimizes wastages, corruption, risks and mismanagement. · It enables logo formation and improvement.
- It guarantees business enterprise is controlled in a way that suits the high-quality hobbies of all.

9.20 NEED FOR COMPANY GOVERNANCE

The need for company governance is highlighted by the subsequent factors:

(i) wide unfold of Shareholders

nowadays an organisation has a completely huge quantity of shareholders unfolding all over the nation and even the sector; and a majority of shareholders being unorganized and having a detached mind-set closer to corporate affairs. The concept of shareholders' democracy remains restricted best to the regulation and the Articles of affiliation; which requires a practical implementation via a code of behavior of company governance.

(ii) changing ownership structure

The pattern of company possession has modified significantly, in the present-day-instances; with institutional traders (overseas as well Indian) and mutual budget becoming biggest shareholders in big company non-public regions. These investors have grown to be the greatest undertaking to company managements, forcing the latter to abide by using some mounted code of corporate governance to build up its image in society.

(iii) company Scams or Scandals

public self-assurance in company management. The occasion of the Harshad Mehta scandal, which is possibly one of the biggest scandals, is in the heart and thoughts of all, connected with corporate shareholding or otherwise being educated and socially aware. The want for corporate governance is, then, vital for reviving investors' self-belief within the corporate region towards the financial improvement of society.

9.21 PRINCIPLES OF COMPANY GOVERNANCE

The fundamental or key standards of company governance are defined under:

(i) Transparency

Transparency means the pleasantness of something which allows one to apprehend reality without problems. within the context of company governance, it implies an correct, adequate and well timed disclosure of applicable information approximately the working consequences etc. of the corporate employer to the stakeholders.

In truth, transparency is the foundation of company governance; which enables to develop a high degree of public confidence within the company quarter. For ensuring transparency in company management, an organization has to post relevant statistics about company affairs in leading newspapers, e.g., on a quarterly or 1/2 every year or annual basis.

(ii) accountability

responsibility is a liability to explain the effects of one's decisions taken inside the hobby of others. Within the context of company governance, responsibility implies the obligation of the Chairman, the Board of directors and the chief government for the use of the organization's assets (over which they have got authority) within the best interest of the organisation and its stakeholders.

(iii) Independence

appropriate corporate governance requires independence on a part of the pinnacle control of the company i.e., the Board of directors have to be a robust non-partisan body; so that it can take all company decisions based totally on business prudence. without the pinnacle management of the agency being independent; suitable company governance is most effective an insignificant dream.

SEBI CODE OF COMPANY GOVERNANCE

To sell true corporate governance, SEBI (Securities and alternate Board of India) constituted a committee on corporate governance under the chairmanship of Kumar Mangalam Birla. On the basis of the hints of this committee, SEBI issued certain pointers on company governance; which can be required to be incorporated inside the list agreement among the business enterprise and the stock exchange.

an overview of SEBI recommendations on company governance is given underneath, underneath suitable heads:

(a) Board of directors

some factors in this regard are as follows:

(i) The Board of administrators of the company shall have an most efficient aggregate of government and nonexecutive directors.

(ii) The range of impartial directors might rely on whether the chairman is govt or non-government.

In case of non-executive chairman, at the least, one 1/3 of the Board must contain impartial administrators; and in case of govt chairman, as a minimum, 1/2 of the Board have to incorporate independent directors.

The expression 'impartial directors' method administrators, who apart from receiving director's remuneration, do no longer have any other fabric pecuniary dating with the organization.

(b) Audit Committee

some factors in this regard are as follows:

(1) The employer shall form an independent audit committee whose constitution might be as follows:

(i) It shall have minimum 3 participants, all being non-govt directors, with most people of them being impartial, and at least one director having economic and accounting expertise.

(ii) The Chairman of the committee will be an unbiased director.

(iii) The Chairman shall be given a gift at the Annual fashionable meeting to answer shareholders' queries.

(2) The audit committee shall have powers which should encompass the following:

(i) to investigate any activity inside its phrases of reference

(ii) To are seeking for records from any employee

(iii) To acquire outdoor felony or other expert recommendation

(iv) To relax the attendance of outsiders with relevant know-how, if requisite.

The role of audit committee have to consist of the following:

(i) Overseeing of the company's monetary reporting procedure and the disclosure of its economic records to make certain that the economic statement is correct, sufficient and credible.

(ii) Recommending the appointment and elimination of an external auditor.

(iii) Reviewing the adequacy of internal audit function

(iv) Discussing with outside auditors, earlier than the audit commences, the character and scope of audit; in addition to to have put up-audit discussion to ascertain any region of subject.

(v) Reviewing the company's monetary and hazard control rules

(c) Remuneration of administrators

the following disclosures at the remuneration of administrators shall be made in the section on the company governance of the yearly file:

(i) All factors of remuneration package deal with all of the directors i.e., profits, benefits, bonus, inventory alternatives, pension and many others.

(ii) info of fixed aspect and overall performance linked incentives, at the side of performance standards.

(d) Board process a few factors in this Regards are

(i) Board conferences shall be held as a minimum, 4 instances a year, with a maximum gap of four months among any meetings.

(ii) A director shall no longer be a member of more than 10 committees or act as chairman of greater than five committees, across all companies, wherein he's a director.

(e) management

A control dialogue and evaluation report should form a part of the annual report to the shareholders; containing dialogue on the subsequent matters (in the limits set by using the agency's competitive position).

(i) opportunities and threats

(ii) phase-wise or product-clever performance

(iii) risks and concerns

(iv) dialogue on monetary performance with admire to operational overall performance

(v) fabric development in human resource/industrial family members the front.

(f) Shareholders

a few factors on this regard are:

(i) In case of appointment of a new director or reappointment of a director, shareholders should be furnished with the subsequent information:

1. A brief resume (precis) of the director

2. Nature of his knowledge

3. variety of organizations wherein he holds the directorship and membership of committees of the Board.

(ii) A Board Committee under the chairmanship of non-govt directors will be formed to in particular look at the redressing of shareholders and investors' complaints like switch of stocks, nonreceipt of balance Sheet or declared dividends and so forth. This committee will be unique as 'Shareholders / investors grievance Committee'.

(g) file on company Governance

There shall be a separate phase on company governance within the Annual document of the employer, with an in-depth record on company governance.

(h) Compliance

The organization shall obtain a certificate from the auditors of the employer regarding the compliance of situations of company governance. This certificate shall be annexed with the administrators' document despatched to shareholders and additionally despatched to the stock exchange.

9.22 CORPORATE GOVERNANCE – HISTORY IN INDIA

Corporate governance is concerned with a set of principles, ethics, values, morals, rules regulations, & procedures etc. Corporate governance establishes a system whereby directors are entrusted with duties and responsibilities in relation to the direction of the company's affairs.

The term "governance" means control i.e., controlling a company, an organization etc or a company & corporate governance is governing or controlling the corporate bodies i.e. ethics, values, principles, morals. For corporate governance to be good the manager needs to meet its responsibilities towards its owners (shareholders), creditors, employees, customers, government and the society at large. Corporate governance helps in establishing a system where a director is showered with duties and responsibilities of the affairs of the company.

Corporate governance concept emerged in India after the second half of 1996 due to economic liberalization and deregulation of industry and business. With the changing times, there was also a need for greater accountability of companies to their shareholders and customers. The report of the Cadbury Committee on the financial aspects of corporate Governance in the U.K. has given rise to the debate of Corporate Governance in India.

Need for corporate governance arises due to separation of management from the ownership. For a firm to succeed, it needs to concentrate on both economic and social aspects. It needs to be fair with producers, shareholders, customers etc. It has various responsibilities towards employees, customers, communities and at last towards governance and it needs to serve its responsibilities at the best in all aspects.

The "corporate governance concept" dwells in India from the Artshastra time. Instead of CEOs at that time there were kings and subjects. Today, corporate and shareholders replace them but the principles still remain the same, unchanged i.e. good governance.

The 20th century witnessed the glossy of the Indian Economy due to liberalization, globalization, and privatization. Indian economy for the 1st time here was together with the world economy for product, capital and labour market and which resulted into a world of capitalization, corporate culture, business ethics which was found important for the existence of corporations in the world marketplace.

For effective corporate governance, its policies need to be such that the directors of the company should not abuse their power and instead should understand their duties and responsibilities towards the company and should act in the best interests of the company in the broadest sense.

The concept of 'corporate governance' is not an end; it's just a beginning towards growth of the company for long term prosperity.

9.22.1 CORPORATE GOVERNANCE IN INDIA PAST, PRESENT AND FUTURE

Good corporate governance in the changing business environment has emerged as a powerful tool of competitiveness and sustainability. It is very important at this point and it needs cooperation for one and all i.e., from the CEO of the company to the ordinary staff for the maximization of the stakeholders' value and also for maximization of pleasure and minimization of pain for the long-term business. Global competitions in the market need best planning, management, innovative ideas, compliance with laws, good relation between directors, shareholders, employees and customers of companies, value based corporate governance in order to grow, prosper and compete in international markets by strengthen their strength overcoming their weaknesses and running them effectively and efficiently in an efficient and transparent manner by adopting the best practices. Corporate India must commit itself as reliable, innovative and prompt service provider to their customers and should also become reliable business partners in order to prosper and to have all round growth. Corporate Governance is nothing more than a set of ideas, innovation, creativity, thinking having certain ethics, values, principles etc which gives direction and shape to its people, employees and owners of companies and help them to flourish in the global market. Indian Corporate Bodies having adopted good corporate governance will reach a benchmark for the rest of the world; it brings laurels as a way of appreciation. Corporate governance lays down ethics, values, and principles, management policies of a corporation which are inculcated and brought into practice. The importance of corporate governance lies in promoting and maintaining integrity, transparency and accountability throughout the organization. Corporate governance has existed since the past but it was in a different form. During Vedic times kings used to have their ministers and used to have ethics, values, principles and laws to run their state but today it is in the form corporate governance having same rules, laws, ethics, values, and morals etc which helps in running corporate bodies in the more effective ways so that they in the age of globalization become global giants. Several Indian Companies like PepsiCo, Infuses, Tata, Wipro, TCS, and Reliance are some of the global giants which have their flag of success flying high in the sky due to good corporate governance. Today, even law has a great role to play in a successful and growing economy. Government and judiciary have enacted several laws and regulations like SEBI, FEMA, Cyber laws, Competition laws etc and have brought several amendments and repeal the laws in order that they don’t act as barriers for these corporate bodies and developing India. Judiciary has also helped in great ways by solving the corporate disputes in a speedy way.

Corporate bodies have their aim, values, motto, ethics and principles etc which guide them to the ladder of success. Big and small organizations have their magazines' annual reports which reflect their achievements, failure, their profit and loss, and their current position in the market. A few companies have also shown awareness of environment protection, social responsibilities and the cause of upliftment and social development and they have deeply committed themselves to it. The big example of such a company can be of Deepak Fertilizers and Petrochemicals Corporation Limited which also bagged 2nd runner up award for the corporate social responsibility by business world in 2005. Under the present scenario, stakeholders are given more importance as shareholders, they even get a chance to attend, vote at general meetings, make observations and comments on the performance of the company.

Corporate governance from the futuristic point of view has a great role to play. The corporate bodies in their corporation have a much futuristic approach. They have a vision for their company, on which they work for future success. They take risks and adopt innovative ideas, have futuristic goals, motto, and future objectives to achieve.

With increase in interdepence and free trade among countries and citizens across the globe, internationally accepted corporate governance standards are of paramount importance for Indian Companies seeking to distinguish themselves in global footprint. The companies should always keep improving, enhancing and upgrading themselves by bringing more reliable integrated product and service quality. They should be more transparent in their conduct.

Corporate governance should also have a holistic view, value-based governance, should be committed towards corporate social upliftment and social responsibility and environment protection. It also involves creative, generative and positive things that add value to the various stakeholders that are served as customers. Be it finance, taxation, banking or legal framework each and every place requires good corporate governance.

Hence corporate governance is a means and not an end, corporate excellence should be ended.

9.22.2 PERSPECTIVE AND IMPORTANT ISSUES IN CORPORATE GOVERNANCE

There are several essential troubles in corporate governance and they play an excellent position, all the problems are interrelated, interdependent to deal with each difference. Every issue connected with corporate governance has distinctive priorities in every of the corporate bodies. The issues are listed as under:

1. value primarily based company lifestyle

2. Holistic view

3. Compliance with legal guidelines

4.. Disclosure, transparency, & responsibility

5. company governance and human resource control

6. Innovation

7. Necessity of judicial reforms

8. Globalization helps Indian agencies to become international giants based on true company governance.

nine. training from corporate failure

1. cost primarily based on company subculture: For any organization to run in an effective way, it wishes to have positive ethics, values. longer term commercial enterprise desires to have a primarily based corporate way of life. price primarily based on company culture is good practice for company governance. it can be a motto i.e. A short phrase that is unique and enables in strolling organization, there may be imaginative and prescient i.e., dream to be fulfilled, mission and reason, objective, purpose, goal.

2. Holistic view: This holistic view is a greater or less godly, non-secular mind-set which allows in running corporations. It is not less complicated to adopt it, it desires unique efforts and once adopted it ends in developing features of nobility, tolerance and empathy.

3. Compliance with laws: those businesses which actually need development, have excessive moral values and need to run longer term business they abide and comply with legal guidelines of Securities change Board Of India (SEBI), foreign exchange law Act, opposition Act 2002, Cyber laws, Banking legal guidelines and so forth.

4. Disclosure, transparency, and accountability: Disclosure, transparency and accountability are essential factors for true governance. timely and accurate data must be disclosed on the subjects just like the financial role, performance and many others. Transparency is wanted in order that the government has faith in company bodies and consequently it has reduced company tax costs from 30% today as opposed to 97% for the duration of the overdue 1970s. Transparency is wanted in the direction of corporate bodies in order that due to extraordinary opposition in the marketplace the clients having alternatives don't shift to other companies.

5. corporate Governance and Human resource control: For any company body, the employees and body of workers are just like a circle of relatives. For an enterprise to be ideal the position of Human useful resource management becomes very essential, they each are at once linked. every character needs to be treated with individual recognition, his achievements ought to be recognized. Each group of workers and employees should be given the best possibilities to show their worth and these can be carried out through the Human aid department. Therefore, in corporate Governance, Human resource has an extraordinary function.

6. Innovation: each corporate frame wishes to take the hazard of innovation i.e., innovation in merchandise, in services and it plays a pivotal function in company governance.

7. Necessity of Judicial Reform [5]: there may be a necessity of judicial reform for a great economic system and additionally in nowadays times of globalization and liberalization. Our judicial machine even though having achieved salutary position these types of years, genuinely are becoming out of date and outdated over time. The postpone in judiciary is because of several pursuits worried in it. however then with changing state of affairs and rapid-developing opposition, the judiciary needs to carry reforms consequently. It needs to rapidly clear up disputes in value powerful manner.

8. Globalization supports Indian groups to emerge as international giants primarily based on top governance: In nowadays age of competition and due to globalization, our several Indian company bodies are becoming global giants which can be feasible and most effective due to good corporate governance.

9. instructions from corporate Failure: each tale has a moral to analyze from, each failure has achievement to study from, in the same way, company frames have rules which if is going as a failure they want to learn from it. Failure can be each internal in addition to outside something it can be, in proper governance, company our bodies need to research from their disasters and need to move to the route of achievement.

GOOD GOVERNANCE; MEANING AND CONCEPT

Defining good governance properly is a term used with brilliant flexibility; depending at the context, true governance has been stated at diverse times to encompass: full admire of effective participation, human rights, the rule of thumb of law, multi actor partnerships, and responsible tactics, political pluralism, transparent and institutions, an green and powerful public quarter, legitimacy, get admission to to expertise, data and schooling, political empowerment of human beings, equity, sustainability, and attitudes and values that foster responsibility, harmony and tolerance.

9.23 RIGIN AND EMERGENCE OF CONCEPT OF GOOD GOVERNANCE

- “Good governance” was to begin with expressed in a 1989 international financial institution e-book.
- In 1992, the financial institution posted a report entitled, Governance and improvement, which explored the idea in addition and its utility.

- In 1997, the bank redefined the idea of "accurate governance" as a necessary precondition for development.

Good governance is to promote and preserve holistic and integrated human improvement. The valuable awareness is to look how the government permits, simplifies and authorises its human beings, irrespective of variations of caste, creed, magnificence, and political ideology and social starting place to assume, and take certain selections a good way to be in their excellent interest, and for you to allow them to steer a clean, decent, happy, and autonomous lifestyles.

"true" approximately governance properly Governance manages and allocates assets to respond to combined troubles of its citizens. Subsequently states need to be assessed on each exception and the amount of public items supplied to citizens. The policies that supply public items are guided by using ideas together with human rights, democratization and democracy, transparency, participation and decentralized electricity sharing, sound public administration, accountability, rule of regulation, effectiveness, equity, and strategic imaginative and prescient.

The Human development record issued insists on "suitable" governance as a democratic exigency, in an effort to rid corruption, gives rights, the method, and the capability to take part in the selections that affect their lives and to maintain their governments accountable for what they do.

BASIC FEATURES OF ELEMENTS OF GOOD GOVERNANCE

An appropriate governance has eight main characteristics. It's participatory, consensus oriented, accountable, obvious, responsive, powerful and green, equitable and inclusive and follows the rule of thumb of regulation. It assures that corruption is minimized, the views of minorities are taken into consideration and that the voices of the maximum prone in society are heard in choice-making. It is also attentive to the present and fixture desires of society.

Participation in precise governance calls for that civil society to have the possibility to take part via both males and females during the formula of improvement strategies. This element of governance is a vital element in securing dedication and assisting for projects and enhancing the satisfaction in their implementation. Participation needs to be knowledgeable and organized. This means freedom of affiliation and expression and a prepared civil society must cross hand in hand.

1. RULE OF LAW: Right governance requires a fair, predictable and solid felony framework enforced impartially. complete safety of human rights, specifically

minorities should be covered. unbiased regulation enforcement requires a judiciary to be independent and police pressure must be independent and incorruptible.

2. TRANSPARENCY: Transparency in government is an important precondition for desirable governance, and people's choices taken and their enforcement are finished in a way that follows policies and regulations. Transparency guarantees that sufficient statistics is provided and that it's miles provided in effortlessly understandable forms and media.
3. RESPONSIVENESS: Exact governance requires the institutions to serve all stakeholders in a given time-body. There are numerous actors and viewpoints and the different pastimes in society desire mediation. The quality interest of the network needs to be analysed and achieved which calls for a large and long-time period attitude on what is needed and a way to achieve the goals of sustainable improvement
4. EQUITY AND INCLUSIVENESS: A society's wellbeing depends on ensuring that all ladies and men have possibilities to improve or hold their proper-being. This requires all corporations, in particular the most vulnerable, to have possibilities to improve or keep their standards of lifestyles.
5. EFFECTIVENESS AND PERFORMANCE: Proper governance approach processes and establishments produce consequences that meet wishes at the same time as making the best use of sources. The concept of performance covers the sustainable use of natural resources and the protection of the environment
6. ACCOUNTABILITY: It's miles a key requirement of true governance. both Public and personal area and civil society organizations should be responsible to the general public and to their institutional stakeholders. A company or an organization is responsible to individuals who might be tormented by its selections or actions. duty may be enforced most effectively with transparency and the rule of thumb of regulation.
7. RULE OF REGULATION: Rule of regulation helps the demand for fairness and equity and means to be impartial, not corrupt and to defend the human rights of all. Those are the leading criteria becoming benchmarks one has to keep in mind whilst striving for precise Governance within the choice-making methods.

9.24 SIGNIFICANCE OF SUITABLE GOVERNMENT

India follows republic, democratic and secular shape of governance, and the values which can be enshrined in our constitution. The term "governance" methods a political unit for the functioning of policy-making for both the political and administrative gadgets of the presidency. Good governance is primarily based on the conviction that a guy has the ethical and rational potential, as well as the absolute right, to govern himself with motive and justice. The concept of suitable governance is associated with successful and actual management in democratic installation.

Practically, there are three particular functions of precise governance that makes its significance inside the operating of the authorities.

- First, the empowerment and ability of the presidency to frame and enforce policies and discharge functions.
- second, the form of political will.
- third, the technique via which authority is exercised inside the control of a country's economic and social resources for development.

It additionally displays the attitudes of the human beings towards the functioning of so many businesses of the government. “Precise” governance promotes gender equality, sustains the surroundings, allows citizens to workout private freedoms, and affords equipment to lessen poverty, deprivation, fear, and violence. The UN regards exact governance as participatory, transparent and responsible. It encompasses nation establishments and their operations and consists of personal sector and civil society businesses. Correct governance is sizable in public establishments to behave and manipulate public affairs and resources to guarantee human rights free of abuse and corruption, and with due regard for the rule of law.

it's far giant because it guarantees to supply on the promise of human rights: civil, cultural, financial, political and social rights. True governance is, as a result, a feature of installation of effective virtues of management and removal of vices of dysfunctional ties. It makes the government paintings effective, credible and valid in administrative devices and citizen-friendly, value caring and people-sharing.

9.25 SUMMARY

This unit summarizes ordinary minimum corporate governance concepts and high-quality practices relevant to all agencies (whether public, private or non-income). An organisation is created to cope with goals which are tons extra than creating services and products, it has to serve the larger cause of enjoyable multilevel needs of the society. Wholesome company governance practices are no longer the want of the law but have grown to be critical for the very survival of the companies, the present-day economic disaster has confirmed that beyond doubt. The businesses have constantly faced the tug of war of protecting the interests of the shareholders (the prison proprietors) or the stakeholders which incorporate suppliers, lenders, government and communities.

This unit discusses certain modern satisfactory practices as endorsed through corporate governance businesses and practiced with the aid of a few Fortunes public organizations, with the knowledge that fine practices tend to conform over time. We proceed on the idea that a 'nice exercise' is one wherein the blessings to the corporation significantly exceed the price of implementation. What's a pleasant practice these days won't be a first-class exercise inside the destiny?

M.COM

SEMESTER I

COURSE: BUSINESS ENVIRONMENT

UNIT 10: STRUCTURE OF INDIAN ECONOMY

STRUCTURE

10.0 OBJECTIVES:

After completing this lesson, you will be able to:

- Define the "Structure of Indian Economy''
- Explain the Prime Moving Force of Indian Economy;
- List out various aspects of Indian Economy;
- Describe the strategy of Strong Emphasis on Public Sector;
- Explain Various sectors of Indian Economy;
- Conduct the SWOT Analysis of Indian Economy

10.1 INTRODUCTION AND HISTORY OF STRUCTURE OF INDIAN ECONOMY

The economic profile of India was in complete disarray at the time of independence. As a typical colonial economy, India had been serving as a means of development for the United Kingdom. Both agriculture and industry had structural distortions while the state was playing a very minimal role. About half a century before India became independent, the world was going through accelerated development and expansion in its agriculture and industry with the same happening in the UK as well.

Some Facts about the Indian Economy at that time:

1. The unilateral transfer of investible capital to Britain by the colonial state along with the unequal exchange was crippling India's commerce, trade and the thriving handloom industry day by day. The colonial state practiced policies which were significant impediments to the process of development of the country. Throughout the colonial rule, the economic vision of the state was to increase India's capacity to export primary products, increase the purchase/import of the British manufactured goods and raise revenues to counter the drain of capital as well as to meet the revenue requirements of the imperial defence.
2. The social sector was a neglected area for the British rulers which had a negative impact on the production and productivity of the economy. Under the British rule, India remained a continent of illiterate peasants. At the time of Independence, the literacy rate was merely 17%, with 32.5 years of life expectancy at birth.
3. The industrialisation of India was also neglected by the colonisers— the infrastructure which was built served to exploit India's raw materials rather than to industrialise the country. Indian capitalists who did emerge during the time were highly dependent upon the British commercial capital and many sectors of the industry were dominated by British firms, for instance shipping, banking, insurance, coal, plantation crops and jute.
4. The pre-independence period was a period of near stagnation, showing almost no change in the structure of production or in the levels of productivity— the aggregate real output during the first half of the 20th century was estimated at less than 2% a year or less.
5. The overall economic performance of India under the British rule was very poor. According to economic statistian Angus Maddison, there was no per capita growth in India from 1600 to 1870— per capita growth was a meagre 0.2% from 1870 to 1947, compared with 1% in the UK.

6. The per capita incomes of ₹18 for 1899 and ₹39.5 for 1895 in current prices tell the true story of the abject poverty Indian masses were facing.
7. The repeated famines and disease epidemics during the second half of the nineteenth century and the first half of the twentieth century show the greatest socio-economic irresponsibility and neglect of the British government towards India.
8. The political leaders and the industrialists were very aware and conscious about the economic inheritance once India became independent. Somehow, these dominant lot of people who were going to lay down the foundation stones of the independent Indian economy had a consensual view, even before the independence, on many major strategic issues:
   - (i) State/governments should be given a direct responsibility for development.
   - (ii) An ambitious and vital role should be assigned to the public sector.
   - (iii) The necessity for the development of heavy industries.
   - (iv) Discouraging foreign investment.
   - (v) The need for economic planning.

Once India became independent, it was a real challenge for the government of the time to adopt a systematic re-organisation of the economy. This was a challenging task full of hurdles as the state of the Indian economy at that time was not optimistic. The need to initiate a noticeable growth and development of Economy was a great challenge in front of the political leadership as the country was riding on the promises of these leaders. It was not a simple task. The decisions taken by the political leadership of the time would build the foundation of the future of the country. Many significant and strategic ideas which were decided upon by 1956 have shaped the Indian economic journey till date— undoubtedly, they heavily dominated the pre-reform period, but the post-reform period is also not completely free of their impact. To understand the nature and scope of the Indian economy in current times, it is not only useful but essential to go through the facts and reasons which made the economy evolve and unfold the way it did.

10.2 PRIME MOVING FORCE OF INDIAN ECONOMY-AGRICULTURE VS. INDUSTRY

A significant topical issue of the debate regarding India has always been the choice for the sector which would lead the process of development. The government of that time opted for industry to be India's prime moving force of the economy. Many experts question whether India should have chosen agriculture as its prime moving force for better prospects of development. It is undeniable that every economy develops using its natural and human resources. The availability and the non-availability of resources, natural as well as human, are not the only issues which make an economy decide to declare whether it opts for agriculture or industry as its prime moving force. There are many socio-political compulsions and objectives which play their roles in such decision making. The political leadership selected industry as the leading force of the economy after Independence— this was already decided by the dominant group of the nationalist leaders back in the mid-11050s when they felt the need for economic planning for India before setting up the National Planning Committee (1938).

Given the available resources, it seemed an illogical decision as India lacked all those pre-requisites which could suggest the declaration of industry as its prime mover:

(i) There was almost no presence of infrastructure sector, i.e., power, transportation and communication.

(ii) The negligible presence of the infrastructure industries, i.e., iron and steel, cement, coal, crude oil, oil refining and electricity was also a noticeable issue.

(iii) A significant lack of investible capital— be it in the case of either the government or the private sector.

(iv) The absence of required technology to support the process of industrialisation and almost no research and development.

(v) The lack of skilled manpower.

(vi) The absence of entrepreneurship among the people.

(vii) The absence of market for industrial goods.

(viii) Many other socio-psychological factors which acted as negative forces for the proper industrialisation of the economy.

The obvious choice for India would have been the agriculture sector as the moving force of the economy because: (i) The country possessed fertile land which was fit for cultivation. (ii) Human capital did not require any kind of higher training. By merely organising the land ownership, irrigation and other inputs to agriculture, India could have achieved better prospects of development.

Once there were no crises of food, shelter, basic healthcare for the masses, one goal of development could have been realised— the general welfare of the people. Once the masses were able to achieve a level of purchasing capacity, India could have gone for the expansion of industries. India was capable of generating as much surplus income for its masses as was required by the emerging industries for a market success. The People's Republic of China did the same in 1949, taking a realistic evaluation of its resources, it declared agriculture as its prime moving force for the economy. The surplus generated out of agriculture was suitably invested to develop the pre-requisites for industrialisation and the country went for it in the 1970s. The emergence of industrial China was so vivid that its impact was felt in the so-called highly developed and industrialised economies of the world— the industrial structure of China catapulted it into a giant economy.

Was the political leadership of Independent India not able to analyse the realities and conclude that agriculture should have been the moving force of the economy instead of industry? How could India, whose leadership had fought the nationalist movement on the Gandhian fervour of villages, agriculture and rural development, not have opted for agriculture as its prime moving force. Even if Mahatma Gandhi was not in the government there were many devout Gandhians in it and no one should doubt that the main internal force which vibrated throughout the governmental decisions was nothing but 'Gandhian Socialism'. There were many decisions which were taken under the influence of the main political force of the times, still some very vital ones were influenced by the visionary hunches of the political leadership mainly being Pt. J. L. Nehru.

This is why the economic thinking of independent India is considered and said to be nurtured by the Nehruvian Economics till today. If we go through the majority of literatures on the Indian economic history, views of the critiques of the time and the contemporary experts, we may be able to feel the answer as to why India chose industry as its prime moving force in place of the obvious and logical choice of agriculture: Looking at the resources available, agriculture would have been the obvious choice as the prime moving force (PMF) of the economy (i.e., cultivable land and the manpower), but as Indian agriculture was using the traditional tools and technology, its modernisation as well as future mechanisation would have been blocked due to the lack of indigenous industrial support. If India had opted to import, it would have required enough foreign reserves and led to a natural dependence on foreign countries.

By choosing industry as the prime moving force we were aiming for industrialisation of the economy as well as modernisation of our traditional mode of farming. During that period, the dominant ideology around the world as well as in the World Bank and the International Monetary Fund were in favour of industrialisation as a means towards faster growth which could translate to faster development. Same was the case with the developed economies. It was possible to practice industrialisation faster due to these supports. In addition, there was also the hope to emerge as an industry goods exporter. Such support was not being offered to an agriculturally motivated economy. Essentially, choosing to opt for the agriculture sector was considered a symbol of 'backwardness' at the time. The political leadership wanted to carry India forward. It was only in the 1990s that the world as a whole and organisations such as World Bank and the International Monetary Fund changed their opinion regarding the agriculture sector— and emphasis on this sector by an economy was no longer considered to be a sign of 'backwardness'.

The Second World War had proved the supremacy of defence power. For defence, a country required both the support of science and technology as well as an industrial base. India also required a powerful defence base for herself as a deterrent force. By opting for industry as her PMF, the economy tried to solve many challenges simultaneously— first, industry would lead to faster growth, second, agriculture would be modernised in time and third, the economy would be able to develop its own defence force.

Since the economy had also opted for scientific and technological preparedness, its achievements were to sustain the pace of modernising world. Even before Independence, there was a socio-economic consensus among social scientists along with the nationalist leaders, that India needed a boost towards social change as the country lagged behind in the areas of modernisation.

A break from the traditional way of life and cultivation of a scientific outlook was a must for the country. Such feelings also made the political leadership of the time proceed in favour of industrialisation over agriculture. By the time India got her independence, the might of industrialisation was already proven and there were no doubts regarding its efficacy. Ultimately, it is not wrong to say that perhaps the resource-related and temperamental realities of India were set aside in favour of the hopes and wishes of a future India which was industrialised and developed.

It is impossible to conclude whether the economy has completely failed to live up to those hopes. Experts have divided opinions on the issue. The last decade of the 20th century saw major changes taking place in the world economic idea about the agriculture sector. It was no longer a symbol of backwardness for an economy if it emphasised its agriculture sector as the engine of growth and development. China had proved to the world that agriculture could be made the prime moving force of an economy and demonstrate internal as well as external strength to emerge as an industrial economy.

In the wake of an ongoing reform process, India was deliberating over almost all economic policies it had followed since Independence. It was time for the agriculture sector to have prime attention. A major shift took place in the Indian economic thinking when the government announced that agriculture will be the prime moving force of the economy in the year 2002. This was a policy shift of historic magnitude which was announced as the economy commenced the Tenth Plan (2002-07).

As per the Planning Commission, such a policy shift would solve the three major challenges faced by the economy: (i) Economy would be able to achieve food security with the increase in agricultural production. Besides, the agricultural surplus would generate exports in the globalising world economy benefiting out of the WTO regime. (ii) The challenge of poverty alleviation will be solved to a great extent as the emphasis will make agriculture a higher income generating occupation and induce growth in the rural economy by generating more gainful employment. (iii) The portrayal of India as an example of 'market failure' will cease. Though the world outlook towards agriculture sector had changed by the early 1990s, the Government of India announced the policy shift more than one decade later.

There is now a consensus among experts, policymakers and the governments alike that for the development of India, it is necessary to strengthen the sector which was responsible for the income and livelihood of the majority of the masses. More than 65% of the Indian population depends on agriculture and allied activities, while only 18.5% of the gross domestic product (GDP) comes from the sector. It means that more than 65% of Indian population shares just 18.5% of the gross income generated by the economy. The rest of the population that does not depend upon agriculture (i.e., below 35%) share 81.5% the gross income generated by the economy. The gap of incomes demonstrates the lower purchasing power of the people involved in agricultural activities— which is more than two-third of the total population.

As the economy was more in favour of a market economy, the situation of market failure needed to be addressed. The income of the population dependent upon the agriculture sector required strengthening. Though the effects of the policy shift are not clearly visible yet, we may glance at the major policies which are intended towards the strengthening of the agriculture sector:

(i) New Agriculture Policy, 2000: The policy mainly intends to convert agriculture into the category of industry so that the population dependent on it could earn income and profit out of agricultural activities with the same pace as the industry has enabled the population dependent on industrial activities.

(ii) National Agricultural Insurance Scheme, 1999-00: The new insurance scheme launched for agriculture intends to provide insurance coverage to all agricultural activities right from seeds, sowing, harvesting to marketing risks— a necessary support to which the industry had access but agriculture had no reach.

(iii) Exim Policy, 2002-07: The Export Import Policy, 2002-07 for the first time accepted at the policy level the long-standing opinion of the experts— that a 1% increase of the agricultural products in India's exports supplies additional ₹8,500 crores to the agricultural sector. Many policy initiatives were taken to increase the share of agriculture in the total export of the economy.

(iv) Second Green Revolution: A major programme to boost agricultural production with the sustainable approach was launched in 2004 with an initial corpus of ₹50,000 crore.

(v) Bharat Nirman: A major programme to focus on the agricultural and rural infrastructure (totalling six items) was launched by the government in 2005 with the ultimate intention of strengthening rural economy.

(vi) Others: Similarly, many time-bound programmes and schemes have been launched since 2002 which focus on the agriculture sector and the rural areas from different angles— education, electricity, wage, as well as self-employment, healthcare, communication. Considering the size of the population dependent upon the agriculture sector, comparatively longer government apathy towards the agricultural realities and the late start of the reform process, make it very tough to effect visible changes in the sector in a short time span. It also requires comparatively longer period of time. Visible results of the policy shift as well as the results of the economic reforms in the agriculture sector may be seen over time, provided there remains a continued political commitment to the cause. One positive development of the last decade has been that India has been able to reach a silent political consensus on some of the very important aspects of development, such as on the process of economic reforms, foreign investment, deregulation, social justice, emphasis on agriculture, priority to the social sector and more, which gives us hope that the economy will be able to take care of the agriculture sector in due course and more accelerated growth and development can be achieved.

10.3 INDIAN ECONOMY AS PLANNED AND MIXED ECONOMY

Independent India was declared to be a planned and a mixed economy. As the political leadership had decided almost a decade before Independence - India needed national planning. India was not only facing regional disparities at the level of resources but inter-regional disparities has also been prevalent for centuries. Mass poverty could only be remedied once the government started the process of economic planning. Economic planning was, thus, considered an established tool for resolving such disparities. Essentially, in order to find a solution for the abject poverty of the masses, the government opted for planning so that it could play an active role in the allocation of resources and mobilise them for equitable growth and development. Though India was constitutionally declared a federation of states, in the process of planning, the authority of regulation, directing and undertaking economic activities got more and more centralised in the Union government.

India's decision for a planned economy was also shaped by some contemporary experiences in the world. Firstly, the Great Depression of 1929 and the reconstruction challenges after the Second World War had made experts conclude in favour of state intervention in the economy, as opposed to the contemporary idea of 'non-interference' as proposed by Adam Smith. Secondly, it was the same time that the command economies (i.e., state economies) of the Soviet Union and the East European countries started becoming known for their faster economic growth. In the 1950s and 1960s, the dominant view among the policymakers around the world was in favour of an active role of the state in the economy. Thirdly, a dominant role for the state in the economy to neutralise market failure situations was gaining ground around the world.

For many newly independent developing nations, economic planning was therefore an obvious choice. Economic planning was deemed best to help states to mobilise resources to realise the prioritised objectives in a well-defined time frame. Once the political leadership had decided in favour of a planned economy for India and a major role for the state in the economy, they needed to clarify the organisational nature of the economy, that is, if it was to be a state economy or a mixed economy, because planning was not possible in a free market or a capitalistic economy.

The idea of planning in India was inspired by the Soviet, which was a command economy and did not suit the requirements of the democratic India. The dominant force behind planning in India, at least after Independence, was Pt. Nehru himself who had strong socialist leanings. He believed it was crucial to define the role of the state in the economy, which would be at times similar to the state in the Soviet Union and at times completely dissimilar to it. Though there was an example of a capitalistic-democratic system in France, but by it had little experience to offer the Indian policymakers as France had just adopted a mixed economy around 1944-45. With the basic urge to accelerate the process of economic growth, the planners went to define the respective roles of the state and the market, in the very first Plan itself.

The following lines look refreshingly ahead of time and crystal-clear about the scope of the government’s role in the economy vis-a-vis the private sector. “This brings us to the problem of the techniques of planning. A possible approach to the problem is, as mentioned earlier, through a more or less complete nationalisation of the means of production and extensive system of government controls on the allocation of resources and on the distribution of the national product. Judged purely as a technique of planning, this may appear a promising line of action. But, viewed against the background of the objectives outlined above, and in the light of practical considerations, such an expansion of the public sector is, at the present stage, neither necessary nor desirable. Planning in a democratic set-up implies the minimum use of compulsion or coercion for bringing about a realignment of productive forces. The resources available to the public sector have, at this stage, to be utilised for investment along new lines rather than in acquisition of existing productive capacity. Public ownership of the means of production may be necessary in certain cases; public regulation and control in certain others. The private sector has, however, to continue to play an important part in production as well as in distribution. Planning under recent conditions thus means, in practice, an economy guided and directed by the state and operated partly through direct state action and partly through private initiative and effort."'

* The above-quoted lines are imaginatively ahead of the times. It will be suitable to note here that as 1950s and 1960s made the world experts favour state intervention in the economy, the East Asian Miracle (WB) 19 of the coming three decades was going to define the very limits of such an intervention.

The East Asian economies were able to sustain a high growth rate over three decades and had once again revived the discussions regarding the respective roles of the state and the market as well as the nature of the state's role in the economy. The kind of conclusions drawn were very similar to the ones put forth in India's First Plan which was presented by the World Bank in 1993. The real nature of the Indian brand of mixed economy, initially outlined in 1951, went through a process of detailed evolution in the decade of the 1950s.

By the end of the 1950s, the concept of the mixed economy was almost forgotten and it slowly rose to distinction by mid-1980s and finally gained prominence in early 1990s, in the wake of the process of economic reforms. The state-market mix (i.e., the public sector and private sector) defined for India clearly delineated the nature of mixed economy, though the vision was obviously blurred in the coming decades due to economic mis-management.

10.4 INDIAN ECONOMY: STRONG EMPHASIS ON THE PUBLIC SECTOR

The state was to be given an active and dominant role in the economy – this was decided by the time India became independent. Naturally, there was going to be a giant structure of the government-controlled enterprises to be known as the public sector undertakings (PSUs). Criticism aside, there was at the time, a strong reason behind the glorification of PSUs. Some of the reasons for heavy investments in the PSUs were quite natural while others were consequential in nature. There were certain highly commendable objectives set for them, some of the other goals would go on to serve the very soul of the mixed economy. We must impartially and rationally analyse the matter, regarding all the criticism of PSUs and the contemporary moves of privatising them, in order to understand their roles in the Indian economy.

10.5 WHY THE STRONG EMPHASIS ON PUBLIC SECTOR?

We may understand the reasons behind the ambitious expansion of the PSUs in the face of the following major requirements.

1. **Infrastructural Needs:** Every economy whether it is agrarian, industrial or post-industrial, requires suitable levels of infrastructure such as power, transportation and communication. Without their healthy presence and expansion, no economy can grow, and develop. At the eve of Independence, India had almost no presence of these three basic requirements. There was just the very basic setup in the area of railways, and post and telegraph. Power was

restricted to selective homes of government and the princely states. This means, even if India had opted for agriculture as its prime moving force, it had to develop the infrastructure sector.

These sectors required too much capital investment as well as heavy engineering and technological support for their development. Expansion of the infrastructure sector was considered not possible by the private sector of the time, as they could not possibly manage the following components: (i) heavy investment (in domestic as well as foreign currencies), (ii) technology, (iii) skilled manpower, and (iv) entrepreneurship. Even if these inputs were available to the private sector, it was not possible for them to manage the same as there was no market for such infrastructure at the time. These infrastructures were essential for the economy, but they needed either subsidised or almost free supplies as the masses lacked the market-determined purchasing capacity. Under these conditions, it was only the government which could have shouldered the responsibility. The government could have managed not only the inputs required for the development of the sector but could also supply and distribute them to the required areas and the consumers for the proper growth of the economy. There were no alternatives and that is why the infrastructure sector in India has such a dominant state presence wherein many areas such as power, railways, aviation, tele-communication etc. have obvious government monopolies.

2. **Industrial Needs**: India had opted for the industrial sector as its prime moving force, as we have previously established. Now there were some industries which required government investment, due to several unavoidable reasons. For industrialisation and its success, every economy needs the healthy presence of some ‘basic industries’, which are also known as the ‘infrastructure industries’. There are six basic industries which every industrialising economy requires, namely (i) Iron and Steel (ii) Cement (iii) Coal (iv) Crude oil (v) Oil refining and (vi) Electricity

[Note: At present, there are eight Core Industries in India (with the Base: 2004— 05=100), six existing ‘basic/infrastructure industries’ with two new additions, i.e., Natural Gas and Fertilizer. Core industries together have a combined weight of 37.90% in the Index of Industrial Production (IIP). Individual percentages of them are: Coal (weight: 4.38%); Crude Oil (weight: 3.22%); Natural Gas (weight: 1.71%); Petroleum refinery (weight: 5.94%); Fertilizer (weight: 1.25%); Steel (weight: 6.68%); Cement (weight: 2.41%); and Electricity (weight: 10.32%).]

Similar to the infrastructure sector, these basic industries also require high level of capital, technology, skilled manpower and entrepreneurship which was not considered to be manageable for the private sector of the time. Even if the private sector supplied goods from the 'basic industries', they might not be able to sell their products in the market due to the lower purchasing power of the consumers. Perhaps, that is why, once more the responsibility of developing the basic industries was taken up by the government. Out of the six basic industries, the cement industry had some strength in the private sector and in the iron and steel sector a lone private company was present. The coal sector was controlled by the private sector and crude oil and refining was just beginning to be privatised. The level of demands of an industrialising India could not possibly be met by the existing strength of the basic industries. Similarly, the existing number of private players could not contribute to the required level of expansion required by these basic industries. Thus, the government had to play the main role here as well. As a result, we see a natural monopoly for the PSUs once again.

3. Employment Generation: The PSUs were also seen as an important part of the employment generation strategy. A government in a democratic set up cannot think only economics, it has to focus upon the socio-political dimensions of the nation as well. The country was faced with a significant problem of poverty as the workforce was increasing rapidly. Giving employment to the poor people is a time-tested tool for poverty alleviation. The PSUs were believed to be able to create enough jobs for the employable workforce of the economy. A need for a social change was also felt. The poverty of a greater section of the country was connected to the age-old caste system. This system perpetrated the stronghold of the upper castes over the ownership of land which was the only means of income and livelihood for more than 80% of the population. Along with the ambitious policy of land reforms, the government had decided to reserve a certain percentage of jobs for the weaker sections of the society.

The upcoming PSUs were supposed to put such jobs at the disposal of the government which could have been distributed along the decided reservation policy— such reservations were considered an economic tool for social change. In the highly capital-intensive sectors in which the government companies were about to enter, managing investible funds to set them up was not going to be an easy task. The government did manage the funds with sources like taxation, internal and external borrowing and even taking the last refuge in the printing fresh currency. The government attempted to justify the high taxation and heavy public debt by trying to supply employment to the Indian employable population. The government considered the PSUs as the focus of the 'trickle-down effect'.

The government did everything to set up and run the PSUs as the benefits were meant to percolate to the masses, finally reinforcing growth and development in the country. Employment in the PSUs was seen as the effect of the trickle-down theory. At a point of time, Pt. Nehru even proclaimed the PSUs as the 'temples of modern India'. The government went as far as to commit a job in every household via the PSUs, without calculating the dimensions of the future labour force in the country and the required resources to create jobs at such a large scale. However, the government went on creating new PSUs without analysing the fiscal repercussions, believing them to be the real engine of equitable growth. The responsibility of employment generation of the PSUs was extended to such an extent by the government that most of them had over-supply of the labour force which started draining their profits on account of the salaries, wages, pensions and provident funds (the latter two had late financial impact).

4. Profit and Development Of The Social Sector: The investment to be made by the government in PSUs was in the nature of asset creation and these entities were to be involved in production activities. It was natural for the government to gain control over the profits and dividends accruing from them. The goods and services which the PSUs were to produce and sell were slated to provide disposable income to the government. The government had a conscious policy of spending the income generated by the PSUs. They were to be used in the supply of the 'social goods' or 'public goods, which referred to the universal supply of certain goods and services to the Indian people. And thus, India would have a developed social sector.

The 'social goods' included education, healthcare, nutrition, drinking water, social security, etc., in India. It means that the PSUs were also envisioned as the revenue generators for the development of the social sector. Due to many reasons the PSUs were not be able to generate as much profit as was required for the healthy development of the social sector. This eventually hampered the availability of public goods in the country. In place of giving profits back to the government, a large number of the PSUs started incurring huge losses and required budgetary supports regularly.

5. Rise Of The Private Sector: As the PSUs were to take the responsibility of supplying the infrastructure and the basic industries to the economy, a base for the rise of private sector industries would follow. With the rise of the private sector industries in the country, the process of industrialisation would be completed. Out of the many roles the PSUs were supposed to play, this was the most far-sighted. Here, one understands why the government of India opted for such an ambitious plan of expansion of the public sector post-independence. Besides, the PSUs were aimed at many other connected areas of developmental concerns, such as, self-sufficiency in production, balanced regional development, spread of small and ancillary industries, low and stable prices, and long-term equilibrium in balance of payment. Over time the PSUs have played a critical role in promoting the growth and development of the country.

10.6 SECTORS OF INDIAN ECONOMY

Sectoral Contribution or Distribution of National Income by the Industrial Origin Sectoral contribution of national income depicts a clear picture about the composition or distribution of national income by industrial origin. Thus, it shows the contribution made by different sectors towards the national income of the country. In India, among the different sectors, the primary sector and more particularly agriculture still plays a dominant role in contributing the major portion of the national income of the country. Table.1.3 shows the changes in the sectoral contribution towards the national income of the country since 1950-51.

1. **Primary Sector**: The contribution of primary sector which is composed of agriculture, forestry, fishery and mining gradually declined from 56.4 per cent of GDP in 1950-51 to 45.8 per cent in 1970-71 and then finally to 19.0 per cent in 2014-15. It is also interesting to look at the trend in the contribution of agriculture which is contributing the major share (nearly above 90 per cent) to the primary sector. Thus, agriculture contributed about 48.6 per cent of GDP in 1950-51 and then its share however declined to 39.7 per cent in 1970-71 and then to 29.5 per cent in 1990-91 and then finally to around 24.0 per cent in 1996-97. The share of forestry has also considerably declined from 6.0 per cent in 1950-51 to nearly 1.4 per cent in 1990-91. But the contribution of fishing and mining remained more or less stable varying between 1 to 2 per cent of GDP during this entire period of 60 years.

2. **Secondary Sector**: The secondary sector which is composed of manufacturing industries, construction, electricity, gas and water supply increased its share of GDP from 15.0 per cent in 1950-51 to 22.3 per cent in 1970-71 and then to 28.4 per cent in 2014-15. Among the major constituents of the secondary sector, the share of manufacturing industries to GDP also increased from 11.4 per cent in 1950-51 to 15.1 per cent in 2012-13. But the share of construction to GDP marginally improved from 3.3 per cent in 1950-51 to 5.0 per cent in 1980-81 and then slightly declined to 4.3 per cent in 1996-97.

3. **Tertiary Sector**: The share of tertiary sector which is constituted by trade, transport, storage, communications, banking, insurance, real estate, community and personal services gradually increased from 28.5 per cent in 1950-51 to 31.8 per cent in 1970-71 and then finally to 52.6 per cent in 2014-2015. Among the major components of tertiary sector, the

share of transport, communication and trade also increased from 11.0 per cent in 1950-51 to 18.9 per cent in 2014-15. The share of community and personal services to GDP marginally increased from 8.5 per cent in 1950-51 to 12.80 per cent in 2014-15.

Thus due to the developmental strategy followed in economic planning of the country, structural changes occur in the composition of its national income by industrial origin. With the rapid expansion of manufacturing' industries, the share of manufacturing sector recorded a sharp increase. But the agriculture could not record a faster rate of growth. But the services sector has improved its position and became the major contributor to the growth process attaining a faster and higher rate of growth in the later stage. Thus growth scenario in India is termed as services-led growth.

10.7 SERVICE LED GROWTH:

The growth scenario in India shows that the services sector has become the most dominant in the later part of its growth process. The share of services sector in GDP increased from 28.5 per cent in 1950-51 to 39.6 per cent in 1990-91 and then to 52.6 per cent in 2014-15 while the share of primary sector declined from 56.4 percent in 1950-51 to 33.4 per cent in 1990-91 and then to only 19.0 per cent in 2014-15. During the Ninth Plan, in spite of slowdown in overall growth process, the services sector grew at a rate of 7.9 per cent per annum as compared to that of 2.5 per cent and per annum as compared to that of 2.5 per cent and 4.3 per cent attained by agriculture and industry sector respectively. Moreover, expansion of services sector accelerated further since 2002-03, propelled considerably by high rates of growth attained by communications (especially telecom), business services (especially information technology) and finance.

During the period 1991-97 services sector contributed about half (49.8 per cent) of total growth of GDP. But in the subsequent five years, i.e. during 1996-2002, the contribution of services sector to GDP growth increased significantly to 68.3 per cent and continued to grow at 60.4 per cent over the next six years, i.e. during 2001-08. Again, during 2008-14 periods, the contribution of services sector to GDP growth in India was as high as 69.8 per cent as shown in the study made by Shankar Acharya. Sri Acharya also observed that "these shares would "be even higher if the construction sub-sector were included under services instead of industry". Thus the above analysis clearly, shows a 'services-led' pattern of economic growth attained by India in the later part of its economic transformation realising a structural transformation of the economy. Even post 2020, Service sector is significantly contributing in to Indian Economy.

10.8 SWOT ANALYSIS OF INDIAN ECONOMY

SWOT analysis of the Indian economy can be done in following way:

Strengths

1. India has a huge pool of working young population & labour force
2. There is a high percentage of cultivable land available
3. It has a huge English-speaking population, availability of skilled manpower
4. High growth rate amongst various Economies of world
5. Rapid growth of IT and BPO sector bringing valuable foreign exchange
6. Stable economy, does not get affected by external changes
7. Diversified nature of the economy
8. Extensive higher education system, third largest reservoir of engineers
9. Abundance of natural resources

Weaknesses

1. Very high percentage of workforce involved in agriculture which contributes to only 23% of GDP
2. Around a quarter of a population below the poverty line
3. High unemployment rate
4. Stark inequality in prevailing socio economic conditions
5. Poor infrastructural facilities
6. Low productivity
7. Huge population leading to scarcity of resources
8. Low level of mechanization
9. Red tapism, bureaucracy
10. Low literacy rates
11. Unequal distribution of wealth
12. Rural-urban divide, leading to inequality in living standards

Opportunities

1. Scope for entry of private firms in various sectors for business
2. Inflow of Foreign Direct Investment is likely to increase in many sectors
3. Huge foreign exchange earning prospect in IT and ITES sector
4. Investment in R&D, engineering design
5. Area of biotechnology

6. Huge population of Indian Diaspora in foreign countries (NRIs)

7. Area of Infrastructure

8. Huge domestic market: Opportunity for MNCs for sales

9. Huge natural gas deposits found in India, natural gas as a fuel has tremendous opportunities

10. Vast Forest area and diverse wildlife

11. Huge agricultural resources, fishing, plantation crops and live stocks

Threats

1. Global economy recession/slowdown
2. High fiscal deficit
3. Threat of government intervention in some states
4. Volatility in crude oil prices across the world
5. Growing import bill
6. Population explosion, rate of growth of population still high
7. Agriculture excessively dependent on monsoons

10.9 SUMMARY OF LEARNINGS:

1. Many significant and strategic ideas which were decided upon by 1956 have shaped the Indian economic journey till date— undoubtedly, they heavily dominated the pre-reform period, but the post-reform period is also not completely free of their impact. To understand the nature and scope of the Indian economy in current times, it is not only useful but essential to go through the facts and reasons which made the economy evolve and unfold the way it did.

2. One positive development of the last decade has been that India has been able to reach a silent political consensus on some of the very important aspects of development, such as on the process of economic reforms, foreign investment, deregulation, social justice, emphasis on agriculture, priority to the social sector and more, which gives us hope that the economy will be able to take care of the agriculture sector in due course and more accelerated growth and development can be achieved.

3. The PSUs were aimed at many other connected areas of developmental concerns, such as, self-sufficiency in production, balanced regional development, spread of small and ancillary industries, low and stable prices, and long-term equilibrium in balance of payment. Over time the PSUs have played a critical role in promoting the growth and development of the country.

4. With the rapid expansion of manufacturing' industries, the share of manufacturing sector recorded a sharp increase. But the agriculture could not record a faster rate of growth.
5. 'Services-led' pattern of economic growth attained by India in the later part of its economic transformation realising a structural transformation of the economy. Even post 2020, Service sector is significantly contributing in to Indian Economy.

10.10 PRACTICE QUESTIONS

Q1: List out various facts of Indian Economy after the independence.

Q2: What is the rationale behind Indian Economy as Planned & Mixed Economy?

Q3: Critically analyse why in Structure of Indian Economy there is a special focus on PSUs?

Q4: Critically analyse the Prime Moving Force of Indian Economy-Agriculture Vs. Industry.

Q5: How the Service sector is contributing in to Indian Economy?

Q6: What are various sectors of Indian Economy?

Q7: Conduct the SWOT analysis of Indian Economy

M.COM

SEMESTER I

COURSE: BUSINESS ENVIRONMENT

UNIT 11 – ECONOMIC PLANNING

STRUCTURE

11.0 OBJECTIVES

After studying the Unit, students will be able to

- define “Planning’’;
- realize the need for planning;
- point out the objectives of planning;
- describe planning strategy of India;
- explain new economic policy;
- point out the targets set by our planners in terms of various objectives of planning;
- explain the achievements made with respect to the plan objectives; and
- realize the shortcomings or unfulfilled part of the objectives.

11.1 INTRODUCTION TO ECONOMIC PLANNING

India is a large country with many challenges confronted by its citizens. For nearly two centuries, the British seized control and plundered its wealth for their own gain, leaving the country in abject poverty. Except for 'independence,' there was nothing to be fortunate of or glad about when the British left India in 1947. Before the Indian government, there were numerous issues. There was also the issue of food scarcity and inflation, in addition to widespread poverty. Other severe issues confronting the country included illiteracy, a lack of health care, and a lack of infrastructure. As a long-term investment plan. The solution to these issues was 'economic development planning.'

The Constitution took effect on January 26, 1950. Following that, on March 15, 1950, the Planning Commission was established, and the plan era began on April 1, 1951, with the launch of the First Five Year Plan (1951-56). This will keep you informed about the history and goals of economic planning in India, as well as the FiveYear Plans, the Planning Commission, and its successor, the NITI Aayog.

11.2 MEANING OF ECONOMIC PLANNING

Economic planning involves the following steps:

(i) Making a list of the economic issues that need to be addressed.

(ii) the priority order of the list is done. The most pressing issue should be placed first, followed by the next most pressing issue, and so on.

(iii) The next stage is to identify the issues that must be fixed immediately and those that must be addressed over time.

(iv) Setting a goal to accomplish the desired outcome. The goal could be a specific time frame in which the issue must be handled. If the problem is to be solved in the long run, it must be specified how much of the problem will be solved in the first phase. Second, the goal could be a specific quantity to be reached. In the case of production, for example, the government can set a quantity objective.

(v) Calculating the quantity of resources required to meet the goal. Financial, human, and physical resources are examples of resources.

(vi) Another key responsibility is mobilising resources. This implies that the organizers must know where they can get the resources they need. For example, when it comes to funding the project, the planners must create a budget and outline the various sources of funding. When the government is making plans, one of the most important sources of funding is tax money. A bank loan is among the sources of funding for a businessperson. When multiple sources of financing are accessible then the organizer must also determine as to how much funding to be acquired from these sources.

Another significant responsibility in carrying out the plan proposal is the use of human resources. To complete the assignment, the organizer must estimate the sort of manpower and the quantity of people required. This need should be well estimated from the start. Likewise, an accurate assessment of physical assets should be presented. Commercial properties, vehicles, furniture, and stationery are examples of physical resources.

(vii) Once the resources have been organised, the implementation and execution phase can begin to accomplish the intended result. Periodic reviews must be conducted to ensure that everything is going properly and to correct any errors that may have occurred, as well as to alter the working style to accommodate any changes.

11.3 ECONOMIC PLANNING IN INDIA

To solve its diverse socio economic difficulties, India adopted a five-year planning system. To recap, these issues include widespread poverty and inequality, low agricultural production and food grain storage, a dearth of industrial and infrastructure development, and so on. Because these issues will take time to resolve, the Indian government adopted a five-year plan beginning with the first year plan in 1951. The goal was to establish a list of critical problems that needed to be tackled while keeping in mind the available resources and the ability to organise them. Then, after five years, examine what has been accomplished and correct any errors in the next five-year plan period, and so on.

P.C Mahalonobis, Jawaharlal Nehru, V.R Gadgil, and V.K.R.V Rao are some of India's greatest planners. In 1950, after becoming India's first prime minister, Nehru founded the Planning Commission. The Planning Commission's main job was to come up with plans that took into account the country's resources and suggested the most effective and balanced ways to use them. For the years 1951 through 1956, the Planning Commission created the first five-year plan (FYP). India had already gone through more than 60 years of planning by 2014, with the eleventh five-year plan completed and the twelfth FYP in progress.

The phrase "economic planning" refers to the Indian government's long-term plans to expand and regulate the economy while making efficient use of resources. Economic planning in India began after independence in 1950, when it was regarded as important for the country's economic growth and development.

11.4 OBJECTIVES OF PLANNING IN INDIA

Long-term goals of India's Five-Year Plans include: a high pace of growth to increase the living standards of Indian citizens.

- Economic stability is necessary for success.

- Economic independence.
- Reduced inequality and social justice
- The economy is being modernised.

Under the socialist ideology of the first Prime Minister Pt. Jawahar Lal Nehru, the idea of five-year economic planning was borrowed from the Soviet Union. The first eight Indian five-year plans focused on expanding the public sector through massive investments in heavy and basic sectors, but since the start of the ninth five-year plan in 1997, the focus has moved to making the government a growth facilitator.

<u>Objectives of Economic Planning in India</u>

The original goals of economic planning in India were as follows:

- *Economic development* is the primary goal of Indian planning. Increases in India's Gross Domestic Product (GDP) and Per Capita Income are used to gauge the country's progress.
- *Increased Employment:* An essential goal of Indian economic planning is to effectively utilise the country's existing human resources by raising employment levels.
- *Self-sufficiency:* Through economic planning, India aspires to be self-sufficient in essential goods while simultaneously increasing exports. During the third five-year plan, from 1961 to 1966, the Indian economy had gained considerable momentum of development.
- *Economic Stability:* In addition to India's economic growth, India's economic planning aspires for stable market conditions. This implies keeping inflation low but simultaneously avoiding price deflation. Economic planning seeks to avoid fundamental faults in the economy when the wholesale price indices go very high or very low.
- *Social Welfare and Efficient Social Service Provision:* All five-year plans, as well as those proposed by the NITI Aayog, aim to improve labour welfare and social welfare for all parts

of society. India has planned for the advancement of social services such as education, healthcare, and emergency services.

- *Regional Development:* India's economic planning tries to decrease regional development discrepancies. Some states, such as Punjab, Haryana, Gujarat, Maharashtra, and Tamil Nadu, are economically developed, whilst others, such as Uttar Pradesh, Bihar, Orissa, Assam, and Nagaland, are not.
- Others, such as Karnataka and Andhra Pradesh, have evolved unevenly, with world-class economic hubs in cities and a less developed hinterland. In India, planning aims to investigate these inequities and propose methods to address them.
- *Comprehensive and Long-Term Development*: One of the fundamental goals of economic planning is to develop all economic sectors, including agriculture, industry, and services.
- *Economic Inequality Reduction*: Since independence, wealth redistribution through progressive taxation, job creation, and job reservation has been a fundamental goal of Indian economic planning.
- *Social Justice:* This planning goal is intertwined with all the others and has long been a primary concern in India. Its goal is to lower the number of individuals living in poverty by providing them with employment and social assistance.
- *Higher Standard of Life:* One of the key goals of India's economic planning is to raise the standard of living by raising per capita income and ensuring equal distribution of income.

The numerous economic planning objectives in India were drawn in light of the country's socioeconomic challenges. The following are the objectives:

1. Economic growth
2. Increase in employment
3. Reduction in inequality of income
4. Reduction in poverty
5. Modernization of the economy
6. Ensuring social justice and equality.

Let us discuss these objectives one by one.

1. Economic Growth: The goal of achieving economic growth necessitates that real national income and per income per capita grow at a set rate each year. Real national income is really the measure of the overall income at a specific year's price or at a constant price. The average income of persons in the economy is known as real per capita income. It is stated that in order for each individual/household and society as a whole to reach a greater quality of living, both per capita and national income must increase in real terms. Because income is a measure of purchasing power, a rise in income will boost people's and the country's purchasing power. A rise in real income also signifies that the total output or quantity is higher than it was previously. To meet the needs of India's rising population, an annual rise in productivity is required. To reach a higher rate of output, the economy needs to invest more to build infrastructure and capital stock. Power projects, highways, railways, airports, harbors, telecommunication networks, and buildings are examples of infrastructure. Plant, machinery, banking, and insurance are examples of capital stock. To enhance economic growth in real income, investment in all of these items is required, hence the country's planners set a growth objective in each five-year plan.

2. Increase in Employment: Employment is defined as the participation of workers in a productive economic activity like the production of products and services. Revenue is generated through the process of production, which employs household-provided factors of production. Land, labour, capital, and organization/entrepreneurship are all known components of production. These factors are held by the country's households. Because factors are limited resources that are required to generate commodities and services, the government must establish chances for them to be properly utilised. The number of factor resources possessed by an economy determines its production capability. If these production parameters are employed, the appropriate level of production can be produced. The value of the output can then be dispersed among the factors as income in the form of wages for labour, rent for land and building owners, interest for capital owners, and profit for the entrepreneur. The requisite level of output and thus income cannot be produced if the country is unable to develop occupations to gainfully employ the factors of production. Take, for example, the country's labour resources. You are aware that the country's population provides a labour force between the ages of 15 and 59. Every year, as the population grows, the number of persons in the working population grows as well. They are mostly educated as well. They will stay unemployed and underutilised if there is insufficient opportunity for employment. In truth, India's unemployment rate is extremely high. Unemployment is a cause of several societal problems like poverty and crime, in addition to increasing consumption without equal increases in production. As a result, the Indian economy's planners have made job development a main goal of their five-year plans.

3. Reduction in Inequality of Income: India is a nation with a wide range of economic standards. This suggests that India lacks consistency in terms of economic levels. A vast portion of India's population is classified as impoverished, whereas a small percentage of the population is extremely wealthy. Women, regardless of their race or religion, are the worst impacted in terms of economic gap, which is a big societal concern. Similarly, scheduled class and scheduled tribe people are disadvantaged in Indian society as they're at the bottom of the development pyramid. The uneven distribution of asset holdings, such as per capita land holdings, possession of mobile and immobile property from inheritance, and so on, is one of the key causes of income inequality. The bulk of India's population lives and works in rural areas. However, just a few are large landowners, with the bulk being borderline or small farmers and farm labour. Farm labourers are so named because they do not own land to cultivate and travel long distances looking for work on a daily or weekly basis. Their predicament is made worse by their own illiteracy and lack of organisational skills. Due to their poor income, they have nothing to leave to their future generations; on the other hand, landowners enjoy higher returns on their property, and the property is passed down down the generations due to the existence of an inheritance law. As a result of having and not having private property, the rich stay rich and the poor stay poor in the country. Inequality has a negative impact on India. The impoverished are unable to sustain the market due to a lack of purchasing power, but the wealthy have too much purchasing power, causing wasteful consumerism to rise. Inequality is responsible for the majority of social ills. As a result, our planners attempted to reduce income inequality through planning.

4. Reduction in Poverty: Another significant goal of Indian planning is "poverty reduction." More than half of India's population was poor at the time of independence. According to government predictions, roughly 27 to 28 percent of India's population will be poor by 2014. In the course on poverty and employment, you will learn about the methods used to evaluate poverty in India. For the time being, let us confine our definition of poverty to a situation in which a person is unable to meet his or her basic human needs. Many people in this nation do not even receive a single square meal per day. Poverty is exacerbated by a lack of job. Uneven distribution of national income and wealth exacerbates it. Poverty is regarded as a blight on human dignity, and it has harmed India's international image. India is not taken seriously by developed countries because of its inability to eradicate poverty. To eradicate poverty from the country, adequate planning is required.

5. Modernisation of the Economy: India has been a country that has been continuously exploited by external governments such as the Mughals, who reigned for over two centuries, and the British, who controlled for another two centuries. When the British turned over authority to the Indian government in 1947, they left the country in a state of poverty and underdevelopment. The Indian economy has been unable to progress beyond its customary level of functioning due to historical factors. Its economy remained rural and industrially backward. There was no advancement in technology or technical advancement. The Indian economy is suffering from low agricultural productivity and dearth of industrial growth due to a lack of contemporary technology. Because of India's weak manufacturing and service sectors, it was the largest contributor to GDP at independence in 1947 and for many years afterward. The occupational structure has remained tilted towards agriculture due to a lack of greater training and education among the populace. To reverse this tendency, India's GDP structure must be changed by boosting the development of human capital and strengthening industries and the service sector. This can be accomplished through economic modernization.

6. Ensuring Social Justice and Equality: Indian planning aspired to achieve a socialistic society as well. It can be accomplished through ensuring social fairness and equity for its citizens. In fact, achieving social justice necessitates all of the above goals. However, introducing reforms in different sectors by changing age-old systems that have propagated poverty and inequality, obstructed industrial and service sector development, or caused low agricultural productivity is a necessary requirement for sustaining social equality and equitable income distribution. As a result, the planners decided to implement agricultural and economic policy reforms in order to support growth and equal distribution of development advantages.

11.5 TEST YOUR UNDERSTANDING (A)

1. Economic growth means
    1. (a) Increase in real national income
    2. (b) Removal of inequality
    3. (c) Increase in price level
    4. (d) None of the above
2. National income can be increased by
    1. (a) Increase in population
    2. (b) Increase in the rate of investment
    3. (c) Increase in unemployment

4. (d) Decrease in price level

3. Who is the owner of factors of production?
   1. (a) Government
   2. (b) Rest of the world
   3. (c) Households
   4. (d) Firms and industries

4. Labour force comes from the population in the age group of
   1. (a) 4 to 14
   2. (b) 60 to 75
   3. (c) 10 to 15
   4. (d) 15 to 59

5. One of the reasons of inequality in income is
   1. Existence of private property
   2. Lack of equal distribution of wealth
   3. Both of the above
   4. None of the above

6. Which of the following sector used to have larger share in India's GDP at the time of its independence

   a. Industry b. Agriculture c. Service d. None of the above

Short Answer Questions

1. What do you mean by economic planning?

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……………………………………………………………………………………………

2. Write a short note on inequality.

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Long Answer Questions:

1. Write a note on long term objectives of economic planning.

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2. What are the various (general)objectives of economic planning?

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…………………………………………………………………………………………………

11.6 NEED FOR PLANNING

The foregoing definition of planning has answered a large main question about the need for planning. We said before that planning entails a number of processes for successful implementation and execution. In truth, the Indian economy is beset by numerous issues. Each problem is unique and isn't possible to get solved in a brief period. Take, for example, the issue of poverty. There is no way to remedy these issues instantly. The government must gather information to determine the number of persons suffering from poverty and the nature of that poverty. Given India's wide geographical extent and absence of access to many locations, data collection is a major effort in and of itself. In a democracy, the government is responsible for formulating policies following thorough debate and discussion, which takes time. Then, in order to alleviate the problem of poverty, appropriate resources must be mobilised and resources must be provided to implement these changes over time. It is impossible to accomplish without good planning. Planning is also required to avoid wasting money, reduce costs, fulfil deadlines, and make the most use of resources.

11.7 STRATEGY FOR PLANNING

By strategy, we imply employing the proper approach/method/formula for reaching the planned goal. There was no precise strategy chosen during the first plan era of 1951-56, but the government of India focused more on agriculture because the bulk of India's population is reliant on farming and there was an immediate issue of appropriate food grain supply to alleviate food shortages. The first five-year plan was a huge success since it attained the desired growth rate, allowing India to move forward with a long-term strategy. In the 2nd plan phase (1956-61), the strategic plan was spelled out extensively. The strategy was to focus on –

1. Industrialization
2. Within industrialization more emphasis is placed on basic and heavy industries.

11.8 JUSTIFICATION OF THE STRATEGY OF INDUSTRIALIZATION

To solve challenges such as poverty, unemployment, growth of the economy, and self-reliance, Indian planners selected an industrialization strategy in general and the establishment of large and basic sectors in particular. The following are some of the arguments in favour of an industrialization and major industries strategy:

1. With a fixed amount of land readily accessible for cultivation, India's population has become overly reliant on agriculture, resulting in overcrowding in rural areas, tension on land, fragmentation of land holdings, underemployment, and unemployment. With a fixed amount of land available for agriculture, the amount of land available per capita has become very small or non-existent. This has resulted in land distribution inequity, which has a negative impact on agricultural production. The only way to shift surplus agricultural labour to industry and relieve land pressure is through industrialization.
2. Agricultural activities offer fewer work chances than industrial ones. As a result, industrialization will aid in the employment of the country's unemployed.
3. Industrialization is required for agricultural development. Agriculture provides raw materials to industries, while agriculture requires industrial machinery and equipment such as pump sets, tractors, and power.
4. Prioritize the development of basic and heavy industries. Iron and steel, aluminium, chemicals, heavy electrical, and other basic and heavy industries are examples. These are industries that produce capital goods. Such businesses are necessary in every economy because they process the apparatus and equipment required to develop other sectors that may generate consumer items to satisfy desires. As a result, heavy industries form the economy's backbone.It is worth noting that, following the adoption of the heavy industry plan, the Indian government created a public sector to construct and operate such industries. Bharat Aluminium Company (BALCO), Steel Authority of India Limited (SAIL), Bharat Heavy Electrical Limited (BHEL), National Aluminium Company (NALCO), and others are some of the instances.
5. Aside from major and basic industries, the Indian government has prioritised the development of micro, small, and medium businesses. These industries are characterized by the amount of money invested and can be started by private individuals. These industries have several advantages, including the promotion of self-employment as well as the creation of additional jobs, the utilisation of local resources, the reduction of economic disparity because they can be headed by individuals, and so on.

11.9 NEW ECONOMIC POLICY

As previously stated, the heavy industrial policy was implemented under public ownership and control. Budgetary allowances were created for the government sector to build infrastructure and develop industries. The process took more than 3 decades to complete. However, the government's own examination of the public sector's performance concluded that, with the exception of a handful, over half of the public enterprises are losing money. The public sector divisions were plagued by chronic mismanagement and labour issues. The government was taken aback when it discovered all of the public sector's flaws. The failures of the government sector on multiple fronts was considered as one of the key reasons for the country's lack of overall development in terms of industrialisation, poverty alleviation, and unemployment, among other things. As a result, the central government issued a new economic strategy decision in 1991. The following are the primary features of this policy:

(i)Liberalization
(ii)Privatization
(iii)Globalization

The policy is also popularly called LPG model of development.

11.9.1 *Meaning of and Need for Liberalization*

Liberalization refers to the government's removal of limits and regulations on the creation and operation of businesses in the country. Even if they were labelled autonomous bodies, all public sector units remained virtually under the government until 1991. The government's ministries made several interventions in the public sector's operation. As a result, there was politilization, a decline in professionalism, and inefficiency. To address this issue, the administration agreed to sign a cooperation agreement prohibiting political interference in the operation of public sector units. The administration of public sector entities will be granted autonomy, but they will also be held accountable, according to this.

The elimination of the licencing system is another major characteristic of liberalisation. Previously, any independent individual or organisation had to obtain government approval before beginning any industrial operation. A large line formed outside the office of the relevant government department to obtain a licence. This technique gradually caused delays in obtaining a licence. Bribes were paid to government personnel to clear files. Such corrupt activities tarnished the government's image. As a result, the government decided to abolish the licencing system in 1991, allowing interested persons to begin their economic activity without seeking authorization. Permit is still required solely in the context of strategic industries like medical and defence equipment.

11.9.2 *Meaning of and Need for Privatization*

Privatization entails opening up industrial activity previously restricted solely for the public sector, with the exception of nuclear weapons and defence. There's no room for competitiveness because basic and large industries were exclusively public. Due to a lack of competitive rivalry, the quality of the product and services worsened. As a result, consumers suffered the most as a result of the lack of quality goods and the bad distribution network and other services. As a result, the state chose to enable and encourage private sector entry into previously public-sector-only domains. As a result, the private sector has entered telecommunications, civil aviation, and other fields. The government has chosen to sell a portion of several public-sector enterprises' assets to the general public.

11.9.3 *Meaning of and Need for Globalization*

Globalization refers to the process in which various governments strive to allow unlimited movement of products and services, workforce technology, and investments, among other things. India is a member of the World Trade Organization (WTO), the globalization's main institution. In order to stimulate competition, India's industrial strategy in 1991 established a lenient stance toward foreign enterprises doing business in India. It also promised to eliminate or cut tariffs on commodity imports. India, on the other hand, has implemented policies to stimulate exports. The government also authorised foreign firms to possess 51 percent or more of a joint venture with an Indian company, allowing them to operate freely and as owners. This will also make it easier to bring cutting-edge technology into India.

11.10 TEST YOUR UNDERSTANDING (B)

1. Liberalization aims at retaining the licensing system. True or False
2. Privatization policy will help in enhancing competition in the market. True or False
3. Globalization aims at imposing tariffs on imported goods. True or False

11.11 ACHIEVEMENTS OF ECONOMIC PLANNING

India's economic planning began in 1951. As previously said, economic planning has several goals, including attaining economic growth in line with the rise in real national and per capita income, increasing employment, reducing income disparity, eliminating poverty, and ensuring social and economic justice. India had accomplished 63 years of planning by 2014 and had begun the twelfth plan period. It is past time to learn about planning's accomplishments in light of its goals. Let's talk about them.

11.11.1 *Achievements in Economic Growth*

One of the main goals of planning was to achieve economic growth. Increases in national income and per capita income, as well as increases in agricultural and industrial production, are required to accomplish growth. A examination of the various plans reveals that the first five-year plan was a success, with a growth rate of 3.6 percent against a projection of 2.1 percent in national income growth. Then, with the exception of the fifth and sixth plans, the projected growth rate in national income cannot be achieved during the other plan periods, i.e. the second to eleventh five-year plans.

Similarly, while per capita income has increased, the rate of increase has been moderate. For example, per capita income expanded at a very modest rate of 1.2 percent per year in the first Thirty years of planning. This rate of growth has recently accelerated to some extent. When it comes to agriculture, food grain output increased from 51 million tonnes at the start of the very first plan to 257.4 million tonnes in 2011-12. Rice and wheat production has been particularly impressive, although pulse and oil seed production has fallen short of expectations.

Diversification of Indian industry has been a key achievement in terms of industrial development. There has been significant success in steel, aluminium, industrial equipment, chemicals, fertilisers, and petroleum products, as well as increase in the production and distribution of power.

Consumer products and other important products have become much more readily available per capita over the planning period. Cereals, sugar, dairy, egg, oil seeds, tea, fabric, and power are among the items worth mentioning.

11.11.2 *Creation of Infrastructure*

India has made significant progress in terms of infrastructure development. Road and railway networks have seen significant expansion. Domestic aviation travel has considerably increased. Agriculture has benefited from the growth of irrigation and hydroelectric plants. Due to improvements in urban infrastructure, the number of towns and cities has increased. The internet and mobile telephony have greatly increased the communication network.

11.11.3 *Development in Education*

The development of education in India has been one of the shining areas of planning achievement. There's been a huge increase in the number of youngsters enrolled in school. In India, there are 378 universities and 18,064 colleges, indicating a positive trend in higher education. There are additionally 1.52 lakh secondary schools and 10.43 lakh basic and higher primary schools in India.

11.11.4 *Development of Science and Technology*

Another key area of accomplishment has been the rise in science and technology along with the increase in specialized and trained workforce. The developed world has taken notice of India's progress in space science. It has also had an impact in the realm of nuclear power. India's reliance on foreign specialists for advice has decreased in recent years. It can currently deploy technical experts to different international countries in the Middle East, Africa, and elsewhere.

11.11.5 *Expansion of Foreign Trade*

India's reliance on capital goods imports has decreased as a result of its industrialization. Many products that were previously imported are now produced domestically. India may now export engineering and manufacturing items as a result of its industrial advancement.

11.12 TEST YOUR UNDERSTANDING (C)

1. During which plan period, the actual growth rate of national income was more than the targeted growth rate.

(a) Second plan (b) First plan (c) Eleventh plan (d) Ninth plan

2. The growth rate of per capita income was higher in the beginning of the plan period as compared to the period in the beginning of the 21st century.

True or false.

11.13 DRAWBACKS OR FAILURES OF PLANNING

Aside from the accomplishments mentioned above, there are several tasks that India's planning has yet to finish:

11.13.1. Failure to Remove Poverty and Inequality completely:

India has also not been able to entirely eradicate poverty despite over sixty years of planning.

Official estimates put the number of people living in absolute poverty at about 240 million. In rural areas, the situation is far worse. Many anti-poverty efforts have been implemented by the government. However, they have had limited success thus far.

Similarly, there has been no major change in income and asset distribution, resulting in the existence of inequality. In comparison to the land-owning population, the proportion of landless farm labourers is extremely high. Some large industrial houses have benefited from the industrialization process. As a result, economic wealth and influence have concentrated in a few hands. If India wishes to attain fairness and social justice, it must reverse this tendency.

11.13.2. Problem of Unemployment Persists:

Despite increased income and output, India's employment situation has remained stagnant. The problem has gotten worse due to greater population and workforce expansion. India's rate of unemployment is 6.6 percent, according to official figures. There is also a significant unemployment backlog due to the failure to create the required number of jobs each year.

11.13.3 Failure to Curtail Corruption and Black Money:

In India, widespread corruption in many government offices is a major source of concern. The average person has a hard time getting stuff accomplished without paying bribes. In fact, during elections, bribery has become a political issue. Paying or receiving bribes, not paying taxes to the state, political influence to obtain a contract, and hidden agreements among vendors to raise prices are all examples of corruption. Fraud has drawn attention to black money, which is not tracked and is widely circulated. Unaccounted for income accounts for a significant component of India's GDP. Inflation and societal pressure are caused by black money. It is also the primary source of income disparity, as persons with black money become wealthier at the expense of ordinary citizens.

11.14 LET'S SUM IT UP

- Since 1951, India has used five-year plans to address its numerous economic concerns.
- Economic growth, increased employment, reduction of inequality and poverty, and promoting equity and social justice are all goals of planning.
- To attain its goals, India established an industrialisation plan that prioritised fundamental and heavy industries.
- Even though India's national income and per capita income increased during the

planning era, the rates were lower than the aim.

- India has made significant development in infrastructure, education, research and technology, and foreign trade.
- In India, one of the major disadvantages of planning is the inability to totally eliminate poverty, inequality, and unemployment.
- In India, public corruption and the existence of black money are key development challenges.
- In 1991, the government implemented a new economic policy to address issues with the public sector, boost industrialization, and achieve higher economic growth.
- The LPG model, which stands for liberalisation, privatisation, and globalisation, is the current economic policy.
- LPG policy strives to eliminate licensing laws, increase market competitiveness, and promote global free trade.

11.15 TEST EXERCISE

1. Give the meaning of planning?

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2. Write two objectives of planning in India?

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3. Name two types of resources needed for planning with examples?

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4. Give one justification for adopting the strategy of industrialization?

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Long answer type questions

1. Explain the steps involved in the process of planning?

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Discuss the objectives of removal of inequality and poverty?

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Which strategy did India adopt to achieve the plan target and why?

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Explain the objectives of economic growth and increase in employment under planning in India?

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2. Explain 3 achievements of economic planning in India?

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Evaluate the performance of planning in removing poverty and inequality?

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Write a short note on achievement of planning with respect to economic growth?

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Comment on the development of infrastructure in India?

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Give reasons for adopting a new economic policy?

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Explain the LPG model of the government to promote economic growth?

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11.16 ANSWERS TO TEST YOUR UNDERSTANDING

Test your Understanding A

1. a
2. b
3. c
4. d
5. c
6. b

Test your Understanding B

1. False
2. True
3. False

Test your Understanding C

1.b

2. False

11.17 FURTHER READING

- Ashwathappa, K.,Business Environment for Strategic Management, Tata McGraw Hill.
- Adhikari, M.,Economic Environment of Business, Excel Book.
- Cherunilam, Francis.,Business Environment, Himalaya Publishing House.
- Dutta & Sundaram.,Indian Economy, S.Chand.

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SEMESTER I

COURSE: BUSINESS ENVIRONMENT

UNIT 12 – ECONOMIC POLICIES

STRUCTURE

12.0 Objectives

12.1 Introduction to Economic Policies

12.2 Need for Economic Policies in India

12.3 Aims of Economic Policies in India

12.4 Instruments of Economic Policies in India

12.4.1 Macroeconomic policies

(i) Fiscal policy

(ii) Monetary policy

(iii) Commercial policy

(iv) Foreign trade policy

(v) Price policy

12.4.2 Micro economic policies

12.5 Process of Economic Policy Formulation

12.5.1 Planning Commission of India

12.5.2 Central Statistical Organisation

12.5.3 ICSSR

12.5.4 Lobbyists

12.5.5 NGOs

12.5.6 International Politics and Multilateral Lending

12.6 Disappointing Outcomes

12.7 Let Us Sum Up

12.8 Exercises

12.9 Further Readings

12.0 OBJECTIVES

After studying the Unit, students will be able to

After going through this unit, you shall be able to:

- declare the need for and goals of economic policy;
- describe the many economic policy instruments;
- investigate the dynamics of economic policy formulation in India; and
- determine the reasons for India's economic policy failures

12.1 INTRODUCTION TO ECONOMIC POLICIES

The business economic environment is made up of multiple economic policies, an economic system, a growth and development strategy, resource endowment, market size, and the level of basic infrastructures in a country. All of these economic policies have an impact on the business environment in some way.

Fiscal policy, monetary policy, international trade policy, and price policy are examples of economic policies. These policies create a framework within which all organisations must operate. Let us go over each of these elements in depth to see how these policies affect the business environment.

Economic policies are those that are framed in order to operate the economy optimally, to accomplish desired results, or to meet economic objectives. The government formulates these policies in order to achieve a balanced economy. The government employs a variety of economic policies.

Economic policies are generalisations of goals and ideals that the government intends to attain using various instruments defined by the law to direct the economic growth process. It can be seen as a systemic response to the market imbalances in some ways (and inequality). The government controls resource allocation by influencing social and economic variables in order to achieve the intended level of economic growth while fostering social justice and equilibrium.

At the macro level, an economic policy fundamentally refers to one or more of the three main economic decisions: "what to produce," "how to produce," and "for whom to produce."

Economic policymakers, in general, are said to be driven by economic factors backed by economic theories when designing various subcategories of economic policies. In representative democracy countries like India, however, elected representatives at various levels make decisions involving public governmental policy and economic affairs in particular. As a result, these are primarily political decisions. Apart from lawmakers, varying hues of public opinion exert 'pulls and pressure' on the formation of economic policy through the media, bureaucracy, court, trade organisations, expert bodies, non-governmental organisations (NGOs), as well as other interest groups. As a result, understanding the connection between economics and politics can help us obtain insight into the major questions of economic policy and programme "making, execution, and failure." This course will introduce you to the economic policymaking process, which includes interactions between academics and policymakers as well as a vast variety of institutions and organisations.

12.2 NEED FOR ECONOMIC POLICIES IN INDIA

Why do we need government-defined economic policies? The solution to this issue leads to the most enthralling and never-ending ideological argument in Economics, which is outside the purview of this unit. However, a quick debate on this topic will aid you in developing an understanding of the Indian government's economic policies and intentions.

The market system is an institutional framework that has survived and evolved for hundreds of years because it has considerably aided our economic well-being. It isn't ideal, though, and in some cases, we can improve our economic well-being by limiting it or even avoiding it entirely. The most essential cause for the making of an economic policy is market failure.

Choices over time, under-provision of common utilities, externalities, the availability of public properties, imperfect competition, asymmetric knowledge, and other well-documented causes for ‘market failures are only a few of the well-documented reasons for'market failures.' Government involvement in the form of "economic policies and programmes" is required. Furthermore, even if resources are optimally allocated under a Pareto optimal solution, the allocation may not be "equitable." The state can direct resource allocation in a more effective way in the wider public interest by participating in production activities. It has the ability to directly own and control a variety of public utilities. In such industries, competition is wasteful, hence they are best entrusted to the government. The state can produce and distribute public commodities that are intended for community consumption. Public goods production is required not just for its own sake, but also to provide new opportunities in order to achieve full employment. The government may produce services that are desirable but do not draw private enterprise, either because they are too hazardous or because the return on capital on invested money is too low. Certain strategic goods cannot be left in the government's hands. The government can also function as a check on private monopolies. The state has the power to, (i)prevent the consumption of harmful items and (ii) protect consumers from deceptive activities.

Furthermore, India was economically and socially disadvantaged just at the time of independence. The writers of the Constitution established several Directive Principles to address these issues. According to 'directive principles,' it is the state's responsibility to ensure that all citizens have a sufficient means of subsistence; to ensure equitable distribution of the country's material resources for the greater good; and to allocate resources in such a way that it does not concentrate mostly in the hands of a few participants.

All such constitutional requirements can be achieved by a good economic policy.

12.3 AIM OF ECONOMIC POLICIES IN INDIA

In a growing country like India, the primary purpose of economic policy is to hasten the country's economic development and hence ensure rapid economic development. It is important to note that the definition of economic advancement is different than the traditional definition of economic growth. The following are the economic development goals:

1) **Rapid Economic Growth:** The primary purpose of economic policy in a developing economy is to assure rapid economic growth. Growth, defined as increasing production of goods and services, aids in the development of backward and forward linkages, which are critical for ensuring drip and other widespread effects.

2) **Full Employment:** The purpose of full employment, or finding profitable uses for all resources available in the economy, is related to the growth goal. Full employment has huge economic benefits. Individual security is a result of full employment, which fosters development, contributes to human dignity, and lowers non-functional discrimination.

3) **Better Distribution of Income:** When left to its own devices, the market mechanism encourages inequities in income and wealth distribution. Inequalities result in resource

misallocation and misuse. They result in major social welfare violations. Economic policy could be tailored to promote a somewhat more equitable distribution of wealth.

4) **Human Development and Decent Work:** Human development is viewed as an important goal of economic growth since it measures improvements in quality of life. The measurement of such traits involves several criteria such as education and illiteracy rates, life expectancy, nutrition, energy consumption per person, and so on. With the increased concern for human development, another economic development goal has emerged: decent work. Work and employment, fair working conditions, protection, and participation and dialogue are the four aspects of decent work.

5) **Stability of Prices and Rates of Foreign Exchange:** Monetary volatility has a negative impact on both the growth and welfare processes. Variations in the value of foreign exchange have an impact on international trade and add uncertainty to the country's economic existence. Economic policy is a major tool for maintaining stability.

6) **Maintenance of Fair Competition:** For welfare maximisation, competitive conditions are required. A strong antimonopoly policy can ensure these.

7) **Avoidance of Cyclical Fluctuations:** Business cycles, often known as trade cycles, are an important aspect of free market economies. Regular cyclical swings in business activity with attendant repercussions are referred to as this. One of the most essential goals for economic policy is to eliminate the economy's ups and downs.

After discussing the primary goals of economic policy, tell us about the weapons in the state's arsenal for addressing the targets, i.e., economic policy instruments.

Check Your Progress 1

1. What do you mean by the term ‘Economic Policy’?

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2. Why do we need state intervention in the economic affairs of a country? Give two reasons in support of your answer.

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3. Why is ‘full employment’ included among the objectives of economic policy? ……………………………………………………………………………………………………
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12.4 INSTRUMENTS OF ECONOMIC POLICIES IN INDIA

Though there is no theoretical foundation for the essential components of an economic policy, we may list a few of them based on our historical experience.

Some of the key parts of a sound economic policy are clearly specified aims, a clearly outlined strategy to accomplish those targets, specific execution programmes, and reliable methods of evaluating outcomes. A robust backup of statistical information also aids in the generation of other possibilities, the setting of quantitative targets, and the determination of the optimal line of action(s), i.e. strategy, to meet these targets. 'Failure to attain expected outcomes' is frequently attributed to errors on the 'estimation front.'

In today's complicated environment, good statistical tools for analysing public policy challenges and policy solutions are critical. Simple and general linear regression modelling, linear probability model , and simultaneous equation models are some of the techniques used. The tools of economic policy differ depending on the type of policy.

In general, there are two sorts of economic policies:

(i) macro-economic policies (also known as aggregative policies) and

(ii) micro-economic policies (or sectoral policies).

1) **Macroeconomic policies** are intended to handle large aggregative macroeconomic factors such as economic income, employment, price level, investments, saving, exchange rate, and so on.

2) **Microeconomic policies** are sector specific policies that aim to guide and contribute to growth in certain economic sectors such as agriculture, industry, and services.

12.4.1 Macro-economic Policies

The state's entire potential is found in the macroeconomic arena. It covers the entire range of economic activities. To achieve its objectives, the government must use a variety of weapons. Before we begin to compile a quick list of these weapons, it is important to note that these weapons cannot be viewed in isolation; they must be used in concert to achieve balanced growth.

The principal instruments of macro-economic policy can be defined as follows:

(i) **Fiscal Policy:** The fiscal policy, often known as budgetary policy, is the most important instrument of macroeconomic policy. The fiscal operations are how the policy works. The yearly financial report of the government's transactions is called a budget. The basic components of a budget are government revenue and public expenditure. Taxes of various forms are the main sources of public revenue. Furthermore, states can and do borrow significant quantities of money, both domestically and from foreign sources. Subsidies, the economic and social sectors, and other expenditure categories are the most important. Each revenue and expenditure item has the ability to influence the trajectory of economic growth, both in the aggregate and in the context of individual sectors.

Fiscal policy refers to the government's taxation, spending, and borrowing operations. The government can use these to both encourage and prohibit consumption, investment, and savings practises. Assume that a country is experiencing inflation. Inflation indicates that individuals have a lot of money and want to buy things. To combat it, the government may increase both personal and corporate taxes. Individuals will have less disposable income as a result, and they may begin saving via various tax-saving strategies to reduce their tax burden. In the case of corporations, they will have to pay more in taxes to the government, which will reduce the rate of gain and dividend declared. As a result, the company would raise prices, potentially leading to a further drop in sales and profits and services. The government would lower taxes during a deflationary time to stimulate more investment spending. Even in taxation policy, the state can be opportunistic in taxing the wealthy more and fully exempting the poor. This would make income redistribution easier and enhance the lives of the impoverished. Similarly, the government might influence the current economic situation by changing its spending on numerous public programmes. Infrastructure construction, public utility services such as hospitals, and new industrial units of really large size are all examples of government expenditures. Consider the case of a country experiencing inflation. The government would cut back on spending, lowering people's income. Demand would fall as income fell, and so would the price. During a period of recession, the government would increase its public spending by investing in a variety of public projects, generating income and demand to help the economy recover. Public borrowing is another another tool in the government's toolbox for influencing a country's economic situation. The government issues bonds and encourages the general public as well as other institutions to purchase them. The government will be able to lower the purchasing power of the economy and stabilize prices this way.

It is a policy which is regulated by the Ministry of Finance, Government of India.

- Fiscal policy promotes economic growth while maintaining price stability.
- It also aids in the formation of capital, resource allocation, revenue generation, and income redistribution.

The government uses two tools to control economic activities in the country. They are:

- Government Expenditure
- Government revenues (mainly taxes imposed by the government).

Government Expenditure: The government's expenditure for the public at large is known as government expenditure. It's also known as government spending. Public spending is further divided into two categories:

1. *Capital and Revenue Expenditures:* This category includes all spending on long-term investments. Loans from the federal government to states / union territories, investments, and debt repayment are examples. Revenue Expenditures, on the other hand, are those expenses incurred by the state for day-to-day operations or to pay interest on the loans taken out by the government, as well as grants made during times of emergency.
2. *Plan and Non-Plan Expenditures:* Plan expenditures are the expenditures for those items that are mentioned in the plans of Niti Aayog and budget. Example- Construction of Roads and Bridges, Various other development plans. Whereas, Non-Plan Expenditures are those general expenditures incurred by the government on economic and social services of the government. Example- Subsidies, defence services, pensions, etc.

   Government Revenues: PSUs, RBI surplus earnings, Railway, Fees & Fines, Coinage, and mostly taxation and other duties create cash for the government, which is then spent for various welfare reasons. Taxes, the government's principal source of revenue, are divided into two categories.

- Direct Taxes (Income Tax, Corporate Tax)
- Indirect Taxes (GST)

Elements of Fiscal Policy

There are four key elements of Fiscal Policy are as follows:

- *Taxation Policy*

  The government seeks to keep taxes progressive in character and maintains price stability, inflation management, and income distribution through direct and indirect taxes. Higher taxes mean lower purchasing power for people, while lower taxes mean higher purchasing power for people.

- *Expenditure Policy*

  The government's expenditure policy addresses both revenue and capital expenditures.

  The government's capital expenditures include the purchase of long-term assets such as infrastructure or manufacturing equipment that will create revenue or further profits for the government. Revenue expenditures are those that do not result in the creation of productive assets, such as interest paid by the Indian government on all internal and foreign loans, as well as pensions and salaries for government employees.

- *Investment and Disinvestment Policy*

  Investment and disinvestment policy refers to foreign direct investment (FDI) or foreign direct investment (FII) in a country's economy, as well as the transfer of government holdings to public or private shares.

- *Debt / Surplus Management*

  A surplus occurs when the government receives more money than it spends. A deficit occurs when the government expenditures are more than its receipts. The government must borrow money from domestic and international sources to cover the deficit. It can also issue money to cover deficits.

Main objectives of Fiscal Policy in India:

- Economic growth: Fiscal policy assists in maintaining the economy's growth rate in order to meet particular economic objectives.
- Price stability: It regulates the country's price level so that pricing can be regulated when inflation is too high.
- Full employment: As a tool for recovering from low economic activity, it seeks to attain full employment.

Importance of Fiscal Policy in India:

- In a nation like India, fiscal policy is critical in increasing both public and private sector capital formation rates.
- The fiscal policy helps channelise a significant quantity of cash for supporting its varied projects through taxation.
- Fiscal policy also contributes to increasing the savings rate by providing stimulus.
- The fiscal policy provides the private sector with sufficient incentives to grow its operations.
- The goal of fiscal policy is to balance the distribution of wealth.

QUESTIONS

Short answer questions

1) What do you mean by fiscal policy?
2) Write a short note on capital expenditure.

Long Answer Questions:

3) What are the elements of fiscal policy?
4) What are the main objectives of the importance of fiscal policy?

ii) Monetary Policy: The supply and value of money in the economy are dealt with through monetary policy. The amount of money in circulation in the economy is referred to as the volume of money. While an insufficient amount of money in an economy may struggle to provide the required liquidity for the rising number of transactions in the economy, and thus may harm the economic growth process, an elevated supply of money, on the other hand, may indicate inflationary trend, and thus may harm the economic growth process. As a result, the state (or the country's monetary authority, i.e. the Central Bank) would have to exercise prudent supervision over money creation in the economy (both by the Reserve Bank and by Commercial Banks).

The level of domestic prices has an impact on the currency's foreign worth. Fluctuations in the exchange rate, or the external value of a currency, can have a negative impact on domestic economic activity. This is another significant reason why an economy cannot create too little or too much money.

The interest rate, or the price of money, is affected by the overall supply of money (together with its demand). The real interest rate, in turn, influences a variety of macroeconomic variables such as consumption, saving, and investment.

The policy framework decided and implemented by a country's central bank to govern the economy is known as monetary policy. The primary responsibility of a country's central bank is to keep its price level and money supply stable. This is only possible if the central bank possesses specific instruments. Monetary policy instruments are the tools available to the reserve bank to control the money supply and market price. Credit control policies are what they're called. Quantitative and qualitative credit controls are the two forms of credit controls available. The former is used to regulate the money supply, while the latter is used to redirect the country's available credit.

Three techniques are used in quantitative credit control policy: bank rate, open market operations, and cash reserve ratio. The bank rate is the rate at which the central bank re-discounts qualifying bills that have already been discounted by commercial banks. The central bank could make discounting by corporate organisations with commercial banks more expensive by raising the bank rate. Discounting would be discouraged as a result, and the economy's money supply would decrease. Alternatively, by decreasing the bank rate, the central bank makes credit more affordable, causing businesses to seek out greater discounts on eligible payments from commercial banks. The economy would benefit from this expansionary credit strategy. Similarly, the reserve bank would use open market operations to buy or sell securities directly, increasing or decreasing the liquidity in the economy. Assume that an economy is experiencing inflation. The reserve bank would sell its securities, which would be purchased by commercial banks as well as other organisations, in order to reduce the money supply. The extra money in these organizations would be drained off in this method, forcing them to restrict credit. In the event of deflation, the reserve bank would acquire the securities and transfer the money equivalent to the banking system, facilitating the introduction of liberal credit. The term "variable reserve ratio" refers to the amount of Statutory liquidity ratio and Cash reserve ratio that commercial banks must maintain as a percentage of their total deposits. Commercial banks will have less money if the ratios are raised, hence they will be able to lend less. By lowering the ratio, commercial banks will have more cash with which to make more liberal lending decisions. All of these monetary policies would have an immediate influence on businesses and their operations.

The central bank can monitor consumer credit, change margin requirements, use persuasion tactics, take direct action against errant commercial banks, and so on, using qualitative credit controls. The reserve bank would've been able to manage and direct available credit to priority sectors while discouraging credit to less important or no priority sectors through these policies. As a result, businesses in the priority sector will be able to grow their operations with low-cost capital and help.

- The governor of the Central Bank uses monetary policy to regulate the flow of money in an economy.
- The Reserve Bank of India announces India's monetary policy.
- It was traditionally released twice a year. However, the RBI continues to adjust to the needs of the economy, and the practise of releasing it twice is still in place

<u>The Objectives of Monetary Policy are:</u>

Measures to control and regulate inflation.

<u>Two types of tools are used to control and regulate inflation:</u>

1. Quantitative Measures
2. Qualitative Measures

Quantitative Measures/Tools are used to control the flow of money in the economy. The various quantitative tools are as follows:

1. *Repo rate.* - Commercial banks borrow funds from the central bank at a rate of interest known as the repo rate. The RBI serves as a banker to all commercial banks in the country, as we all know.
2. *Reverse repo rate*- Commercial banks provide credit to the central bank, the RBI, at a rate of interest known as reverse repo.
3. The *Bank Rate* is the interest rate that the RBI charges commercial banks for long-term lending. Only long-term credit is permitted at this rate.
4. The *Cash Reserve Ratio (CRR)* is the amount of money that commercial banks must keep on deposit with the central bank. This ratio is determined by the RBI, and the RBI does not pay interest on this cash.

5. *SLR (Statutory Liquidity Ratio):* The Statutory Liquidity Ratio (SLR) is the government-mandated deposit ratio that a commercial bank must keep with itself in cash and gold.
6. *OMO (Open Market Operations):* This is the RBI's open market instrument for buying and selling all types of government securities. This is done to change the amount of money flowing through the economy.

The Reserve Bank of India uses qualitative metrics to control the flow of money and the quality of loans in a few specific industries. A lottery, bidding, or any other type of speculative enterprise, for example, is not eligible for a loan. The instruments that the RBI uses to enforce its checks

1. *Credit Rationing:* Under this strategy, the RBI instructs commercial banks to restrict their lending based on the customer's or loan seeker's credibility. The RBI also instructs commercial banks to lend to the poorer sectors of society at cheaper rates for certain purposes as and when required.
2. *Margin Requirements:* When a loan is made, the commercial banks must keep some collateral security. The RBI establishes a ratio for the proportion that can be loaned and the proportion that should be kept for hedging during market swings.
3. *Moral Suasion:* RBI instructs commercial banks, both orally and in writing, not to lend money for speculative or insignificant objectives.
4. *Direct Action*: If commercial banks do not follow the Reserve Bank of India's instructions, the RBI intervenes immediately and takes action.

(iii) **Commercial Policy:** Commercial policy is a third significant aspect of macroeconomic policy. Commercial policy refers to the government's attitude toward the economy's external sector, i.e., policy toward foreign capital investment in the host country (both portfolio and direct investment), as well as policy toward outflows and inflows of foreign exchange, goods, and services. A state may have a completely open approach; another extreme may be requiring a call to the state at every entrance or exit. Mild protection could be a good compromise. The economic environment, both home and abroad, determines which of the policies, extreme free trade or restriction, or light protection, is chosen.

(iv) Foreign Trade policy: The breadth of trade between countries is determined by international trade policy. It would have a direct impact on corporate organisations' prospects. A liberal policy would broaden the range of exports and imports, whereas a restrictive policy would limit them. Likewise, if protectionism is promoted, international businesses will pose less market risks to commercial organisations. If, on the other hand, liberalisation is the policy, then every local corporate organisation must adapt to any challenge offered by multinational corporations. Exchange rate policy, exchange controls, and customs charges are all part of foreign trade policy. All of these things are necessary for a company's success. If full convertibility is achieved, for example, companies will be able to export and import more freely and make payments with fewer constraints. On the other side, if just partial convertibility exists, trade opportunities are limited, and businesses must go through a painful process of obtaining export or import licences and routing all payments through the correct channels. Customs duties can have a significant impact on the amount of international trade. Increased customs taxes would deter domestic demand since the cost of imported products and services would grow and remain high in comparison to those produced domestically. Imports would be encouraged and domestic manufacturers would benefit from lower customs duties. The government constantly alters its international trade policy in response to the country's needs and economic conditions. To deal with the looming payment problems, the government may use a variety of policy tools such as currency depreciation, forex clearance agreements, tariffs and taxes, and exchange control rules. To achieve the intended results, these instruments would be appropriately adjusted. For example, to stimulate exports and prohibit imports, the state may create inflation, making Indian goods cheaper to import abroad and foreign goods more expensive in India. As a result, corporate organisations must constantly monitor changes in trade policies in order to position themselves appropriately.

(v) Price Policy

Price policy refers to the government's price regulations in a certain country. This is vital because inflation and economic instability are inevitable if prices are not managed. Furthermore, in India, nearly 35percent of the total of the population lives in poverty. They are not employed on a long-term basis. Poverty in rural areas is very severe. To deal with this, the government implements a pricing control policy. All necessary and essential items are subject to price controls. While the poor and downtrodden receive needed items at a regulated and discounted pricing through public distribution, the rest of the population is expected to meet their needs on the open market. The government works hard to keep prices under control through market dynamics management. The government, for example, handles food shortages during difficult times by slowly building buffer supplies. Similarly, industrial facilities in underdeveloped areas and rural areas are given special treatment. This allows them to operate on a solid foundation. The government uses the managed price mechanism to manage the prices of produced goods. For example, cooking gas is sold at one price to the general public and at varying prices to commercial organisations. This reduces the load on the population who use LPG as a cooking medium. Sugar, cement, and other commodities are likewise subject to price administration. As a result, the government defends the interests of the public through price policy, and this policy has a significant impact on how businesses operate in our country.

12.4.2 Micro-economic Policies

The government does not have to limit itself to broad macroeconomic aggregates. The government can and does define its stance toward many aspects of the economy, such as agriculture, industry, and other sorts of services. Certain fields of agriculture, industry, and services may be permitted and promoted by the state. On the other hand, the government may restrict or discourage specific actions. The following are examples of microeconomic policy instruments: (i) industrial licensing, (ii) quota-permit system, (iii) import control, (iv) export control, (v) competition or anti-monopoly policy, (vi) procurement policy, (vii) policy of minimum support prices, (viii) policy of buffer stocks, etc.

12.5 PROCESS OF ECONOMIC POLICY FORMULATION

Policy-making is essentially the responsibility of legislatures as political institutions. In a democracy like India, policymakers are made responsible to the electorate by direct election or appointment by elected authorities. As a result, in India, political decision-making reigns supreme. Political parties and members of Parliament, on the other hand, lack professional and research resources to explain alternative (public) options.

Typically, the government takes a hint (or a problem) from the public domain, forms a committee or response team to develop policy measures, makes "necessary political changes" to those recommendations, and then announces its decision in appropriate forums, either via executive order or legislative resolution.

When it comes to recognising and prioritising problems, the nature of the political system is critical. As can be seen, India's democracy has progressed from a conventional democratic system in the 1950s to a more meaningful and participatory democracy in the 1990s. As a result, the policy-making process became "more consultative and responsive." It's mirrored in the shift in "policy rhetoric." 'Big Public Sector Enterprises' are no longer mentioned by any political party. Instead, they talk about establishing "village business clusters."

In addition, the role of the press and non-governmental organisations in lobbying for new policy alternatives has gained acceptability in the policy-making process. One example of broadening the consultative process is the formation of the National Advisory Council (NAC), which is made up of non-governmental activists and led by the chairman of the ruling coalition.

Despite the fact that economic policy development is a democratic activity, economists and professionals play a critical part in the deliberative process. They have been included into government institutions in order to facilitate continual interaction. They come up with policy options using "rational economic and technical criteria." We have a huge number of technical, scientific, and development organisations and institutions in India that can provide an institutional venue for expert assistance. The duty of describing policy texts is still left to administrative bodies made up of specialists and bureaucrats.

The following are some of the bodies/agencies involved in the development of national policies for consultation:

12.5.1 Planning Commission of India

One such organisation is the Planning Commission. The Planning Commission was established by an agreement of the Indian government in March 1950 in order to encourage a rapid rise in the people's standard of living through effective utilization of the country's resources, increased production, and providing opportunities for all to work in the community's service. The Planning Commission was tasked with assessing all of the country's resources, supplementing those that were insufficient, devising plans for the most efficient and balanced use of resources, and determining priorities.

12.5.2 Central Statistical Organisation

The Central Statistical Organization is in charge of coordinating statistical activities throughout the country as well as creating and managing statistical standards. National Income Accounting, conduct of Annual Surveys of Industries, Economic Censuses and follow-up surveys, collection of Index of Industrial Production, as well as Consumer Price Indices for Urban Non-Manual Workforce, Human Development Statistics, Gender Statistics, providing the necessary instruction in Official Statistics, Five Year Plan work relating to Development of Statistics in the States and Union Territories, and dissemination of statistical information are some of the activities it undertakes. It has a Graphical Unit that is well-equipped. The Director-General leads the CSO, which is supported by two other Director-Generals, four Deputy Director-Generals, Directors and Joint Directors, and other support employees. Delhi is home to the CSO. Calcutta is responsible for a component of the Industrial Statistics work related to the Annual Survey of Industries.

12.5.3 Indian Council of Social Science Research (ICSSR)

The Indian government founded the ICSSR in 1969 to support social science research in the country. The Council's mandate included advising the Government of India on all issues concerning the social science (including economics) research as may be regarded to it from time to time, as well as taking such general measures necessary from time - to - time to promote social science research and its use.

With 27 research institutes, the Indian Council of Social Science Research (ICSSR) was founded to provide regional focus to research that can be used for policy reasons. All of these institutions are funded by the state and hence must follow the paymaster's instructions.

Following that, a number of privately sponsored research organisations emerged, including the National Institute of Public Finance and Policy, the Centre for Science and Environment, the Tata Energy Research Institute, and the Tata Institute of Social Sciences, among others. These institutions, in addition to doing research, play a vital role in advocating by publicising their findings in the media and hosting seminars for policymakers. The government also creates committees and task groups from time to time in which social as well as other experts play key roles.

12.5.4 Lobbyists

Other kinds of organised private interest advocacy in the design and execution of public policy exists. Via representation and collective action, organised labour (Trade Unions) and its counterparts, Trade Associations (FICCI, ASSOCHAM, CII), also impact the policy process. These privately formed interest groups are typically well-connected to various political parties, as the latter rely on their financial and human resources during elections. Election costs have risen to the point where candidates must generate hundreds and thousands of rs just to run for a legislative seat. 'Special interests' are the only ready source of such large quantities of money. They have a personal interest in economic policies, of course.

12.5.5 Non-governmental Organisations (NGOs)

With the introduction of economic reform programmes in 1991, the importance of markets and quasi-governmental organisations has been explicitly recognised (NGOs). In reality, the Eighth Plan made a good case for the voluntary sector playing a larger role. As a result, the number of non-governmental organisations, or NGOs, has exploded. The Societies Registration Act grants the majority of these NGOs legal recognition to raise donations from both public and non-government sources. NGOs like this number in the thousands. They also strive to influence policy by offering policy solutions based on their micro-level expertise.

12.5.6 International Politics and Multilateral Lending

External pressures also affect policy development in India under the pretence of recommendations based on "cross-country experiences." During the 1950s, we noticed'socialistic' tendencies, and since the 1990s, we've felt 'push for privatisation and liberalisation.' Developed countries have been pressuring India's fast-growing economy to open up to global firms. In this light, the recent adjustment in the "policy framework" is understandable.

On the record, it is the Government of India's departments and ministries, led by political functionaries (ministers), that oversee the formulation of economic policies in their own respective areas. These policies are usually announced once the Union Cabinet has given its approval. These policy statements are occasionally accepted by Parliament in the form of Resolutions/Acts.

12.6 DISAPPOINTING OUTCOMES

With the preceding explanation, you should have a good understanding of the policymaking process.

In India, we have democracy. Local and national governments' (and parties') economic policies indicate the course and parameters for the formation of laws, government programmes, and budgets. The role of bureaucracy, or the implementing agency, becomes significant after the policy is approved and programmes are initiated. The bureaucracy is in charge of carrying out the government's economic policies and programmes. The administration (agent) is the vehicle through which the political leadership's policy is carried out (principal). For policies to be implemented with some certainty, equity, and due process, bureaucracies are required.

In the past, the government had a hard time meeting policy goals. We previously maintained that the best way to address "market failures" is for the government to intervene through policies and programmes. But, as we have shown, "government failure" can also occur.

The outcomes of the government's programmes were consistently disappointing for a variety of reasons. Pointing fingers at any single element is pointless since failure is so broad and success is so rare.

Political interests take precedence over economic thinking at the formulation stage. Policymakers may accept or even welcome deliberate ambiguity as a temporary expedient for finalising a plan (or programme), so authorising a policy that is frequently ineffective, disagreeable, or even conflicting to other policies. The lack to specify clear and practical goals, objectives, processes, and plans leaves implementing agencies with plenty of room for job ambiguity.

Sometimes the 'policy-makers' have insufficient information on the 'bureaucracy's' efforts. In other words, policymakers have no way of monitoring how well 'implementing agencies' are performing. The bureaucracy may be inclined to shirk as a result.

Policymakers, especially economists, may not have the time to investigate the effectiveness or viability of implementing 'agents.' This could lead to policy objectives not being met.

Another stumbling block is the enormous bureaucratic system. There is considerable room for buck passing in a federal organisation. Furthermore, there is no suitable structure in place within administration to reward extra effort and/or penalise non-performance.

Another key factor for plan failure is the proliferation of similar types of schemes. Similar types of 'benefits' compete for the same segment of 'beneficiaries' due to the absence of inter-ministry or Centre-State coordination. The accomplishment of one programme causes the failure of others.

For India's economic policies to achieve undiluted success, policymakers, particularly economists, must create policies that take into account all of the aforementioned "influences" so that the immediate benefits of deviating become small. Policymakers must establish tools and strategies to assess implementing agencies' performance and suitability. To put it another way, rules and procedures should be written in such a way that 'deviations' may be simply and quickly identified. Furthermore, economists must create methods to improve politicians' 'technical expertise' on economic matters. In other sense, process and policy reform should be complementary.

Check Your Progress 2

1. State the principal instruments of macro-economic policy.

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2. Do you think that economic policies are essentially political decisions? Give two reasons in support of your answer.

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3. How is CSO useful in the policy formulation process?

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4. State any two disappointing outcomes of Indian Economic Policy.
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12.7 LET US SUM UP

Economic policies are expressions of the government's goals and aspirations to be attained through various instruments. State involvement in the system of economic policy is required due to many "market failures." The primary goal of economic policy is to ensure rapid economic development. The significant aspects of economic policy include rapid growth, employment creation, human development, and dignified labour, price and exchange rate stability, fair competition, and the avoidance of cyclical swings. In general, economic policies are divided into two categories: macroeconomic policies and microeconomic (sectoral) policies.

India's economic policies are political decisions. Economists and technocrats, on the other hand, play a significant role in the formation of economic policy. Furthermore, policymakers must consider the views of the media, labour unions, trade groups, and non-governmental organisations (NGOs). Even world politics and multinational companies (MNCs) have an impact on how emerging countries like India make economic policy.

Some indigenous institutions have emerged over time to generate macro-level policy options. The government funds and/or financially supports the majority of them. In India, bureaucracy is in charge of putting economic plans and programmes into action.

Economic policies and practices in India have failed for a variety of reasons. Although inflexible bureaucracy bears the most of the blame for underperformance (or failures), some of these issues can be traced back to weaknesses in the formulation process.

Policymakers can increase their chances of reaching development goals by setting clear workable goals, operational procedures, and an "inbuilt system for performance assessment."

12.8 EXERCISES

1. 'Economic Policy in India is a purely political process'. Comment.

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2. Examine how different shades of public opinion influence the process of economic policy formulation. Give illustrations in support of your answer.

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3. Discuss the various disappointing outcomes of the poor implementation of economic policies.

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4. Suggest some measures to improve implementation of economic policy and programmes in India.

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12.9 FURTHER READINGS

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